

# What World Leaders Should Do to Halt the Spread of Protectionism

Edited by Richard Baldwin and Simon J Evenett



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CENTRE FOR TRADE  
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A VoxEU.org Book



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**A VoxEU.org publication**

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# Introduction

*Unless world leaders strengthen trade cooperation, new tariffs and competitive devaluations could trigger a protectionist spiral of WTO-consistent trade barriers. To rule this out, world leaders should: 1) Reduce protectionist pressures by fighting the recession with macroeconomic policies; 2) Translate APEC and G20 leaders' words into deeds by agreeing a framework for concluding the Doha Round; and 3) Establish a real-time WTO/IMF surveillance mechanism to track new protection.*

Protectionism is back on the policy agenda.

When incomes, investment and jobs are under threat, national governments try to cushion the blow – in part by erecting new trade barriers. This time is no exception. According to the latest data from the ITC and WTO, the number of antidumping cases jumped 40% in the first half of 2008 and many nations have already raised tariffs in 2008.

The magnitude of the new protection is modest. However, as the recession spreads and deepens globally, this could change – especially if world leaders lose control of the situation; protectionism and competitive devaluations could trigger a vortex of beggar-thy-neighbour policies.

The universal respect of WTO rules and 60 years of tariff negotiations make a repeat of the 1930s tariff war unlikely. But a WTO-consistent protectionist cycle is a real possibility.

Much of the world's recent tariff and subsidy cutting has been unilateral or regional and thus not bound by WTO commitments. Many nations could massively increase their tariffs on manufactured and agricultural goods without breaking a single WTO rule. Nations could respond to tariff hikes and devaluations with a wave of antidumping and anti-subsidy duties – all perfectly WTO-legal. Indeed, just such a thing happened on a small scale in the last global crisis – the 1997 Asian crisis. And beside tariffs and 'fair trade' duties, governments can discriminate against foreign goods in WTO-legal ways using policies that are justified in the name of health, safety, and environment requirements.

But not all is bleak. The global crisis is an opportunity as well as a threat. It often takes a crisis to break the status quo and allow a new, better, more cooperative equilibrium to emerge.

## The need for action

With both the threat and opportunity in mind, we have gathered 17 leading trade scholars from across the globe to address the question: 'What must world leaders do to halt the spread of protectionism.'

The essays – which were written in the first week of December with a minimum of coordination – provide a surprisingly consistent response. Authors differed on many points, but three main messages emerged.

### **1) Macroeconomic initiatives are the best way to fight this crisis, not protectionism.**

National leaders should utilise macroeconomic and financial policy instruments as well as social safety nets to address problems like recession, unemployment, and credit crunches. Or, as Professor Ann Capling puts it: 'Practice Keynes at home and Smith abroad'

In addition to reducing the severity of the recession, deploying these macro policy tools will lessen political pressure for protectionist solutions. Professor Douglas Irwin, perhaps the world's leading trade historian, notes that the failure of politicians in the 1930s to fight the slump with macroeconomic and financial measures is one reason they relied so heavily on tariffs.

### **2) APEC and G20 leaders' words should be translated into deeds by agreeing a framework that will allow completion of the Doha Round.**

As Dr. Hadi Soesastro, a trade scholar who advises to the Indonesia President puts it: 'A successful Doha Round is the best insurance policy against increased protectionism.'

Fulfilling the leaders' pledge to agree modalities this year will not be easy, but it is do-able, as Jagdish Bhagwati and Arvind Panagariya argue.

Moreover, the crisis may actually make it easier. By focusing national-level attention on the problem, the crisis should allow trade ministers to put the final sticking points in a much broader context – one where failure would undermine the G20's new-found credibility. Moreover, since the crisis makes backsliding a real possibility, a Doha deal that locks-in nations' unilateral liberalisation look like a much more worthwhile achievement. Before the crisis nations took the unilateral cuts for granted.

### **3) World leaders should establish a surveillance mechanism to track any new protection, whether it is WTO consistent or not.**

As Harvard Professor Robert Lawrence argues, a global surveillance mechanism, operated by the WTO and in conjunction with the IMF, would stiffen national leaders' resolve to reject calls for protection. Knowing that trading partners will learn almost immediately about restrictive measures may cause governments to think twice.

Moreover, a list of crisis-linked protection could be the basis of the 'exit strategy' that the world will need to unwinding protection after the crisis has passed. This point should not be overlooked. As Professor Kevin O'Rourke points out, interwar tariffs strengthened import-competing interests to the extent that they succeeded in maintaining tariffs decades after the Great Depression was over.

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Richard Baldwin and Simon J. Evenett  
Geneva and St. Gallen, Switzerland  
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# What should world leaders do to halt protectionism from spreading?

**Hadi Soesastro**

*Centre for Strategic and International Studies, Jakarta*

*G20 countries must exercise leadership to wrap-up the Doha Round, fight unemployment with macroeconomic policies and strengthen safety nets to minimize calls for protection. A fund should also be created to assist emerging and developing countries in undertaking counter-cyclical fiscal measures. Regional surveillance processes, as in the 1997 Asian Crisis, could help support politically difficult policy measures.*

Protectionist pressures around the world are on the rise. G20 leaders have made a strong commitment to maintaining an open global economy and to resisting the temptation to resort to protection in these difficult times. Yet one participant at the G20 Summit argued for an extensive increase in the common external tariffs of the regional trade arrangement it is a party to.

This sort of protectionism can be contagious. To halt this, world leaders should take three steps.

## **1) Make solid progress in the Doha Round**

A successful Doha Round is the best insurance policy against increased protectionism. Last July, the mini-Ministerial WTO meeting could have succeeded in concluding a deal on the critical first stage of negotiations (known as 'modalities'). With a push from the leaders, ministers that will be dispatched to Geneva this December could finally seal that deal.

National leaders will have to keep a close eye on the negotiating process to ensure that their political commitments are not undermined by the negotiators. The remaining hurdles include the special agricultural safeguard mechanism for developing countries, the treatment of sensitive farm products in industrialised countries, the sectoral tariff elimination in non-agricultural market access as well as some unfinished business like the issue of cotton and some TRIPS-related issues.

These hurdles can only be overcome with the personal and collective attention of G20 leaders.

*National leaders must stay engaged in the Doha talks*

G20 countries must lead by demonstrating their willingness to make the necessary compromises. This cannot be left to negotiators because many of the solutions available to national leaders lie outside the narrow WTO negotiations. To make the necessary compromises, leaders must be able to ensure their domestic constituents that they will implement a comprehensive and effective policy package at home to overcome the crisis.

### *More flexibility from the US and India*

Greater flexibility must be shown by the two largest holdouts in July's negotiation – the US and India. The Bush Administration is eager to have an agreement before its term ends. It does not have a negotiating mandate from the Congress and it cannot assure that the incoming Administration will stand by what it agrees. But the US administration should take this risk, and others should support them. An accord reached by the 153 countries in the WTO could in fact help the Obama Administration focus on this matter soon after the inauguration.

India is facing national elections in May 2009 and therefore may not want to compromise on what their politicians consider as the main safeguards for the livelihood of its subsistence farmers. However, India today is in a much better position than a decade ago or so. It now has the means to use measures other than trade barriers to overcoming the problems facing its poorest farmers. Indian corporate leaders at the 24th India Economic Summit held recently in New Delhi have also spoken unambiguously about the need for all to reject protectionism.

## **2) Keep the economy growing and strengthen safety nets**

Protectionist pressures at home tend to increase with a rise in the feeling of helplessness that overcomes the population in an unfolding economic crisis. To be able to maintain open economies policies governments must show that they have sufficient instruments and resources to keep the economy growing at a reasonable rate and that, especially in developing economies, effective safety nets are in place.

Small open economies are not likely to resort to protectionist measures that would be suicidal given their reliance on trade. They have few options other than strengthening their safety nets to minimise the suffering of its populace. It is the larger economies that could be tempted to turn inward by raising their trade barriers.

To reduce protectionist pressures at home, governments of larger economies should find ways to stimulate their domestic market through monetary and fiscal measures. Several larger emerging economies in East Asia should and could do so. Collectively they could play an important role as an engine of growth for the recovery of the global economy. As such they bring an added benefit in the form of reduced protectionist pressures in other countries.

However, it will not be easy to stimulate the domestic market at a time of financial crisis as the world is facing today. Only emerging economies with huge reserves can readily do so. Others, like Indonesia, will have to make special efforts to mobilise additional external funding since it can no longer rely on international bond markets.

At the G20 Summit in Washington DC, the Indonesian President made a case for setting up a special fund for such a purpose. This was favourably greeted by the World Bank, but further work will be required to make the concept operational. Whatever form this fund takes, its purpose should be to assist emerging and developing countries to undertake counter-cyclical fiscal measures.

In many emerging and developing countries existing safety-net programs provide the most immediate channel for disbursing the resources. However, safety-net programs in many countries need to be become more effective. These efforts should become an integral part of a comprehensive policy package that must be in place in order for governments to be able to effectively resist protectionist pressures at home. An effective safety net program should be seen as a necessary feature in the age of globalisation.

### 3) Make effective use of regional cooperation arrangements

Regional arrangements can help defuse protectionist pressures. Collective actions in a regional setting can often be useful in supporting individual governments in their efforts to implement politically difficult policy measures.

#### *The ASEAN Surveillance Process as an example*

At the time of the 1997/98 Asian financial crisis, ASEAN economic and finance ministers were forceful in opposing inward-looking policies. Several agreements were made to strengthen regional financial cooperation, including the development of an ASEAN surveillance process. It was significant that the crisis was used by the group as a reason to accelerate the implementation of the ASEAN free trade area. They also worked together to ensure that trade financing, which collapsed during the Asian crisis, was quickly restored with the assistance of the international community. As a group, the ASEAN countries also agreed to look into the strengthening of their safety net programs.

The APEC leaders meeting that took place in Peru one week after the G20 Summit have reinforced point 13 of the G20 Washington Declaration on refraining from taking protectionist measures and on working towards a successful conclusion of the Doha Round. This is also a significant development. Apart from the eight overlapping members, APEC has 13 other members from the Asia-Pacific region. Together they should further strengthen the APEC structural reform programs focusing on 'behind-the-border' and capacity-building issues. This will be a major effort to help reduce protectionist pressures in the region over the longer term.

### About the author

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# Doha: The last mile in the marathon

**Jagdish Bhagwati and Arvind Panagariya**

*Columbia University*

*The global recession creates a real risk of "beggar-thy-neighbours" trade policies being implemented. To counter this risk, world leaders should get the stalled Doha talks back on track. This is do-able but will require additional compromise from the US and India.*

With the global financial crisis leading to either recession or deceleration of growth in virtually every major country in the world, the risk of 'beggar-thy-neighbours' trade barriers to secure domestic markets for domestic firms is real.

While some developing countries may be using the flexibility provided by the gap between applied and bound tariffs to protect domestic firms, the US is contemplating achieving the same objective through massive WTO-inconsistent bailout subsidies to the auto industry.

Considered in isolation, each of these actions may seem beneficial for the country taking the action in the short run but when considered in totality, with the long run implications taken into account, they are likely to be hugely detrimental to all.

Therefore, at the G20 meeting in Washington and APEC summit in Peru, major players have rightly emphasised the need to bring the stalled Doha negotiations back on track. While a final agreement would seem unlikely till the President-elect Barack Obama has settled in his new job and a new government is installed in India in May or June 2009, an agreement on the modalities may be well within the grasp of the member countries.

## **Doha modalities can be achieved**

Pessimists have repeatedly pronounced the Doha Round dead. Yet, it is important to remember that to-date no round has failed. They often break down, are often thought to be in intensive care where the pessimists predict that they will expire, and they come back like the proverbial cat and are concluded. Doha will be no exception.

When the Doha talks broke down at the Cancun Ministerial meeting of the WTO, the principal players from the EU and US publicly broke into acrimony. The post-collapse atmospherics at the last round of negotiations in Geneva in August 2008 were altogether more amiable.

Thus, the WTO Director General Pascal Lamy has stated that the Geneva meeting successfully resolved the specifics of 17 difficult issues, leaving only three to be thrashed out, of which the major one was the conflict on agricultural protectionism between India and the US. Since the August meeting, India has expressed some disagreement with this view arguing that there remain unresolved issues with respect to the 17 issues considered resolved by Mr Lamy, it remains true that the three unresolved issues from the Geneva meeting will remain the most critical for bringing the negotiations on the modalities to a happy conclusion.

When one probes the matter in depth, one immediately sees that a political compromise is within reach.

### **The subsidies-SSM deadlock**

At Geneva, the US had offered to cap its trade-distorting subsidies at \$14.5 billion. This subsidy exceeds its current payout, which is placed at \$9 billion or less according to published reports. The US has 2 million farmers. India, which has nearly two-thirds of its population in the rural sector, has hundreds of millions of small subsistence farmers. Faced with competition from subsidised, often large farms, India's reaction has been exactly like that in the US where nothing works up politicians and lobbyists more than the often-imagined, not even real, allegation that foreigners are subsidising their products 'unfairly.' So, just as the US, fearful of competition from China, introduced an unprecedented product-specific safeguard in its bilateral agreement of November 1999 and a special textile safeguard during the transition to freer trade in textiles, India wanted a Special Safeguard Mechanism (SSM).

The SSM India proposed, however, was excessive and unacceptable to the US, which had virtually pioneered the practice.

### **The essential compromise**

The central problem therefore arose from the fact that the US offer on trade-distorting subsidies was too low, prompting an unacceptable Indian demand for an over-cautious SSM.

Evidently the solution lies in the US capping the distorting subsidies at a minimum of the current payouts. Nothing prevents it from spending more instead on non-distorting subsidies which do not affect output (and hence trade) but which are given, for instance, for environmental improvements and for raising poultry and cattle in an ethically-acceptable fashion. In return, India could surely agree to a serious down-scaling of the SSM.

This solution is not politically impossible. It requires the US to move away further from distorting subsidies, and substituting them with non-distorting subsidies, a move that is surely possible since total farm support can be maintained while its composition changes in a pro-trade direction.

### **Higher food prices help**

An additional factor that makes a compromise on subsidies feasible is the recent increase in food prices.

The removal of subsidies on agriculture has been strenuously resisted, particularly in the US, causing India to argue that any opening up of agriculture would be doubly difficult politically because exposing one's farmers to the impact of highly subsidised foreign producers is regarded as yielding to unfair trade. The Food, Conservation and Energy Act, passed in the US in May 2008, has been a terrible step backwards, holding up the agricultural liberalisation without which Doha will fail. But now that food prices have risen dramatically, the payouts to US farmers will be almost negligible since they vary inversely with market prices.

High prices are expected to continue, so the need for subsidy will also remain negligible. It should therefore be possible to soften significantly US opposition to restricting post-Doha agricultural subsidy payments to lower levels, making it likely that India would respond and making Doha success possible.



The compromise on the part of the US will make it easier for India to compromise on the SSM. Here the point made by economist Robert Baldwin is important and must be brought to the forefront of the negotiations.<sup>1</sup> Currently, the negotiations have focused on defining the trigger points for the SSM in terms of percentage increase in imports. When initial imports are tiny, even a small absolute increase in imports that could cause little injury to the domestic farmers would translate into large percentage increase and trigger the safeguard. As Baldwin points out, the economically meaningful definition of trigger points is in terms of imports as a percentage of total consumption.

## About the authors

**Jagdish Bhagwati** is University Professor at Columbia University and Senior Fellow in International Economics at the Council on Foreign Relations. He has been Economic Policy Adviser to then GATT Director General Arthur Dunkel, Special Adviser to the UN on Globalisation, and External Adviser to the WTO. He served on the Expert Group appointed by the Director General of the WTO on the Future of the WTO and the Advisory Committee to Secretary General Kofi Annan on the NEPAD process in Africa as well as member of the Eminent Persons Group on the future of UNCTAD. Five volumes of his scientific writings and two of his public policy essays have been published by MIT press. His latest book is: 'Termites in the Trading System: How Preferential Agreements Undermine Free Trade' (Oxford).

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1 'How to resolve the Doha stalemate: A better agricultural safeguard trigger', 25 September 2008, <http://voxeu.org/index.php?q=node/1697>.



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# What should leaders do to stop the spread of protectionism?

**Gary Clyde Hufbauer and Jeffrey J. Schott**

*Peterson Institute for International Economics*

*Hard times ahead provide plenty of opportunities for opaque and harmful but still WTO-consistent protectionist policies. World leaders should give the WTO a mandate for 'real-time reporting' of new trade barriers, even WTO-compliant ones.*

On November 15th, at the Washington Summit, G20 leaders from across the globe acknowledged the severe economic downturn and pledged not to make things worse by raising trade barriers. On November 24th, at the APEC Summit in Peru, Asia-Pacific leaders pledged much the same. Mission accomplished? Protection averted? Hardly.

The task has just begun. Grade inflation is a disease of our era, and no where is the affliction worse than in the minds of national leaders. Left to their own scorecards, each and every leader will declare his government in full compliance, an A+ grade. Even the Russian President Medvedev, who hoisted automobile tariffs when he returned to Moscow from the G20 summit, and Indian Prime Minister Singh, who jacked up steel tariffs soon after, see no inconsistency between deeds and words.

## **Letter versus spirit of the commitment**

In legal terms, the wayward summiteers are within their rights, even if their actions blatantly violate the spirit of their commitments. The WTO allows members to impose a variety of measures to protect domestic firms: antidumping, balance of payments and general safeguards, Article XX exceptions for food and product safety (and possibly climate change policies), and boosting applied tariffs up to bound levels. Use of these measures tends to increase as economic conditions deteriorate, so 2009 could well see a boom in the erection of 'WTO-consistent' trade barriers.

## **An honest judge to cry foul**

Much needed, before such breaches get out of hand, is an honest judge to cry foul when leaders betray their promises. The G20, led by its 'troika' of current and future chairs (Brazil, the UK, and South Korea), should require monitoring of the agreed 'standstill' on new protection.

And who should they pick to be the honest judge? Obviously the WTO, in the person of Director-General Pascal Lamy, with the full support of World Bank President Robert Zoellick and IMF Managing Director Dominique Strauss-Kahn. Every week the WTO should publish a running report card of raised tariffs, trade remedies, and other new policy measures that obstruct commerce. It doesn't matter whether the measures are WTO-compliant; what matters is that they are new and that they limit trade. Truly WTO-compliant measures might be marked with an asterisk (and perhaps clear breaches should be marked with a Scarlet A), but the point of the G20 and APEC

pledges is to stop the slide into the world of trade contraction, not to mince legal niceties.

## **Hard times ahead mean protectionism**

Even with bold fiscal and monetary responses, guided by President-elect Obama and Fed Chairman Bernanke, hard times are likely to endure into 2010. The recession ahead is more likely to have the shape of an L flipped backwards on its side, than a V. If so, that will give plenty of time for opaque, but harmful, protectionist policies, implemented under the cover of other and often highly desirable goals.

First up will be industrial subsidies, starting with the bailout of the Detroit 'little three', GM, Ford, and Chrysler. Subsidies around the corner may well accelerate the closure of auto plants in Mexico and Canada; they will surely impede imports from Europe, Korea, and Japan; and they might even provide a platform for larger US automobile exports. The same story could easily be repeated in other industries and other countries.

WTO rules don't prohibit such domestic support, but the programs should be targeted at restructuring firms, encouraging innovation, and assisting displaced workers. Well before a rush to industrial subsidies appears in the offing, the Bretton Woods leaders should issue an urgent plea for nations to step harder on their fiscal and monetary accelerators, to support their credit markets and their consumers, but not to divert money into losing industrial firms.

## **Longer term threats**

On a somewhat longer horizon, the US Container Security Initiative (CSI) poses a real threat to commerce, especially exports from developing countries. Very few ports in Africa, Asia, or Latin America can meet the 100% container scanning requirement mandated to take effect in 2012. Nor does 100% container scanning represent an efficient way to thwart terrorists. Under the joint leadership of the World Bank and the WTO, alternative means must be designed to ensure cargo security but to minimise the toll on commerce.

Meanwhile, many countries and sub-federal jurisdictions are legislating measures – such as cap-and-trade systems -- to limit greenhouse gas emissions, especially carbon dioxide (CO<sub>2</sub>). But countries fear the competitive consequences of these steps, so they are devising border controls to avert 'leakage' and to encourage other countries to limit their own emissions.

Unless the WTO quickly addresses these prospective measures, world trade could well face a thicket of new restrictions erected in the name of averting climate change that imposes unnecessary and unintended protectionism and has adverse consequences for the negotiation of a post-Kyoto global climate regime. What should be done? In the short term, WTO members should commit not to introduce border measures pursuant to climate policies. This 'peace clause' would provide time for the completion of the post-Kyoto climate pact and also give WTO members the chance to fashion a code of good practice to say what border controls are, and are not, permissible under WTO rules.

Other protectionist threats, such as the Lacey amendment (on illegal logs and downstream wood products), emotional food safety standards, and the coming flood of antidumping actions, could be recited. But the message is broader and goes beyond individual trade restrictions.

## Conclusion

The time is at hand when the WTO, backed up by the World Bank and the IMF, must mount an energetic defence of the world trading system we now enjoy. The G20 countries should make good on their summit commitment by promoting agreements on modalities that presage an ambitious and balanced Doha outcome on agriculture, manufactures, and services. To that end, the group should consider an early harvest of reforms already developed in the Doha negotiations, such as the agreement on trade facilitation and the elimination of farm export subsidies.

Completing the Doha Round would be a signal of accomplishment. Allowing the current trading system, erected after a half-century of hard work, to be destroyed by an army of ants would be true disaster.

## About the authors

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# What should world leaders do to halt a resurgence of protectionism?

**Ann Capling**

*University of Melbourne*

*To fight protectionism, governments should practice Keynes at home and Smith abroad. Macroeconomic stimulus should be used to fight unemployment and thus dampen protectionist pressures. They should conclude the Doha Round to fortify the WTO in its role as a vehicle for liberalisation and a barrier against backsliding as the economic crisis spreads and deepens.*

Recent pledges by G20 and APEC leaders to refrain from imposing new trade barriers are welcome indeed. Such vows demonstrate that world leaders are mindful of the lessons of the 1930s, and the danger and futility of 'beggar thy neighbour' economic policies.

There is, however, no room for complacency; no reason to believe that politicians are immune to powerful domestic interests seeking shelter from the economic storm; no shortage of both familiar and new forms of protectionism. Fending off a surge of protectionism will require action at both the domestic and international levels – just as the financial and macroeconomic response have demanded both unilateral and collective governmental action.

So what should world leaders do to halt a resurgence of protectionism? They should practice Keynes at home and Smith abroad.

## **Practicing Keynes at home**

The global financial crisis and the threat of a severe and prolonged economic downturn have seen contemporary orthodoxies shattered. Keynesianism – a theory developed in the crisis-stricken 1930s – has made a comeback. Governments around the world are taking measures to stimulate their domestic economies by cutting taxes, increasing public spending, and running budget deficits.

But the (temporary) rehabilitation of Keynesianism entails some risks. Coupled with the crisis-driven nationalisation of financial institutions it could lead to a more generalised perception that governments be more interventionist, that they should be doing more to protect economies from the 'excesses' of global capitalism.

## **Practicing Keynes at home might make it harder to practice Smith abroad**

It is not hard to see how this could lead to a ratcheting up of protectionist demands. Debates on the merits of free trade that are now considered settled may as yet become unsettled by the prospect of a deep and long global recession. To be sure, we are not likely to see a repeat of the spiralling protectionism and 'tit for tat' strategies of the 1930s. Nonetheless, it is worth remembering that there is still plenty of scope for the return of old-fashioned protectionism.

The substantial gap between the applied and bound tariff rates, for example, leaves plenty of leeway for tariff increases by the majority of WTO members. And there are currently few limits on the ability of rich countries with deep pockets to provide trade-distorting subsidies to their agricultural producers. Moreover, there is evidence that new forms of protectionism are on the rise, typically in the name of rescuing 'strategic' industries, promoting food and energy security, and environmental protection.

## **Practice Smith abroad: Finish the Doha Round**

Out of crises come unexpected opportunities.

The Doha Round, since its launch seven years ago, has not been the main game for international trade cooperation. Governments have chosen instead to liberalise unilaterally or preferentially through bilateral and regional trade agreements. Some have attributed the sidelining of multilateral trade negotiations to the buoyant global conditions of recent years, powered by strong growth in East Asia. But the good times now are gone and the spectre of a global recession has breathed new life into the Doha Round, with the G20 and APEC leaders having expressed their commitment to reach an agreement on modalities by the end of this year.

The crisis is making world leaders look at the Doha talks in a new light. What would have been considered as a minimalist agreement only a few months ago – the binding of developing country industrial tariffs at their currently low applied rates and a cap on the level of trade-distorting subsidies in agriculture in developed countries – looks very attractive in the present circumstances.

Reaching a framework agreement in Geneva this month would also be preventative medicine. It would help prevent serious back-sliding that might otherwise occur should the international economic downturn bite as deeply as many now fear. Notwithstanding the well known benefits of unilateral liberalisation, the presence of international rules makes it much easier for governments to hold the line on protectionism against powerful domestic forces.

If world leaders are serious about their pledges, they must redouble their efforts to finish the Doha Round, starting with an agreement in Geneva in December.

## **Find new ways of doing business in the WTO**

Concluding the Doha Round will have the additional benefit of driving home the importance of the WTO to facilitate international trade cooperation. Indeed, if pressure for new protection gathers momentum, governments will gain a renewed appreciation of the benefits of collective action through the WTO, as preferential trade agreements cannot substitute for multilateral rules in this regard. And with near universal membership, consensus decision-making, and a commitment to transparency, participation, and inclusiveness in its processes, the WTO has a level of political legitimacy that is absent in organisations like the IMF and the G7/8 grouping. The WTO is likely to become more not less important to global governance in the future.

## **Decision-making in the WTO, a.k.a. G153**

Decision-making in a G153 is not without its problems. It is not just the size and diversity of the WTO's membership that poses a challenge to effective decision-making but also the current requirement that all agreements apply to all Members. Such demanding criteria make it nearly impossible to get new issues onto the agenda and



produce lowest common denominator outcomes. This has been evident for some years now, and there are a growing number of proposals aimed at making decision-making more flexible and efficient.

### **Critical-mass decision making**

In order for the WTO to maintain its ability to adapt to the changing times, world leaders need to give serious consideration to some root-and-branch reforms. The introduction of 'variable geometry' into the WTO, in the form of critical-mass decision-making, would allow groups of members to put new ideas into the mix, propose, advance and develop initiatives and negotiate new rules. Critical mass agreements could be designed in such a way so as to protect the interests and rights of all Members. Such an approach will help to strike a better balance between the goals of inclusiveness and efficiency in decision-making, and it will ensure that the WTO and the system of multilateral rules remain relevant into the 21st century. A robust, responsive and adaptive WTO, more than anything else, will help world leaders restrain protectionism.

### **About the author**

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# Protectionism and the crisis

**R. V. Kanoria**

*Kanoria Chemicals & Industries Ltd. and ICC*

*The current crisis was brought on by greed, herd behaviour and unregulated lending. Insulating national economies from the world and adopting protectionist stances will not prevent another crisis. The solution lies in pushing ahead with the Doha Round. Countries should also strengthen their trading systems, particularly with regard to trade finance and trade facilitation measures. Finally, global governance reforms are necessary to ensure that global financial, fiscal and monetary systems are adequately regulated in a transparent and rule-based manner.*

The ongoing economic slump triggered by the failure of financial institutions in the US and elsewhere, has rekindled the debate of protectionism. Factors leading up to it do not suggest that open economies were a cause. In my opinion the crisis is the result of 'greed'. Indiscriminate lending by financial institutions and absence of prudent financial regulation, combined with a 'herd instinct' seems to me to be the cause. The proliferation of derivatives far in excess of global GDP has compounded the speed of the crisis and led to a systemic failure. I believe this is not a once in a lifetime crisis but can happen again unless some basic issues are addressed, and I do not think that insulating national economies and a protectionist stance are in any way a part of the answer.

At the recently concluded APEC summit in Lima, leaders of 21 nations agreed that protectionism was a road to ruin and reaffirmed their belief in liberalising world trade and concluding the Doha Round. While recognising the economic downturn they all agreed that protecting their own interest would not be sufficient to overcome the crisis.

The current situation only underscores the importance of multilateral action especially in the trade and finance sectors. Countries too, need to liberalise their trading systems in order to minimise the impact of the crisis. It has been shown that protectionist policies run the risk of creating higher unemployment as well as higher prices and burgeoning debt. Consumers in protected countries are invariably disadvantaged by way of limited choice of goods and uncompetitive prices. Globalisation needs to be reinforced, albeit with local discipline and oversight.

Moving forward, there is urgency for concluding the Doha Round at the WTO. The first step towards this end is to ensure that there is no rollback from what has already been agreed upon. This is the right time to send out a strong signal to the global community and to ensure that there is no dilution in the agreements on multilateral trade issues. At the same time, countries need to strengthen their trading systems, particularly with regard to trade finance and trade facilitation measures. Strong supportive trade finance measures are the need of the hour for countries to overcome the downturn in global trade. Inability to do so may isolate countries and prevent accrual of the benefits of open trade. Trade facilitation measures are components of the WTO

discussions but have been getting side-tracked with other issues such as the NAMA and agriculture negotiations taking precedence. This issue is of particular relevance to developing countries to strengthen their trade infrastructure, and to the developed ones to allow their consumers the choice of quality products at competitive prices.

The WTO negotiations are based on the principles of reciprocity. However, many points are being brought on to the table only as bargaining tools while keeping acceptable stances 'up-one's-sleeve'. To demonstrate greater credibility, it is of utmost importance that issues are not kept pending for too long. Instead there needs to be a proactive effort to table final positions and not just interim negotiating stances. In fact, countries need to take unilateral measures to open up trade and voluntarily globalise. That and that alone can instil confidence and provide a fair chance for a multilateral agreement to succeed.

The lingering discussions of critical issues tabled at Doha may be perceived by the world as the inability of nations to arrive at a consensus towards a rule based multilateral trading regime. Worse, it may even be perceived as a reluctance to do so. This cannot be an acceptable situation and can threaten the very purpose of WTO and years of efforts.

In an attempt to safeguard trade and keep it open, there is a need to revisit capital flows which go hand in hand with trade. At this juncture a global framework is required which does not destabilise trade and create imbalances. The role of IMF and World Bank, which have almost lost their meaning, needs to be re-evaluated. The IMF and World Bank either in the present form or in a new avatar need to be restructured. New institutions need to evolve with a new mandate and a new structure keeping in mind the new emerging world order. A significant aspect of the role of such institutions would be to facilitate free flow of capital under a multilaterally agreed framework of rules. Further, the central objective should be governance and surveillance. Not only should this role include regulating financial flows but also monitor them to prevent breakdown of financial systems across the world. Considering the increasing importance of the Asian economies in the last two decades, there is a case for recapitalisation of the Asian Development Bank and including it in the process of evolving global guidelines.

Currently, there is a complete absence of a global mechanism on finance. Bretton Woods today has just been reduced to being the name of a hotel. Countries are competing with each other to attract capital and in the process diluting the essence of a prudent financial system.

The International Chamber of Commerce has made significant contributions to the world trading system in the areas of documentary credits and arbitration. Perhaps the evolution of a global financial regulation can be driven by business for a more pragmatic and workable solution.

There is also the need for stability and congruence in exchange rates. A framework is required that would find a solution to stop inordinate fluctuations and at the same time align currencies along realistic values. Tariffs as a mechanism of market access are only one side of the coin. Artificially managed exchange rates defeat the very purpose of tariff correction.

Trade and financial imbalances have led to the current crisis. Cheap exports of trade surpluses by trade surplus countries have been used as a means of inexpensive finance for financing budget deficits of others such as the US. It is imperative that the concept of globalisation also encompasses the need for more equitable and balanced trade flows.

## Conclusion

Economic events in the past decade have reaffirmed the need for freer and more open trade. I believe that the path to liberalisation cannot be allowed to be reversed because doing so would fragment the global economy to the extent that it may become dysfunctional. The call of the day, therefore, is to ensure that the WTO negotiations reach a positive conclusion. At the same time, there is need to ensure that global financial, fiscal and monetary systems are adequately regulated in a transparent and rule based manner.

## About the author

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# Protecting open markets

**Robert Z. Lawrence**

*Harvard University*

*The current sense of urgency needs to be mobilised to finish the Doha Round and establish a WTO surveillance mechanism to which all members would report what measures they are taking. G20 leaders should extend their anti-protectionist pledge to cover new subsidies and discriminatory government procurement.*

The world economy is in the greatest jeopardy since the 1930s. The crisis has spread through global financial markets like a virulent pandemic, leaving no country unaffected. Plummeting freight rates and massive inventory build-ups on the docks attest that the crisis has spread to global markets for goods and services.

But the worst is yet to come; the real economy will inevitably fall more deeply into recession.

## **Countries hang together or they are hanged separately**

If there was still need for evidence of global economic interdependence, it was surely provided by the way no country has been spared. The idea that growth in developing countries could be sustained despite the slump in advanced countries – decoupling – has proven misguided. Today the choice is clear; countries hang together or they are hanged separately.

## **Will we repeat the Great Depression?**

Historians debate whether the Smoot-Hawley tariffs in the US and the protectionist responses they engendered in other countries actually caused the Great Depression. But few dispute that the precipitous decline in global commerce between 1930 and 1933 made the depression worse. Efforts by the US and its trading partners to bottle up demand at home with tariffs proved counterproductive because it led to a vicious circle of retaliation that in the end made everyone worse off.

Unlike the 1930s, policymakers today are moving speedily and decisively to run larger budget deficits and expansionary monetary policy. Financial policymakers are also trying with impressive ingenuity to avoid the mistakes of their historical counterparts who stood by and allowed massive bank failures.

It remains to be seen, however, whether trade policymakers can do likewise. Thus far their efforts have been disappointing. We need decisive action – more meaningful commitments to avoid new discriminatory measures against foreign products and firms, and a speedy end to the Doha Round.

## **Can Obama keep those new jobs at home?**

Many countries are now simultaneously adopting programs of fiscal stimulus to offset the retrenchments in private consumption and investment. Since economies have become more open, some of the stimulus will inevitably leak abroad. The December 8th cover of Business Week Magazine raises questions about by asking: 'Can Obama keep those new jobs at Home?' But it is far better to create a virtuous cycle in which countries prop each other up, than to repeat the experience in which they dragged each other down.

## **The WTO bulwark**

The world economy is better off today because it has established a multilateral system based on the rule of law that has bound tariffs for the most part at fairly low rates in developed economies. It is unlikely therefore, that protection will take the overt form of raising average tariffs to 60% levels. Nonetheless, as governments massively increase involvement in their domestic economies, their protectionism could take more subtle forms that could prove very damaging.

## **Beware financial sector nationalisations**

In many countries, large parts of the financial system are effectively being nationalised. Firms in other sectors are receiving government financial support. The temptation to adopt measures that discriminate against foreign firms and products in this context is very strong.

As national policymakers take actions to bolster their domestic economies they need to be continuously reminded of the dangers of beggar-thy-neighbour policies. WTO rules prohibit subsidies favouring domestic over imported output, but it will be extremely tempting for countries to confine their programs to domestically owned firms.

The US Congress, for example, is currently debating a plan to bail out the Big-Three US automakers. What impact will such a plan have on foreign-owned auto companies in the US and those that export autos to the US? Similarly, there is uncertainty whether the tax breaks granted US-owned banks in the recent \$700 billion bailout apply to foreign owned banks that operate in the US.

## **New pledges on subsidies and a WTO surveillance mechanism are needed**

It is worrying that while the recent statement of G20 leaders underscored the critical importance of 'rejecting protectionism, and avoiding WTO-inconsistent measures to stimulate exports,' there was no mention of avoiding discriminatory domestic subsidies.

The G20 should now explicitly extend their anti-protection pledge to include new subsidies and discriminatory procurement spending. And they should back up these pledges by establishing a WTO surveillance mechanism to which all members would report what measures they are taking.

While policymakers will be preoccupied with restoring financial stability and renewing economic growth, they are also likely to undertake other policies, both domestically and through international agreements, to deal with climate change, terrorism, food safety and food security. All of these are legitimate social concerns and in some cases, it might be necessary to adopt measures that impact trade. But as with domestic subsidies, the principle that intervention should adhere to the least trade-



distorting approach should be adopted. Border taxes on carbon content and complicated certification schemes for imported bio-fuels are far less desirable, for example, than having all countries adopt binding commitments on climate change and sustainable practices. Similarly, ensuring food security through inventory policies and long term supply commitments from exporters are far preferable to efforts to achieve self-sufficiency.

### **Save the Doha Round**

The other item for action is concluding the Doha Round. The current sense of urgency needs to be mobilised. Nothing would be more effective in underscoring global commitment to an open multilateral trading system than a speedy agreement that captures what is now on the table.

One would have hoped our leaders would have realised all this. But the best the G20 leaders could do recently was to retreat into bureaucratic jargon and instruct their trade ministers to 'strive' to reach agreement on the Doha Round modalities by year end'. Strive? 'Just modalities' That's pathetic. Why not instructions simply to reach agreement?

### **Bridging the differences**

The leading developed (the US and the EU) and developing countries (India and China) must now bridge their differences for the greater good. The cost of failing to reach any agreement now outweighs additional marginal gains. The window of opportunity is closing rapidly and delay could prove fatal.

As unemployment rises and commodity prices fall in response to slowing global demand, concluding an agreement to reduce trade barriers and cut farm subsidies will become increasingly difficult. The key is to act before a deep and possibly long lasting recession sets in.

### **About the author**

**Robert Z. Lawrence** is the Albert L. Williams Professor of Trade and Investment at the John F. Kennedy School of Government at Harvard University, and Senior Fellow at the Peterson Institute for International Economics in Washington, having previously served as a member of President Clinton's Council of Economic Advisers. He also held the New Century Chair as a non-resident Senior Fellow at the Brookings Institution and founded and edited the journal *Brookings Trade Forum*. Before coming to Harvard, he taught at Johns Hopkins School of Advanced International Studies and Yale. He has served as a consultant to the Federal Reserve Bank of New York, the World Bank, the OECD, and UNCTAD. The author of numerous scientific articles and books, his most recent is: *Case Studies in US Trade Negotiation* (2006).



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# Keeping the global economy open

**Wendy Dobson**

*University of Toronto*

*To head off protectionist responses to the unfolding economic crisis governments should take several measures: complete the Doha Round, cooperate to reduce global imbalances and implement domestic reforms to cushion the burdens of adjustment to economic change.*

The open trading system is a form of global public good. Everyone benefits from its existence, whether they protect it or not, yet choosing their narrow national interests over the collective interest can bring about its demise.

As the global financial crisis enters the next phase in which growth is slowing and major industrialised countries enter recession, politicians will be pressured by interest groups. G20 leaders at their meeting on November 15th recognised the collective interest in keeping the global economy open. Now they need to follow the example of East Asian governments in the wake of the 1997-98 financial crisis who put more, not less, emphasis on trade openness. Strong growth in trade through cross-border production chains followed and regional trade agreements (RTAs) proliferated in part because of uncertainties about the future of the multilateral trade negotiations. Despite the G20 pledge, the recent rise in import barriers by some countries is disquieting and commitments to complete the Doha Round are vague.

There are several routes to head off protectionism: by completing the Doha Round so that the WTO can move on to deal with other emerging issues, by addressing global imbalances through inter-government cooperation in the G20, and by domestic policies that help people adjust to economic change.

## **Find the political will to complete the Doha Round**

The Doha Round has variously been described as dead, deadlocked, moribund and failed, but there are important reasons to resurrect and complete it. The WTO, whatever its failings, is the central symbol of governments' commitment to an open multilateral trading system. When the talks broke down in July 2008 victory was within reach; the atmosphere among negotiators was one of regret rather than recrimination. There was very little left to agree. What was missing was political will in major countries. Only a few months later, we face extraordinary times when extraordinary leadership and political willpower are required. 'Whatever it takes' say those at the centre of the financial crisis. Similar resolve should apply to the global trading system at a time when free trade is being mixed up with critiques of free markets. Analyses of the farm trade standoff in July show that a compromise is possible. So are improved offers in services and agreement on rules. In previous rounds governments have been pushed by their business communities to complete an agreement but this round, up to now, has been too narrow in scope to attract such support.

Private sector pressure is now needed now to finish this round and restore WTO

legitimacy so that the next round can get started on the emerging collective issues of climate change and threats to food and energy security. Already we can see politicians reaching for trade instruments to use against the products of countries which they consider sustain competitive advantages by taking actions that do not compare favourably to those taken in the US and Europe.

Completing the Doha Round will also help to reduce the case for RTAs that many countries now use as part of a multi-pronged approach to trade liberalisation. RTAs can be trade creating as long as they observe basic WTO principles but, as the World Bank and others have shown, many are negotiated for political reasons, promise little in the way of trade creation, and cause a proliferation of costly rules of origin which no one has yet vetted for consistency.

### **Reduce global macroeconomic imbalances**

This also requires inter-governmental cooperation. Global growth has for the past years depended heavily on US consumers who are now repairing their balance sheets and further driving the US economy into recession. Exporting countries were beneficiaries of the US propensity to import, running current account surpluses, managing their exchange rates and building up large reserves which financed the large US current account deficit. Will they now pick up the slack to cushion global growth? Fiscal stimulus in large countries is part of the answer but governments should cooperate to prevent this adjustment from becoming disorderly and refrain from reaping short-term political gains from protectionist measures. The G20 is the logical forum for this kind of cooperation, giving all involved equal voices at the table. It will need support based on new levels of cooperation between the WTO and IMF to provide the objective analysis of both the diagnosis and the prescription.

### **Provide citizens with more help to adjust to change in a global era**

Domestic actions are also needed to head off political pressures for protectionism. Particularly worrisome is the perception that globalisation is bad for the middle class and needs to be disciplined. This perception is fed by evidence of rising income inequality in a number of countries. As many have pointed out, this inequality has multiple causes including technological change, changing relative prices, as well as openness. Each causes creative destruction that sustains growth but causes dislocations which those with political voice lament. Yet the main scapegoat is openness.

The appropriate response lies in domestic policy reform, not protection. A prominent example of this can be found in the US, where fear of change has been tapped by public commentators and organised interest groups. Foreign competition and trade agreements have become the lightning rod for fears of job loss even though net trade-related job losses have been shown to be a tiny fraction of the annual churn in the 155 million-strong civilian labour force. What people actually fear is the insecurity of losing the health care and pension benefits that go with those jobs, putting them a heartbeat away from catastrophe. These fears can be addressed by creating a social safety net that provides universal access to health care and improves the portability of pensions.

Crises frequently open windows of opportunity for policies and ideas which in good times are dismissed as politically unacceptable. Now is one of those windows.

## About the author

**Wendy Dobson** is Professor and Director, Institute for International Business, Rotman School of Management at the University of Toronto. Prior to that she was Associate Deputy Minister of Finance in Ottawa and President of the C.D. Howe Institute, Canada's leading independent economic policy research organization. She serves as Director of the Institute for International Business and is a non-executive director of Canadian companies in finance, energy and life sciences as well as being Vice Chair of the Canadian Public Accountability Board.



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# The crisis and protectionism: History doesn't repeat itself, but sometimes it rhymes

**Richard Baldwin**

*Graduate Institute, Geneva and CEPR*

*The 1997 Asian Crisis saw crisis-stricken nations raising tariffs and devaluing currencies, and rich nations raising antidumping duties. Today's version of this WTO-legal tariff war could be vastly worse given the scale of the crisis. To limit protectionism, world leaders should get the Doha Round back on track and set up a 'Global Crisis Safeguard Mechanism' to monitor new protection and facilitate its post-crisis removal.*

The last major financial crisis – the 1997 Asian Crisis – saw a wave of protectionism. Several of the crisis-stricken nations raised tariffs and rich nations replied with a wave of new antidumping and countervailing duties. All of this was consistent with WTO rules and commitments.

Today, we see similar events unfolding. The latest data from the ITC (International Trade Centre) shows that many nations raised tariffs in 2008. The latest data from the WTO shows that the number of antidumping cases jumped 40% in the first half of 2008.

The situation today, however, is far more serious than it was during the Asian Crisis. Three reasons:

- The WTO system was in solid shape in 1997; today it suffers from years of setbacks.

In 1997, the multilateral trade system was riding high on the 1994 completion of the Uruguay Round and the signing of two major WTO liberalisation initiatives (the Information Technology Agreement and the Financial Services Agreement).

The contrast with 2008 could not be greater. The Doha Round negotiations crashed as recently as July, with this coming on the heels of years of deadlocks and disappointments. Moreover, 60 years of WTO-centricity is now under a question mark; most of this century's trade liberalisation has occurred unilaterally or regionally – not under the WTO's aegis.

- The 1997 Asian Crisis was limited; today's crisis is global.

The 1997 events posed problems for many nations but were a crisis for only eight nations that collectively accounted for just 9% of world GDP. The 2008 financial crisis has already pushed into recession nations that account for more than two-thirds of global imports and income – the US, EU and Japan. Many more are on their way down. As unemployment starts climbing, domestic political pressure for protection will mount around the world.

- Today's applied tariffs could rise massively without violating WTO-commitments.

If nations raised their applied tariffs up to their 'bound' rates (i.e. the tariff ceilings they have committed to under WTO rules), tariffs facing the exports of rich and middle-income nations would double; those facing poor nations would triple (see Table).

**Tariffs on high-, middle- and low-income nations: status quo vs. bound rates**

	Protection faced by exporters from:		
	High-income	Middle-income	Low-income
Status Quo	4.6%	4.6%	4.0%
Tariffs raised to bound rates	9.0%	8.9%	11.7%

Source: 'The cost of a non-Doha', Bouet and Laborde, IFPRI Briefing Note, November 2008.  
<http://www.ifpri.org>

**Keep the protectionist snowball from getting started**

To prevent protectionism from snowballing, world leaders should take two steps.

- Reinforce the world's best bulwark against a protectionist spiral – the WTO system, and;
- Establish a system that helps G20 nations stick to their pledges on avoiding protectionism.

**1) Getting 'modalities'**

The best way to shore-up the WTO's credibility is to get past the first crucial milestone on the road to finishing the Doha Round talks. This milestone – known as modalities in WTO jargon – refers to the basic parameters that will underpin the Doha Round deal, which would, in the best of cases, take many more months to complete.

Getting past the milestone will not be easy. This is exactly where the July 2008 Ministerial broke down. The hope springs from the fact that G20 leaders pledged to, '... reach agreement this year on modalities that leads to a successful conclusion to the WTO's Doha Development Agenda with an ambitious and balanced outcome.'

Even if trade ministers cannot settle all of the sticking points, they should meet, agree what they can, and declare victory. Completing modalities would send a powerful message of reassurance to world investors. Failing to do so after the G20's high-level intervention would send the opposite message; how could investors then trust anything G20 leaders say?

**2) Disciplining the inevitable rise in protection**

The futility of protectionism in a global recession is not a new lesson – every world leader knows the morality tale of protectionism in the Great Depression. But leaders find themselves in ageless 'two brain' situation. Their intuitive 'right brain' hears the cries of workers losing jobs and firm-owners losing money; protectionism feels like a natural reaction. Their logical 'left brain', however, knows that protectionism in a global slowdown is a self-defeating tactic.

The challenge facing world leaders is to find mechanisms that help them mutually commit to doing the right thing.

Fortunately, the WTO has a long tradition of providing such mechanisms.

**The WTO doesn't prohibit protection, it disciplines it**

The WTO/GATT is a pragmatic set of rules, one which acknowledges that nations will construct and maintain trade barriers. The bulk of the WTO/GATT rules concerns ways of disciplining such protection. One important set of rules allows nations to



raise barriers in various emergency situations.

Such provisions, generally known as ‘safeguards’, permit members to raise tariffs but subjects them to a series of conditions – typically, requiring the measures to be the least trade-distorting possible, temporary and transparent, with all such measures reported to the WTO Secretariat. Many safeguard rules also require a plan for removing the barriers. The GATT Article XII on what nations can do in a balance of payments crisis is a classic example.

### **An idea: A Global Crisis Safeguard mechanism as exit strategy**

The leaders of WTO members should agree a new set of such provisions, a ‘Global Crisis Safeguard’ mechanism.

This would establish rules for disciplining the protection that we all know will occur during this crisis regardless of what national leaders say in their press communiqués. This mechanism would require WTO members to announce all increases in import protection to the WTO Secretariat. This would cover WTO-legal measures such as new antidumping duties (as is already the practice) and increases in applied rates that are currently below their bound level. It should also cover less transparent measures forms of protection. Along with the declaration to the WTO secretariat, the member should provide some justification and an explicit promise to remove the new protection within 2 years.

This mechanism would slow the protectionist snowball as everybody would know that everybody knows about the rising barriers. Nations would be forced to realise that they are not acting alone – that their protectionist moves are being matched by those of their trading partners.

While this sounds like sanctioning new protection, it would merely make explicit the ‘balance of threats’ that underpins all WTO cooperation. New protection that benefits a nation’s import-competing industries would indirectly encourage protection abroad that harms its export industries. Surely some protection would occur, but not because nations thought they were getting it ‘for free.’

More importantly, the mechanism would establish an ‘exit strategy’ from the crisis-induced protection. Since much of the crisis-induced protection will be WTO-legal, we must find a way to unwind the barriers after the crisis. When the world pulls out of the recession – say in 2010 – the mechanism would give leaders a list of the barriers to be dismantled. History suggests that this would be helpful. Much of the damage from the 1930s tariffs came well after the Great Depression passed as the tariffs stayed in place for decades.

### **About the author**

**Richard Edward Baldwin** is Professor of International Economics at the Graduate Institute, Geneva, having previously taught at Columbia, MIT, Bocconi, Kiel and the Norwegian School of Business and Economics. He is founder and Editor-in-Chief of VoxEU.org and Policy Director of CEPR. He has been Co-managing Editor of the journal *Economic Policy*, Programme Director of CEPR’s International Trade programme, and Senior Staff Economist for the President’s Council of Economic Advisors in the Bush Administration (1990-1991). He did his PhD at MIT with Paul Krugman. He has also worked as consultant for the European Commission, OECD, the World Bank, EFTA, USAID and UNCTAD. The author of numerous books and articles, his most recent book is: *Impact of the Euro on Trade and Foreign Direct Investment*. He is a CEPR Research Fellow.



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# What should world leaders do to halt protectionism from spreading?

**Patrick A. Messerlin**

*Institut d'Etudes Politiques de Paris*

*G20 leaders should focus on making tangible progress on Doha negotiations before the end of the year. This will require more realism on industrial tariffs, more transparency on agricultural liberalisation, greater boldness on service liberalisation, and more responsibility taken by all G20 nations.*

The ongoing financial crisis has tremendously increased the price tag of the failed Doha negotiations in July.

The crisis has made increasingly plausible an additional loss of hundreds of billions of dollars to the loss of the estimated gains of \$50 to \$70 billions that a successful negotiation in July would have generated. What are these additional losses? The losses would come from huge tariff increases that dozens of crisis-stricken economies – ranging from Brazil to India and from Australia to Singapore – could impose. Such increases are possible because these countries are applying tariffs that are much lower (8% on average, but much more on many products) than the tariff ceilings they agreed to respect in previous WTO negotiations.

The world leaders should realise that these two dozen countries are large enough – they amount to 30% of the world trade – to generate chaos in the whole world trading system if they increase their tariffs. This should be a major concern since there is now nothing in the WTO system that can prevent this.

## **What would happen if unbound tariffs rose?**

Two recent studies shed some light on the mounting dangers. First, the top-30 products with high risks of sharp tariff increases are concentrated in the automobile and electronics sectors. These are two key industries – one of which is already in trouble. Higher tariffs on such products would increase the costs of current world imports by roughly \$30-\$50 billion. Second, the first available estimates of the welfare costs generated by such tariff increases range from \$135 to \$350 billion, making the global price tag of failing to keep the Doha Round on track in the range of \$205 to \$420 billions.

Once world leaders realise that the magnitude of the impending trade crisis would rival that of the financial crisis, the world leaders should apply the fresh lessons learnt from the financial crisis. Pre-emptive actions are more efficient than reactions, and the wider and faster the better. In the trade context, ‘wider’ means that the Doha negotiations have an absolute priority over preferential trade negotiations, and ‘faster’ that the Doha negotiators should deliver key tangible results before the end of the year.

To reach such a goal, world leaders should instruct their trade ministers to be more realistic, transparent, consistent, bold, and responsible during the coming weeks of

negotiations.

Five elements for a successful Doha Round negotiation:

- More realism is needed in manufacturing.

So far, the industrialised countries are asking for massive tariff cuts from the emerging economies. Emerging economies are requesting huge exceptions to such cuts. Such a game can only deliver deep tariff cuts for marginal products and few tariff cuts for key goods – definitely not an economically and politically sound bargain. The financial crisis requires a both humbler and firmer approach. Industrialised countries should ask for less massive tariff cuts; emerging economies should ask for fewer exceptions.

- More transparency is needed in agriculture.

The current negotiations on ‘agriculture’ deal with two very different groups of products: farm products and processed food products. This approach hides the fact that the high tariffs in ‘agriculture’ are concentrated in processed food. By revealing these facts, making a distinction between farm and processed food products would help to cut the (relatively lower) tariffs on farm products less and to cut the (relatively higher) tariffs on processed food more – an economically sound, politically attractive (food processing firms do not enjoy the popular support given to small farmers), and fundamentally honest policy.

- More consistency is needed in ‘contingent protection’ (antidumping, safeguards, and countervailing duties).

Where is the rationale for banning tariff increases higher than the bound tariffs in the safeguard cases in agriculture when it is a routine outcome of the antidumping cases in manufacturing of the last decade? The principle of imposing similar – and sounder – constraints on all these procedures should be recognised.

- Greater boldness is needed in services.

First, negotiators should acknowledge – and convince business people – that more open markets in industrial and agricultural products will bring vast benefits to the many services embedded in the traded goods. In short, current negotiations in manufacturing and agriculture are negotiations in such services. Second, when opening the Doha negotiations in services per se, negotiators should follow one principle. Although it may be diplomatically convenient in the short run, it would be diplomatically self-defeating in the long run and economically costly to focus on ‘early harvests’ – that is, on a few services sectors relatively easy to liberalise. The coverage of trade liberalisation in services should thus balance the benefits of opening in some services by the cost of leaving the situation unchanged in other services.

- More responsibility is needed.

The time has come for negotiators to abandon tactical posturing that induces them to minimise the magnitude of the progress achieved. They should openly begin to recognise that a do-able Doha package would yield impressive advances in the openness of manufacturing and agriculture markets.

In the industrial sector, the emerging economies would cut their average bound tariffs to roughly 15%, with few tariffs above 25%. In addition to notable effective tariff cuts, exporters from industrial countries would thus benefit from a huge increase in the certainty of the world in which they operate – something that they take as granted today. Meanwhile, the peak industrial tariffs that the advanced economies have kept for so long on developing countries' key exports would be greatly reduced; exporters from developing countries would finally get the market access that they have been asking for decades.

In agriculture, the package would also be substantial. After sixty years of high protection, tariffs imposed by industrialised countries on agricultural imports would become moderate on average (about 15% in the EU case), all types of export subsidies would be banned, and domestic subsidies in agriculture would be curbed at about 15% of the farm domestic output.

Such a deal would fulfil a key mandate of the Doha Round – the ‘equivalent level of ambition’ between liberalisation in industrial and agricultural products – would be met (in average terms) by the fact that the tariffs on industrial goods, those on agricultural products and domestic support in agriculture would converge to a roughly similar level (15%) in most industrialised and emerging economies.

### **Leadership to avoid failure**

All this will be possible only if the world leaders make clear that they will put aside the vested interests opposed to a Doha agreement with the same energy that they did when addressing their banks' difficulties. And world leaders have a strong incentive to do so.

The economic effects of a trade crisis would likely swamp all their past and present efforts to solve the financial crisis. A failure in the Doha Round may well be the failure of their whole set of economic policies.

### **About the author**

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# No turning back: Lock-in 20 years of reforms at the WTO

**Simon J. Evenett**

*University of St. Gallen and CEPR*

*Two decades of trade reform could be largely reversed without violating WTO commitments. To avoid this, trade ministers should translate APEC and G20 leaders' words into deeds by agreeing a framework for the Doha Round that emphasises the locking-in of reforms, even if agreement comes at the expense of some market-opening ambition. Short of a Doha Round deal, other tangible steps could signal the world's commitment to keep markets open to trade.*

The WTO is where countries make legally binding trade barriers reductions, right? Well, sort of. The WTO helps but it is not a complete insurance policy against a new wave of crisis-induced protection.

## **What a WTO-consistent protectionist wave could look like**

Legally speaking, there is plenty of room for governments to erect new, WTO-consistent trade barriers. Here are just a few examples.

- Bound versus applied developed-country agriculture subsidies.

For historical reasons, WTO subsidy negotiations do not involve commitments on actual subsidies; they involve commitments on subsidy ceilings – ‘bindings’ in WTO jargon. Today there is a large gap between applied and bound subsidies, so there is much room for nations to raise barriers without violating WTO commitments.

Take for example EU and US agricultural subsidies – a key concern of many developing countries. Given the current binding/applied gap, the US and EU could treble their agricultural subsidies without running into WTO ceilings. At a time when Western policymakers have little trouble spending billions on distressed sectors, this is surely a concern. One cannot rule out a return to the 1980s when a ‘subsidies war’ flooded world food markets with artificially priced Western products.

- Withdrawal of Generalised Systems of Preferences.

Under WTO rules, developed countries have voluntarily provided better-than-normal market access to developing nation exports. Developing-country policymakers should remember that the market access benefits they get through the Generalised Systems of Preferences can be withdrawn at will under current WTO rules.

- Unbound emerging market tariffs.

Exporters to emerging markets cannot take their current market access for granted. For example, on average India is allowed to charge a maximum tariff of 50% on its imports, although in practice it levies them at a much lower rate (around 10%). According to IMF statistics, the last time India actually charged tariffs that averaged 50% of its import bill was in 1989. This means that 20 years of progress could be reversed at the stroke of the pen of India's commerce minister, without any need to offer compensation to trading partners.

Such calculations can be repeated for every single one of the 10 largest emerging markets and, with the exception of China, across the board tariff increases by the remainder would wipe out 20 years of tariff cutting without breaching WTO limits. Worse, if you look closely at the obligations of some of the 10 largest emerging markets, there are literally thousands of imports where the tariffs aren't subject to any WTO ceiling.

- Antidumping and anti-subsidies duties.

WTO rules allow all members to impose new tariffs on goods that the member itself determines are 'unfairly' traded. WTO restrictions on what 'unfair' means are quite loose, so nations have wide scope for imposing new barriers. This is especially true in the current environment where national governments are bailing out specific sectors and/or engaging in competitive devaluations – both of which have triggered antidumping investigations in the past. A slew of such antidumping and anti-subsidy investigations have been recently announced.

- Protectionist bailouts and investment restrictions.

Additional sources of WTO-compliant protection can come in the form of subsidies to the car sector, restrictions on foreign direct investment, and takeovers by the rich nations..

## **No time for complacency**

With all this in mind, surely policymakers can see how fragile are current global commercial opportunities that many have been taking for granted. If times get very ugly then we'll soon see the limited bite that WTO disciplines have.

The response is not to turn our backs on the WTO but to make use of this machinery to lock-in current commercial policies, and thereby maximise trade's contribution to economic recovery.

## **Doha isn't the only WTO option, but it would be a great place to start**

Completing the Doha Round would be a powerful demonstration of the world's commitment to open markets at a time of economic distress. Perhaps the realisation of the potential for a protectionist backlash, and the few legal limits on such a backlash presented by current WTO rules, will convince prime ministers and presidents to overcome the hurdles that stopped a deal being concluded over the summer.

Trade negotiators should see the previous draft modalities as locking-in much prior trade reform, be content with that, and not antagonise trading partners and jeopardise the conclusion by squeezing out the last drop of extra-market access.

Many Western manufacturers won't like this, as it means forgoing certain sectoral deals that they desire. Surely these demands miss the forest for the trees; limiting the potential of turning the clock back 20 years in emerging markets should now take priority. Likewise, developing countries should not seek a couple billion more here or there in cuts in agricultural subsidies from Western countries. Rather, take what's on the table before Western farmers get as organised as their counterparts in the car manufacturing and banking sectors.

## **Other options for world trade ministers**

Even if a Doha Round framework deal isn't possible, three other options could be pursued – individually or together – at the likely December WTO Ministerial Meeting or afterwards.



- As a demonstration of world trading powers' commitment to trade as a vehicle of economic recovery, the WTO's current trade facilitation negotiations could be wrapped up and implemented on a provisional basis.

These negotiations, that concern principally cutting red tape and delays at border crossings, have been very constructive. Finalising them would require an extra push but should be do-able. Implementation of this agreement could start on 1 January 2009 with industrialised countries committing to create a fund for the poorest developing countries to implement red-tape cutting measures.

- More ambitious would be a temporary binding commitment by the G20 and APEC nations not to raise their applied most-favoured-nation tariffs, agricultural subsidies, and export taxes and restrictions above the levels that prevailed during November 2008, when their leaders spoke out so boldly on this matter.

This binding commitment would last so long as the world economy's growth rate fell below a certain level (say 4%-5%) and could be reviewed every 2 years (at subsequent WTO ministerial meetings.) Since the G20 and APEC nations include almost all the major trading nations, this commitment would provide a tangible legally-binding way of implementing calls for a standstill on tariff hikes. Without this step, the fine words heard in Washington and Lima may end up ringing hollow.

- At any December WTO meeting senior officials could agree to limit – for the the duration of the global recession – antidumping investigations to accusations that sales abroad are taking place at prices lower than in home markets. This would suspend investigations into loss-making exports.

Some of the worst bureaucratic games get played in anti-dumping investigations into loss-making export sales, which are often treated as 'not in the ordinary course of trade.' These abuses result in implausibly high duties and often distort other aspects of the dumping investigation. Many nations' antidumping laws treat loss-making export sales as dumping, arguing that making losses is not normal corporate behaviour. The best that could be said for this argument is that it applies, at most, during booms when firms can make bumper profits. However, during deep recessions many firms make losses on sales to domestic and foreign markets without their being any evil intent to monopolise markets.

## **Conclusion**

The bold declarations at the G20 and APEC summits need to be followed up with similarly bold actions. Not only should WTO members resist the temptation of protectionism during the current global economic slowdown, but steps should be taken to lock-in the many commercial policy reforms implemented since the Uruguay Round. Finalising the Doha Round would be a great place to start, but it's not the only option that ministers should consider either in the run-up to December's possible WTO meeting or afterwards.

## **About the author**

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# What should ASEAN+3 do to help avert a collapse of the global economy?

**Yung Chul Park**

*Seoul National University*

*The Doha talks are the G20's first concrete test; its credibility as the world's new governing body would be undermined if progress is not made this year. In addition to pushing for a Doha deal, ASEAN+3 can help by boosting their imports via domestic demand stimulus and by utilising all channels of mutual assistance to members with short-run balance-of-payments difficulties.*

Before the G20 leaders' meeting in Washington on November 15th, few believed the Doha Round had much of a chance after having dragged on for more than 7 years. This pessimistic outlook has changed. There is new hope.

## **The spectre of a protectionist vicious cycle**

The global crisis – which could precipitate the deepest recession since 1929 – has awakened the global community to the spectre of a vicious circle in which the recession puts pressure on both developed and developing countries to renew trade protectionism, which in turn exacerbates further global economic downfall. In realizing this risk, G-20 leaders have risen to the challenge of resisting the threat of a return to protectionist policies.

With this in mind, G20 leaders made two pledges on trade. They agreed on a standstill on trade restrictions within the next 12 months, and they instructed their trade ministers 'to reach agreement this year on modalities that leads to a successful completion of the Doha Agenda.' A week later, the G20 declaration was followed by a similar APEC leaders' statement at their meeting in Lima.

Despite the urgency and the strongly worded statements, there is still lingering doubt as to whether the remaining issues on agricultural trade could be resolved within a month. Recent developments hold out hope for an early conclusion. The negotiations on the Doha modalities on agriculture and industrial goods are close to completion as a result of the G20 summit and signals coming from the UN's recent development conference in Doha. More importantly, China, India and the US, which have been mired in dispute over agricultural trade issues, have all signed on for an early conclusion of the Doha Round.

## **The price of failure: G20's loss of legitimacy**

The global community cannot afford to let the Doha Round fail. Failure could mean a major setback in international policy coordination critical for crisis resolution and multilateral trade liberalization. The Doha Round negotiations are the first test of viability and effectiveness of G20 international policy coordination as mapped out by

the G20 leaders. If once again the planned WTO ministerial meeting fails to reach an agreement, the G20 will lose its legitimacy as an international body to coordinate economic policies among its members.

The Doha accord may also help stem the rising tide of trade protectionism in the US.

## **Stemming the rising tide of protection**

There is a widespread perception that the new Obama administration with its emphasis on fair trade may not be as disposed as the Bush administration has been towards multilateral trade liberalization. Sensing the protectionist mood of the new US Congress, Obama may decide not to push for ratification of the FTAs signed by the Bush administration. If the planned WTO ministerial meeting could reach an agreement on modalities, the Doha Round may help the new administration carry on with the free trade stance of the Bush administration.

## **Doha is not enough: What ASEAN+3 leaders should do to help**

The successful finalization of the Doha Round negotiations will not, however, be enough to mitigate the ongoing global economic crisis unless the G20 and APEC leaders come through with their agreement on policy cooperation on the macroeconomic front.

In this regard, ASEAN+3 as a regional cooperative organization has an important role to play.

East Asia – the 13 members of the so-called ASEAN+3 group – is forecast to post the highest rate of regional growth in 2009. All of its members with a possible exception of Indonesia are expected to produce substantial current account surpluses. They all have room for fiscal stimulus needed to boost domestic demand. By coordinating their trade and macroeconomic policies, its members can prevent further deterioration of their own economies and thus help the global economy.

ASEAN+3 cooperation, however, has eluded the region's leaders. At this juncture, ASEAN+3 members are expected to coordinate trade and macroeconomic policies with those the EU and US. To this end, ASEAN+3 members must be prepared to do three things.

- They should be at the forefront of promoting regional free trade by committing to global efforts to finalize the Doha Round negotiations.

They should reiterate not only their support for the Washington and Lima declarations, but go one step further in promoting freer trade in East Asia by articulating their intention to commence negotiations for an ASEAN+3 FTA at their meeting later this month. Regionalism and multilateralism can go hand in hand.

- ASEAN+3 members should collectively stimulate domestic demand to sustain robust growth and thus absorb more imports from the rest of the world.

If they are serious about participating in global policy coordination for augmentation of global aggregate demand, the ASEAN+3 leaders need to consider announcing targets for cutting down their combined surplus by setting a target level of surplus as a proportion of regional GDP.

- They should utilize all formal and informal channels of mutual assistance in providing US dollar liquidity to those members who are experiencing short-run (not structural) balance-of-payments difficulties.

The goal is to allow them to pursue expansionary monetary and fiscal policy with-

out the fear of running into a liquidity crisis.

The eight Chiang Mai Initiative participants are sitting on a total of \$4 trillion in foreign exchange reserves. A lack of US dollar liquidity is thus one thing they can easily overcome, if they enlarge the size and streamline the activation procedure of the Chiang Mai bilateral swap arrangements.

## About the author

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# Trade and the global crisis: What it means for Africa and the response of African leaders

**Peter Draper**

*South African Institute of International Affairs*

*A gloomy scenario is unfolding across Africa that developed-nation protection could make much worse. African leaders must overcome protectionist instincts and contribute to completion of the Doha Round. The crisis also presents ideal opportunities for African reformers with sufficient leverage and vision to take advantage of them.*

There is a saying in Africa: 'when elephants fight, the grass gets trampled'. This accurately depicts the fallout from today's global crisis. Africans had little to do with the makings of the crisis, but we will suffer from it.

This suffering will manifest in two ways: the direct economic impacts, and growing regulatory protectionism. The direct effects will come via three channels.

- Direct financial contagion.

Capital flight from emerging markets will create the usual macroeconomic dislocations: weaker exchange rates, higher domestic interest rates, and higher debt servicing burdens. Official development assistance is unlikely to offset this financial squeeze; the donor nations are scraping pennies together to recapitalise their banking systems and pay for fiscal shock therapy to revive their own economies.

- Reduced remittances from Africans abroad.

Financial inflows from African diasporas in the developed world have been important in recent decades, cushioning the ill-effects of macroeconomic mismanagement and underpinned positive structural transformation stories. Reduced remittances will exacerbate foreign exchange shortages, dampen domestic growth prospects through reduced consumption, and heighten pressures on government revenue.

- Reduced prices and volumes of major commodity exports.

Recessions in the developed world, now spreading to China and India, have already slashed commodity prices. This will reduce economic growth across the African continent even though some countries will benefit from the lower commodity prices.

## **Protection would make things worse**

Things are likely to get considerably worse for the world's most vulnerable continent if certain developed-world lobbies get their way. The threat will come in the form of higher antidumping and countervailing duties and regulatory protectionism, especially in Europe.

Currently regulatory protectionism takes the form of standards protection, covering industrial, consumer, health, and increasingly environmental regulations. All of these are likely to intensify in response to recessionary conditions, whilst compensatory financing flows to assist African exporters in overcoming regulatory hurdles are

likely to decrease. Meanwhile attempts to shield ‘national champions’ from recessionary impacts and ‘unfair competition’, using safeguards, antidumping duties and the like will grow.

## **Use macroeconomic tools to fight a macroeconomic problem**

Global leaders need to reinforce efforts to shore up domestic demand. This would put a floor under their own growth prospects, but also those of poor developing countries in Africa and elsewhere. China has already shown the way. The developed world should follow in earnest with fiscal stimulus combining tax relief with infrastructure spending. They should avoid special deals for distressed sectors in order to minimise protectionist impulses.

World leaders should also commit to seeing the Doha Round through, whilst offering maximum flexibility in their ‘red line’ areas. The truth of the matter is that the Doha Round deal is there for the taking – provided entrenched domestic lobbies particularly in the developed world can be stared-down. This is the moment when decisive interventions from the highest levels of government can make a decisive difference.

## **What Africans can do for themselves**

A Doha Round ministerial has been mooted for December. How will ‘the’ African approach stack up against the gathering protectionist winds? Up to this point the Africa group’s positions on the core market access package have been overwhelmingly defensive, including inter alia:

- Retaining preferential access into developed country markets by minimising tariff reductions there;
- Resisting wholesale reform of EU agricultural regimes for the same purpose;
- Tempering EU demands for an overhaul of US food aid practices in order to avoid disruptions in provision of food aid (the continent being chronically dependent on such imports);
- Avoiding liberalisation of domestic services markets ostensibly because we do not have services to export;
- Advocating developed country liberalisation of temporary movement of natural persons in order to encourage growth of remittances; and
- Seeking wholesale carve-outs from industrial tariff reductions in order to protect so-called policy space.

## **A defensive strategy is not the answer**

This defensive agenda is not surprising given the continent’s major economic and governance challenges. However, in the current and unfolding global environment it does not serve Africa well.

Defending developed-country agricultural protection blunts the price signals African farmers need to build their productivity. It also locks economies into cash crop production for export at the expense of food security. Yet the global environment is likely to entrench existing developed country policies potentially for decades to come.



Retaining policy space for tariff protection only makes sense for those imports that generate substantial revenues. Overall Africa does not have a comparative advantage in industrial production. It could benefit by importing from more efficient Asian producers. The global competitive environment will become much more contested in the coming years as production is reallocated (and the process resisted) from developed countries to rapidly growing emerging Asia. In the interim, surplus capacity will ensure prices remain depressed, further discouraging African production.

To build competitive economies, not least in manufacturing, African producers and consumers need access to low-cost, efficient network services. With very few exceptions African producers are not in a position to provide these, whereas foreign producers require attractive regulatory settings to do so. African countries should thus seize the services liberalization nettle – retaining due regard for universal access policies – and embrace this element of the Doha Round.

Benefits of a forward-leaning strategy

Adopting this approach would make a substantial contribution to unlocking the reciprocal concessions required from developed countries in order to bed down the Doha Round. Altogether African leaders need to overcome their own protectionist instincts in order to contribute to unlocking developed world lobbies in our own, African and global interests. Times of crisis present ideal opportunities for reformers with sufficient leverage and vision to take advantage of them. Personally I suspect such people are in desperately short supply.

## **About the author**

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# The crisis is an opportunity to push multilateral trade liberalisation

**Ryuhei Wakasugi**

*Kyoto University*

*The global crisis may not see the re-enactment of the Great Depression's race to protectionism. The crisis, however, is a great opportunity for strengthening the WTO through further multilateral liberalisation. Global leaders should also consider fighting recessionary pressures via export insurance and other measures to offset the collapse of trade credit.*

The financial crisis is spreading worldwide. What began as the 'subprime crisis' in the US has induced recessions in Europe, the US and Japan and growth slowdowns in emerging countries such as China, Brazil, India, and Russia. The scope of challenges facing these economies has widened from monetary and financial issues to problems in the real economy – notably reduced consumer spending and private investment outlays. Japan's problems also extend to stagnating exports. All this is spilling over into the labour market.

A weak employment market tends to induce protectionist actions as government seek to shield the domestic market from foreign competition. The most famous example came in 1930, when the US Congress passed the Smoot-Hawley Tariff Act. This curtailed US imports, infuriated trade partners, and eventually aggravated the Great Depression. Furthermore, the reduction in US imports sent shock-waves throughout the global economy and triggered retaliatory tariff increases by almost all trading partners. World trade suffered a major contraction and European countries, which had taken on large amounts of debt, were especially hard hit.

## **Pledges to avoid a 1930s style protectionist reactions**

The current economic recession reminds us of the nightmare recession and protectionism of the 1930s – an episode of history that must have been in the minds of leaders at the 15 November G20 Summit when they pledged to:

- Refrain from raising new barriers to trade and investment; imposing new export restrictions, or implementing WTO-inconsistent measures to stimulate exports; and
- Reach an agreement on modalities for Doha negotiations.

These are steps on the right direction.

In recent years, the slow progress in multilateral negotiations led countries to grant market access improvements through regional or free trade agreements (RTAs and FTAs). FTAs and RTAs may be effective in removing trade barriers among trading partners, but are they robust enough to provide a barrier against protectionist backsliding when the crisis-driven unemployment rates start to rise?

Even if FTAs and RTAs can prevent their members from lapsing into protectionism, they do nothing to prevent protectionism by non-member countries – only the WTO

can do that. In an environment where almost all policymakers in the world economy are strongly tempted by protectionist forces, reinvigorating the multilateral trading system with its global rules is crucial to halting the spread of protectionism.

### **East Asia's role in supporting multilateralism**

East Asia must play a critical role in ensuring the preservation of the open trade system that has served her so well. Today, the region accounts for more than 1/5th of world trade in goods and services, and its role in global production and distribution network continues to deepen. Countries like China, Japan, and South Korea have every interest in living up to the expectations that come with East Asia's global importance in world trade. In this sense, we have observed timely signals from the APEC 19-22 November 2008 ministerial summit where APEC members reaffirmed the G20 pledges concerning the Doha Round negotiations.

### **The crisis as an opportunity to shift back to multilateralism**

The present crisis in the world economy can be used as a driving force to reach an agreement in the multilateral negotiations of the WTO. It is time for the emphasis to switch from regional to multilateral trade liberalisation. The upcoming WTO ministerial meeting in Geneva must successfully complete the modalities of the Doha Agenda – a step that should put the wheels in motion for finalising the Doha Round in 2009.

### **Take steps to fix trade credit problems**

Beyond trade liberalisation, governments should address the issue of failing trade credit – a failure that is now much more harmful to trade flows the protectionist measures we've seen to date. More than 90% of trade transactions involve some form of credit, insurance or guarantee. As credit and insurance markets are functioning poorly in this crisis, trade has been harmed. Just as governments have tried to kick start lending domestically, they should step in to get trade financing back on track. Expansion of export insurance, for example, would be a decisive step in the right direction.

The financial crisis has already curtailed the capacity for issuing export insurance in East Asian countries. This should not be seen as a regional or developing country specific problem, but rather as a worrisome trend that will affect world trade. The contraction of trade insurance capacity could potentially become an important channel of transmission of the financial crisis into the real economy and it must be avoided. In this sense, one should commend and perhaps build on the Japanese initiative to expand reinsurance cooperation among Asian-Pacific export credit agencies.

However, there is a fine line between export subsidies and government assistance with trade financing. This is why world leaders need to deal with this problem on a global rather than regional scale. Avoiding the dangers of a 'subsidies war' will require leadership of world leaders.

### **About the author**

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# Engage multilateral institutions in solutions to today's problems

**Kevin H. O'Rourke**

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*The political sustainability of open international markets is under threat. To fight protectionism in the short term, governments should use macro stimulus to hold down unemployment. In the longer term governments should adopt policies which to convince ordinary voters that international cooperation and open markets are helping them, rather than hurting them.*

What should world leaders do to prevent protectionism from spreading? The real worry, of course, is that world leaders will not want to prevent protectionism, and may indeed come to actively desire it.

The crisis with which we are immediately faced – which could lead politicians worldwide into temptation – is superimposed upon a longer run context which also threatens to undermine liberal international trade. History has lessons for policy-makers regarding both the immediate and longer-run threats to international economic integration.

## **The short-run threat to open markets**

The short run threat is obvious. The way we view exports is turned on its head as the world moves deeper into recession. From being a necessary evil – something we have to do to pay for imports – they now become a valuable source of demand; imports become a threat to local employment.

The incentive for individual countries to pursue protectionist policies is obvious, and a lot of the available historical evidence suggests that interwar protectionists were not completely irrational. For example, in countries particularly badly hit by the Crash, high tariffs were associated with faster rather than with slower growth, other things being equal. One can well imagine that policy makers of the time would have been aware of this (even without the benefit of advanced statistical analysis) and reacted accordingly.

## **The historical reasons to shun protection**

The historical record also gives policy makers at least three compelling reasons not to give in to this protectionist temptation.

- Interwar protection was beggar-thy-neighbour; what might have been individually rational was collectively catastrophic, even in the short term.
- These beggar-thy neighbour policies had disastrous political consequences, for example undermining the more liberal elements in Japanese politics, and strengthening militarism there.

- Interwar tariffs and quotas created or strengthened powerful import-competing interests in many countries, which often succeeded in locking in protectionism well into the late 20th century, when it was certainly a long time past its sell-by date, whatever its impact in the 1930s.

## **Get the macroeconomics right**

The main lesson of the interwar period is that if these dire consequences are not to come about, then getting the macroeconomics right is crucially important. Given the spillovers involved, this will involve effective, coordinated, multilateral action to stimulate the world economy, while avoiding the exchange rate misalignments and payments imbalances that have historically been such a cause of trade restrictions.

One of the factors hampering such international cooperation in the 1930s was the very different analyses of the situation held by different governments, and so it is a matter for concern that the current German Chancellor is openly querying the wisdom of the sort of massive monetary and fiscal stimuli that seem to be necessary today, as they were then.

## **Protectionist sentiments in the air**

What is particularly dangerous about this crisis is that there are a number of longer-run pressures increasing the demand for protectionism, especially among rich countries.

Chief among these is the unravelling of the 'Great Specialisation' of the 19th century. This saw the development of a classic North-South pattern of trade, with the North exporting manufactures and the South exporting primary products. As late as 1953, the 'industrialised' economies still accounted for approximately 90% of world manufacturing output, while the share of manufactured products in the exports of developing regions was less than 10%. That share had reached 20% in 1980, but 55% in 1990 and 65% in 2000. The South's share of world manufacturing trade rose from 5% in 1955 to 28% in 2000. Two-way trade in manufactured products now characterises not just trade within the North, but also between the North and the South.

When mass inter-continental trade in such basic agricultural commodities as wheat emerged around the middle of the 19th century – the so-called Grain Invasion – it did not take long for a protectionist backlash to emerge. The agricultural protection which emerged in the 1870s has since become a permanent feature of the world economic landscape. The fear now must be that today's equivalents of 19th century European farmers – that is to say, unskilled workers in the OECD – will seek and obtain new protection. This time, the protection would be against unskilled-labour-intensive imports from the rapidly industrialising economies of Asia and elsewhere.

As we all know, the relative (and in some cases absolute) economic position of these workers has been declining in recent decades. Even if that decline has been largely (or even mostly) due to technological change as many economists argue, it is strengthening protectionist sentiment.

## **The new protectionist political class**

A voluminous international literature now exists documenting that fact that the unskilled are anti-trade and anti-immigration in rich countries (but not in poor countries). The enormous class divides which emerged in the 2005 and 2008 French and Irish votes against the European constitutional treaty and its Lisbon successor were in



part a reflection of the way in which globalisation is perceived to have differentially impacted various groups in society. They should serve as a wake-up call to politicians.

The political sustainability of open international markets can no longer be taken for granted. With a Great Crash now superimposed upon a latter-day Grain Invasion, we need different policies and we need them now.

### **New policies to convince voters that openness works**

These policies need to convince ordinary voters that international cooperation and open markets are helping them, rather than hurting them.

The current priority is to boost demand and maintain employment, but beyond that governments need to re-establish the post-war contract between labour and capital, providing safety nets for workers which are paid for by taxes more progressive than those to be found in many countries at present. In my view the Scandinavian example undermines the argument that capital (and human capital) mobility makes such policies impossible. Gordon Brown's raising the marginal British tax rate is about to provide us with a nice natural experiment, and I suspect that the British economy will not collapse as a result. But clearly international cooperation could also play a role here, most obviously in ostentatiously cracking down on tax havens.

### **Opportunity in the crisis**

The current crisis offers policy-makers a golden opportunity to show voters that multilateralism works.

If workers see American, Asian and European stimulus packages providing them with jobs, and if governments can effectively cooperate on bank regulation and tax havens, perceptions could shift dramatically – especially among those who feel that the world economy has been working against them.

The current crisis also offers the opportunity to reform international institutions in a way that reflects the geopolitical realities of the XXI century. If emerging economies use the leverage that the current crisis gives them to achieve this, we will all benefit in the long run.

### **About the author**

*Kevin O'Rourke is Professor of Economics at Trinity College Dublin, and a co-organiser of the CEPR's Economic History Initiative, which aims to promote a more 'presentist', quantitative and comparative approach to European economic history. He received his PhD from Harvard in 1989, and has taught at Columbia, Harvard, University College Dublin and Sciences Po Paris. He has served as an editor of the European Review of Economic History, and as an editorial board member of the Journal of Economic History and World Politics. He is President-elect of the European Historical Economics Society. He has written extensively on the history of globalization, and his Globalization and History (co-authored with Jeffrey G. Williamson) won the 1999 American Association of Publishers/PSP Award for the best scholarly book in economics.. His latest book is Power and Plenty: Trade, War and the World Economy in the Second Millennium, co-authored with Ronald Findlay. He is also a municipal counsellor in the French mountain village of St Pierre d'Entremont.*



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# Trade policy in 2008: Great Depression redux?

**Douglas A. Irwin**

*Dartmouth College*

*The global crisis raises the appeal of protectionism but a 1930s-like scenario is highly unlikely. Policy makers today don't have to rely on protection to promote unemployment and WTO disciplines limit protectionist backlash at least in rich nations. Nonetheless, world leaders must remain vigilant against a slide toward protectionism.*

The world's current economic and financial crisis – complete with plummeting stock markets, sharply rising unemployment rates, and the threat of deflation – has prompted many comparisons to the Great Depression of the 1930s.

Fortunately, today's policy makers seem determined to avoid the mistakes of the past. Not only have they responded to the downturn with aggressive macroeconomic policies and financial market interventions, political leaders have pledged to avoid imposing new restrictions on international trade. 'We underscore the critical importance of rejecting protectionism and not turning inward in times of financial uncertainty,' the G20 leaders declared in mid-November. They also agreed to 'refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing World Trade Organisation inconsistent measures to stimulate exports.'

Unfortunately, such pledges alone may not be enough to stop the spread of protectionism in the face of an enormous economic crisis.

## **World leaders' pledge in 1929: No new protection**

World leaders in the 1930s were not blind to the costly protectionism that then enveloped the world. In September 1929, the League of Nations recommended that member countries agree to a 'tariff truce' in which tariff levels would not increase for two to three years. A conference was convened five months later for this purpose, but it broke down as central and eastern European countries embraced intensive agricultural protectionism in the face of a sharp decline in commodity prices. A few countries ratified the tariff-truce pledge, but it had little effect on subsequent policy.

Instead, as the collapse intensified in 1931 and 1932, countries resorted to ever higher trade barriers in a desperate attempt to prop up their economies and promote domestic employment. These futile responses became known as a 'beggar thy neighbour' policy because trade restrictions were used by countries seeking to prop up their own economy at the expense of others. But this backfired. Blocking imports to expand domestic employment failed because one country's imports are another's exports. The combined effect of this inward turn of policy was simply a collapse of world trade and a deepening of the global economic slump.

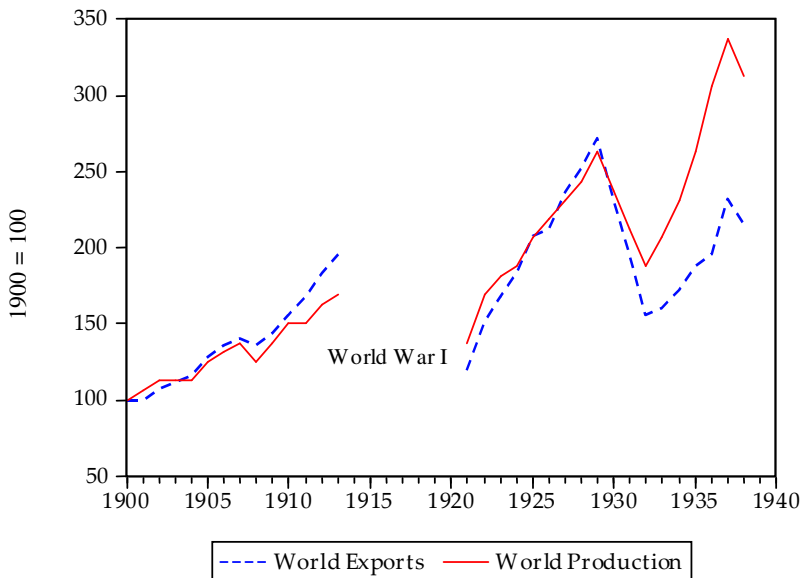
The US bore some responsibility for this turn of events. The US was not a member of the League of Nations and exercised no international leadership as the crisis

unfolded.

What started out in 1929 as a legislative attempt to protect farmers from falling agricultural prices led to the enactment of higher import duties across the board in 1930. The Hawley-Smoot tariff of that year pushed already high protective tariffs much higher, undermined the possibility of a tariff truce and provided an excuse for other countries to act similarly. As the League of Nations noted at the time, ‘the Hawley-Smoot tariff in the US was the signal for an outburst of tariff-making activity in other countries, partly at least by way of reprisals.’

### The spread of protectionism in the 1930s

The spread of trade barriers around the world in the early 1930s intensified the economic downturn. The volume of world trade fell by nearly one half. By one calculation, the imposition of discretionary trade barriers was nearly as important as the decline in national income in accounting for the sharp decline of world trade from 1929-1932.



The trade barriers that accumulated during the early 1930s did not disappear once the recovery began. Instead, the trade barriers hampered the economic recovery. As the chart shows, while world output recovered in the second half of the 1930s, world trade lagged, failing even to reach its 1929 peak by the end of the decade. It took the GATT decades of work to undo the damage to world trade from the accumulated trade barriers of the interwar era.

### Why today may be different

For these reasons, the G20 pledge to resist protectionism is welcome. Yet even though talk is cheap, it should be pointed out that today's environment is very different from the early 1930s. These differences augur well for preventing another outbreak of protectionism.

- Countries today have many more policy instruments now for addressing economic crises.

Governments then took no responsibility for propping up financial institutions and were unable to pursue reflationary monetary policies because of fixed exchange rates under the gold standard. In fact, those countries that remained longest on the gold standard also imposed the most draconian import restrictions (tariffs, quotas, and foreign exchange restrictions). They did so in an effort to reflate their economy and discourage imports from countries with depreciated currencies.

Restrictive trade policies were at most a third-best or fourth-best policy for addressing economy-wide problems, but countries resorted to them because they lacked other macroeconomic policy instruments, mainly monetary policy, to stabilise the financial system and improve economic conditions.

- In the early 1930s, countries imposed higher trade barriers unilaterally without violating any international agreements or anticipating much foreign reaction.

Today, WTO agreements restrict the use of such discretionary trade policy by WTO members. And countries that are tempted to violate WTO agreements can have no illusion that they will avoid swift foreign retaliation if they choose to do so. If a country is certain that its exports will face new impediments abroad if it chooses to impose WTO-inconsistent import restrictions, it will think twice about restricting imports. However, this threat applies with the greatest force to developed nation WTO members, since the developing nation members have either not bound their tariffs or bound them at levels that are often far above the actual tariffs applied. As such, developing nations have plenty of room to raise protection without violating WTO commitments.

- Unlike the early 1930s, foreign investment has transformed the world economy.

Leading firms around the world have become so multinational in their production operations and supply chains that they have a vested interest in resisting protectionism. Many industries that faced import competition in the past – such as televisions, automobiles and semiconductors – have found that international diversification or joint ventures with foreign partners are a more profitable way of coping with global competition than simply stopping goods at the border.

Moreover, many domestic industries no longer have much of an incentive to ask for import restrictions because foreign rivals now produce in the domestic market, eliminating the benefits of trade barriers for domestic firms. For example, unlike in the early 1980s, US automakers are not asking for trade protection because it would not solve any of their problems. They are diversified into other markets with equity stakes in foreign producers, and other foreign firms operate large production facilities in the US.

- Unlike the early 1930s, the US accepts its international responsibilities and is prepared to exercise its leadership to prevent an outbreak of protectionism.

The strong economic team of president-elect Barack Obama is likely to prevent the administration from imposing new trade barriers.

These key factors distinguish the present era from the past. They have sustained political support for an open trading system and have prevented the outbreak of a globalisation backlash.

## **The need for vigilance**

Despite the welcome pledge by the G20 leaders, world leaders must remain vigilant

against any the temptation to slide toward protectionism. For example, the pledge has already been broken by Russia. In addition, the pledge presumably does not include antidumping duties, which are a non-discretionary, WTO-legal form of administrative protectionism.

Still, there is ample reason to hope that the current economic crisis, unlike the Great Depression, will not be marked by an outbreak of economically-damaging protectionism.

## About the author

*Douglas Irwin is the Robert E. Maxwell Professor of Arts and Sciences in the Department of Economics at Dartmouth College. He is author of *Free Trade under Fire* (third edition, Princeton University Press, 2009), *The Genesis of the GATT* (Cambridge University Press, 2008, co-authored with Petros Mavroidis and Alan Sykes), and *Against the Tide: An Intellectual History of Free Trade* (Princeton University Press, 1996), and many articles on the history of U.S. trade policy in professional journals. He is a Research Associate of the National Bureau of Economic Research and the editor of the *World Trade Review*. He has also served on the staff of the President's Council of Economic Advisers and the Board of Governors of the Federal Reserve System.*

In late 2008, as the global financial crisis was spreading, so too was protectionism. Despite pledges by G20 and APEC leaders, tariffs were being raised in developing countries and industrialised nations had launched a slew of investigations into 'dumped' imports as a means of justifying tariff hikes.

The futility of protectionism in a global recession is not a new lesson now and was not a new lesson then – every world leader is and was well aware of the role protectionism played in exacerbating the Great Depression. But even as the global economy is recovering, leaders continue to find themselves torn. Their heart tells them to help industries and workers under stress; their head tells them protectionism will backfire.

This book, first published as an eBook in December 2008, collects essays from world-class economists on what global leaders must do to halt the slide towards protectionism. It identifies three areas where world leaders should act:

- World leaders must finalise the WTO's Doha negotiations. WTO rules remain the world's best bulwark against 1930s-style trade wars.
- All nations should commit to a standstill on raising their applied tariffs and other forms of protection.
- Industrialised and developing nations should refrain from initiating new antidumping cases, and postpone imposing antidumping duties wherever possible – economic nationalism should not be allowed to creep in.

With protectionism continuing to threaten global prosperity, many of this book's recommendations hold true today.

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