Trade and the global crisis

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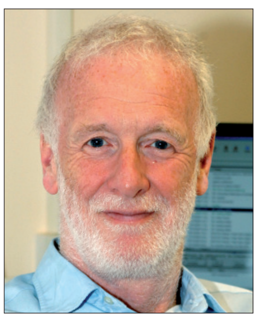

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World trade threatens to implode in the short term as the current crisis unfolds. Trade credit has dried up along side other credit circuits. More important even, the credit crunch has turned into a sharp contraction in real demand world wide carrying trade with it.

G20 governments must act at the London Summit to coordinate a global impetus to demand and to kick start trade credit. They must also prevent increased protectionism making a very bad situation catastrophic by freezing new protectionist measures (including WTO legal measures) and opening themselves to WTO led surveillance of their trade policies while the crisis lasts. In the longer term the depth of the crisis threatens the model of export led growth that has led billions out of poverty since 1950. We explore what needs to be done to minimise the long term costs of getting out of the hole the world economy has fallen into.

The Fall in World trade

Following the G20 Summit in Washington in November 2008 the economic situation has been getting worse by the day. The fall in world trade that emerged in the third quarter of 2008 has accelerated and although the picture is messy, some clear facts have emerged. The World Bank has forecast a 2.1 per cent fall in world trade in 2009 – after an overall 6.2 per cent rise in 2008; and the IMF has updated its WEO forecasts and suggested that world trade and production shrank by 45 per cent and 15 per cent annualised in the fourth quarter of 2008.

The fall in world trade is driven primarily by the fall in demand in the OECD countries in particular and by the drying up of trade credit as financial markets seized up. Protectionism while on the rise is not yet the driving force of this decline but the threat of subsidy wars is real with support for the auto industry in the lead. So the immediate challenge is to stop and then reverse the decline in demand.

The fall in trade is important in two dimensions: first trade is a bellwether of the wider economy and hence of the crisis. Second trade fluctuations first follow and then amplify fluctuations in output and demand. The more so if countries respond to the crisis with beggar thy neighbour trade and exchange rate policies. This trade policy driven amplification of the fall in output is what Kindleberger identified as a key feature of the great depression and is the fear shared by many economists.

It is important for the G20 to acknowledge that there are many WTO legal means of increasing protectionism and to forswear those as well. Raising applied tariffs closer to bound levels, increased use of anti dumping or countervailing duties or safeguard measures or appeal to environmental protection to justify trade barriers would all contribute to deepening the global downturn. These commitments to standstill must be backed by WTO led surveillance.

Failure to complete Doha Development Agenda is a dangerous signal of policy coordination failure

The second important news since the G20 summit in November is the abject failure of the world's trade ministers to get the DDA process back on track; all despite direct instructions from the G20 leaders in Washington to meet in Geneva in December 2008 and get it done.

A success in Geneva in December 2008 would not have changed much directly or soon. Any quick impact on trade requires coordinated macro-economic policy responses to increase global demand. But, the symbolism of an agreement in the WTO – after all the pre-eminent organisation of global economic governance – cannot be underestimated. Moreover, the symbolism of continued failure is little short of catastrophic. If the nations of the world, in the face of the greatest peacetime economic crisis since 1929, cannot complete a negotiation already 7 years in the making and by most assessments un-ambitious, what chance is there to negotiate policy coordination let alone the radical changes to global economic governance and regulation required to repair the damage already initiated by the crisis and help guard against future crises?

What should happen in London?

The trade agenda remains the same now as at the G20 Summit in November 2008 but more so, therefore the G20 in London should act on two key fronts: first, on falling trade volumes and second, on protectionism.

On falling trade volumes, the G20 must act by finding funds for trade credit and through a concerted, coordinated and larger monetary and fiscal stimulus than has so far been the case.

To prevent protectionism accelerating the downturn, the G20 must first make a public and high profile G20 re-commitment to freeze new protectionist trade policy measures, including explicitly on WTO legal measures (November rhetoric on trade was unclear on this issue and on subsidies). Second the G20 should task the WTO , with help from the IMF and World bank, to monitor G20 Trade policies. Third the G20 should send trade ministers back to Geneva to finish the DDA – if necessary take their passports away and lock them in a room until they agree!

The threat the Credit Crunch presents to export led growth as a development strategy

There is a tendency for the policy implications of trade to be treated at the national; and micro level. But there is a two way interaction between trade and the macro economy at a national and global level.

Export led growth has propelled billions out of post conflict devastation and poverty by generating historically unprecedented rates of growth. It has also however contributed to major instabilities in the global economy mainly via persistent undervalued exchange rates and consequent global imbalances – Germany and Bretton Woods, Japan and the Plaza/Louvre accords, East Asia and the current crisis. Net importers are to blame too as domestic policies were too loose in all of these episodes, but creditors cannot walk away from their responsibility either.

A worst case scenario

This is the deepest crisis so far and global imbalances are at the heart of the problem both as symptom and as cause. The threat of sustained protectionism and competitive devaluations to boost domestic production in net deficit countries is still potential but nonetheless real. If that were to happen there would be no consumer(s) of last resort function to sustain export led growth at the rates we have seen since 1950. This scenario threatens a structural slow down in world trade and output growth. Such a scenario would leave a huge number of new entrants to the global labour market, as population surges towards 10 billion over the next generation, at risk of dire poverty. The resulting political instability this could stimulate is frightening not least when combined with the stresses that global warming could set up.

A new global settlement

The degree of policy coordination required to prevent a collapse in world growth rates points to the potential need for new global system. Such a system needs agreed rules or a hegemon. This will not be easy. The Bretton Woods system and took 12 years from the bottom of the depression and a world war to design and agree. Any new system will require at least as much commitment in a world of much greater political complexity. Such a system must provide guarantees of open markets, stable macro economic policy and disciplines to curb unsustainable imbalances emerging that impact on importers and exporters. For any new system to be effective and legitimate cannot just be an escape mechanism for the US or any other big economic power to force the costs of its domestic adjustment on to foreigners. To that end any new system will need to be managed by a new G5/7 (US, eurozone, China, Japan, India to reflect economic weight and population plus Brazil and South Africa or Nigeria for regional reasons). No major economy can be exempt from monetary and fiscal disciplines if the global system is to resume anything like business as usual

Conclusions

It is imperative that there is recognition that shrinkage in global trade is a macro-economic problem that needs macro economic solutions and that the allocation of action among actors as well as instruments must be coordinated.

For the longer term the world needs a set of rules on global coordination of macroeconomic policy that smooth the adjustment of the global economy to the emergence of new trading powers and spreads the burden of adjustment among creditors and debtors. The lesson of the 1930s is that all nations will become more inward looking economically and resort to beggar-their-neighbours economic policies without such rules. After all it took more than a decade and a world war for the Bretton Woods system to emerge from the wreckage of the great depression.

Failure to move on such rules now will be measured not just in near term recession or depression but also in the lost ability of future billions to emerge onto the world market and grow their way out of abject poverty. Policy failure now will pull up the ladder on the poorest for decades and possibly generations F

See papers by Erixon and Stern for further details

G20 Imperatives

- *Stimulate global trade*
- *Macro-economic solutions*
- *Global coordination of macro-economic policy*
- *Avoid protectionism*
- *New global settlement*

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