BRIEFINGS2

World trade

Unpredictable tides

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World trade is no longer collapsing and fears of rampant protectionism have not been realised. Even so, the way to revival looks far from smooth

Rex Features

THE worst global economic slump since the Depression has generated reams of mind-boggling numbers. Among the starkest—and the most worrying—have been measures of world trade. According to the World Bank, the dollar value of trade is about a third lower than it was a year ago. Barry Eichengreen, an economic historian at the University of California, Berkeley, estimates that trade has contracted by more in this crisis than it had at a comparable stage of the Depression (see article).

Lately the news has been more encouraging. Trade is far from booming, but it has at least stopped declining. The World Bank even detects “hints of an uptick” in early data for June. Bernard Hoekman, director of the bank’s international trade department, has “little doubt that the decline in trade has bottomed out”.

Whether global commerce makes a speedy and lasting recovery depends, in the first place, on how quickly and sustainably global demand picks up. But it also depends on two other factors.

One is the reason why trade slumped so badly at the turn of the year. If the main culprit was the drop in global demand, as most economists believe, trade should recover smartly when demand picks up. But if it was an increase in protection, trade will be slow to emerge from the doldrums. Such measures, as past crises show, are easier to put in place than to remove.

The second is global trade politics. Governments will continue to be under pressure to erect trade barriers as unemployment continues to rise and as their room for more fiscal and monetary expansion becomes cramped. Leaders of the world’s biggest economies have repeatedly promised to conclude the

Doha round of trade talks, which have already dragged on for more than seven years and been near to death several times. In doing so, they have set themselves an important test.

A hole in the hull

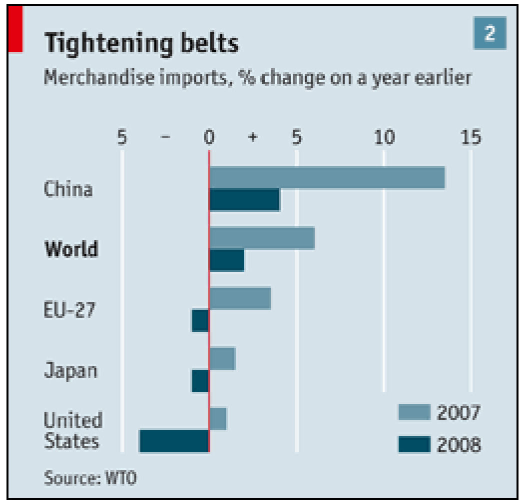
Compared with a year ago, the state of trade is dire. According to the World Bank, the dollar value of exports in the 48 countries for which final data for May are available was still about one-third lower than in May 2008. However, year-on-year data mask recent changes (see chart 1). Month-on-month figures point to a dramatic slump at the turn of the year, but stability since. The bank reckons that the average value of exports (for 44 economies accounting for three-quarters of world trade) dropped by 15.4% in November, held steady in December and plunged by 12.2% in January before flattening out.

The precipitate drop in trade—far more marked than anything that has happened to global GDP—was caused in part by the way production is now organised. Trade has always been more than proportionally affected by fluctuations in output, but the globalisation of the supply chain has increased its responsiveness. Stages of production that were once local are now much more likely to be carried out abroad. Douglas Irwin, of Dartmouth College, estimates that in the 1960s and 1970s, if global GDP increased (or decreased) by 1%, trade would grow (or shrink) by about 2%. In the 1990s, the change in trade was 3.4%.

In recessions, according to a new paper by Caroline Freund of the World Bank, trade contracts even more sharply than it responds in easier times. Using data from the global downturns of 1975, 1982, 1991 and 2001, Ms Freund finds that whereas real income growth was, on average, 1.5 percentage points lower than its pre-recession rate, trade growth stumbled by 7.2 points, or nearly five times as much.

Several reasons why trade should decline so fast in recessions suggest themselves. It could be that, anticipating a sudden slowdown in growth, firms draw down accumulated inventories sharply, causing a rapid contraction of trade. But it is also possible that during downturns governments turn to protectionist policies, heightening the responsiveness of trade to a fall in demand.

Broadly speaking, the timing of the collapse and stabilisation in trade flows, as well as the sectoral and geographical pattern of the decline, suggest that demand and destocking, rather than a retreat into protection, are the chief causes. The World Trade Organisation (WTO) points out that America, which was the first big economy to enter recession, also saw the sharpest contraction of imports last year (see chart 2). Data for America and Japan show that trade in non-durable consumer goods like clothes and food, for which a basic level of demand persists and purchases of which cannot be put off for as long as those of bigger-ticket items, has declined least among main product categories. Exporters specialising in capital goods and durables, such as Germany, have been hit harder than others. And even for cheap non-durables, the early falls were the sharpest, suggesting that retailers were furiously running down their inventories.



Differences in the trends of goods and services trade also support the destocking thesis. Aaditya Mattoo and Ingo Borchert, economists at the World Bank, point to the relative resilience of trade in services, which unlike goods cannot be stored and are therefore immune to the inventory effect. In April America's imports of goods were 34% lower than a year earlier. Its exports were 27% lower. Both imports and exports of services, however, were down by only 10%. Imports of business, professional and technical services (including information-technology services outsourced to places like India) were 4% higher in the first quarter of 2009 than a year earlier.

The WTO has analysed trade policies as well as trade flows. There have been several instances of countries raising tariffs, within the limits of their WTO commitments. America, the European Union and Switzerland have all introduced new farm subsidies (or restarted programmes that had been allowed to lapse). The number of anti-dumping cases initiated by WTO members rose sharply in 2008, from a 12-year low in 2007, and continued at a high rate in the first quarter of this year.

Other measures, especially when carried out by sub-national governments (counties and states), are less explicit. Local-procurement provisions attached to several stimulus packages, including America's and China's, are intended to favour domestic suppliers over foreigners. Sectoral subsidies, particularly to carmakers, have often come with pressure to ensure that any job cuts take place abroad, not at home.

But changes in trade policy have not all gone one way. Several countries, from Australia and China to Ecuador and Paraguay, have moved in a liberal direction, reducing import duties or removing non-tariff barriers since the beginning of March. Chad Bown, an economist at Brandeis University, points out that the total value of trade targeted by the flurry of new anti-dumping actions is small: less than 0.45% of the total value of G20 countries' imports.

All this is fairly reassuring. The bottoming-out of trade reflects a slowing of the decline in the world economy. Destocking may have run its course. Given its responsiveness to output, a lively rebound in trade is not inconceivable. Meanwhile, protectionism has not run riot.

But caution is still needed. Several big economies are being supported by expansionary fiscal and monetary policies, which will eventually have to be unwound. Recovery is likely to be sluggish. Unemployment will probably continue to rise—by between 21m and 50m this year, according to the International Labour Organisation. With monetary and fiscal stimulus already near their limits, trade barriers may seem a tempting way to protect jobs. Some countries could raise tariffs substantially without breaking WTO rules. Or stricter buy-local provisions, say, could squeeze trade.

The road back to Doha

This is why the politics of trade—not least the prospects of completing the Doha round—remain important. Some of the round's doubters have questioned its value because it promises no substantial further reductions in actual tariffs, merely aiming to limit countries' scope to raise them. The World Bank's Mr Hoekman is more optimistic. Countries realise that open markets cannot be taken for granted, and few of them want to be seen to fall foul of their international commitments. This makes the "insurance" aspect of the Doha round more attractive than it was just a few months ago.

But the crisis has also revealed the limitations of existing multilateral norms. WTO rules on public procurement do not restrict the ability of local governments to discriminate against foreign suppliers. Countries that have not signed the WTO Agreement on Government Procurement are free to pursue discriminatory policies. This leads Mr Hoekman to argue that another benefit of concluding Doha will be that it will open up the scope for negotiations to establish rules of the game in areas such as international financial sector regulation, government procurement and services trade, where the crisis has revealed scope for protectionism.

Unfortunately, a successful conclusion to the round is still far from certain. The last attempt collapsed in July 2008, when India insisted on more protection for its farmers against sudden surges in imports than America was willing to accept. For all the good intentions of world leaders, hope therefore rests largely on Ron Kirk, America's new trade representative, and Anand Sharma, India's new commerce minister, finding common ground. The two have already met several times. Mr Kirk has spoken of the need to conclude Doha in a way that is "balanced and ambitious". Mr Sharma has stressed that he has a mandate from his prime minister to sign a global trade deal.

But since his appointment, Mr Kirk has focused mainly on the enforcement of existing trade rules. His latest policy speech, at a steel plant in Pittsburgh, concentrated on detecting violations of labour standards by trading partners and promises to resort to legal action if necessary. Gary Hufbauer, of the Peterson Institute for International Economics in Washington, worries that a "fusillade of cases will set Doha back".

Some argue that by demonstrating that his resolve to a worried domestic audience, Mr Kirk may find it easier to get the authority he needs to negotiate Doha. Those who are hoping for the trade talks to reach a successful end can only hope that this reading is correct. If it is not, an agreement may be no nearer.

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