The collapse of global trade, murky protectionism, and the crisis: Recommendations for the G20

Edited by:
Richard Baldwin and Simon Evenett

WTO
supply chains
trade credit
export financing
imports
protectionism
recession
applied tariffs
trade collapse
regional development banks
Buy America
global crisis
bindings
trade barriers
anti-dumping duties
London Summit
emerging markets

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Foreword

Trade is not the cause of the current economic crisis, but is likely to be one of its most important casualties. The G20 Summit in November recognized this when it noted "the critical importance of rejecting protectionism and not turning inward in times of financial uncertainty" and pledged to "refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing World Trade Organization (WTO) inconsistent measures to stimulate exports" and agreed to "strive to reach agreement this year on modalities that leads to a successful conclusion to the WTO's Doha Development Agenda."

No agreement on modalities was reached, and the agreement to conclude the Doha Round has been overshadowed by continued instability and uncertainty in the financial sector and a rapid decline in economic activity throughout the world economy. In addition, the measures designed to stabilise the financial system and reduce the severity of the recession risk creating the very barriers to trade that the November Summit agreed to avoid.

These dangers were highlighted in the VoxEU ebook *What world leaders should do to halt the spread of protectionism* (at *http://www.voxeu.org/index.php?q=node/2651*) published in December 2008 and launched at meetings in Geneva and London. At the December meeting (at *http://www.cepr.org/membership/meetings/2403*), organized jointly with the Department for Business, Enterprise and Regulatory Reform (BERR), Richard Baldwin and Patrick Messerlin presented evidence suggesting that protectionism was indeed on the rise in a number of countries.

CEPR has continued its work on this issue with support from the joint **BERR-DFID Trade Policy Unit,** and the Unit has contributed to the costs of producing this VoxEU.org ebook. The Trade Policy Unit welcomes a strong academic debate on the best ways to address the dangers of protectionism, which poses a very serious threat to global prosperity. While the views expressed here are those of the authors, not the UK Government, they hope this ebook will help to inform the debate over practical measures to address the problem, underway amongst policy makers, leading up to the London Summit in April and beyond. CEPR shares this hope.

We thank the high level of competency displayed by Team Vox in assembling this ebook, with special thanks to Anil Shamdasani, Pierre-Louis Vezina, and Agustin Cornjeo.

Stephen Yeo, CEPR Chief Executive Officer
5 March 2009, London

Introduction and recommendations for the G20

Richard Baldwin and Simon J. Evenett

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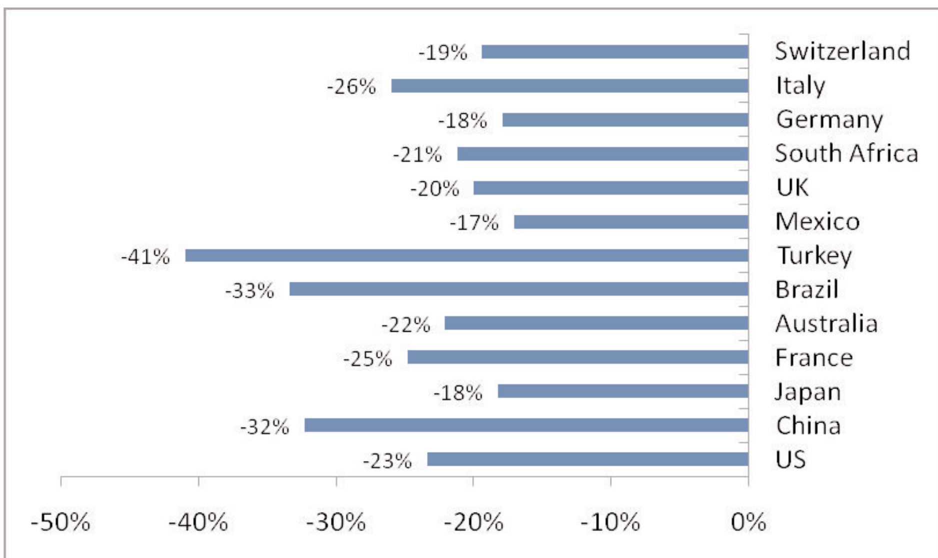
When G20 leaders met last November in Washington, trade was a side issue; urgent efforts focused on stabilising financial systems and kick-starting economies. When leaders meet at the London Summit in April 2009, trade must move to centre stage.

Trade is experiencing a sudden, severe and globally synchronised collapse (see Figure 1). Protectionist forces have already emerged and will strengthen as the recession gets worse. But this is not 1930s-style protection. Governments' crisis-fighting measures have spawned new, murkier forms of protection which discriminate against foreign firms, workers and investors – often in subtle ways. The use of WTO-legal protection, such as antidumping measures, is also up sharply.

Figure 1 Collapse in world trade: sudden, severe, synchronised (change in monthly trade flows between October and December 2008, or latest data). ComTrade data; see chapter 9 for seasonally adjusted figures.



This creeping protection is not yet a major cause of falling trade – at this point it is a consequence not a cause. But a protectionist spiral is one thing that has not yet gone wrong during this crisis. The authors of this ebook – a list of eminent thinkers and practitioners which includes Australian Trade Minister Simon Crean and former Mexican President Ernesto Zedillo – are worried about this trend and the threat it poses to the global recovery.

President Zedillo writes:

> What we do know with certainty is that protectionism could derail all those efforts applied on the fiscal and monetary fronts. Despite the multitude of statements against protectionism made by leaders and their finance and trade ministers in recent months, it would be irresponsible not to recognise that the mercantilist spectre is knocking at everybody's door. … Unfortunately, as the recession gets worse, protectionist forces will become even stronger. A perverse cycle of feedback between recession and protectionism is no longer an historical reminiscence of the 1930s but a possible scenario now – hopefully still with a low probability – in the months and years to come.

Minister Crean writes:

> We must re-commit ourselves to renouncing protectionism, be it trade or financial. To ensure we get the biggest bang for our buck, we need to ensure the benefits of our stimulus and rescue packages can flow across borders, so that all can benefit from the actions we take individually. G20 leadership by example is essential to create a virtuous cycle in which countries lift each other up rather than pull each other down through protectionism. From 'beggar-thy-neighbour' to 'nurture-thy-neighbour'.

It is critical that G20 leaders get ahead of the crisis and take steps that prevent murky protectionism from threatening the global recovery. Having invested hundreds of billions in bailouts and stimulus packages to counter falling domestic demand, it is foolish to risk triggering further falls in another major source of demand, namely exports.

This ebook presents several concrete proposals that G20 leaders could adopt to reduce the chances that a protection-recession spiral derails macroeconomic efforts to stimulate the global economy.

Why is trade collapsing?

We do not yet have all the facts, but the two leading explanations of the sharp contraction in trade are the widespread use of international supply chains, and the drying up of short-term trade credit.

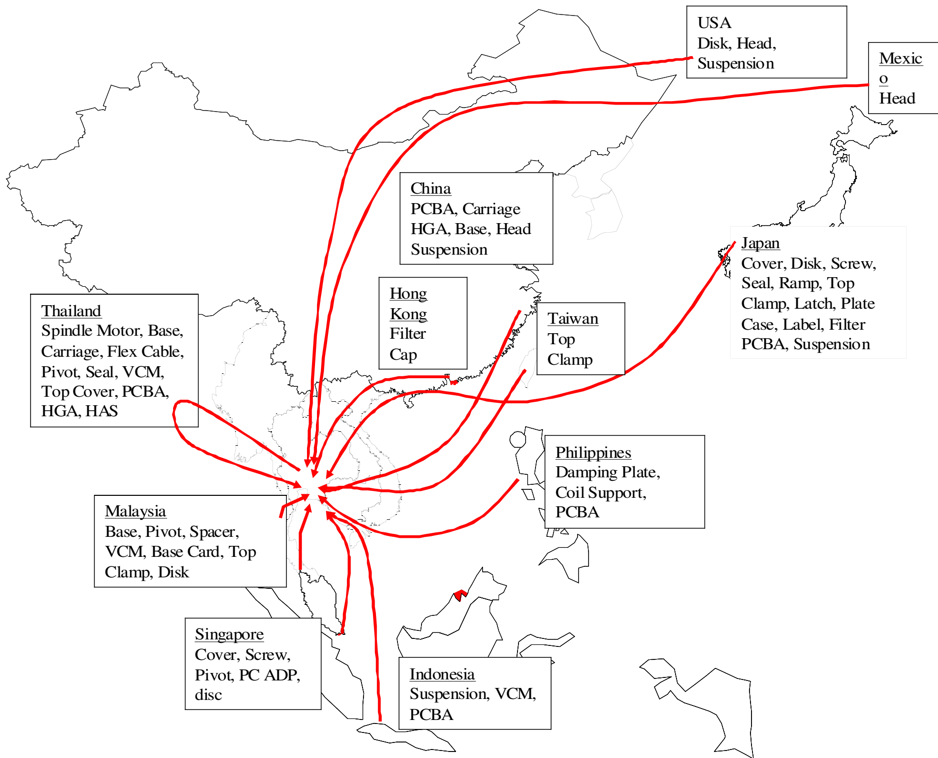
International supply chains

As Kei-Mu Yi argues in Chapter 9, there are strong hints that the massive reorientation of trade flows towards multiple-step supply chains has played a large role. Manufactured exports are no longer made in one nation and sold in another. Today, goods are made via complex, international networks; effectively, nations are nodes in international supply chains. (Figure 2 shows an example – the supply chain for hard-disk drives assembled in Thailand.)

A fall in US spending on laptops assembled in China lowers Chinese exports directly, but much more as well. The laptop's parts and components come from all over the world; exports across the entire supply chain fall. Even US exports fall, as fewer imported laptops lowers demand for US-produced laptop parts. The decline in trade is a multiple of the recession-linked decline in US final-good import demand. The point is that trade is measured in gross value terms, and the same value-added often crosses borders many times as parts become components, components become intermediate goods, and intermediate goods become final goods. This is how international supply chains amplify the trade effects of national downturns in demand.

The unusually sudden and synchronised nature of the trade collapse is also most

Figure 2 A supply chain example. (This shows the nations where parts are sourced for a hard-disk drive assembled in Thailand.)



Source: Baldwin (2008) based on data adapted from Hiratsuka (2005).

likely connected to supply chains. The supply-chain nodes are in continuous communication to ensure the flow of parts and components just matches the demand for final goods. When the message comes that one less laptop needs to be assembled in China, the entire supply chain scales back immediately. This is surely one part of the remarkable synchronicity of the global trade collapse.

Finally, supply chains may also account for the nature of the protectionist reaction. In the modern world of manufactures trade, the competitiveness of a nation's exports is directly connected to the cost of imported parts and components. This is why there is little fear that emerging nations will raise the tariffs that they cut unilaterally over the past decades. This liberalisation focused on imported parts and components because cutting these tariffs improved their manufacturers' competitiveness. Raising tariffs on manufactured imports – the vast major of which comprises parts and components – does not protect domestic manufacturing jobs, it destroys them.

Trade finance has dried up

Lack of trade credit is also part of the problem, although as Marc Auboin notes in Chapter 15, data on trade credit financing is so poor that we cannot quantify the impact. Still, experts reckon they understand the harmful dynamics currently at

work.

Most international trade involves one company ordering products from another. The exporter faces payments uncertainty and the buyer faces counterparty risk until the exported good is actually delivered to the foreign port and paid for. To bridge this uncertainty, the buyer's and seller's banks will typically issue paired credits, with a Letter of Credit being a prime example.

The crisis has affected trade finance in two ways. The first is that traders who have always used such trade financing are finding it harder to obtain. Banks no longer trust each other and so the issuing of paired credit is breaking down, even though trade credit is viewed as a particularly safe credit risk. Trade credits – like all forms of credit – are being affected by the generalised credit crunch. The second is that widespread fear of the unknown has led many traders to insist on letters of credit from partners with whom they previously traded on the basis of trust.

Experts in the international organisations and the private sector have been tracking this issue. Auboin's chapter points to a package of measures that G20 leaders could embrace to reduce the impact of trade credit problems.

What is murky protectionism?

Most examples of murky protectionism witnessed in recent months are not direct violations of WTO obligations; they are abuses of legitimate discretion which are used to discriminate against foreign goods, companies, workers and investors. Examples include abuses of health and safety regulations, and clauses in stimulus packages that confine spending to domestic producers.

Chapter 10, by Elisa Gamberoni and Richard Newfarmer, presents some figures drawn from the World Bank's list of proposed and enacted trade measures gathered from various sources including media accounts. According to this data, governments have proposed or enacted 78 trade measures. The 'offenders' include 17 of the G20.

They note that developed nations tend to rely on subsidies while developing nations deploy all forms of protection, but especially tariffs and other border measures. Tariff increases comprise only about half of these actions. For example, Russia raised tariffs on used automobiles, and Ecuador raised tariffs on more than 900 items. Non-tariff measures include Argentina's imposition of non-automatic licensing requirements on auto parts, textiles, TVs, toys, shoes, and leather goods, and Indonesia's requirement that five categories of goods (including garments, footwear, toys, electronics, food and beverages) would be permitted through only five ports and airports. In some countries, tightening standards have slowed import entry. For example, India banned Chinese toys, and China banned imports of Irish pork and rejected some Belgian chocolate, Italian brandy, British sauce, Dutch eggs and Spanish dairy products.

Another form of murky protectionism comes under the guise of 'green' policies. For example, in Chapter 18 on 'green protectionism', Simon Evenett and John Whalley point out a clause in the recent US stimulus legislation that subsidises the manufacturing of advanced batteries and components, but only for manufacturers located in the US.

The recent bailout packages are another source of murky protectionism. Chapter 16 on bailouts, written by Simon Evenett and Frédéric Jenny, provides many examples. These include the fact that UK banks receiving bailouts were encouraged to redirect lending towards the home market. Another example is the plan to support French banks which includes conditions on lending to airlines that might cancel

orders for Airbus planes.

While the very rapid and very large increase in such spending makes this a pressing problem, protectionism in government procurement is an old problem, as Steven Schooner and Christopher Yukins, the authors of Chapter 17 point out. The methods of reducing such biases and inefficiencies are equally well known and Chapter 17 lists the most important recommendations for national leaders to adopt.

The murky nature of this protection makes it hard to enumerate. Worse, the lack of transparency makes it harder for politicians to resist retaliation against a trading partner's measures. The automotive sector bailouts announced or discussed following the US discussion prove a deliberate pattern of retaliation/reaction. After the US started talks on a massive bailout of US automakers, Britain, Canada, France, Germany, Italy, Russia, Sweden and China are all considering or have implemented auto-industry bailout measures. President Sarkozy recently remarked "The situation in Europe means that you cannot accuse any country of being protectionist when the Americans put up $30 billion to support their automotive industry."

What should leaders at the G20 summit do?

Protectionism is creeping into national policies and trade volumes are collapsing, bringing down manufacturing employment. So far the causality is mostly one way. Apart from the auto and banking sectors, the protectionism seems to be a reaction to job losses, not reactions to other nations' protection. This ebook proposes a number of preventive measures that G20 leaders should embrace to ensure that this relatively benign situation does not deteriorate.

As President Zedillo stresses, time is of the essence. To allow the stimulus packages to work, to allow trade to start to play a positive-feedback role, it is crucial that a protectionist spiral is avoided – especially during the next nine months when governments are hoping their stimulus spending will begin turning around the global slump. The concrete proposals fall into three categories:

- Standstills and Surveillance
- Exit Strategies
- Zedillo's 'aggressive deterrence' approach
- Getting Doha back on track
- Resisting green protectionism

Standstills and surveillance

The G20's current standstill on protectionism, agreed less than five months ago in Washington, is in tatters. While no one has imposed across-the-board trade restrictions, many national economic recovery programmes contain discriminatory measures.

Chapter 14 – jointly authored by renown trade experts from India, China, Brazil, Costa Rica, Britain and Germany – proposes a very specific strengthening of the G20's protection standstill contained in the Washington declaration. This proposed "Protocol on state intervention during the current global economic downturn" covers the new, murkier forms of protection as well as traditional discriminatory measures, and it proposes that the commitment be backed up a tough real-time surveillance mechanism. The goal is not to stop governments from intervening, but rather to

encourage them to stick to the non-discrimination principle when designing and implementing measures to promote economic recovery.

There is also widespread agreement among authors that heightened surveillance is necessary – a mechanism that provides rapid identification of potentially harmful measures. As chapter X6 by Peter Gallagher and Andrew Stoler argues, rapid identification is important to allow political pressure to dissuade governments. The prime example here is how foreign pressure (and US exporters' fear of retaliation) managed to eliminate the most egregious features of the US's "Buy American" clause in its recent stimulus package. While the media can bring to light the largest, most obvious protectionist measures, much of the murky protectionism is buried in the details of stimulus and bailout packages. Shining daylight on these devil-in-the-details measures will require a more systematic, more professional effort.

Exit strategy

The world is seeing one of the largest peacetime expansions of government intervention in the economy. It is an iron law of politics that such an increase will be accompanied by measures that favour domestic parties over foreign parties. It is another that temporary measures have a nasty habit of becoming permanent, morphing their purpose along the way.

While there is often a case for extraordinary measures during a global economic crisis, G20 leaders must make sure that the beneficial reforms of the past 20 years are not reversed. Urgent thought should be given to putting in place the review mechanisms that will encourage the orderly, unwinding of temporary measures taken during the crisis, in particular those measures that discriminate against foreign firms, subsidiaries, and workers. Chapter 16 contains recommendations on "exit strategies" – the principles of which could be applied more widely.

Aggressive deterrence

The boldest proposal in this ebook would not require any international coordination by the G20 or any other body. The logic flows from the old Roman expression, "If you want peace, prepare for war".

Ernesto Zedillo, the former President of Mexico puts it bluntly: "pledges to avoid protectionism by leaders or other high-level officials are always welcome, but as recent events have shown, sooner rather than later, those pledges are blown away by the wind of domestic political pressures … The only thing that will make leaders think twice about whether or not to fall into the temptation of pleasing a particular constituency with protectionism will be the possibility that, as a consequence of such an action, another of its political constituencies will end up being seriously hurt."

He suggests that countries pledge to use whatever legal means they have at their disposal to retaliate against others for protectionist actions that harm their exports. "All you need," he writes, "is one major trade partner to commit to retaliation for others to follow suit … We need tough love, not sweet words in our present circumstances."

Get Doha back on track

The authors, lead by Jagdish Bhagwati, Anne Krueger, and IDB President Moreno, all agree that getting the Doha talks back on track is a critical task for the G20 leaders at the London Summit. While the actual liberalisation would in any case be years down the road, this buttressing of the WTO-centric trade system and its rules would be one of the most important ways of reducing protectionism's threat to the global recovery. This crisis – and the lack of old-fashioned protectionist moves by G7 nations – clear-

ly demonstrates the value of the WTO-based multilateral trading system.

As President Moreno and the African Development Bank secretariat argue, the Doha talks contain some of the most practical issues for developing nations. Latin America, Africa and parts of Asia are endowed with highly competitive agricultural sectors. The Doha talks are the only realistic way of further opening world markets to such exports. Other Doha-linked initiatives, such as Aid for Trade, and WTO trade facilitation talks are also important for developing nations. Chapter 19 by Gerard McLinden covers these issues in depth and suggests concrete steps G20 leaders could take.

In his capstone essay, President Zedillo captures the consensus by arguing that G20 leaders need to "descend" to the lowly task of deal making. They should show up at the London Summit fully briefed on the most contentious issues, and proceed to outline compromises. This should be followed by an unequivocal commitment to do whatever necessary to have their Ministers deliver the so-called modalities by early summer 2009.

Resist green protectionism – or pay the price at Copenhagen

A final and very important point is made in Chapter 18, written by Simon Evenett and John Whalley.

Many G20 leaders say they want a climate change deal at the Copenhagen summit in December 2009. Most indications are that a climate-change deal would involve the introduction of complex new taxes and schemes. Given the inevitable uncertainties and evolving nature of the challenges, such schemes must involve substantial discretion if they are to be properly implemented. It is very naïve to think that developing country governments – whose assent is needed to conclude a climate change deal – will cooperate if they feel that the discretion associated with existing environmental policies in industrialised countries was misused to shut out imports during the current global economic downturn. A developing country veto of a strong climate change deal may well be the price of crisis-induced green protectionism.

G20 policymakers need to bear this in mind and instruct their government officials to implement environmental initiatives in a manner that not only puts foreign firms on an equal footing with domestic firms but also is seen to do so. Just like other forms of murky protectionism, being seen to give unequal treatment is almost as damaging as the unfair treatment itself.

Conclusion: Push trade further up the London Summit agenda

Today's crisis is very different from the one facing Global leaders at their November 2008 meeting in Washington. Last November, the crisis was, or at least was perceived as being, mostly a financial crisis – and mostly confined to the G7 economies. To use a military analogy, it was as if the crisis were a landmine that the US and European economies had stepped on. Because the landmine had also been 'planted' by US and European financial markets, Brazil, India, China, South Africa and other emerging nations at the November 2008 meeting seemed to be only indirectly concerned.

In the past six months, the landmine crisis has become a cluster-bomb crisis, with recession-inducing projectiles flying in every direction. While G7 financial rescue and macro stimulus efforts must be at the heart of the world's response, many G20 nations – perhaps a majority – are bystanders in discussions of massive stimulus packages and fundamental reform of the world's most sophisticated financial prac-

tices. Trade, by contrast, concerns every G20 nation.

This simple truth seems to have escaped the attention it deserves – perhaps because the G20 process is guided by Finance Ministries and Central Banks. Whatever the reason, it is odd that the emerging-economy members of the G20 have not insisted on a higher profile for trade issues that affect them much more immediately than agenda items such as financial reform or long drawn-out efforts to readjust the 'shares and chairs' at the IMF, World Bank and other international financial institutions.

The creeping protection we've seen to date is not yet a major cause of falling trade; it is not yet an independent threat to aggregate demand. But a spiral of murky protectionism is the shoe that hasn't dropped. It is one of the few things that have not yet gone wrong in this crisis. But it could.

History teaches us that protection does not move in a straight line. It is critical that G20 leaders get ahead of the crisis and agree cooperation that prevents murky protectionism and plummeting exports from threatening the global recovery.

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PART I
CAPSTONE ESSAYS

1. Protectionism and the global economic crisis – the role of trade in the response

Simon Crean

Australia's Minister for Trade

We see around us evidence of a rolling economic crisis, spreading and deepening across the global community. What started in the financial sector has moved into the real economy, forcing company closures and significant job losses. No country is immune from the fallout. A global response is required.

International trade is one of most important arenas in which we must combat the real effects of this crisis. Trade is itself a stimulus. World trade grows faster than world output. Each successful multilateral trade Round has expanded trade growth. Preserving open trade flows must be a central part of our policy response to the economic crisis. If it is not, we will be losing a significant opportunity to reinforce other expansionary fiscal and monetary policy measures taken by governments. If the world turns inwards on trade, we will be undermining those very same expansionary efforts.

Trade is the mechanism through which growth and prosperity are transmitted between countries. Every day billions of dollars of goods and services are bought and sold around the world, giving consumers access to new products and generating wealth and prosperity for the people and businesses that make them. According to OECD analysis, a 10% increase in trade is associated with a 4% rise in per capita income.

Unfortunately, however, the crisis we now face has thrown this process into reverse. World trade flows are falling, forcing businesses to close and threatening to drive millions into poverty. According to the World Bank, 2009 will be the first year in over a quarter century[1] in which international trade is forecast to fall.

The latest forecasts from the IMF are for world trade volumes to fall by 2.8% this year. In some parts of the world, the impact is much greater. Already, we have seen that the value of China's exports fall by 18% in January (year-on-year). Japan's exports fell 47%. We need to halt these falls and ignite a 'positive feed-back loop' in which increased trade stimulates growth and growth drives increased trade.

One thing is clear: protectionism is not the answer. In fact, protectionism is a misnomer. In the long run it protects nothing, but erodes competitiveness, growth, employment and real incomes. This has never been more true than it is now. A tit-for-tat spiral into protectionism would be self-defeating and would only exacerbate the global downturn.

This is another reason for us to conclude the WTO Doha Round, which would be our best insurance against the risk of renewed protectionism. We forget that if all nations raise their tariffs to their bound rate (the highest rate consistent with their WTO commitments), exporters from middle and high income countries could face tariffs twice as high as current levels. A recent paper by IFPRI estimates that the costs to world trade flows of a global resort to protectionism (where tariffs rise to their his-

1 The Bank has noted that global trade is forecast to shrink in 2009 for the first time since 1982. See *http://www.worldbank.org/html/extdr/financialcrisis/*.

toric maximum level) would be up to US$728 billion[2]. Recent events have thrown into stark relief the importance of international trade obligations in combating protectionist pressures. The EU reintroduced dairy export subsidies earlier this year, reinforcing the value of the Doha package which would outlaw this form of agricultural support. Conversely, measures taken by other governments – including the "Buy America" provisions introduced by the US Congress – have highlighted the importance of trade obligations in constraining these pressures.

We must re-commit ourselves to renouncing protectionism, be it trade or financial. To ensure we get the biggest bang for our buck, we need to ensure the benefits of our stimulus and rescue packages can flow across borders, so that all can benefit from the actions we take individually. G20 leadership by example is essential to create a virtuous cycle in which countries lift each other up rather than pull each other down through protectionism. From 'beggar-thy-neighbour' to 'nurture-thy-neighbour'.

The G20 can and must play a critically important role in promoting open international trade flows. Australia helped build support for open markets in Washington last year with the agreement by G20 Leaders to implement concrete measures to address the crisis. These included an Action Plan for reform to restore growth, a renewed call for progress on the WTO Doha negotiations, and a standstill on protectionism. We must continue to honour and monitor these pledges. Our commitment to these goals has since been echoed by the 21 members of APEC and others. G20 Leaders will be meeting again in London on 2 April to review progress to date, and to build on it.

Our global political consensus must also extend beyond maintaining our open financial and trading systems. In crafting our fiscal and industry support packages we need to avoid perverse and inefficient incentives. Extravagant or distortionary subsidies will only trigger a competitive response from others. We should not sidestep a tariff war, only to embark on a subsidy war.

Although this crisis had its origins in the developed world, it is the developing countries that could end up being hardest hit. The World Bank has identified 40 countries that are 'highly vulnerable' to the effects of the crisis and estimates that as many as 53 million more people could be trapped in poverty as global economic growth slows. The London Summit must ensure that once demand returns, developing countries are able to trade their way back to prosperity.

The challenge before policy makers at this stage of the crisis is to prevent us disengaging further from each others' economies. We must instead work closely – and urgently – to forge a more robust global financial system, and reinforce our cooperation on trade. Serious and effective policy coordination on both fronts is essential if we are to rebuild growth and restore open and integrated markets. That is the kind of cooperation we need to see in the months ahead.

About the author

Simon Crean *is Australia's Trade Minister in December 2007, before which he held a range of Shadow Ministerial positions including Shadow Trade and Regional Development Minister, and Shadow Treasurer. He was Leader of the Opposition from November 2001 to December 2003. In a previous Labour Governments, he served as Minister for Primary Industries and Energy, and Minister for Employment, Education and Training. Before entering Parliament, he was President of the Australian Council of Trade Unions. He has taken an active role within a number of national and international organisations, including as member of the governing body of the International Labour Organisation.*

2 Antoine Bouet and David Laborde, "The Potential Cost of a Failed Doha Round", IFPRI Issue Brief 56, December 2008.

2. The multilateral trading system: a response to its challengers[3]

Ernesto Zedillo

Yale University, former President of Mexico

In order to avert the risk of total financial collapse and global depression, monetary and fiscal policies have been activated in many countries in ways not seen in a long time. However, it is yet to be known whether those massive policy interventions will suffice to avoid the worst declines in output and employment suffered since the 1930's. Suddenly we realise that we lack the conceptual and empirical frameworks to prescribe with a reasonable degree of confidence what and how long it will take to overcome the most dangerous phase of this crisis. Neither do we know what the exit strategy will be once the emergency has been overcome. Quite frankly the economics profession has been deeply embarrassed by recent events.

Protectionism could derail recovery efforts

What we do know with certainty is that protectionism could derail all those efforts applied on the fiscal and monetary fronts. Despite the multitude of statements against protectionism made by leaders and their finance and trade ministers in recent months, it would be irresponsible not to recognise that the mercantilist spectre is knocking at everybody's door. It hasn't taken long to confirm again that pledges and actions are not necessarily consistent in this crisis. Interest groups everywhere are already working the system to take advantage of the global recession and advance their protectionist agendas, something they haven't been able to do for a full generation.

Unfortunately, as the recession gets worse, protectionist forces will become even stronger. A perverse cycle of feedback between recession and protectionism is no longer an historical reminiscence of the 1930s but a possible scenario now – hopefully still with a low probability – in the months and years to come. We could soon find ourselves regretting how little, or in fact nothing, states have done to improve the institutions created mostly in the second half of the 20th century to manage the process of global integration. For it is a fact that in the last ten years as globalisation accelerated dramatically, the process of international reform stalled.

Multilateral trading system: A victim of indifference

Sadly, the multilateral trading system has been a major victim of states' indifference to international reform. Given how much global trade and investment has propelled

3 Based on the TAIT Lecture delivered at the The Graduate Institute, Geneva on 24 February, 2009

world economic growth over the last decade, it is hard to believe how little effort has been applied to updating the multilateral trading system. For years the multilateral trading system has been challenged, almost under siege, on many fronts.

It has been challenged in the first place by the failure to honour the Doha Agenda and conclude the Round successfully. The story of unaccomplished deadlines and the repeated collapse of the talks are so well known that doesn't need to be repeated here.

The system has been challenged not only by what countries have failed to do, but also by the damage they have done through the proliferation of discriminatory trade agreements (DTAs) that for the most part run head on against the essential principles of reciprocity and non-discrimination upon which should rest the entire system. DTAs have taken attention and political capital that could have been used to improve the multilateral system and, by aggravating the discrimination instilled in trade preferences, they have made the hurdles to achieve multilateral agreements much higher. Furthermore, DTAs have introduced unnecessary and costly complications to the practice of international trade through the rules of origin that unavoidably accompany them.

The multilateral trading system's value and suitability for pursuing effective trade reform has been questioned even by true free traders. Observing both the rather low proportion – one-fourth -- of total trade liberalisation achieved multilaterally over the last quarter of a century as well as the failure to conclude the Doha Round, a few otherwise unquestionable supporters of globalisation concluded some time ago that the WTO should be deemphasised as an instrument of trade liberalisation and, rather, that this liberalisation should be allowed to proceed along unilateral or preferential routes. In this vision, instead of helping to build a liberal international order, the WTO, with its complicated agenda and institutional architecture could, in fact, be retarding its completion.

This view is wrong. It's true that a country should not need to expect reciprocity to harvest the benefits of freeing its own trade. But unilateral liberalisation is not sufficient to provide trade partners with the certainty and stability offered by market openings delivered through the multilateral system. Nor does it help to solve commercial disputes. It has also failed to provide reform in sectors, like agriculture, of great interest to producers of developing countries and consumers of developed ones. Furthermore, it should not be ignored that sometimes creating the domestic political conditions for trade reform truly does require the reciprocity supplied by multilateral negotiations, particularly in the presence of powerful domestic vested interests that are against the liberalisation policies.

The present crisis will give ample evidence, for better or for worse, that multilateral liberalisation is irreplaceable. The fact that it has not made significant progress since the conclusion of the Uruguay Round is not proof that it is not needed – or that it is not possible.

Was Doha doomed to failure from the start?

I reject the idea that it was pre-ordained that the Doha Round should fail as it has failed so far. It is unfortunate that after the July 29, 2008 Geneva collapse of the negotiations, some commentators rushed to explain this outcome not as a consequence of the key players' incompetence to deliver a global public good important for their own national interest, but rather as a consequence of the Doha Agenda's irrelevance for addressing present and future challenges. They based their argument on a compari-

son between the conditions that prevailed at the time of the Round's launching and those prevailing seven years later. The evolution of commodity prices, particularly those of food, provided their favourite illustration of how substantially conditions had changed since late 2001.

Yet, I find the argument about the irrelevance of the Doha Agenda outright unwarranted. To use the detractors' favourite example, just look at what really caused the surge in food prices, once proper account is taken of the rather modest growth in global demand and the effect of exceptional droughts. The real culprit can be found in the protectionist policies used to foster the production of grain-based ethanol and also in the wrongheaded – again protectionist – reactions to the rise in prices on the part of some grain producing and consumer countries. Preventing the adoption of these kinds of policies is exactly what paragraph 13 of the Doha Ministerial Declaration and the comprehensive negotiations thereby committed were supposed to achieve.

One may think that the Doha Agenda was too ambitious and even overloaded; that its promises of delivering on development were exaggerated. But there is no way to claim that the Doha Declaration did not comprise the issues that to this day continue to be crucial for advancing towards a rules-based global liberal trade regime. Can we advance towards that regime without solving the agricultural reform outlined in the Doha Declaration? Can we advance without completing meaningful negotiations on manufactured goods, or without disciplining the use of anti-dumping and countervailing actions? Without improving the Dispute Settlement Understanding (DSU)? Hardly, and probably impossible! More important in the short run is to acknowledge how less worried we all would be now about the risk of a protectionist explosion as a result of the ongoing global recession.

The sceptics of the Round's value should make a proper recollection of the negotiation commitments solemnly adopted by all country members at Doha in November of 2001. Checking this would be useful to understand better what the failure has been, by whom and to whom. This exercise is not about fuelling anew any blame game. We have had too much of that already. It is rather about avoiding hurried judgments on the relevance of the WTO and the Doha Agenda and being able to reason with cooler heads on what can be done realistically to avoid having our worst fears come to life.

Mattoo and Subramanian are wrong

For sure, one thing we should not believe is that it is realistic or convenient at this time to undertake a reinvention of the WTO in order to introduce further complexities into its mandate.[4] It is somewhat ironic and contradictory, as some authors have done, to recommend on the one hand that the Doha Round should not be revived and on the other to submit that what is needed is a more ambitious agenda for the WTO. Most likely it was premature to charge the institution with not strictly trade issues at the time of the Uruguay Round and insist on such a route in the Doha Agenda. But it would be dead wrong to make the same mistake again in the face of the present crisis.

It looks disingenuous to suggest that, in lieu of finishing Doha, the WTO should now be asked to perform tasks such as enforcing the IMF's exchange rate policy rec-

4 As suggested in Mattoo, Aaditya and Subramanian, Arvind, "From Doha to the Next Bretton Woods: A New Multilateral Trade Agenda," Foreign Affairs, January/February 2009.

ommendations, overlooking the sovereign wealth funds, being an important player in global financial regulation and fighting climate change with trade sanctions. In all sincerity, with friends like the ones who propose such new responsibilities for the WTO, the institution does not need enemies!

More seriously, proponents of extending the WTO's mandate are both naïve -for thinking that a major overhaul is now feasible – and inconsistent – for wanting to add more goals to one instrument already overloaded with too many objectives. Clearly and regrettably, the DSU – a great asset of the multilateral system – continues to be the "forbidden fruit" desperately desired by every advocate of every conceivable global governance cause.

I am all in favour in reforming, strengthening and, when needed, creating new multilateral institutions. In fact, I am absolutely convinced that we are in the present mess, in no small measure, because of a lack of global governance of essential phenomena inherent to our increasing interdependence. Yet I am opposed to attempting to fill this gap by doing something that would end up crippling one of the few institutions that continues to deserve high marks for accomplishment of mission, the WTO.

The spectre of a protectionist avalanche

This criterion seems equally pertinent in thinking about how to deal with the spectre of a protectionist avalanche. In my view, the only realistic option is to use, to the maximum extent possible, the instruments that are already available. Of course, pledges to avoid protectionism by leaders or other high-level officials are always welcome, but as recent events have shown, sooner rather than later, those pledges are blown away by the wind of domestic political pressures and there remains little of practical value.

The only thing that will make leaders think twice about whether or not to fall into the temptation of pleasing a particular constituency with protectionism will be the possibility that, as a consequence of such an action, another of its political constituencies will end up being seriously hurt. This possibility will make dubious the net political benefit of walking the protectionist tightrope.

Avoid protectionism by threatening WTO-legal retaliation

What I am suggesting is that pledges by countries to use whatever legal means they have at their disposal to retaliate against others for protectionist actions that harm their exports will prove far more effective than their own pledges not to introduce new trade barriers. Interestingly, a credible pledge to legally retaliate for others' protectionism does not need to be the result of collective action, unlike the case of a pledge to avoid new trade barriers. All you need is one major trade partner to commit to retaliation for others to follow suit.

If a leader of a trading power is convinced that worldwide protectionism will make of this crisis an even worse disaster, then, in addition to resist domestic pressures for higher trade barriers, that leader should firmly declare that any new action restricting access of his country's exports to any foreign market shall lead to retaliation against the export sectors of the trade transgressor.

Tough love, not sweet words: The aggressive deterrence approach

We need tough love, not sweet words in our present circumstances. Pledges by leaders not to increase tariffs – and asking others to follow suit – will be ineffective. The only way to go is to say whoever moves first will be severely punished, and the system has instruments to apply that punishment. This would be far more effective than sweet words.

Some may think that this approach has hardly any chance to be effective simply because there is so much "water" in tariffs as well as lots of latitude in other WTO sanctioned instruments so that tons of additional legal protection is possible. This is true, but the argument cuts both ways. Leaders playing with the idea of going protectionist within the limits of their countries' WTO commitments should be aware that others also have ample "legal" margin, not only in tariffs but also in an arsenal of other instruments still insufficiently disciplined at the WTO, to hurt their export sectors at least temporarily.

Needless to say, I am not arguing for the convenience of a nasty trade war. What I am submitting is that if you want to prevent one, it's better to make the potential contestants aware of the full cost of their own folly starting from day one. In other words, let's use whatever tools the system has in order to make clear to whoever decides to ride the protectionist wagon that there will be no such a thing as a free ride, but rather that there shall be blood. In short, let the WTO's teeth bite!

The safeguard proposal is counterproductive

Obviously, the approach I am suggesting is not consistent with other proposals that have been put forward by some esteemed colleagues, including Simon Evenett and Richard Baldwin's idea of a global safeguard mechanism.[5] This safeguard would be counterproductive for it will encourage even more the protectionist forces already unleashed and will weaken seriously and permanently the WTO's authority. Any institutional accommodation to protectionism will be fatal under the present circumstances where most players are keen to free ride the system more than ever.

It is true that the aggressive deterrence approach I favour could conceivably put unbearable strains on the DSU. My expectation, however, is that in practice this would not happen as long as the key trade players formulate credibly and firmly their intention to retaliate legally for whatever protectionist action that affects their exports. Besides, reinforcing the DSU to be more expeditious is not a task that needs to wait for a comprehensive Doha deal; nor does the necessary sharpening of the WTO's surveillance capabilities. No effort should be spared to empower the WTO to fulfil its surveillance responsibilities to an unprecedented scale, even at the expense of irritating some of its members.

Furthermore, if the leaders of the major trading countries are truly convinced that a protectionist surge would be in nobody's interest, then they should finally get serious about concluding the Doha Round by putting their political will and capital where their mouth is.

5 Baldwin, Richard, and Evenett, Simon J., "Restoring the G20s credibility on trade: Plan B and the WTO trade talks," VoxEU.org, December 13, 2008.

Don't put Doha on hold: National leaders agree the deal themselves

I don't share the idea that leaving the Round on hold for the time being is a necessity.[6] True, a Doha final outcome as it was envisioned by many of us in November of 2001 will hardly ever happen, but a compromise delivering a deal that approaches what looked feasible in July of 2008 should be sufficient to keep the system moving forward, rather than backsliding into suicidal protectionism. It's not only about sending a precise rejection of the mercantilist menace. It's also about preparing the recovery that one day, hopefully not too far into the future, will come.

Yet with all due respect to ambassadors in Geneva and their immediate bosses in the capitals (the trade or foreign ministers) finishing Doha is not really within their capacities. It's up to leaders to get the job done. Leaders need to descend to the lowly task of deal making. They should go to the upcoming G20 meeting better informed about the most contentious pending issues and right then and there use some time to advance a solution, followed by an unequivocal commitment to re-launch the negotiations, do whatever necessary to have their ministers deliver the so-called modalities by early Summer, and conclude the whole Round by year's end.

Defend the multilateral trading system. It's one of humanity's greatest assets

It is not only the trading system that is being challenged now. More fundamentally, the opportunities that globalisation has provided to fight poverty in the developing world are dangerously at stake. If we cede the economic interdependence we have achieved in the last few decades, we will be living in a much more dangerous world. That is why we must do whatever is in our capacity to protect the multilateral trading system. It is one of humanity's greatest assets.

About the author

__Ernesto Zedillo__ is the Director of the Yale Center for the Study of Globalization and Professor in International Economics and Politics as well as Chairman of the Board of the Global Development Network, an organization that works with developing country researchers and policy research institutes. Previously, he served as President of Mexico from 1994-2000. After earning his PhD at Yale, he was with the Central Bank of Mexico before serving as Undersecretary of Budget, Secretary of Economic Programming and Budget, and Secretary of Education. He was recently appointed by the World Bank President as chair a High Level Commission on World Bank functioning and governance, and he co-chairs the Partnership of the Americas Commission on the International Commission on Nuclear Non-proliferation and Disarmament. He is a Member of the G30.

6 As my admired mentor Jagdish Bhagwati suggested in his January 8, 2009 Op-ed in the Financial Times print edition.

3. Keeping borders open: why is it important for Latin America and the Caribbean and what can the region do about it?

Luis Alberto Moreno

President of the Inter-American Development Bank

The last time the world was engulfed by a crisis as severe as we are living now, Latin America and the Caribbean (LAC hereafter) virtually closed its door to the world economy. It was not alone in doing that – the knee jerk reaction of most countries after the 1929 crash was to resort to outright protectionism. Yet, whereas most the world was on its way to re-embrace trade right after World War II, it would take LAC more than half a century to significantly open its borders and shed all the misconceptions about trade. This long delay has proved to be rather costly in lost growth opportunities and the region's decision on how to react to the current downturn should be evaluated against this background.

Having history as guide

Whereas turning its back on trade did not prevent some of the largest countries in the region from posting high rates of growth, it soon became clear that this strategy was not sustainable and a long decade of stagnation ensued. LAC fell badly behind other developing regions, particularly East Asia nations, which were quick to see the growth benefits of trade.

The region's *rapprochement* with the world economy has not been easy. The concerted effort to bring trade back to LAC's growth agenda has often given ground to the misconception that bringing tariffs down is enough. Free trade is no substitute for strong institutions, sound fiscal and monetary policies, robust investment in education and, above all, pure and simple hard work. Likewise, there are a number of other complementary actions governments should purse to boost the benefits of trade, ranging from investment in infrastructure, to trade facilitation and to trade adjustment programs.

Learning the lessons

We are learning these lessons the hard way, as we move, but there is little doubt that the region has made good progress on all these fronts and has good results to show. LAC today can claim that it has the most open economy in the developing world. All countries have embraced an ambitious agenda of free trade agreements and have also liberalized unilaterally and multilaterally under the WTO. The growth benefits, which were somehow slow to come, have become unmistakable in the last decade. Since 2003, the region's GDP has been growing at annual average of 5%, driven by a 17% annual growth of its exports.

As good as it has been in the last years, there is little doubt LAC's growth will suf-

fer with the current downturn as demand for the region's commodities has been falling sharply throughout the world. Our estimates for 2008 still suggest a strong export growth of 17%, but there are clear signs of an import slowdown in the last quarter. For instance, in that quarter, Mexico's, Chile's and Argentina's exports fell by as much as 13, 17 and 5.7% (year on year), respectively.

Protectionism

It would be nothing short of a tragedy if this current downturn prompts governments in LAC to change their attitude towards trade. A relapse into protectionism can only aggravate the situation, prompting retaliations form partners within and outside the region and destroying business relationships and regional and multilateral institutions that took decades to build. But, perhaps, more important than that is the fact that there is no proven alternative to trade and integration as path to prosperity and poverty eradication. We have our own history to prove this point.

A multidimensional challenge calls for a multidimensional strategy

Making the case for open borders is important, but only takes us so far. The clarity about what it is at stake has to be matched by a strategy that aligns incentives towards keeping trade flowing. It is also clear that the region cannot do it alone. Part of the problem is to make sure that our partners in the world share our objectives and do not impose any new restrictions on our products, some of which are already the subject of the worst distortions in global trade. We have also to bring them to agree to dismantle this distortion in the medium to long term. In short, the region needs both a regional and a multilateral strategy that can advance both short and long terms goals.

Acting regionally...

On a regional level, LAC can take advantage of its well-developed network of trade agreements to face the protectionist pressures brought about by the downturn. At the very least, we could use the institutional arrangements already in place to make sure the rules governing trade are properly enforced. If we want to be more ambitious, the goal could be to negotiate a region-wide agreement, whereby countries or their trade blocs sign formal commitments not raise any new barriers to intra-regional trade for a specific number of months or years, enough to cover the worst of the crisis. Given the region's strong ties with both the US and Canada, those countries could also be brought into what could be the "Americas standstill".

Other pressing short-term actions involve the need to re-establish short-term trade financing, a key ingredient for trade flows. Even though this is a global issue, the regional institutions could be used to tackle the problem at the regional level. The Inter-American Development Bank, for one, has already taken action in this direction expanding recently its Trade Finance Facilitation Program's limit to US$1 billion. Other very specific actions would be needed; perhaps involving currency swaps between regional trade partners.

Looking beyond the short term, LAC needs to push forward its regional integration agenda by addressing long-standing issues such as: (i) perfecting, deepening, harmonizing of rules and promoting the accumulation of the current trade agreements; and (ii) promoting a trade facilitation agenda with a focus on reducing transport costs.

...and globally

The regional agenda has to be complemented by decisive action on the multilateral stage, addressing some of the very same issues, but of course with different instruments. It is the best interest the region to strengthen an institution such as the WTO, which can provide not only the necessary tools to address the coordination failures involved in trade negotiations, but also a safe haven for relatively small global traders, as it is the case for most countries in the region, against the asymmetry of bargaining power, the distortions and discrimination practices that can arise from bilateral and regional negotiations.

Proposals put forward by others such as an increase in surveillance of trade measures, a global pledge to a standstill and a "big-push" towards trade facilitation can all be considered in the best interest of LAC. Even though the details have to still to be worked out, they seem to be the best available options to counter the worst protectionist pressures that are already beginning to arise. There is no better institution to take the lead in advancing these proposals than the WTO and governments in LAC would be acting in their own best interest if they provide all the necessary political and material support. The worst that can happen is leaders to be complacent about any deterioration of the trade environment.

Doha Round

As important as the short-term is, leaders would be well-advised not to lose sight of the more ambitious, long-term goals, which can be best summarized by the aspirations of the Doha Round. It is hard to overestimate the importance of completing these negotiations for a region that is endowed with one of the most competitive agricultures in the world and that is also striving to diversify its exports and markets. For all its benefits, regional integration alone cannot come close in providing the same growth opportunities that can be found in an open, global economy. Other initiatives that were put together during the negotiations of the round, such as Aid for Trade, also deserve to be kept alive more than ever to make sure the benefits of trade are widely spread and political support for free trade does not falter.

The challenges and complexities of this multidimensional strategy are nothing short of daunting, but the payoff is clear. Keeping the global and regional economy open is arguably the best governments can do to safeguard the long-term growth prospects of their economies. If history is any guide, this is an understanding that should be particularly dear for us in Latin America and the Caribbean.

About the author

Luis Alberto Moreno *is president of the Inter-American Development Bank since 2005, having previously served as Colombia's Ambassador to the US for 7 years. Prior to his post as Ambassador, Moreno served in both the public and private sectors in Colombia, including as Minister of Economic Development and President of the Instituto de Fomento Industrial, the Colombian government's industrial finance corporation, and a holding company for many of the largest state enterprises in the country, where he led a successful privatisation program and developed new financing instruments for private industry.*

4. Jobs, global trade and the perils of protectionism: the imperative of restoring confidence

Victor K. Fung

Chairman of the International Chamber of Commerce and Chairman of the Li & Fung Group, Hong Kong

One must not minimise the depth of the current global crisis. What started off as a "financial" crisis has since metamorphosed into many different forms including an economic crisis, a trade crisis and an employment crisis. Perhaps most alarming is that it is also a huge crisis of confidence. There is a crisis of confidence with respect to the global market system, with respect to the global institutions that provide the legal, institutional and, to a considerable extent, ideological framework of the system, and with respect to leadership, both government and business. The apparent retreat of globalism has sparked the forces of populism, which in turn are the political and emotional underpinning of protectionism. There is a strong risk that the process of globalism will be reversed. Confidence needs to be restored.

In seeking to reverse this trend of anti-globalism, one must recognise that protectionism can provide a sense, albeit a false sense, of confidence. To many people, it can seem understandable that at a time of crisis, it is the prerogative of the state to protect its citizens. Politicians can be masters in making protectionism sound understandable, logical and preferable. Protectionist rhetoric appeals to patriotism and to reason as President Sarkozy demonstrated in his "car wars" with the Czech Republic. Slogans such as British jobs for British workers or the sentiments lying behind the Buy American Act or banks being told they must only lend to national companies are all expressions of the same visceral reaction.

Looking at the past, there is no reason to believe that Senator Reed Smoot and Representative Willis Hawley were ill-intentioned men. Yet the Smoot-Hawley Tariff Act that got passed in 1930 had catastrophic effects on trade, employment and ultimately contributed to war. Within three years, the trade of most countries fell between 50 and 80%; in the case of China, trade dropped by 71% and this greatly contributed, as everywhere else in the world, to dramatically increased poverty and socio-political turmoil. The collapse of trade was accompanied by a surge in unemployment: in the case of the US from 3% in 1929 to 25% in 1933. Unemployment and protectionism combine in generating a terrible spiral.

Thus, as understandable, logical and preferable as it may sound, the reality is that protectionism does not protect employment. At worst it generates massive unemployment, as in the 1930s; at best it can protect jobs over a short-term period but with inevitably deleterious longer-term consequences. The case for protectionism protecting jobs must be strongly rejected not on ideological grounds, but on the basis of the overwhelming empirical evidence.

So far the emphasis has been on the domestic repercussions of protectionism. But protectionism cannot occur in "splendid" isolation. As was witnessed in the 1930s, when country A engages in protectionism, inevitably there will be retaliation from

countries B to Z! This is more so today when the world is even more inter-connected through the global supply chain. In an excellent paper published by the Peterson Institute for International Economics (*Buy American: Bad for Jobs, Worse for Reputation*, February 2009), authors Gary Hufbauer and Jeffrey Schott estimate the possible gain of 1000 jobs in the US steel industry arising from the Buy American Act could result in the loss of 65,000 jobs due to fall in exports arising from retaliation. That is the true "logic" of protectionism.

Trade, innovation, national economic reforms, competitive corporate strategies and capital flows, especially in the form of FDI (foreign direct investment) cause change in the employment landscape of nations and the global market economy in ways that are dynamic and constructive. Just one among countless examples: policy reforms in Vietnam and the opening of the country to FDI have resulted in Vietnam going from nowhere on the global economic map to becoming, among other things, one of the world's biggest producers of shoes. The production of shoes and the employment it has generated have contributed to Vietnam's remarkable record in poverty reduction, which in turn has transformed millions of Vietnamese into consumers of global goods and services. Thus, while Vietnam's emergence as global shoe producer may have resulted in the loss of jobs in certain countries, e.g. Italy, overall it has created more jobs and also contributed to more wealth which will allow Vietnamese to consume Italian and other counties' products. When Gordon Brown stated that global challenges require global solutions, he was correct. This is also true of global firms. If all firms try to preserve jobs everywhere, including in their own domestic markets, ultimately the global labour market will be reduced, rather than increased.

Unquestionably, companies and economies can enhance their competitiveness by their ability to create jobs on a sustained basis. The movement of people, goods, money, and information has shaped an interdependent world and we cannot afford to simply protect jobs and leave new job creation to chance. Jobs can be created by focusing on the right industries, providing incentives for research to drive the development and growth of those industries and implementing plans that support the upgrading of skills. Industry, universities, vocational institutes and government must work together in this critical endeavour to ensure we seize all opportunities and avoid the trap of protectionism.

In looking at the global economic landscape today, while recognising the severity of the crisis, it is also more than legitimate to celebrate the fact that the last twenty years of the global market economy have witnessed phenomenal growth among many developing economies and unprecedented reductions in poverty. Without a single exception, all of the high growth developing economies have been ones that have embraced the global market economy. This is now at risk. The perils of protectionism must be actively combated.

The crisis of confidence

We must also address the crisis of confidence which is coupled with a strong sense of insecurity. This is true across the world, whether among the millions of Chinese migrant workers who fear for their livelihoods or among American workers who fear losing their jobs and hence their health insurance. In rejecting protectionism, we must at the same time recognise that if confidence is to be restored, while it is wrong to try to protect jobs through protectionism, people do need to be protected. This

protection should be done in a constructive manner that will enhance both the individuals concerned and the economies. Government as well as business leadership have a role to play in this regard. This means investing in human security and in human development.

The crisis has clearly demonstrated the perils and pitfalls of the uncontrolled financial capitalism of recent decades. It has done enormous harm and must be buried. A very grave risk, however, would be if the crisis were allowed to do irreparable harm to the credibility, legitimacy and reputation of the global market economy system and the rules-based open multilateral trade regime. It is the global market economy that will restart growth and create the millions of jobs tomorrow that are required. Protectionism will destroy jobs and inevitably destroy the global economy as it did in the past.

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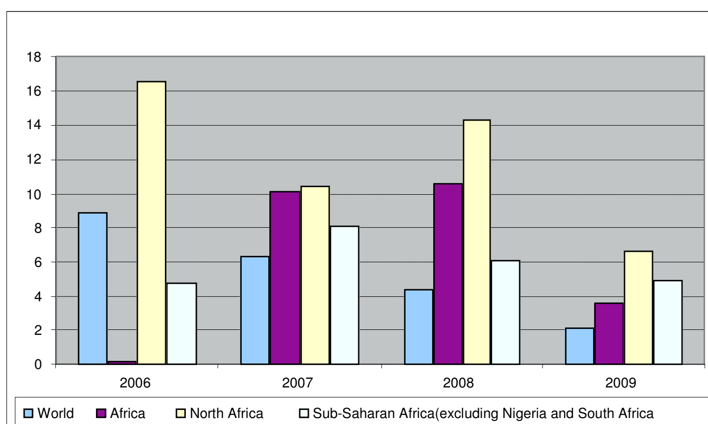
5. What can the G20 do on trade that can benefit Africa?

African Development Bank Secretariat

The global economy continues to grapple with the impact of the financial and economic crisis, with global output growth in 2009 estimated to contract to about 0.5%, the worst record since World War II.[7] This sharp economic downturn worldwide has led to an immense contraction in international trade. Growth in exports volume in Africa is expected to decrease to 3.6% in 2009 from a buoyant rate of 10.6% in 2008 (Figure 1). Africa's economic growth is expected to follow suite, declining to 3.2% in 2009 from 5.7% in 2008. In countries such as South Africa, export growth declined from a buoyant 7.5% in 2007 to 2.1% in 2008 and is expected to contract by -1.4% in 2009.[8]

Figure 1 Volume of exports, growth rate (%)



Source: African Development Bank estimates; United Nations World Economic Situation and Prospects, 2009

The shortage of liquidity in financial markets has reduced credit for trade finance. Given that 60% of trade finance is handled by private agents and 90% of the $14 trillion worth of global trade is financed by trade credits, further tightening of markets has dire consequences on trade performance. The WTO estimates that liquidity shortage and aversion to risk have caused a shortfall in trade finance to the order of $25 billion, disrupting trade, and ultimately exacerbating effects of the crisis.

Liquidity shortage has also affected trade in services, particularly due to declining

7 International Monetary Fund, World Economic Outlook Update, January 2009.
8 National Treasury of South Africa, Budget Review, February 2009.

FDI as investors retrieve their capital from emerging markets.[9] Egypt, for example, recorded a fall in FDI of about 44% in December 2008.[10] Africa's tourism has also not been spared of the effects of the crisis. Globally, a decline of up to about 2.1% in 2009 is predicted, depending on the magnitude of the global contraction.[11] The growth rates of international arrivals to Sub-Saharan Africa in 2008 have already shrunk to 4.2% in 2008 from 7.5% in 2007. Countries such as Seychelles, Cape Verde and Mauritius, where tourism receipts are greater than 20% of GDP, are expected to be hard hit by the crisis.

What should Africa expect from the G20?

The full impact of the financial crisis is still uncertain. The major concern for African countries is the potential adverse impact on major economic activities, especially trade and investment, which is feared to compromise the modest gains already made towards poverty reduction and other development goals.

It is clear that solutions must entail intervention beyond national boarders if they are to be effective and sustainable, making international coordination a vital goal. From an Africa perspective therefore, this raises the question as to what should the continent expect from the G20?

The G20 has great opportunities to support Africa not only in addressing the impact of the crisis but by advancing its long-term development goals. This will involve a multi-prong action.

- First, it is important for the G20 to commit to refraining from any protectionist tendencies both on the trade front and in credit markets.
- The G20 can also assist by urging multilateral financial institutions to strengthen their lending and capacity building in favour of African countries to help them cushion the impact of the external shocks. Most importantly, the IMF should assist in resolving liquidity constraints faced by African countries.
- It is also critical that the G20 makes a firm commitment to concluding the Doha Development Round and to supporting the Aid for Trade agenda.
- Equally important, the G20 can help by securing affirmations from donor commitments to increase official development assistance to Africa.

Onus on African countries

African countries are looking forward to the results of the deliberations of the G20, which may be helpful in assisting in dealing with the impact stemming from the crisis. The onus is, however, on African countries to craft short-term and long-term strategies that boost trade as a tool for driving the development agenda. This includes pursuing domestic trade policy reforms that support international rules (simplification, harmonisation and standardisation of rules, procedures and processes), unlocking trade opportunities in the regional agenda, and increasing their voice and partic-

9 Estimates by the United Nations Conference on Trade and Development.

10 African Development Bank, Trade, Investment and Domestic Resource Mobilisation", Background Paper presented at the C10 meeting in South Africa, January 2009.

11 World Tourism Organisation, January 2009.

ipation in the Doha Development Round.

All these actions will come at a cost and will require financing. As such, it is critical for the Multilateral Development Banks to come up with innovative instruments to support the adjustment process in Africa. Again, the role of the G20 will be critical especially in ensuring the Multilateral Development Banks have sufficient resources to meet the increased demand from Regional Member Countries.

G20 trade initiatives that will benefit Africa

Resist protectionism at home and abroad.

Countries are using every available instrument to minimise economic distress; these responses are now about preserving jobs and livelihoods. Historically, however, crises have also induced protectionism, through various instruments, including tariffs, subsidies and trade remedies (safeguards, countervailing measures or safeguards).[12] It is important that countries find a balance between the use of tools that minimise the damage on their economy while at the same time abiding by global trade rules. So far, countries are making every effort to refrain from implementing protectionist measures. However, there are some countries which have introduced support and imposed higher tariffs and non-tariff barriers or trade remedies (Table 1).

Table 1 Levels of Support and Protection since the Global Financial Crisis

Country	Type of Protection
European Union	(i) Re-introducing export subsidies for butter, cheese and whole and skim milk powder from January 2009
	(ii) Support the auto industry - France, Germany
Russia	Introduced measures to support domestic car manufacturers including state subsidies, and in January raised import duties on cars and trucks
Canada	Aid package of short-term loans to the auto industry
Australia	Planning to set up a A$2 billion fund to provide liquidity to car dealer financiers
India	Increased tariffs on some steel products in November 2008
Republic of Korea	Tariffs on imports of crude oil will increase from 1 per cent to 3 percent in March 2009
Indonesia	Restricted the entry points for imports, such as electronics, garments, toys, footwear, and food and beverages to only five ports and certain international airports since December 2008
Argentina	Imposed non-automatic licensing requirements on products considered as sensitive, such as auto parts, textiles, TVs, toys, shoes, and leather goods
Mercosur	Members have proposed to raise their common external tariff by 5 per cent on average, on a number of specific items, including wine, peaches, dairy products, textiles, leather goods and wood furniture. Waiting for ratification

Source: World Trade Organisation, JOB(09)/2, January 2009

12 N. Joubert, N., (2005) "The reform of South Africa's anti-dumping regime," in *Managing the challenges of WTO participation* (Low, P. and A. Stoler, Eds), UK: Cambridge University Press.

Leaders around the world have voiced warning of the perils of protectionism in the context of the current economic crisis. This was strongly articulated in the G20 November 2008 summit. Protectionist tendencies particularly threaten some sectors, including agricultural export commodities, which is a mainstay for many African economies. The challenge in 2009 is for the developed and emerging economies to hold up to their promises of trade liberalisation. Any temptation to "turn inward" will be disastrous for the world economy; it will definitely jeopardise Africa's growth prospects and undermine its chances of reaching its development goals.

Unwavering support for leading multilateral initiatives.

The Doha Development Agenda (DDA) offers African countries an opportunity to improve their growth prospects, notably by locking-in domestic or unilateral reforms and getting other countries to open up to their exports and thereby levelling the playing field with key competitors. Failure of the DDA to meet its objectives does not only undermine the importance the WTO but will also jeopardise trade and growth prospects of developing economies, with Africa standing out clearly among the biggest losers.

Agricultural issues are central to the successful completion of the DDA. Hence Africa should continue to push for more progress on agriculture's three main contentious issues: (i) agricultural tariffs; (ii) the trade distorting, domestic support that developed countries provide to their farmers; and (iii) export subsidies. The G20 can be used as a forum for ensuring progress on these issues.

Today, as much as 40% of exports from developing countries go to other developing countries. Therefore, the trade barriers of low-income countries against one another significantly restrain their own development. For example, Latin American exporters of manufactured goods face tariffs in neighbouring Latin American markets that are seven times higher than those they face in industrialised country markets. In the case of Africa, the average tariff rate is about 19%, which is still higher than the average global tariff rate. Thus developing countries are foregoing enormous market opportunities. Ensuring effective export growth for African countries requires that the issue of trade barriers of both developed and developing countries be addressed hand-in-hand.

The conclusion of the Doha Round would yield substantial benefits for Sub-Saharan Africa (SSA). The World Bank estimates that SSA would see a $4.8 billion increase in merchandise trade (some 1.1% of the region's GDP), with agriculture accounting for 78% of the total gains.[13] African cotton farmers could boost their exports by $1.9 billion. A more ambitious target of full merchandise trade liberalisation, with a supportive domestic policy environment, is estimated to result in gains of approximately 5% of income in developing countries, which would lift some 300 million people out of poverty by 2015. Greater opening of trade in services would yield larger gains than other international economic cooperation, including official development assistance and debt relief. Realising these potential gains is critical and therefore G20 leaders must reinvigorate the Doha Round negotiations.

Aid for Trade Initiative

Trade liberalisation alone is not enough to promote and sustain Africa's trade. Trade

13 Global Monitoring Report, 2006.

barriers have come down a great deal already but trade performance in most African countries has not improved. Other factors such as the investment climate, transport infrastructure, ports, customs, competition policy, skills and macroeconomic policies are also crucial for the success of efforts to scale up trade in Africa. These reforms will require assistance, including Aid for Trade. Under the leadership of the WTO, significant progress has been made in mobilising Aid for Trade. However, it is also important for African countries to be proactive in designing a coherent set of policy options targeted to their own development objectives.

The Aid for Trade initiative must also complement and strengthen Africa's regional integration efforts. The African Development Bank and other pan-African institutions have an important role to play in advancing this agenda. The African Development Bank, in particular, has a comparative advantage through its core programmes in physical infrastructure and private sector development, which definitely advance the Aid for Trade agenda.

For its part, the G20 should continue to recognise that it takes decades to build productive capacity that is effective and sustainable. Therefore, Aid for Trade needs to involve long-term assistance programmes, especially, predictable aid flows which can be fed into budgeting processes. More importantly, Aid for Trade must be a complement, not a substitute, for working towards a more progressive and open world trading system, one which does not prejudice the interests of developing countries. The global economic crisis should not distract the G20 and any donor from supporting long-term improvements in Africa's supply side capacities, so unlocking the continent's trade potential.

The role of the African Development Bank programs

As part of its overall package of activities, the African Development Bank targets two crisis-induced and trade-related challenges:

- Offsetting the decline in government revenues due to falling trade volume, and
- Compensating the decline in loanable funds in the banking sector, including funds available to finance trade.

The African Development Bank continues to strengthen its lines of credit, offers budget support to narrow government financing gaps, supports long-term private sector lending, and is establishing a Trade Finance Facility to address issues that emerge from the liquidity constraints. Further initiatives by the African Development Bank and other MDBs include the now operational Fragile States Facility and the planned establishment of an Emergency Liquidity Facility.

The Bank is also committed to promoting a successful conclusion of the Doha Round negotiations by supporting the voice and participation of African countries, to consolidate solid domestic reforms, and avoid policy reversals such as those associated with trade protectionism. Discussions at the G20 around trade issues may inform strategies by African governments, the African Development Bank, and other international agencies.

Conclusion

The global slowdown threatens Africa's recent economic progress. Sustained protec-

tionism and a recurring paucity of finance not only threaten African living standards but also African benefits from the Doha Development Round. In an interconnected world, the G20 offers a forum for debate on strategies that can assist African countries to minimise the impact of the crisis, notably by supporting trade. Issues that deserve particular attention include constraints to market access, support for the Aid for Trade initiative to address supply side constraints, and promotion of the trade liberalisation agenda. For their part, African countries must continue to deepen their unilateral trade reforms and to strengthen the regional agenda to harness the full benefits from free trade. The African Development Bank remains committed to supporting these processes and agendas.

6. East Asia must share Obama's leadership to keep trade open

Hadi Soesastro

Centre for Strategic and International Studies, Jakarta

The top priority of the London Summit will have to be placed on cleaning up the global financial system. This has become crystal clear as various other measures taken at the national and global levels have brought about only meagre results. But keeping global trade open must be given a prominent place in the Summit's agenda. And leaders must go beyond airing the right rhetoric, which many did. Concrete actions, which remain wanting, must follow.

Global trade has already shrunk and will continue to do so unless real actions are taken. In fact, trade could become a fundamental part of the solution to the global economic crisis. Concluding the Doha Round could amount to a significant global stimulus package resulting from a trade deal. But most importantly, it could help reverse the growing economic nationalism that is manifested in various forms of trade and financial protectionism.

Leaders must give the political push to keeping trade open. In their informal meeting at Davos recently, trade ministers shared with each other their difficulty in facing the rising political pressures at home to introduce some form of trade barriers. They also remain uncertain whether a global trade deal can be reached this year. Until then, they will find themselves fighting a battle on their own and without having an effective weapon. The Indonesian trade minister, for instance, has recently introduced domestic transparency procedures in the decision making on protection to try to minimize the damage.

The London Summit is where words must be translated into action. President Obama will be there, and he will participate with a clean slate. The many noises that have come from Washington DC, like the "Buy America" provision, have been worrying. Obama has clearly and unequivocally signalled his opposition to that provision. He also pledged to curb direct payments to agricultural producers. President Obama is the one that can provide the necessary leadership for open trade at home as well as globally. A clear signal from him at the London Summit can have a tremendous impact.

But the burden of leadership cannot be placed on Obama alone. President Obama's leadership at home cannot be sustained if he is unable to show that others will favourably respond to his initiatives. East Asia must share this burden by making significant concessions. This is in East Asia's self-interest as the region has a very great stake in global trade. To do so, East Asia must be organized and come up with a common stance on the key issues affecting regional and global trade and most importantly, on where they can play that shared leadership role.

Commitment on enforcing stand still must come from the highest political level. Leaders from many East Asian countries have reiterated their commitment to "promoting free trade" but they have not been explicit in "enforcing a standstill". East Asia can exert a credible shared leadership on trade if regional countries agree to do a

number of things. East Asians should have the confidence that they can afford to do so. Japan was the first country to pledge to provide resources to the IMF. At Davos the Japanese Prime Minister made another pledge to provide aid to other East Asian countries to help overcome the crisis. China has demonstrated its "openness" to trade by dispatching a trade delegation on a "Buy European" campaign. But they and other East Asian countries need to focus on collective efforts to be able to exercise an effective leadership role to keep trade open.

Firstly, they will commit to use their actual tariff rates rather then their bound tariff rates as reference. This is the time for East Asia to make that move. They need not make this a part of their negotiations in the Doha Round, but they can be rest assured that this significant decision will not be left unnoticed in that Round. East Asian countries can proudly show that actual tariff rates in the region have fallen much faster than in other regions since the conclusion of the Uruguay Round. However, their bound tariff rates remain high.

Secondly, East Asian countries also need to support this move by setting up a system of monitoring compliance with their commitments. In their recent meeting in New Zealand, the APEC business advisory council (ABAC), representing the business community in the broader region – including East Asia, called for the creation of such a system. East Asian (or APEC) governments should grab this proposal and direct it back to the business community to immediately establish an "independent" monitoring system. Unlike the EU, East Asia (or APEC) does not have a body such as the European Commission to undertake that task. It appears that even in Europe this cannot be taken for granted as indicated by the recent urging by the Danish premier Rasmussen to the Commission to make sure that EU rules on free trade be upheld by the members. The system must focus on protectionist measures that come in disguised forms.

It may well be that a region-wide consultation is in the offing. At the sidelines of the ASEAN Summit at end of February in Thailand, the Singapore Prime Minister, as chair of the 2009 APEC has taken the initiative to have meetings with the Indonesian President and the ASEAN Chair (the Thai Prime Minister), who will both be at the London Summit. They discussed the global crisis as well as trade issues and regional economic integration. The three leaders need to follow this up with approaches to other East Asian G20 leaders, including Australia and India. South Korea, the next chair of the G20, should immediately be drawn into this endeavour.

An East Asian role in the global context helps to strengthen its own regional endeavours, including deepening regional economic integration. East Asia can also demonstrate to the world the real meaning of "open regionalism", namely to organise the region for the well-being of the region and the world at large.

About the author

Hadi Soesastro *is the Executive Director as well as a senior economist at the Centre for Strategic and International Studies (CSIS) in Jakarta. He was a member of the National Economic Council, an advisory council of President Abdurrahman Wahid, from December 1999 to September 2000. He is also a member of the international advisory boards of various international institutions, including The Asia Society. He is Adjunct Professor at the Research School of Pacific Asian Studies (RSPAS) at the Australian National University and has also taught at Columbia University. Furthermore, he is also actively involved in the Pacific Economic Cooperation Council (PECC), Council for Security Cooperation in Asia Pacific (CSCAP) and the Council for Asia Europe Cooperation (CAEC).*

7. Protectionism and the crisis

Anne Krueger
Johns Hopkins University, former Deputy Managing Director, IMF

Since 1945, the world economy has experienced unprecedented growth. That growth was fuelled in significant part by the great liberalization of trade in goods and services, and by capital flows. Virtually all analysts and economic historians regard the reduction of policy trade barriers (tariffs, quantitative restrictions on trade, and other impediments to trade) and of transport and communications costs as having been essential in spurring growth. Countries such as Korea, China and India have been able to make huge gains in living standards and the economic well being of their peoples relying in significant part on the international market. And the industrial countries themselves have sharply reduced trade barriers. While there is still some protection, in most countries it is quantitatively smaller and significantly less protective than 60 years ago.

The crisis has naturally raised concerns in many countries about present and potential losses in employment and incomes. One of the responses has been to call for protection, or direct support, of domestic industries. As understandable as these calls are, responding to them would not increase employment and incomes, and, globally would reduce it. Worse yet, additional protection now would undercut progress made to date and seriously threaten to diminish, if not destroy, growth prospects going forward.

If one or more systemically important countries increase protection – of the traditional tariff-and-quota variety, of targeted support for individual industries, of programs encouraging or requiring purchases of domestically produced goods, or other industry-specific measures – in response to the crisis, other countries will find political pressures to do the same thing irresistible and will retaliate.

Even without taking into account the protectionist reactions on the part of other countries, however, the protection-imposing country or countries would gain very little, if anything, and that only for a very short time. The protectionist measures would have reduced the exports of other countries, thus reducing their incomes and their imports. To the extent that their imports did not fall sufficiently to offset their own reduced receipts, the exchange rate would adjust. The result would be reduced demand for imports from the systemic country. At best, then, the result of increased protection would be reduced employment in export industries which would offset any increase in employment in the protected, import-competing industry. Meanwhile, import-competing goods would have higher prices which would reduce domestic consumption.

But with protectionist responses, which would almost surely follow, the result would be even worse. Incomes would fall in the affected countries whose exports were confronting increased protection, but in addition, their retaliation would reduce export demand in the systemically important country or countries. One result would be higher prices of import-competing goods in both countries, reducing the quanti-

ties of the goods demanded. And it is evident that the level of employment in exporting industries in both countries would fall further.

Those responses guarantee that in anything but the extremely short run, increased protection would lower income and employment in the world economy, as it did in the 1930s. While not all countries are systemically important, enough "small" countries responding to heightened protection in big ones would together have a big effect.

This "negative sum game" is already evident today. American support for the auto industry has already led to plans for similar types of support in a number of other auto producing countries. Since the auto industry has excess capacity, most of the support will result in maintaining that capacity, rather than improving the prospects for the industry in the short or the longer term by letting the industry shed uneconomic units and move to a healthier long run position.

Even worse, however, is the fact that protection is much harder to remove than it is to impose. It has taken over fifty years to bring it down to present levels, and there is still hope that the conclusion of the Doha Round would reduce protection still further, to the advantage of all. But increased protection during the crisis would be hard to remove; when growth does resume, the problem of dismantling protectionist measures would arise and constitute a challenge. The heightened levels of protection would diminish the growth prospects of all countries, but those most badly hurt would be the low-income countries that have not yet shifted to open trade policies; their prospects, even if they did shift, would be greatly reduced. Even emerging market countries would find their growth prospects sadly reduced.

The temptation to adopt protectionist measures is strong in many countries. The G20 can significantly reduce that pressure by foreswearing protectionist measures. Such an announcement would have a significant effect, especially if it were accompanied by a rollback of the measures adopted since the November meeting.

It is clearly highly desirable to find ways to increase employment and reduce the impact of the crisis on workers everywhere. But attempting to use any form of protection as an instrument to that end would have very little short run payoff, would result in reduced worldwide employment very quickly, and make growth prospects when recovery does come that much more difficult. The crisis is harmful enough without retrogressing on the progress the world has made in increasing real incomes and reducing poverty in the past sixty years. A trade war, with heightened protection, would intensify the downward spiral, not mitigate it.

The crisis is imposing high economic costs throughout the globe. It would be tragic if protectionist measures, intended to mitigate some of the difficulties, were adopted and intensified our difficulties.

About the author

Anne Krueger *is Professor of Economics at Johns Hopkins University, having been first deputy managing director of the IMF (2001 – 2006). Before serving at the Fund, she was Herald L. and Caroline L. Ritch Professor in Humanities and Sciences and founding director of the Center for Research on Economic Development and Policy Reform at Stanford University and a Hoover Institution senior fellow. She has also been World Bank vice president for economics and research and President of the American Economic Association.*

8. The Lithium President: fight protectionism with more passion

Jagdish Bhagwati
Columbia University

President Obama faces protectionist pressures. Some are pointedly from the labour lobbies who have led Vice President Joe Biden to chide "pure free traders" and to ask for "fair trade". President Obama himself used his first meeting with Mexican President Calderon, overwhelmed by the brutal fight against drug cartels (that the US failure to legalise drugs has caused in the first place) to astonishingly urge on him tougher labour standards, a protectionist demand that is clearly aimed at raising Mexican costs of production and moderating competition from Mexican exporters. Other pressures come from the lobbies that have pushed for a WTO-inconsistent bailout to Detroit – sectoral subsidies are clearly actionable under the SCM agreement of 1995.

Indeed, President Obama faces anti-openness pressures at several other levels also. There are demands that multinational investment be taxed or intimidated into remaining at home rather than going abroad; and in demands that foreign workers and immigrants be fired first and hired last, especially if the Stimulus Package expenditures are involved.

All around him, President Obama sees near-xenophobic sentiments, proposals and policies put at risk the openness of the US economy and, given America's major role and the importance of her leadership and example, in the global economy, the openness of the world's economies

Through all this, the "no-drama" President Obama has kept a low, indeed an invisible, profile. Unlike the world's leaders at the last G20 meeting, he has not turned his rhetoric loose against protectionism. With his extraordinary innate ability to moderate highs and lows, he has been America's first Lithium President.

Protectionism

Yet, protectionism is a dangerous virus that requires a passionate response. At minimum, President Obama needs to confront dramatically two of the most serious protectionist challenges: from the Buy America provisions that have infiltrated his stimulus package, and from the China-bashing on "currency manipulation" that surfaced dramatically in Treasury Secretary Geithners' confirmation hearings.

The Buy America provisions seem reasonable indeed. If the US has a stimulus package, why should the benefit of it extend to other countries? In fact, the influential columnist Paul Krugman has suggested that this is not what we economists call "beg-

Editors' Note: This is an expanded version of an OpEd published in February in the *Financial Times*.

gar my neighbour" policy. The US is not diverting a given aggregate world demand to itself at the expense of other countries. Rather, it is a case of not rewarding your neighbours when you stimulate spending and are adding to world demand. These neighbours should be doing their own spending to reflate their own economies. And, such protectionism by the US will in fact therefore stimulate other nations into doing their own stimulus packages.

This is a naïve argument, because other nations are not going to see the US protection in this light at all. Instead, they are going to respond in kind, as indeed they did in the 1930s after we enacted the Smoot-Hawley tariff in 1930.

WTO-consistent protection can elicit WTO-consistent retaliation

Since some do worry about thus undermining the WTO which has inherited from the GATT the many roadblocks to re-enacting that history of mutually harmful outbreaks of trade barriers. They have argued therefore that the US can enact WTO-consistent procurement rules by excluding from US procurement China and India, among other developing countries, which have not signed the optional Procurement Code. But remember that these nations can also retaliate in WTO-consistent ways. They often have "bound tariffs", i.e. ceilings, which are significantly above the "applied", i.e. actual, tariffs; and it is possible to raise the applied tariffs towards the bound levels, without any restraint at all.

Nothing would prevent India and China from choosing to raise tariffs thus on items of export interest to the US. Besides, they could shift their own purchases of airplanes away from Boeing to Airbus, and of nuclear reactors from American to French firms. The response would, of course, be for the enraged US Congressmen to start enacting their own retaliation. The game would become lively. The notion that the US would continue to be a player and the referee no longer works; so we would have a Hobbesian chaos.

China exchange rate bashing

The accusation that China "manipulates" its exchange rate, which also promotes protectionism towards it, is another important cause for worry. Most Senators are convinced that the issue is clear-cut. It is not. The Washington magazine, *The International Economy* asked over 60 well-known economists: at what level should the Chinese currency be set? The answers, including from some of our deepest thinkers on exchange rates, were revealing. Some, including Milton Friedman, wanted a float. Ron Mckinnon and Richard Cooper wanted to keep the currency at existing levels. And those who wanted revaluation fell into as many as eleven groups ranging from 5% revaluation to 40% and over! The testimony of Secretary Geithner could only be explained by the fact that the White House was fielding a candidate flawed by tax-filing errors and China-bashing was a way to keep negative votes down.

Obama's leadership needed now

President Clinton marred the first year of his Presidency by indulgiFng the Japan-

bashers whom he had cultivated in his campaign. President George W. Bush succumbed also to steel protectionism in his first year. They had time to change, however. But President Obama, in the midst of a historic economic crisis, can ill afford to repeat this pattern: he has to fight protectionism right away or live to see the virus spread beyond control.

Indeed, he now needs to take a bold, comprehensive overview and confront the real danger that the open economy might unravel in terms of trade, multinational investments and immigration, first in the US and then, by imitation and example, worldwide, thus undermining the unprecedented prosperity and significant reduction in world poverty that openness has brought in the postwar period. Is it too much to expect that he will turn his remarkable oratorical gifts to make a historic speech in this vein at the April meeting of the G20, drawing a truly firm line in the sand against overseeing complacently a protectionist epidemic in America, and inspiring the other leaders to follow him in this crusade?

About the author

Jagdish Bhagwati *is University Professor, Economics and Law, at Columbia University and senior fellow at the Council on Foreign Relations, New York. 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. His latest book is Termites in the Trading System: How Preferential Agreements Undermine Free Trade (Oxford, 2008).*

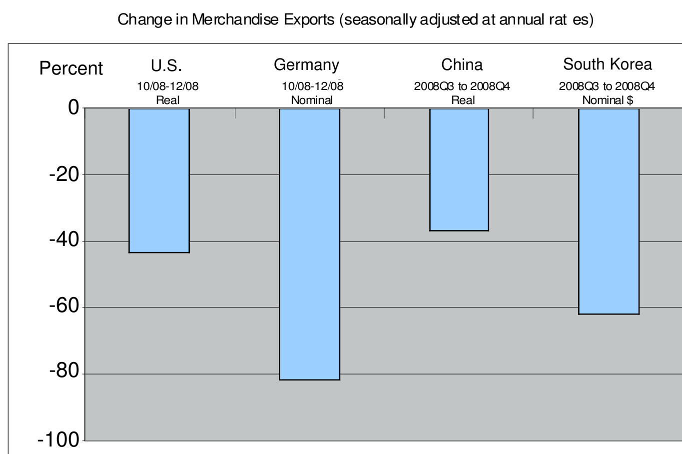
PART II
IN-DEPTH ANALYSES AND PROPOSALS

9. The collapse of global trade: the role of vertical specialisation

Kei-Mu Yi
Philadelphia Federal Reserve Bank

Since last September, the world has seen a stunning collapse in global trade. According to the IMF, the value of world merchandise exports fell at an annualised rate of about 40% in the three months ending last November. The numbers since October are particularly shocking. Figure 1 shows the decline in exports for the world's three largest exporters and South Korea. In the US, real merchandise exports fell at an annualised rate of 43% between October and December, for example.[14] (Hereafter, "exports" refers to merchandise exports.)

Figure 1 Collapse in trade



Source: US; BEA; Germany: Statistiches Bundesamt Deutschland; China: Goldman Sachs; South Korea: Goldman Sachs

This collapse has spared no country that is a part of the global trading system. Even China has suffered. Real exports fell at an annual rate of 36.6% in 2008Q4.[15] Most of the decline in shipments has been in manufacturing, as the chain-linked fence surrounding a presumably shuttered factory on the cover of the February 21st issue of the *Economist* so aptly illustrates. In short, this collapse has been sudden, severe, and synchronised.

Author's note: The views expressed in this column are those of the author and do not necessarily reflect the views of the Federal Reserve Bank of Philadelphia or the Federal Reserve System.

14 The decline in real US exports in 2008Q4 is almost three standard deviations from the mean real export growth rate since 1973Q1.

15 Owing to the sharp decline in oil prices in the second half of 2008, the decline in trade values overstates the decline in trade volumes. Evidence from several countries suggests that the decline in volumes is about one-half of the decline in values.

The causes of the collapse must, of course, ultimately be centred on the financial crisis that hit the US and other countries. This column seeks to contribute to our understanding of the transmission mechanisms or channels from the crisis to the synchronised trade collapse. One often-cited financial mechanism, for example, has been the collapse in trade credit. More broadly, tighter lending conditions worldwide have led to constraints on global spending, including spending on imports.

A real transmission mechanism: Vertical specialisation

However, there is a plausible propagation mechanism coming from the nonfinancial or real side of these economies, namely, the increased presence of vertical specialisation in international trade. Vertical specialisation occurs when goods are made in two or more sequential stages, and when at least one stage of production relies on imported inputs, and some part of that production is exported. Hummels, Ishii, and Yi (2001) and others have documented that vertical specialisation – alternatively known as international fragmentation of production or international production sharing – has been increasing over time.

For purposes of comparison, it is useful to first review the logic behind the standard international trade transmission mechanism. Suppose that the US is hit by a large negative financial shock that leads to a decline in its output. The decline in output is equivalent to a reduction in income for households and firms. They adjust to the lower income by reducing their spending. Some of this reduced spending is on imports. Hence, countries that export to the US suffer a reduction in exports. These countries are now experiencing a decline in their output. An adjustment similar to the adjustment in the US now occurs. The adjustment eventually leads these countries to reduce their spending on imports, implying that US exports decline. Hence, trade declines in both the US and its trading partners.[16] The mechanism described above hinges on the income channel. The speed of adjustment depends on how long it takes for:

- the decline in US output to lead to reduced spending by US households and firms,
- the reduced spending by the US to lead to lower output in its trading partners,
- the lower output in the US's trading partners to lead to reduced spending by their households and firms,
- the reduced spending in the US's trading partners to lead to lower exports by the US.

Depending on how long it takes the income effects to be transmitted, the adjustment could take some time. Moreover, in a world in which all trade is value-added, the decline in trade is exactly equal to the decline in demand for final imported goods. The trade effects are not amplified.

What is the adjustment in a world with vertical specialisation, in which goods are produced sequentially in stages across different countries? Suppose again that the US is hit by a large negative financial shock that leads to a decline in its output. Initially, the adjustment is the same as in the standard international trade transmission mech-

16 The transmission mechanism continues, as the decline US exports represents a further drop in US output, leading to a further drop in US incomes and spending. However, each "round" is smaller than the previous round.

anism. Households and firms suffer a decline in their incomes and adjust by reducing their spending on imports. The point of departure from the standard mechanism is that some of this reduced import spending is on imported vertically specialised goods, say, personal computers (PCs). The lower demand for PCs immediately translates into reduced demand by foreign PC firms for the imported parts and components used to produce them. Some of these parts and components are made by US firms. Consequently, US firms suffer an immediate reduction in their exports. Because international trade in a world with vertical specialisation is directly linked to the production chain, the shock is transmitted more quickly across countries. International trade declines in a more synchronised manner than in the nonvertically specialised world.

An additional channel comes from reduced spending on domestically produced goods. The US may reduce its spending on goods "made in the USA," but which consist of imported parts and components. If these imported parts and components themselves are made from parts produced by US exporting firms, there again will be a direct production chain transmission mechanism from US imports (i.e., foreign exports) to US exports.

The example above also indicates that the decline in trade flows is a multiple of the decline in demand for final imported goods. This is because trade flows are measured as gross flows, not as value-added flows. Imported chips embodied in PCs that are then exported are counted twice in the trade statistics, once as an import and once as an export (as part of the PC).

Supporting evidence

The stories told above are quite stylised. An academic version of the vertical specialisation mechanism is found in Burstein, Kurz, and Tesar (2008). An explanation based on vertical specialisation in principle can account for some portion of the severity and synchronisation of the collapse in global trade. Is there any supporting evidence? There are at least two suggestive pieces of evidence. The first is that the collapse in merchandise trade has been particularly acute in manufacturing. This is true whether one compares manufacturing trade to nonmanufacturing trade within countries or whether one compares countries with intensive manufacturing trade to countries without intensive manufacturing trade. In addition, the collapse in manufacturing production across the globe has also been sudden, severe, and synchronised. Finally, manufacturing, in general, is much more vertically specialised than agriculture and commodities. Hence, the vertically specialised nature of manufacturing could be a contributing force to the larger collapse in manufacturing production and trade.[17]

The second piece of evidence involves motor vehicle trade flows between the US and its NAFTA partners. In 2008Q4, (nominal) US imports from its NAFTA partners were down 23.2%, and imports from all other countries were down 19.6% from 2007Q4 levels. These two declines are fairly similar and consistent with a reduction in demand by US households and firms for all types of motor vehicles. Turning to the export data, US exports to all countries but NAFTA were 1.5% in 2008Q4 higher than in 2007Q4. However, exports to the US's NAFTA partners were down about 20.1%, very similar to the decline in US imports.

What is the reason for the disparity in export performance? The composition of US

17 Another reason for the large role of manufacturing is that many manufacturing goods tend to be durable. Durability adds to volatility. See Engel and Wang (2008).

motor vehicle exports differs greatly across the two sets of countries. Three-fourths of US motor vehicle exports to non-NAFTA countries consist of final vehicles. By contrast, three-fifths of US motor vehicle exports to its NAFTA partners consist of parts and components. The vast majority of these exported parts return to the US embodied in the final vehicles – vertical specialisation. Hence, to a large extent, US export flows to its NAFTA partners are driven by US demand for autos!

Two final notes

The global collapse in trade has been accompanied by a sharp rise in protectionist talk, and indeed, some countries have raised some of their tariff rates. However, countries that produce vertically specialised goods, i.e., that rely on imported inputs for their export production, have less incentive to raise their trade barriers. This hypothesis is worthy of further investigation. Second, the flip side of the vertical specialisation mechanism discussed here is that when there is a sustained recovery in global demand, vertical specialisation should be a force leading to a synchronised surge in global trade.

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10. Trade protection: incipient but worrisome trends

Elisa Gamberoni and Richard Newfarmer

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With the global economy teetering on the abyss of severe recession, political pressures demanding import protection to protect employment are surfacing with increasing intensity around the world. However, if there is one lesson from the experience of the 1930s, it is that raising trade barriers merely compounds recessionary forces – and risks pushing the economy into prolonged contraction.

For this reason, G20 leaders signed a pledge on 15 November 2008, to avoid protectionist measures. However, since then, several countries, including 17 of the G20, have implemented 47 measures whose effect is to restrict trade at the expense of other countries. While the trend is of concern, to date, these measures have probably had only marginal effects on trade. The sharp contractions in trade volumes evident in recent months are a consequence of the global recession and financial feedbacks through skyrocketing costs of a shrunken pool of trade finance, not protection. Nonetheless, the trend in protection is up and the full effects of the recession have not yet been felt, raising concern.

Several countries have adopted new protectionist measures

Since the beginning of the financial crisis, officials have proposed and/or implemented roughly 78 trade measures, according to the World Bank's monitoring list of trade and trade-related measures. This figure is drawn from the World Bank's Trade Department (PRMTR), which maintains a list of proposed, enacted and/or rejected trade measures taken from news accounts, official reports, and other sources. Virtually all measures are taken from two sources and where possible receive confirmation with country staff, but may be subject to a small margin of error as government policies at times are opaque and subject to change, even reversal. This list does not include "automatic" increases in agricultural protection, contingent protection (antidumping), WTO-sanctioned measures to compensate for panel findings against trading partners and financial sector subsidies (discussed in subsequent sections). More important, this discussion does not attempt to quantify the trade effect of any particular event and thereby attach some weight to each action – though obviously some actions have far greater impact in closing markets than others.

Of these 78 new measures, 66 involved trade restrictions, and 47 trade-restricting measures eventually took effect. The trade effects of these measures are difficult to evaluate due to the prevalence of non-tariff barriers, subsidies and contingent protection – a task that nevertheless remains to be done. Nonetheless, the effects of these measures so far are probably minor relative to size of unaffected markets, but of considerable importance for particular exporters shut out of protected markets.

Tariff increases comprise only about half of these actions. For example, Russia

raised tariffs on used automobiles, and Ecuador raised tariffs on more than 900 items. Non-tariff measures include Argentina's imposition of non-automatic licensing requirements on auto parts, textiles, TVs, toys, shoes, and leather goods and Indonesia's requirement that five categories of goods (including garments, footwear, toys, electronics, food and beverages) would be permitted through only five ports and airports. In some countries, tightening standards have slowed import entry. For example, India banned Chinese toys, and China banned imports of Irish pork and rejected some Belgian chocolate, Italian brandy, British sauce, Dutch eggs and Spanish dairy products.

Export subsidies are particularly egregious because they contravene the draft Doha modalities. The EU announced new export subsidies on butter, cheese, and milk powder. Less obviously, both China and India have increased the rebate on the duty drawback system for exporters, and, although the subsidy component is a matter of discussion, the timing of these measures raises questions.

Subsidies proposed for the auto industry have proliferated and total some $48 billion worldwide, mostly in high-income countries ($42.7 billion). In addition to the US direct subsidy of $17.4 billion to its three national companies, Canada, France, Germany, the UK, China, Argentina, Brazil, Sweden and Italy have also provided direct or indirect subsidies – not including Australia's support to its car dealers and South Korea's and Portugal's support to their component suppliers. To the extent that the industry is laden with excess capacity, these subsidies impede exit and delay adjustment. Even worse, subsidies may be linked to requirements that companies preserve domestic employment, even at the cost of shutting more efficient plants abroad in developing countries. (President Sarkozy reportedly proposed that Renault and Peugeot-Citroen shut plants in the Czech Republic to maintain employment in France as part of its €6 billion package.) Moreover, to prevent this, governments have had to react to the policies of neighbours -Canada has matched the subsidies given to Detroit automakers to ensure that Canadian plants of American producers remain open.

A remarkable trend emerging from these actions is the reliance of developed countries on subsidies rather than border barriers, while developing countries have deployed all forms of protection. This undoubtedly is testimony to the superior financial strength of public budgets in developed countries. However, once economic pressures to stimulate economies are replaced with the inevitable need to reduce deficits, this pattern may portend equally severe pressures to wall off trade competition.

Antidumping cases are on the rise

After a period of slowdown, the number of antidumping cases (both investigations initiated and imposition of duties) surged in 2008, especially in the second semester. Compared to 2007, antidumping initiations grew by 15% and findings with imposition of duties grew by 22%. Developing countries accounted for the majority of initiations, though developed countries accounted for the greatest number of duty impositions. India was the most active, accounting for 29% of total initiations. In December alone, India initiated anti-dumping investigations involving both hot- and cold- rolled stainless steel products, affecting 19 countries. In addition to Japan, three developing countries – China, South Africa, and Thailand – were the target in both investigations. The US and EU were the two countries that most frequently imposed duties. For example, the EU in December 2008 imposed duties on preserved fruits

from China as well as on imports of welded tubes and pipes of iron or non-alloy steel from Belarus, China and Russia.

Trends in agriculture, finance and labour movement warrant monitoring

Protection to agriculture may not require new measures because existing laws automatically provide increases in subsidies with declines in agricultural prices. Many programmes – such as those of the EU, US, Japan, South Korea, to name a few – entail price supports, so when commodity prices fall, direct payments to producers increase. For example, we estimate that US overall trade distorting subsidies of about $8.1 billion in 2008 are likely to rise to $9.9 billion 2009 if current price projections materialise. Trade-distorting subsidies push the global burden of adjustment onto commodity producers in Africa, Asia, and Latin America, where governments do not have resources to match subsidies of the wealthier countries.

These measures also ignore the protectionist bias in the financial sector. While serving the urgent public purpose of re-establishing financial stability, virtually all nations have focused their financial subsidies on domestically owned banks rather than subsidiaries of foreign banks (perhaps a consequence of relative size more than national protection).

Workers in some countries have campaigned for increased restrictions on foreign labour. In the UK, for example, the dispute over the use of Portuguese and Italian contractors in oil refining at a time of surging unemployment led workers to strike in protest at the end of January and triggered several sympathy protests across Britain. Workers complained that foreign companies were overlooking skilled British workers. Malaysia in January banned the hiring of foreign workers in factories, stores, and restaurants to protect its citizens from mass unemployment amid the global economic downturn. To their credit, the Swiss voted in a referendum in early February to accept EU labour rules, including foreign labour from newly acceded countries.

Buy America generates a storm

In late January, the US House of Representatives passed a stimulus bill that would provide a 25% competitive margin for US iron and steel for all expenditures under the bill. Several governments, including those of Canada and the EU, and well-known economists objected forcefully to the provisions (Hufbauer and Schott 2009). The final version, which passed last week, expanded the coverage of the provision to all manufactured goods but added a stipulation that the provision "be applied in a manner consistent with US obligations under international agreements" (Sec. 1604 (d)). This apparently exempts the 27 EU member states and the 12 other countries that have signed the WTO Agreement on Government Procurement and the countries with Free Trade Agreements. These countries collectively supply about 25% of US iron and steel imports. According to USTR and private lawyers, this seemingly small change puts the new stimulus legislation into conformity with existing legislation and would imply no new restriction on federal purchases. It would still mean that government purchases of iron, steel and other manufactures from China, India, and Russia, among others, would be subject to the provisions.

…but trade integration and stronger rules have thus far muted protectionism

Several factors have clearly muted protectionist pressures and distinguish this global downturn from the pressures of the 1930s. Countries are far more interdependent through supply chains, imported inputs, and even services, and so export interests are far more powerful than before relative to pure import-competing industries. The simple average of trade-to-GDP today is 96% compared to 55% in 1970 – and parts and components trade, an indicator of supply chains, has more than doubled as a proportion of total trade. Successive GATT/WTO agreements have provided much greater legal stability of trading relations.

Because of this quite different political economy today, a few proposed restrictions have been rejected or not enacted. In Brazil, for example, the bureaucracy attempted to impose widespread licensing arrangements and import controls reminiscent of the 1970s, only to provoke a response of outrage from the private sector that led to immediate reversal. Similarly, the more egregious forms of the Buy America provision appear to have been circumvented. Moreover, about 10 of the 77 proposed and implemented changes in trade policies involved steps toward greater liberalisation, mostly related to free trade agreements.

Also, most countries have flexible exchange rates, and, as capital has sought safety in US Treasuries, nominal exchange rates against the US dollar have plummeted. This shift in relative prices domestically has given import-competing interests considerable protection. The floating rate regimes have arguably pre-empted a wave of competitive devaluations that disrupted markets in the 1930s. For the handful of countries intervening in exchange rate markets, it generally has been to prevent further depreciations – such as Argentina and Russia. China has apparently ceased accumulating reserves since October, and the nominal rate has stabilised after a two-year 20% appreciation.

Forceful leadership can help

The cost of inaction on the Doha Agenda is rising. While thus far most countries have not raised tariffs to bound levels or taken full advantage of headroom on agricultural subsidies, as the recession deepens, many countries may well do so. By the recession's end, it is a safe bet that the lower bindings and caps on agricultural subsidies contained in the draft texts would have kept many markets open that will be closed by the end of 2009. This underscores the importance of pushing forward with a rapid conclusion of the Doha round.

The recent decision by the WTO membership on 9 February 2009, in the Trade Policy Review Body will, in the meantime, contribute to regular multilateral surveillance of the world trading system (WTO 2009).

The G20, for its part, could adopt additional measures that would strengthen the fragile consensus against further protectionism. It could, for example:

- Commit to greater transparency by agreeing to provide quarterly reports on new trade restrictions and industrial and agricultural subsidies to the WTO, together with a mandatory analysis of the trade restriction on employment (since this would create new room for technical analysis and political discussion within member countries).

- Agree to promote use of standard safeguard provisions in lieu of antidumping laws.
- Agree to accelerate progress on technical issues still separating negotiators on the Doha round, including producing new working texts on the special safeguards mechanism, sectoral negotiations, and cotton.
- Advocate greater Aid for Trade for low-income countries.
- And decide to endorse voluntary implementation of the trade facilitation provisions, not as an "early harvest", but in a non-binding fashion linked to overall trade facilitation reforms design to lower trading costs.

Disclaimer: The views in this column are those of the authors and do not necessarily represent those of the World Bank or its Executive Directors.

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11. Protectionism is on the rise: antidumping investigations

Chad P. Bown
Brandeis University

As many WTO members' tariffs are bound – and thus cannot be raised – protectionist pressure often show up as WTO-legal protection such as antidumping, anti-subsidy, and safeguard tariffs. The latest data shows that the spreading economic crisis has been accompanied by a marked increase in such protection.

Comparing 2008 to 2007, the number of new anti-dumping investigations opened in 2008 was up 31%, while the number of anti-dumping measures actually applied increased by 19%. Developing countries dominated this trend on both sides; they initiated 73% of all new investigations and were the target of 78% of them.[18]

These new figures continue a worrisome trend beginning in the second half of 2007 (WTO 2008). In particular, the surge in antidumping use in the last six months of 2008 topped the totals of both the previous six months as well as the period covered by July – December 2007.

Using the best available data

Due to data availability and transparency issues, the data is not yet available for all WTO members. However, we do have reliable statistics for the 16 WTO members that traditionally account for the lion's share of antidumping measures (about 85% of all antidumping investigations during 1995-2006).

Under WTO rules, members must conduct a proper investigation of dumping and subsidy allegations before imposing tariffs. Research shows that the vast majority of new investigations result in the imposition of restrictions, so the 2008 surge in new investigations is very likely to result in a surge in newly imposed import restricting measures in 2009.

Leading initiators

India initiated the most anti-dumping investigations in 2008, filing 54 cases in all with 23 stemming from just 2 types of imports (Cold-Rolled Flat Products of Stainless Steel, where the Indian government initiated cases against 8 different exporting countries, and Hot Rolled Steel Products where they initiated cases against 15 different exporting countries. India's lead position was followed by Turkey and Brazil (23 inves-

18 Here "developed" is not the WTO definition but is rather based on the World Bank's income classification. Specifically, it includes Australia, Canada, the EU, Hong Kong, Israel, Japan, Kuwait, New Zealand, Saudi Arabia, Korea, Switzerland, United Arab Emirates, and the US.

tigations each), Argentina (19), the US and the EU (18 each), China (7), Colombia and Australia (6 each), Korea (5), and Canada, Pakistan, and South Africa (3 each).

Compared to 2007 figures, these numbers represent increases for Canada, the EU, India, Pakistan, Turkey, China, Colombia, Australia, Brazil, and Argentina, and declines for the US, South Africa, and Korea. Egypt and New Zealand, which had initiated new investigations in 2007, did not initiate any new investigations in 2008.

Leading targets

Exporters in developing countries were the subject of 147 anti-dumping investigations in 2008 – 45% more than the 101 investigations directed against them in 2007. In addition, 92 of the 120 new measures in 2008 were applied to developing countries' exported products, compared with 78 of 100 new measures in 2007. China was the most frequent subject of anti-dumping investigations in 2008, as 35% (66 initiations) of all the new initiations in 2008 were directed at its exports. This represented a 27% increase over the 52 new investigations that targeted China's exports in 2007. The EU, Thailand, and Indonesia each had 11 investigations directed at their exports, followed by Malaysia (10), Taiwan (9), South Korea (8), India (7), the US (6), Brazil, Japan, and Saudi Arabia (4 each), Iran, South Africa, Turkey, Vietnam (3 each), Belarus, Canada, Hong Kong, Peru, Russia, and Ukraine (2 each). Thirteen other countries were the subject of one new anti-dumping investigation each in 2008.

Iron and steel most common products

In keeping with past trends, the most frequently investigated products in 2008 were in the iron and steel sector (48 initiations), followed by the chemical sector and the textile/apparel sectors (35 initiations each). Concerning the investigations that targeted the iron and steel sector, India initiated one half of them, while the EU initiated 11.

Data on antidumping measures actually applied

Regarding the application of new final anti-dumping measures, India applied 26 new measures in 2008-two measures less than it applied in 2007. The US applied 23 new measures in 2008, followed by the EU and Brazil (15 each), Turkey (11), South Korea (8), Argentina and China (4 each), Canada, Egypt, South Africa, Australia (3 each), and New Zealand (2). This represented increases for the US, the EU, Egypt, Turkey, South Africa, New Zealand, Australia, Brazil, and Korea, and declines for India, China, and Argentina, compared with the figures in 2007. In addition, Pakistan, Taiwan, and Colombia, which had applied new measures in 2007, did not apply new measures in 2008.

China's products were the most frequent subject to new anti-dumping measures in 2008, comprising 41% (49 new measures) of the 120 new measures applied during this period. These 49 measures applied on Chinese exports represent an increase of 5 new measures from 2007. Exports from the EU were next, with 9 new measures applied, followed by Taiwan (8), South Korea (7), the US (6), India and Indonesia (4

each), Brazil, Russia, Singapore, and South Africa (3 each), Japan, Malaysia, Thailand, Turkey, and Vietnam (2 each). Exports from eleven other countries were subject to one new anti-dumping measure each in 2008.

The chemical sector was the industry most frequently affected by the new measures applied in 2008-accounting for47 of the 120 new measures applied. The iron and steel sector was subject to 18 new measures, and the plastics and rubber sector was subject to 14 new measures in 2008. Concerning the new measures that were imposed on products in the chemical sector, nearly one half (23) of the 47 new measures were applied by India.

Sources

With only two exceptions, the data provided above are collected from the each national government publications that are publicly available on websites (see Bown 2009 for details). Thus the statistics are reliable to the extent that these countries publish their new anti-dumping initiations and applied measures on their websites. Korea's data for 2008 was collected via a trade news website, antidumpingpublishing.com, and its data for 2007 was collected via its semi-annual reports to the WTO. Argentina's data for November and December 2008 was not available from its government website and thus was based on reports made on *antidumpingpublishing.com*.

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12. Commodities, export subsidies, and African trade during the slump

Tonia Kandiero, Abdul Kamara and Léonce Ndikumana
African Development Bank

The steady increase in trade, especially exports, has been a major driver of past growth performance globally as well as in Africa. However, while African exports have grown significantly and often at par with world trade, the continent's share in global trade remains low. African exports represented 5.4% of world exports in the 1960s; this ratio has declined to only 2.6% today. Intra-Africa trade is also very low, representing only 8% of exports and 9% of imports. By comparison, intra-Asia trade accounts for 45% of Asian total trade.

African trade and the crisis

Today, African trade performance is threatened by the current economic crisis which has reduced global demand and weakened credit markets. Exports from Africa are predicted to decline by as much as 7% in 2009; the last decline in African exports was recorded in 2001 (UN, WESP 2009).

Lower export demand has already caused substantial job losses in export-oriented sectors. In Angola, the diamond mining company De Beers warned in December 2008 that cuts in production would cause more than 1,000 job losses. In the Democratic republic of Congo, declining activity in the mining sector has resulted in an estimated 100,000 job losses.

As a result of reduced demand for exports and a slowdown in private sector activity, the continent's growth prospects are bleak. A meagre 2.9% real GDP growth rate is expected for 2009, down from 6% in 2007 and 5.7% in 2008 (African Development Bank). The tourism sector has also not been spared, with tourist arrivals falling worldwide. The 2% growth in 2008 is now projected to be reversed with probable negative growth in 2009. Kenya Airways, for instance now expects its profits to be cut by 25%, due to the financial crisis.

Promoting African trade is therefore critical to avoiding a growth collapse, which will jeopardise the modest gains achieved in poverty reduction. However, efforts to increase and sustain trade are confronted with several key constraints:

- Falling commodity prices;
- Procyclical and declining trade volumes; and
- Inadequate and inefficient physical and soft infrastructure.

Table 1: Commodity prices

Commodity	Unit	Benchmark 07/31/2008	Value at end of week (13/02/2009)	% change index/ benchmark
Crude oil (Brent)*	US$ per barrel	125.73	44.09	-64.93
Gold	US$ per Troy ounce	918.00	935.50	1.91
Silver	US$ per Troy ounce	17.48	13.37	-23.51
Platinum	US$ per Troy ounce	1,758.00	1,055.00	-39.99
Cotton	US$ per pound	49.71	45.22	-9.03
Cocoa beans	US$ per ton	2,908.50	2,682.12	-7.78
Coffee, Arabia	US cents per pound	131.10	99.00	-24.49
Coffee, Robusta	US cents per pound	115.09	81.75	-28.97

Source: Bloomberg and Statistics Department African Development Bank, January 2009

Falling commodities prices

In general, Africa's growth has been attributed to higher commodity prices which were driven by strong demand in developed as well as emerging countries such as India and China. Strong exports earnings provided much needed fiscal space to support infrastructure as well as education and health services. The global financial crisis, which caused a sudden plunge in commodity prices, confirmed the risks that are associated with volatility in commodity prices.

More pronounced has been the impact on the prices of commodities such as oil, platinum, silver, gold, coffee, and others. For instance, the price of crude oil dropped by 65%, from $125.73 per barrel at the start of the financial crisis to $43.48 in January 2009 (Table 1). The fall in commodity prices has had a severe impact on African countries' trade performance and current account balances.

With the deterioration of export performance and declining government revenue, African countries are confronted with a severe "twin deficits" problem (current account and budget deficits). Consequently, the erosion in the fiscal space makes it difficult for government to implement a fiscal stimulus to boost economic recovery. The prolonged slowdown will put breaks on efforts toward poverty reduction and attainment of the Millennium Development Goals by 2015.

Fear of return to export subsidies

In their search for strategies to cope with the crisis, countries may be tempted to resort to export subsidies as a means of supporting the private sector. However, by acting as implicit barriers to trade, exports subsidies would amplify the negative effects of the crisis.

African countries would be particularly hurt by export subsidies, especially given that many of them depend heavily on agricultural exports, which are the most commonly targeted by subsidies. A rise in protectionism in this area will push millions of farmers deeper into poverty as a result of both the decline in farmers' revenue and the inability of governments to sustain social expenditures, especially in health, sanitation, and education

Rising export subsidies will cause deterioration of macroeconomic balances in African countries, further eroding their fiscal space. For example, in Burkina Faso, export growth dropped from 6.9% in 2007 to 3.5% in 2008, following the fall in cot-

ton production and the decline in lint cotton export. The balance of trade sharply deteriorated under the combined impact of falling agricultural production and declining lint cotton export (from CFAF 160 million in 2007 to CFAF 12 million in 2008). The current account deficit is estimated at 12.9% of GDP in 2008, a 3.8 point decline compared to 2007. Other commodity exporters face the same situation, which largely explains the very negative growth outlook for 2009 in the continent.

Hence, it is critical that the world takes all measures to support trade. In particular, all countries should refrain from trade distorting export subsidies given their damaging effects not only on growth but also on the living standards of the poor.

Procyclicality and declining trade volumes

Generally, government spending in most countries are cyclical in nature, meaning that expenditure tends to increase with the good times. It was not surprising that most resource rich countries in Africa raised their public investment levels as their trade volumes surged.

What measures should African countries take to offset the fall in government revenue linked to declining trade volumes?

It is important for countries to focus on the big decisions that ensure sustainable growth. These priorities include low debt levels, higher investment in infrastructure, improving the investment climate, and boosting trade. Countries such as South Africa, which have been severely hit by the financial crisis, have now adopted countercyclical policies to meet the financing gap for development needs as a result of the freezing up of funds in the credit market. In this regard, South Africa will revert to the status of a net issuer of debt in 2009. Other countries in similar situations should be encouraged to use domestic instruments such as bonds and tax revenue to offset the loss in fiscal space due to declining trade volumes.

Infrastructure and African trade

Infrastructure remains a key factor for facilitating trade and anchoring other economic services. Trade in Africa is atypically costly, both in terms of direct and indirect costs.

It is estimated that trade costs represent up to 30% of the price paid by the consumer. Moreover, freight costs constitute about 10% of the value of imports in Africa and other developing countries, compared to 3% in developed countries. For landlocked countries the challenge is even more daunting. Freight costs account for over 20% of the value of imports for Rwanda, 24% for Mali and 23% for Niger. In addition, delays at border posts account for about 40% of transport time, and imply immense costs associated with the deterioration of product quality and staff time. The high costs are due to inadequate physical infrastructure such as roads and ports, causing long delays in the trade chain.

The road infrastructure network in Africa is inadequate, inefficient and poorly managed. The road density in Africa is only 7 kilometres per 100 square kilometres compared to 12 kilometres in Latin America, and 18 kilometres in Asia. Only 30% of the region's roads are paved and many are inaccessible during the rainy season. In addition, ports are in inadequate supply, overloaded, and inefficient. The shipping fleet is also inadequate with vessels that are too small, too few, and often in poor

working conditions. Congestion in ports is the norm, resulting in high costs. The time spent in ports in Africa is as high as 80% of total transport time, compared to 20% in East Asia (Nottenboom 2006). These infrastructure inadequacies account for the high freight costs which are often three times those in developed countries.

Consequently, the linkages between high transport cost and deficient transport infrastructure and management are striking. African countries rank low in the global Logistics Performance Index (LPI), except for South Africa which is ranked 24th. Only São Tomé and Principe, Tunisia, Guinea, Sudan, and Mauritania fall within the second top quartile out of a total of 150 countries. This presents a general problem, especially that trade flows have grown much faster than the supporting infrastructure. The financial crisis notwithstanding, the continent faces serious structural constraints to long-term growth of trade, especially the inadequacy of physical infrastructure.

Recommendations

In conclusion, this note offers the following recommendations that African countries can consider in order to support the trade and growth agenda in the face of the global financial and economic turmoil.

Refraining from expanding export subsidies – While G20 member countries seek strategies to advance domestic goals such as employment and economic recovery in general, it is vitally important that they refrain from introducing, re-introducing, or expanding export subsidy programmes. These domestic goals may be achieved by other instruments that are not only good for domestic economies but also for the global economy as a whole. The G20 presents a forum for raising the awareness of the negative impacts of export subsidies and other artificial barriers to trade both for well-being of the population in poor countries.

Keeping the borders open – resisting temptations for protectionism which may take the forms of high tariffs and other restrictions (i.e. safeguards or anti-dumping duties). Leaders around the world have voiced warning of the perils of protectionism in the context of the current economic crisis. This was strongly articulated in the G20 November 2008 summit. Protectionist tendencies particularly threaten some sectors, including agricultural export commodities, which is a mainstay for many African economies. The challenge in 2009 is for the developed and emerging economies to hold to their promises of trade liberalisation through the Doha Round. Any temptation to "turn inward" will be disastrous for the world economy; it will jeopardise Africa's growth prospects and undermine its chances of reaching its development goals.

Stabilisation mechanisms – During times of prosperity, countries should be encouraged to build up reserves or setup stabilisation funds to help cushion the impact of exogenous shocks which may affect commodity prices. For example, Botswana's mineral revenue and royalties, which accounted for a substantial portion of government revenue, plummeted to 28% of government revenue due to the financial crisis. Botswana is now dipping into its abundant reserves to meet some of its financing needs.

Mitigating procyclicality – African countries need to implement countercyclical programs to minimise the impact of the crisis and speed up recovery. Domestic resource mobilisation instruments such as domestic bonds can help to finance vital public expenditures. Other interventions should include tax reforms, improvement in debt management and strengthening capacity in public service. However, these

measures will not enough; in the short run, African governments need assistance from development partners, notably through budget support programs. The G20 summit should provide a forum for advocating for scaling up and speeding up of assistance to African countries in the context of the economic crisis.

Financing for infrastructure – Priority should be given to financing Africa's infrastructure investment in order to close the funding gap that existed before the financial crisis, which is necessary to meet long-term development goals. Therefore, the need to scale up aid targeting infrastructure should feature prominently in the agenda of the G20. On its part, the African Development Bank considers infrastructure as one of the priority areas in its Medium Term Strategy.

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13. G20 surveillance of harmful trade measures

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Nobody wants to see the mistakes of the 1930's repeated, so it is important that key players in the global economy devise an effective mechanism that provides for rapid identification of potentially harmful trade actions and serves to pressure governments tempted by protectionist actions.

Prevention not retribution

The chief contribution of surveillance through the period of recession lies not in retribution ('naming and shaming') but in prevention. We will all be better off if a new wave of protection never happens. The force of the new mechanism should be the threat of exposure of non-cooperative action. The threat could dissuade governments – or more likely, interest groups – from pursuing plans to load up "stimulus packages" with protectionist provisions.

The dissuasive effect relies for its force on governments' wish to cooperate in the restoration of global growth. Rapid recovery needs cooperation and, even if the economic risks of free-riding are small for smaller economies, the foreign policy costs of being an identified non-cooperator are too high for almost all. If you are an optimist, you might also hope that the publicity generated by the surveillance mechanism would also equip private exporting and other import-competing interests in national economies to fight the costs that protection would impose on them.

Some questions that G20 leaders need to address are:

- Where should the surveillance mechanism be located?
- What kind of trade action should "trigger" the mechanism? and
- Should the surveillance mechanism be linked to a standstill commitment on the part of the participating governments?

G20 surveillance by internet: The Protection Surveillance Website

Surveillance of potentially harmful measures already exists in the WTO (with regard to WTO rules and more) and in the flood of daily print and Internet media. The latter, especially, appears to influence parliamentary and executive intentions on trade as evidenced by the climb-down in the US Senate over 'buy-American' provisions in the Obama stimulus proposals and the debate in Europe on subsidies for automobile production.

In 2009, the most effective way to make information immediately available around

the globe is through the Internet. Additional surveillance does not need to be 'run' by an existing institution or even located in a single media outlet. But for practical purposes a single high profile website, funded and managed by for example, the World Bank, would improve the effectiveness of surveillance. Specifically, websites that allow editorial access by individuals have proved their worth in spreading information. But they are also vulnerable to the 'abuse of the commons'. Moderation is essential to ensure comments are transparent (made by identified individuals), on-topic, and proportional. But moderation is labour-intensive and never free of controversy. In this case, it will need moderators with subject knowledge and probably some institutional affiliation to assure funding and independence.

This proposal calls for the G20 countries to agree on some standards that could be monitored at the website at their April 2009 meeting (more about these later). Surveillance would then operate as follows:

- Participating governments (G20 and any others who signed-on to the G20 standards) would be invited to notify actual or planned measures by other governments that were inconsistent with the standards adopted by the G20
- Private sector bodies (business, non-business, academic) and individuals would be able to post (moderated) information on protectionist measures and their (moderated) views on any notified measures. Private information and comments would not be limited to measures breaching the standards adopted by G20 governments.
- G20 governments, and others that signed on, would agree to respond to allegations concerning a breach of the standards within 10 days of the notifications appearing on the website. They may also respond to any other criticisms.

No other action should be necessary. The pressure generated through this highly public process (we would expect to see key news media tuned into the website) should be sufficient to pressure the "offending government" into not taking the planned protectionist measure. An advantage of the proposal is that the entire process from notification to justification or stand-down could take place in the space of a fortnight.

What triggers a notification?

A notification to the surveillance mechanism should be triggered by a measure that is judged inconsistent with a commonsense standstill commitment to be adopted by G20 members and other countries willing to participate. We all know that a measure need not be inconsistent with a government's WTO obligations to be capable of harming international trade and, in any event, the surveillance mechanism should not aim to supplant WTO notifications or dispute settlement. A commonsense standstill would also allow non-WTO members like Russia to be part of the surveillance mechanism.

No standard that G20 governments would endorse will cover all protectionist action. Some governments (the US for example) could not sign-away individuals' rights in law to seek 'trade-remedies' such as anti-dumping duties and safeguards. Yet these measures are among the most harmful to trade and prone to 'tit-for-tat' responses from trading partners. The best way to handle them would be to allow private notifications on the Surveillance Website, identifying the harm while flagging their 'consistency' with the G20 undertaking.

For maximum effect link surveillance to a meaningful G20 standstill commitment

This recession poses new and surprising problems not encountered in earlier cyclical downturns. As a part of a plan to avoid harming world trade, and to make the surveillance mechanism operable, the G20 should adopt a "real" standstill in their use of protective and market-disruptive measures.

A "real" standstill commitment would not be like the watery promise the G20 made in November 2008 where leaders pledged to not take steps inconsistent with their WTO obligations. A real standstill – coupled with the surveillance mechanism – would provide maximum assurance that G20 nations' desire to stimulate growth extends beyond the borders of the world's largest economies. For some initial period (say until December 2010), the G20 should commit to implement:

- No increases in any MFN applied rate of duty other than for technical adjustments (completion of HS transpositions, for example);
- No increases in any customs fees, excise duties or consumption taxes applying to imports;
- No new export subsidies in any form (as defined by the Hong Kong Ministerial Declaration);
- No new export restrictions or export taxes;
- No new buy local preferences at any level of government for goods or services contracts; and,
- No new regulatory or technical requirements that would have the effect of reducing market access for foreign services suppliers or introducing or increasing discrimination against foreign services suppliers.

This mechanism needs to be in place now

The alarming speed of the deterioration of the global economy and the widespread suspicion that we have yet to hit bottom argue in favour of putting this mechanism in place as soon as possible. The downside risks and costs associated with a new wave of protectionism are enormous and far too important to be ignored. We know what can happen if the mistakes of the 1930's are repeated – and this time it could even be worse. On the other hand, the cost to the G20 of taking the action we advocate is zero. In fact, any right thinking economist will tell you there are important welfare benefits that flow from a liberal trade regime. We think the arguments in favour of the new surveillance mechanism are compelling.

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14. Disavowing protectionism: A strengthened G20 standstill and surveillance

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See end of paper for affiliations

The G20 standstill on protectionism, agreed less than five months ago inWashington DC, has lost much of its force. This calls into question the credibility of leaders' claims to disavow beggar-thy-neighbor responses to the global economic downturn. While no major trading power has yet to resort to across-the-board restrictions on international trade and investment, enough elements of many national economic recovery programmes contain discriminatory measures – or appear to – that a new approach is needed, especially as the measures of greatest concern today are very different from the protectionist measures of yesteryear. The purpose of this chapter is to argue for a strengthened G20 standstill that covers the new, murkier forms of protection as well as traditional discriminatory measures, backed up a tough real-time surveillance mechanism.

The original rationales for a G20 standstill – avoiding beggar-thy-neighbor measures and the almost inevitable retaliation and descent into trade wars that would follow – are sound. That's why the G20 shouldn't abandon its standstill. Even so, recognition of the many – some blatant, some far more subtle – ways in which discrimination against foreign traders, investors, and workers, can creep into national, sectoral, and firm-specific government measures calls for a new form of standstill. Moreover, many non-discriminatory recovery measures that governments may take can have the effect of reducing international commerce, even though the latter is not their purpose. A standstill that is both more comprehensive in scope and better able to discourage stealthy as well as blatant protectionism is needed. Plus, any new standstill should not seek to stop government intervention per se, but rather to encourage governments to use whatever discretion they have in a non-discriminatory manner when designing and implementing measures to promote economic recovery. To prevent retaliation discretion must not just be used in a non-discriminatory manner, but seen to be so.

In this chapter we propose that the G20 leaders adopt, at their April 2009 summit in London, a comprehensive Protocol that reaffirms their commitment to find non-discriminatory ends and means to combating the global economic downturn. The Protocol would not be permanent and would lapse after two years. Subsequently other, non-G20 nations would be encouraged to sign this Protocol too. As a sign of their willingness to take leadership during the current global economic downturn, the G20 would implement the Protocol on an unconditional most-favored nation basis. Taking these steps would send a strong signal to the financial markets and the private sector, boosting confidence. In addition, signing up to this Protocol would provide useful benchmarks against which state measures could be judged. The combination of these agreed benchmarks and a new real-time surveillance mechanism would generate the necessary peer pressure to discourage governments from taking

beggar-thy-neighbor measures.

G20 leaders would commit to a Protocol which has the following elements:

1. Five principles for state intervention that encourage governments to intervene in an evidence-based, reasoned, and transparent manner without deliberately discriminating against foreign commercial interests or workers, unless such discrimination is absolutely necessary and distorts international commerce to the least possible degree.
2. A commitment by G20 leaders to oppose measures proposed by others at home that needlessly discriminate against international commerce.
3. The continuation of a traditional commercial policy standstill, thereby disavowing blatantly protectionist responses to the global economic downturn.
4. Five commitments concerning the proper implementation of so-called bailouts to firms.
5. Steps to allow firms more time to meet new costly technical, safety, and health regulations that can affect both domestic and international trade.

This Protocol would be binding on its signatories but would not become a WTO agreement subject to dispute settlement etc. While there are clear attractions to the latter, two practicalities mean the G20's strengthened standstill should stay outside of the WTO. First, negotiating a WTO standstill would take time, time that the world economy does not have. (Plus, any such negotiations could founder and be seen by some as a distraction from completing the Doha Round.) Second, even if a WTO standstill could be negotiated quickly, dispute settlement under the WTO's rules takes so long that any protectionist measures taken in the near term need not be reversed before the end of 2010 (when any WTO case could be drawn out to), in the meantime the damage has been done and the temptation to retaliate remains. Peer pressure and real-time surveillance, coupled with benchmarks for state action embodied in a Protocol of the kind described below, are the only practicable ways to strengthen a G20 standstill commitment at this time.

PROTOCOL ON STATE INTERVENTION DURING THE CURRENT GLOBAL ECONOMIC DOWNTURN

The Parties to this Protocol shall:

1. Adhere to each of the following **Principles of State Intervention** for every state measure[19] taken while this Protocol is in effect:

   a. No state measure shall have as its purpose to improve the lot of any Party's commercial entities or workers over another Party's. This applies only to those foreign commercial entities and workers whose presence in a Party was legitimately established before 1 January 2008.

19 For the purposes of this Protocol commitments to state measures are in relation to final or interim laws, administrative measures, rules and notices, or any other form of stipulation or guideline. Any state measure controlled by the central government and associated state organs that potentially affects any foreign commercial interest, taken to include interests associated with trade in goods, trade in services, the operations of foreign commercial entities in a Party, and the commercial activities of foreign workers in a Party falls within the purview of this Protocol, irrespective of whether those measures are implemented for ordinary commerce within a customs territory or within a special economic zone, free trade zone, border area, or other such area.

b. A Party shall come to an informed and reasoned decision as to the form that each state intervention shall take. Parties shall base their decisions on the best available expertise and information concerning effectiveness and cost, shall consider any relevant international best practices, shall not confine themselves to considering one possible measure and preserving the status quo, and shall publish with any announcement of a proposed measure the rationale for the measure's objectives, form, duration, and method of implementation. The time frame over which any particular state intervention is implemented shall be proportionate to the circumstances that the state wishes to address.

c. No Party shall implement a measure that has the effect of discriminating against foreign commercial interests and workers. However, nothing in this Protocol shall prevent a measure that discriminates against foreign commercial interests being taken by a Party during this crisis so long as at the time of implementation it is the informed and reasoned judgment of the Party in question that the measure has the least adverse effect on foreign commercial interests while attaining, and not going beyond, the Party's goals for the measure. A Party implementing such a discriminatory measure must demonstrate publicly, at the time the measure is proposed, that it has thoroughly examined credible alternative measures and shall provide compelling reasons as to why those alternative measures were rejected in favor of the discriminatory measure.

d. In every six month interval following the implementation of a significant state measure, a reasoned review of the measure taken, informed by all the relevant facts, shall be undertaken. These reviews shall establish whether the original measure has attained the purpose for which it was implemented and, if not, examine the reasons why. Such reviews shall examine whether credible alternative measures could achieve the same purpose at less cost, less harm to foreign commercial interests or workers, or better attain the stated purpose of the original measure. Should a review reveal that an alternative measure is preferable, then the Party shall replace the original measure within six months of the conclusion of the review. The conclusions of the review and any decision in respect of replacement of the original measure must be made public as soon as possible, and compelling reasons and evidence provided to justify those decisions.

e. For the duration of this agreement the parties shall not undertake any bilateral, regional, multilateral, or other international agreement that involves measures which violate the above mentioned principles.

2. Adhere to each of the following **Commitments to Oppose State Measures that Discriminate Against Foreign Commercial Interests and Workers.** The highest level of the executive branch of a Party's government shall:

a. Oppose any proposal from the legislature to enact a measure that discriminates against foreign commercial interests and workers or is inconsistent with any of the Principles elucidated in 1. above.

b. Subject to the provisions in existing legislation, ensure that when considering state measures that might be implemented government ministries, regulatory agencies (independent or otherwise) exercise any permitted discretion in ways that are entirely consistent with the Principles elucidated in 1. above.

c. Oppose any proposal from a sub-central government that discriminates against foreign commercial interests or is inconsistent with the Principles elucidated in 1. above.

d. Not encourage others to advocate state measures that discriminate against foreign commercial interests and workers or are inconsistent with any of the Principles elucidated in 1. above.

e. Dedicate sufficient state resources to monitor effectively the content of proposals advanced for state measures in the Party in question.

3. Implement a **Commercial Policy-Related Standstill** and therefore **Disavow Blatantly Protectionist Measures.** Each Party shall:

a. Not raise the applied tariff on any good above their level on 1 January 2009.

b. Not introduce any new tariff on any good.

c. Not raise any export taxes from the levels established on 1 January 2009.

d. Not introduce any new export taxes or restrictions, including replacing any such measures due to lapse.

e. Not introduce any new export subsidy schemes, including replacing any scheme due to lapse.

f. For agricultural products, not raise budgetary outlays on export subsidy or domestic support schemes, nor administered prices and prices used to trigger and/or determine subsidies paid to agricultural producers, above the levels applied on 1 January 2008.

g. Ensure that any measures taken in the exercise of existing WTO rights will not go beyond what is strictly necessary to remedy specific situations provided for in the relevant WTO provisions.

h. Subject to any relevant provisions in existing national legislation, not engage in any form of import surveillance that monitors specifically a sector (or sectors) or commerce with any other WTO member.

i. Not enact any legislation that creates new forms of import surveillance.

j. Not negotiate, or encourage others in the negotiation of, a tacit understanding with another WTO member to restrict, distort, or otherwise manage trade between them.

k. Fully comply with any commitments the Party has made in WTO agreements and regional trade agreements.

4. Adhere to all of the following commitments concerning the various forms of **Assistance Granted to Firms Previously Operating Solely on a Commercial Basis** that falls short of complete nationalisation by the state. Each Party may offer assistance to firms in its customs territory but shall ensure that, in addition to adhering to the Principles elucidated in 1. above,

a. No obligations are imposed upon a recipient firm, or assurances sought or given by a recipient firm, that prevent or induce the firm in question from operating subsequently solely on a commercial basis. A Party shall not interfere in any manner with the commercial relations between a recipient firm and any other commercial party or entity. Purchases by a recipient firm shall not fall under any state regulation or control, including the public procurement laws and regulations of the Party in question.

b. Any obligations imposed upon or assurances given by a recipient firm are made public at the time the Party decides to offer assistance.

c. Even if a Party ultimately decides not to award assistance to every firm in a given sector, the Party shall on objective grounds examine whether all of the firms in that sector should receive assistance. This decision should be reasoned, based on verifiable empirical criteria, and made public at the time the assistance is offered.

d. The assistance received shall not take the form of the award of contracts for government goods or services, or any step that increases the likelihood that a government contract is awarded to the firm in question. Nor shall the Party instruct or encourage that other private commercial entities purchase from a recipient firm.

e. No Party shall instruct or encourage other private commercial entities or state entities to provide goods, services, finance, or other items of commercial value to the recipient firm on terms that are more advantageous than those conditions currently prevailing in the markets in question.

5. Adhere to the following commitments concerning **Technical Barriers to Trade and Sanitary and Phytosanitary measures**. Each Party shall to the extent permitted by national legislation:

a. Seek to avoid any new Technical Barrier to Trade, but in all cases, unless there is a demonstrable serious threat that merits expeditious action, each Party shall use the maximum available time allowed to consider, notify, receive comments upon, revise, enact or implement any new Technical Barrier to Trade.

b. Seek to avoid any new Sanitary and Phytosanitary measure, but in all cases, unless there is a demonstrable serious threat that merits expeditious action, each Party shall use the maximum available time allowed to consider, notify, receive comments upon, revise, enact or implement any new Sanitary and Phytosanitary measure.

6. It is understood by all Parties to this Protocol that the binding commitments contained herein are exceptional and need not reflect the binding commitments at the WTO or elsewhere that any Party would be prepared to accept during ordinary economic circumstances.

7. Every commitment contained in this Protocol will be implemented on a unconditional Most Favored Nation basis.

8. The Parties to this Protocol are the members of the so-called Group of 20 plus any other WTO member that wishes to join. Other WTO members may join this Protocol after it has come into force and are encouraged to do so.

9. Each Party agrees that the implementation of the commitments contained in this Protocol shall be subject to multilateral surveillance so as to ensure that it is effective. The Parties to this Protocol will separately decide on the appropriate mechanisms to carry out the surveillance, including periodic reviews and evaluations. Any Party may bring to the attention of the appropriate surveillance mechanism any actions or omissions it believes to be relevant to the fulfillment of the commitments contained in this Protocol.

10. This Protocol will come into force immediately after it has been agreed.

11. This Protocol will lapse after two years. This Protocol can be terminated before this time should the Parties to this Protocol unanimously so decide.

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15. Restoring trade finance: what the G20 can do

Marc Auboin
WTO Secretariat

Shrinking trade finance threatens living standards in both industrialised and developing countries. It reduces trade flows and thus adds to other deflationary pressures. The threat is all the greater in this crisis because international supply chains now extend to trade finance as well the production of parts and components. Sophisticated supply-chain financing operations – including for small and medium-size companies – rely on a high-level of trust among suppliers; trust that they will deliver their share of the value-added and have the necessary finance to produce and export in a timely manner.

What is the situation now?

The global liquidity situation has been a major constraint in 2008 on the largest suppliers of trade finance. Trade credit has also been reduced by a general re-assessment of counter-party risk, and an increase in the expected payment defaults on trade operations.

In the second half of 2008, the situation spread to developing country markets. The market gap initially appeared in Wall Street and London, as US and UK global banks – particularly those with weak balance sheets – could not off-load/refinance on their excess exposure in trade credits the secondary market. As a result, some banks were unable to meet the demand from their customers for new trade operations, leaving a "market gap" estimated to be around $25 billion in November 2008 – out of a global market for trade finance estimated at some $10 trillion a year.

More disturbing is the fact that large banks have reported on several occasions that the lack of financing capacity has made them unable to finance trade operations. Some very large banks used to roll-over up to $20 billion in the secondary market per months are doing $200 million right now due to lack of counterparties. Demand for trade credit is far from being satisfied, and prices for opening letters of credit far outweigh the normal re-assessment of risk according to market specialists.

Further, the liquidity problem, although cooling a bit in Asia, has since spread to other developing countries' money markets in South Asia, Africa, and Latin America. This adds to the problems faced by local banks in certain developing countries even in normal circumstances such as lack of deep money markets, lack of capacity to handle large volumes of trade credit, lack of reliable information on the creditworthiness of customers, all of which lead, in periods of crisis, to difficulties in finding partners in developed countries to accept the counterparty risk.

Survey measures of the decline in trade credit

According to an unreleased BAFT (Banker's Association for Trade and Finance) survey, flows of trade finance to developing countries seem to have fallen by some 6% or more year-on-year – probably more than the reduction in trade flows – hence implying that the lack of trade financing is indeed an issue for these countries. If such numbers were to be confirmed (at least local bankers seem to agree on them according to the survey), that would mean that the market gap could be well over the $25 billion estimate mentioned above (up to $100 billion, possibly more). The scarcity of trade finance is very likely to accelerate the slowdown of world trade and output.

Of course, it can be argued that such "exogenous" factors as liquidity squeeze, exchange rate fluctuations and others impacting risk are not specific to trade finance. Any unhedged cross-border flow is likely to be affected by exchange rate fluctuations and increased risk. Likewise, all credit is dampened by the credit crunch. The combination of scarce liquidity and a re-assessment of customer and country risks resulted in a sharp increase in the price of credit transactions. Spreads on 90-days letters of credit have ramped up in the course of 2008 from 10 to 16 basis points on a normal basis, to 250 to 500 basis for letters of credit issued by emerging and developing economies. Even under stress, it is hard to believe this sort of loan – which is among the safest and most self-liquidating form of finance due to strong receivables and marketable collaterals – could see its price increase by a factor of 10 to 50.

While overall flows cannot be estimated with precision, the overall increase in spreads requested for opening letters of credit, particularly at times when liquidity constraint hitting the money market seems to have relaxed a bit, and other factors point to a mismatch between supply and demand.

Mismatch between supply and demand

Why has this happened? Two arguments are put forward. Public sector actors emphasise market failure while private sector actors tend to blame the costs associated with implementing the Basel II rules.[20]

The market failure argument relies on the inability of private sector operators to avoid herd behaviour, especially when the credit risk and country risk are confused (e.g. amid rumours of sovereign default). Cooperation between global suppliers dries up during crisis, with the best run ones refusing to off load/refinance in the secondary markets the positions of banks that are in less favourable liquidity situations, or carrying excess exposure to trade credit. The failure of private lenders, which account for an estimated 80% of the trade loan market, to meet the demand for cross-border trade finance is unusual given the self-liquidating nature of the market (often backed by strong deliverables, e.g the cargo itself acts as collateral for the loan).

On the regulatory side, commercial bankers have long complained about the implementation of Basel II rules, which are regarded as having a pro-cyclical effect on the supply of credit. That is, in poor market conditions, trade finance would be unfairly treated as capital requirements for it would be significantly increased, particularly for counterparty risk with developing countries' customers. The system of rat-

20 These arguments are not necessarily new (see WTO 2003, page 6) but at present they may well apply with even greater force.

ings agencies won't help here as such counterparty risk tend to be "biased" against developing countries risk.

Measures proposed by the private sector

The Banker's Association for Trade and Finance and other commercial bankers have proposed the three following measures.

- Change the Basel II rules.

In view of the positions developed by both bankers and the Bank for International Settlements (BIS) on trade finance, the WTO Expert Group on Trade Finance has considered that the best course for bankers would be to make a case for themselves on low default and the self-liquidating nature of trade finance, through a survey to be conducted by the International Chamber of Commerce (ICC) on historical data – a survey which is underway and is to be presented at the March 18 Expert Group meeting at the WTO. Some regulators (such as the FSA) are currently discussing with representatives of the banking industry, and it seems that some smaller requests of bankers could be accommodated (this benefits only to banks regulated by the FSA, though, it needs to be agreed globally.

- Introduce a ring-fenced liquidity fund for trade finance.

Here it is important to look at the nature of proposals. Some national Treasuries are unconvinced that a large, sector-specific liquidity fund would be efficient, or fair from a competition point of view. At the recent WTO trade finance conference, their representatives argued that taxpayers would not accept paying once for the overall liquidity injection into cash-strapped banks, and again for a special trade-finance vehicle – especially since such a vehicle would trigger demands for similar things from other credit market segments.

The trade finance departments of banks, it was said, need to compete better internally for the extra cash provided by central banks. The problem is not one of overall lack of liquidity but one of allocation of it, certain institutions remaining overly liquid and having significant room for intervention. It should not be forgotten, that in competitive banking markets, the best run banks are already anticipating a future banking landscape where several of their competitors would have disappeared. However, the design of much smaller, better targeted and experimental liquidity funds, run by international financial institutions, for smaller segments of the market or new countries, in particular those which most likely to be hit by the contraction of supply (for example in least-developed countries' markets), is currently underway.

- Encourage more risk-sharing with public sector-backed institutions.

This proposal is also advocated by the WTO and international financial institutions. The idea would be to mobilise public-sector actors, such as Export Credit Agencies and the Regional Development Banks, in the effort to shoulder some of the private-sector risk as well as encouraging co-financing between the various providers of trade finance. With the support of WTO members, the WTO Director-General has adopted a two-step approach in WTO Expert Group for Trade Finance in 2008, i.e.: (i) finding collective short-term solutions, notably by mobilising government-backed export credit agencies and regional development banks; and (ii) developing technical measures that allow for better interaction between private and public sector players in the short- and medium-term. The latter encompasses projects developed by the International Chamber of Commerce, the IMF, the IFC, and the Berne Union, all of

which aim at removing the obstacles to co-risk sharing and co-financing by various institutions.

The efforts by public players to boost the supply of trade finance

One clear lesson from the 1997/98 Asian financial crisis is that in periods that are prone to a lack of trust and transparency, all actors – including private banks (which account for some 80% of the trade finance market), export credit agencies and regional development banks – should as far as practicable pool their resources (IMF 2003). Strong links among the various players are also important because of an absence of comprehensive and reliable data on trade finance flows. This means that the main channel for making a reasonable assessment of the market situation is via the collection of informed views and partial statistics from various institutions. This has been a key aspect of the activities of the WTO Expert Group.

In this crisis, the response of public-backed institutions has been unprecedented and involves three activities.

All regional development banks and the IFC have doubled on average capacity under trade facilitation programmes since November 2008.

There is some thinking, in the context of the G20, which might further increase the size of such programmes, in particular by adding some features that would ease the liquidity constraint on small customers. The idea of setting up limited liquidity pools for co-financing operations with banks in developing countries are making progress; such moves would be likely to have a high leverage and multiplier effect on trade.

To a large extent, export credit agencies have stepped in, responding positively to the call from governments in the fall of 2008.

These have been accomplished primarily with programmes for short-term lending of working capital and credit guarantees aimed at Small and Medium Enterprises (SMEs). For certain countries, the commitment is very large or unlimited in amount (Germany, Japan). In other cases, very large lines of credit have been granted to secure supplies with key trading partners (the US with Korea and China), or to support regional trade, in particular supply-chain operations. To this effect, the APEC summit announced the establishment of an Asia-Pacific Trade Insurance Network to facilitate intra- and extra- regional flows and investment through reinsurance cooperation among export credit agencies in the region. Japan's NEXI is establishing itself as the leader and main underwriter of this collective re-insurance system.

One problem often underestimated in developing countries is the difficulty for banks and importers to find foreign exchange, for example in cases where the main currency of transactions (say, the Euro or the US dollar) has become scarce because of the depreciation of the local currency, or because of the fall in receipts from remittances and exports.

Central banks with large foreign exchange reserves have been able to supply foreign currency to local banks and importers generally through repurchase agreements. Since October 2008, Brazil's central bank has provided $10 billion to the local market. The Korean central bank has pledged $10 billion of its foreign exchange reserves to do likewise. The central banks of South Africa, India, and Indonesia are also engaged in similar operations. Unfortunately, however, many developing countries lack foreign exchange reserves and are unable to use similar facilities.

Despite these steps, trade finance has not been restored.

The current effort is a race against time. While more financing capacity is provided by public institutions, it seems that the private sector's ability to respond to importers' and exporters' demand for finance, particularly in developing countries is deteriorating even faster. For example, BAFT members have complained that the series of measures announced by Export Credit Agencies and regional development banks were hard to track and that they lack information on who is providing what, and under which criterion. Filling this information gap should be a high priority.

Implementation and design of the programmes of the national export credit agencies may also need to be done cooperatively. The cooperation would involve the beneficiaries (exporters, importers, banks), and cooperation among all the export credit agencies in a region, if not globally.

Public institutions understand that putting new credit or guarantee limits in place involves delays. For a long period of time, the private sector was comfortable to see government guarantees and programmes being withdrawn from export credit agencies' short-term business. Asking today for a 180 degree turn requires time but perhaps also discussion between potential customers about their needs and the suppliers. The issue of financing both exports and imports has also been raised with some relevance by bankers and traders, as the survival of supply chains partly depend on the financing of both sides.

The Asian example of export credit agencies supporting both intra- and extra-regional trade by working as a network should be examined by other regions. In the end, much has been talked about co-financing and co-risk sharing, but little has happened in reality.

A realistic programme for the G20 and others

While there appears to be no quick fixes to the trade finance problem, there is still a case for a faster, better sequenced, and cooperative implementation of a series of measures, many of which are underway. A programme of mutually supporting measures could be adopted as a "trade finance package" by G20 leaders. This package should include:

- Accelerated implementation of IFC and regional development banks' enhancement of trade finance facilitation programmes.
- Filling of the information gap as to what export credit agencies are doing by circulating a list of new programmes (unknown by most bankers).
- Instructing export credit agencies to open quick and user-friendly liquidity and re-insurance windows for both exporters and importers;
- Coordinating actions by export credit agencies, possibly on a regional basis;
- Creating liquidity pools allowing rapid co-financing between banks, export credit agencies and the International Financial Institutions;
- Reviewing the Basel II regulation in light of the self-liquidating character of trade finance.

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16. Bailouts: how to discourage a subsidies war

Simon J. Evenett and Frédéric Jenny

University of St Gallen and CEPR; ESSEC and Cour de Cassation

During the current global economic crisis many governments in industrialised countries have shied away from blatant protectionist measures, such as raising tariffs and imposing quotas, and have instead offered "bailout" packages involving considerable sums of state funds and guarantees to the banking, insurance, and automobile sectors, to name a few. In part, this reflects the drying up of credit offered by traditional financial intermediaries to each other and to the rest of the private sector. As the crisis has deepened, however, the rationale for these bailouts has shifted from the preservation of the payments system (an economy-wide matter) to sectoral initiatives targeting jobs loss and the viability of selected firms. Doubt is cast here on the wisdom of this shift, especially as the discriminatory impact (if not intent) of these bailouts could trigger a wasteful subsidies war between governments.

The systemic purpose of the initial bailouts

In the past 12 months bailouts have implemented for two reasons. First, the sheer magnitude of the total losses from holding mortgage-backed assets (estimated to be of the order of five trillion dollars) and other financial instruments has created concerns about counter-party repayment risk and bank insolvency. So as to prevent runs by bank depositors, that could ultimately jeopardise the viability of the national payment systems upon which monetary economies survive, a compelling case was made for offering financial support to banks.

Second, the destruction of wealth in the financial sector has also hurt the real economy. The decrease in stock values and falling house prices have reduced expenditures by investors and retirees who live off their stock and bond portfolios. Banks with weak balance sheets and financial institutions have less working capital to lend. This further affected the real economy by reducing consumer purchases of goods and services, and investments by firms that use credit to finance their expansions. Furthermore, increased uncertainty about the future (in particular concerning the prospect of being unemployed) generated a fall in spending for risk-averse consumers and investors. Taken together these effects have systemic implications. Many firms have found themselves facing a double squeeze; on their sales and on sources of working capital. Consequently, pressures to lay-off employees and cut investment levels have intensified. In these circumstances governments cannot be realistically expected to confine bailouts to the banks when other large firms face bankruptcy and unemployment queues lengthen.

So it came to pass that governments, through separate interventions and in stimulus packages, have offered subsidies to banks and commercial firms. These subsidies have taken many forms. For example, some have consisted of direct payments to

firms with and without strings attached. Some of the conditions relate to production and employment levels, operations of foreign subsidiaries, and executive compensation. In the automobile sector it has been reported recently that Italy and Spain plan on joining France in conditioning financial support on commitments to retain domestic employment levels. Italy is also said to have demanded that its financial support to car producers be used to pay suppliers on time.[21]

Other subsidies have related to the financing of firms[22], including loan guarantees, access to below-market rates of interest, and lenient default policies. Yet another important form of subsidy relates to wages and employment. Germany, for example, subsidises the wages of over a quarter of a million workers that the crisis prevents working full time. Finally, stimulus packages have included taxation and expenditure provisions of particular interest to a given sector.

The harm done by subsidies at home and abroad

What makes bailouts such a useful vehicle for murky protectionism is that there are circumstances under which certain subsidies can improve national economic performance and resource allocation. Blanket condemnation of subsidies is, therefore, inappropriate. Much turns on how the discretion given to public officials in designing bailouts is employed and whether in fact the principles for the design of effective subsidies (that economists have articulated over the years) have been employed during this crisis. The strong combination of private interests and political imperatives can ride roughshod over the proper design of bailouts and, without much information in the public domain, the beneficiaries can still claim those principles were applied.

Subsidies can have three types of welfare-reducing effects. First, they can distort the recipient firm's incentives. When firms expect to receive a subsidy in case of bad outcomes, they are less likely to bear the cost necessary to avoid sub-standard performance. Likewise, their incentive to restructure and become more efficient diminishes. The mere expectation of a bailout can adversely hit cost competitiveness and productivity growth.

Second, when some firms are subsidised and other firms in the same market are not, the subsidised firms benefit from an artificial advantage. Competition is no longer solely "on the merits" (good products or services, low costs, etc) and more efficient competitors may contract and, in the limit, leave the industry. Firms can also use the subsidies that they receive to engage in anticompetitive practices, such as predatory pricing and to fund competition-reducing acquisitions.

A third problem with many subsidies is that they only indirectly affect the ultimate objective set by the government. If job loss is the state's real concern, then subsidies to production costs or reduced cost of credit will only influence employment decisions through their impact on other aspects of firm performance. The best subsidy is the one that targets precisely the private sector decision in question (employment in

21 See "EU and France ease protectionism row on summit eve," Agence France Press, 28 February 2009.

22 For example, the UK government is reported to have asked beneficiaries of its Asset Protection Scheme for banks to "pledge" to lend more to UK mortgage holders and small and medium-sized businesses. See "The biggest insurance policy in history," *The Independent,* 25 February 2009. Similarly, the Australian government is said to be creating a A$4 billion fund to assist investors in commercial property that cannot refinance foreign debts when they come due; see "Homeward Bound," *The Economist,* 7 February 2009.

the last sentence) and does not have any knock-on effects for other commercial decision-making. So it's not just a matter of using subsidies, but the right type of subsidy.

Worse, many recent bailouts discriminate against foreign firms

There is growing evidence that many of the subsidies and bailouts undertaken in recent months effectively discriminate against foreign firms outright or the subsidiaries of firms headquartered abroad. This is not to suggest that every bailout pits "us" versus "them," indeed some bailouts have discriminated between domestic firms in the same sector. Still, the discrimination against foreign firms is particularly worrying given strong international norms of equal treatment. Worse, there is also evidence that discriminatory subsidies and bailouts are spawning further discrimination by other governments, but more on that in the next section.

The discriminatory nature of a subsidy or bailout has at least two sources; which parties receive the favourable treatment and the nature of any strings attached. In cases where only domestically-owned firms receive bailouts and foreign suppliers (be they located abroad or operate from subsidiaries in the bailout-granting jurisdiction), discrimination in favour of the domestic recipients is said to have occurred and arguably competition for these firms' customers has been altered. In contrast, the strings attached to bailouts can have other adverse effects on foreign commerce. UK banks that have received state support have been encouraged to redirect their lending towards the home market, leading to concerns about "financial mercantilism."[23] A plan to provide five billion euros of support to French banks includes conditions on lending those funds to "cash-strapped" airlines that might cancel, or think twice about placing, orders with European aeroplane producer, Airbus.[24]

Bailouts get noticed – and trigger copycat actions abroad

No G20 policymaker should be under any illusion that they can conduct their bailouts and grant subsidies in secret. Indeed the desire to take political credit for "saving jobs" etc creates the media coverage that other governments notice. This lack of secrecy means that the use of discriminatory subsidies creates systemic concerns for at least two reasons.

First, bailouts tend to spread as governments try to redress the harm done to domestic industries by the discriminatory subsidies and rescue packages implemented by trading partners. Developments in the worldwide car industry following the announcement by the US of the bailout of its automobile industry in late 2008 exemplify this point.[25] China announced in January 2009 various tax incentives and subsidies for its auto and steel industries. Britain, Canada, France, Germany, Italy, Russia, Sweden are also considering or implementing auto-industry bailout measures.

23 See "Homeward Bound," The Economist 7 February 2009. That edition reported that in the fourth quarter of 2008 data from the Bank of England revealed that UK banks had "sharply cut lending to foreign customers" (page 69).

24 "Hypocrisy hangs over EU's growing clamour about protectionism." The Guardian. 4 February 2009.

25 Another example comes from the agricultural sector. Following a decision by the European Commission to reintroduce export subsidies a government minister in Australia indicated that additional aid for dairy farmers might be included in that country's stimulus package. See " Australia Mulls Aid For Dairy Farmers - Minister". Dow Jones International Newswire. 5 February 2009.

President Sarkozy recently remarked "The situation in Europe means that you cannot accuse any country of being protectionist when the Americans put up $30 billion to support their automotive industry."[26]

Within Europe, bailouts for the automobile industry have caused controversy. In February 2009 President Sarkozy stated that it was unacceptable for bailed out French car makers to sell cars in France that were manufactured in other European countries and that the access to bailout money would be conditional on making commitments not to relocate automobile production to outside of France. This €7 billion French bailout plan was met with outrage in the Czech Republic, Sweden, and at the European Commission, and with serious reservations in Germany. It was denounced by the EU's Czech presidency which said there was a danger of a "race towards national subsidies." Fortunately, the outsourcing provisions of the French bailout plans were recently withdrawn, a testament to the benefits of peer pressure in these trying times.[27]

Subsidy wars – or races to the bottom – are not only a potential burden on national treasuries but they can result in serious misallocations of resources. The firms with the "deepest pockets" (the greatest subsidies) will be able to ride out the global economic downturn for longer, raising the prospect that it is access to state funds rather than commercial viability that determines which firms leave a sector and which remain.

Second, the granting of discriminatory subsidies is also upsetting competition between developing and industrialised countries. Developing countries have less financial means available to them and so cannot offer as generous bailouts and subsidies. This means that in those international markets where there firms from industrialised and developing countries compete, to the extent that the former are seen as benefiting from bailouts and subsidies, then this increasingly been seen as unfair. This asymmetry has fuelled resentment in developing countries that may translate into retaliatory trade measures and difficulties in concluding outstanding trade negotiations.

What can the G20 do to avoid a subsidy war?

A purist might want to ban all discriminatory state bailouts. However, given the political factors described above, the chances that such a ban would be agreed are slim and the chances it would be respected even slimmer.[28] So it is worth thinking about mechanisms which would not ban outright discriminatory subsidies but would make them either tolerable or used less widely. The important question facing the international community is how to ensure that the adoption of such measures minimises distortions to trade and competition on international markets. Avoiding a subsidy war is a pre-requisite.

A starting point would be for G20 governments to commit to state the objectives of each bailout, its expected duration, the measures chosen (including strings attached) and the rationale for so choosing. A convention should be adopted that discriminatory subsidies are permissible so long as they are both absolutely necessary

26 "Suspicion and self-interest behind the continental rift" The Times. 2 March 2009.
27 "Sarkozy hints at doubts over renewal of Barroso's mandate" Irish Times. 3 March 2009.
28 The fact that the European Commission has relaxed its rules on state aids for the duration of this crisis is perhaps the strongest indication of the limits of formal, binding rules in curbing the spread of bailouts and subsidies when political leaders face the pressures that they do today.

and distort international commerce the least, the burden of proof being on the implementing country. By creating a benchmark and encouraging transparency, benign interventions may be more readily distinguished from discriminatory measures. With active surveillance, conducted by the press, by independent experts, and by G20 governments themselves, better practices would be encouraged and the temptation to retaliate dampened.

A more ambitious approach would be to define the types of subsidy that are allowable (bearing in mind that there are different types of subsidy and methods for allocating subsidies), the circumstances under which they could be imposed and should be withdrawn, including in principle a time limit on the use of such subsidies in any given instance. This would require negotiation, which inevitably takes time. Still ongoing deliberations on this matter, plus the inevitable stream of press reports, will reveal sooner egregious proposals for new bailouts and peer pressure can follow. In formulating any conventions the EU's vast experience on state aids, with its struggle between political expediency and economic principle, could provide a useful starting point for this deliberation. No doubt other countries' experience with subsidies, including the withdrawal of subsidies, would be of interest, as would the track record of the relevant WTO accord.

Another option would be for G20 members to agree to refrain from imposing any conditions on the recipients of bailouts and state aids that both discourages a firm from operating solely on a commercial basis and encourages the recipient to discriminate against foreign commercial entities. For example, this would rule out instructing recipients to repatriate funds from abroad, to close down foreign factories and other facilities, to influence outsourcing decisions, and to fire foreign workers first. Notice that this proposal is not an outright ban on placing conditions on recipients of state financial support.

Exit strategies

Bearing in mind that bailouts and subsidies appear to be concentrated in certain sectors, the G20 could commit to establish review groups for each of the major sectors affected at a specified future date (that is possibly related to the timing of a future global economic upturn.) The purpose of these review groups would be to encourage the unwinding of bailout packages and crisis-related subsidy programmes. Coordinated reductions in subsidies could follow, providing the G20 countries with sectoral "exit strategies" after the crisis.

Collective post-crisis reviews of selected sectors could be complemented by six monthly national reviews of the effectiveness of bailout schemes implemented. This would force an objective evaluation of the impact of each national scheme. It might also foster serious consideration of alternatives to the bailout package in place, thus undermining the assumption these interventions must last forever.

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17. Public procurement: focus on people, value for money and systemic integrity, not protectionism

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As nations come to grips with the global crisis, proper management of government procurement systems is critical. Massive fiscal stimulus packages mean that government spending is set to expand significantly. States must manage these expenditures wisely to obtain value for their money – a result that is essential to sustaining public and private confidence that public funds are being well spent.

Demonstrate responsible fiscal stewardship

Confidence in government, particularly the government's ability to be a good fiscal steward, is critical as the global economy struggles to recover from the present economic crisis. The stakes are enormous, and they will only become more so. Throughout this decade, the increased volume of public procurement spending has been remarkable. From 1995 to 2006, public procurement in the EU more than doubled as a percentage of GDP, and US federal procurement grew five times faster than the rate of inflation. Given the massive stimulus spending, public procurement's share of total economic activity should rise dramatically.

To meet their goal of stimulating sagging economies, stimulus packages require rapid expenditure of government funds. But history is replete with examples – during times of war and/or natural disasters – that demonstrate that expedited spending, particularly of dramatically increased sums of money, leads to suboptimal outcomes. States tend to pay too much for what they buy and, all too often, experience greater levels of wasteful spending, inefficient outcomes (often in the form of paying above-market prices for, in the worst-case-scenario, substandard goods and services), and, alas, fraud and corruption. As a result, public confidence in government suffers (at a time when confidence in government is particularly vital).

Derailing the "Buy American" express train: a cautionary tale

Economic stress and stimulus spending can bring out protectionism. Here the US's stimulus package offers a cautionary tale.

As legislators rushed to inject a nearly $800 billion into a stagnating economy, special interests demanded that stimulus-funded public works projects use only domestic iron, steel, and manufactured goods. These "Buy American" stimulus provisions would have violated, at worst, the letter and, at best, the spirit of many trade agreements, which commit the US (and the majority of its constituent states) to non-dis-

crimination in public procurement. Among these are the WTO's Government Procurement Agreement (GPA), and bilateral trade agreements with Australia, Jordan, and Chile as well as plurilateal trade agreements such as the North American Free Trade Agreement (NAFTA). These agreements reflect decades of US diplomacy that has sought to open procurement markets around the world. The Obama administration, alarmed by the prospect of a public procurement trade war, interceded and helped broker a less harmful compromise. While Section 1605 of the US stimulus legislation retained certain "Buy American" requirements, the legislation ultimately requires implementation in accordance with existing commitments under international agreements.

While that compromise resolved many of the legal issues posed by the legislation's "Buy American" provisions, the broader political problem remained. Faced with a crisis, the US seemed poised to quickly jettison its decades-old leadership role in, and commitment to, open procurement markets and the pursuit of value for money. This sentiment emboldened free-trade sceptics and empowered states inclined to favour domestic firms and industries in their own procurement systems. To repair the damage left by this imbroglio, leaders must clarify that, as a matter of *law* and *principle*, the world's largest economies remain committed to open markets, in procurement and otherwise.

Protectionism is bad for procurement

Putting aside trade considerations, protectionism undermines the fundamental business-based and value-oriented underpinnings of successful procurement regimes. While protectionism no doubt serves a political purpose, from a public procurement policy perspective, research and experience demonstrate that it is bad policy.

Protectionism restricts markets and limits competition

Yet competition is one of the foundations upon which effective public procurement regimes depend. Faced with limited access to the world's best (and best-priced) firms, facilities, materials, and talent, governments inevitably pay premiums for what they buy. Past studies routinely identify welfare losses in those countries with high barriers to procurement trade.

For example, as with many stimulus packages around the world, one of the stated aims of the pending US stimulus package is to rebuild crumbling infrastructure. If, however, protectionist impulses prevail, favouring domestic steel in US infrastructure spending could result in the government paying above-market prices for raw materials; as a result, the infrastructure stimulus will result in fewer workers employed on fewer public works projects, and the public ultimately will enjoy fewer miles of improved roadways, bridges, and renovated classrooms.

Protectionism increases transaction costs

Artificial constructs that favour domestic over foreign end products based upon percentages of materials or labour or nuances of the manufacturing or "transformation" process are difficult and time consuming to administer. These devices sap human resources that could be better employed seeking optimal value-based purchasing outcomes. Moreover, many of these rules ignore the realities, and reduce the efficiency, of the global supply chain.

Experience shows that customer agencies or bureaus – tasked with actually provid-

ing public services (rather than rhetoric) – more aggressively resist domestic preferences than elected leadership. This makes sense, in that the government agencies more acutely feel the pinch of politically-imposed, inefficient, and potentially crippling welfare losses. Complex preferences also inject unnecessary inefficiency into the procurement process through the time and effort that private-sector firms must devote to learning the nuances of unduly complex government rules and monitoring their manufacturing/ importing/development efforts to remain in compliance.

Protection invites retaliation

By their nature, market-opening procurement agreements are reciprocal. One nation opens its domestic market in return for better access to foreign procurement markets. Protectionism can undo this bargain and this, ultimately, limits domestic firms' access to foreign markets.

Short-term, episodic protectionism has the potential to violate pre-existing international agreements and obligations.

These actions, particularly when adopted by major industrialised nations, also diminish those States' standing as leaders and proponents of free trade. The US, for example, severely undermined its leadership position in free trade when it attempted to restrict other nations' access to Iraqi reconstruction work. The costs of such political theatre clearly outweigh any long-term benefits. Moreover, to the extent that certain protectionist acts, such as invoking emergency exceptions, may be permissible within the letter of the law, they clearly violate the spirit of the free-trade agreements, and even-the most finely crafted technical defences prove unpersuasive in the court of public opinion.

Procurement preferences routinely fail to achieve intended outcomes

Procurement preferences consistently prove themselves blunt, rather than surgical, instruments. They are remarkably imprecise, favouring a small number of sophisticated participants within targeted groups.

Procurement preferences are bad governance

As wealth distribution tools, procurement preferences (as opposed to direct investment, support, or subsidies) impede transparency by masking the true cost of the subsidy or support programs. Should governments intend to assist, support, or subsidise individuals, institutions, or industries (such as a domestic steel industry), they should do so directly and transparently, publicly quantifying and disclosing the level of support, subsidy, or relief. If the costs of, or externalities associated with, that subsidy or support are unpalatable, disguising them in the procurement process is not only inefficient and ineffective, but also disingenuous.

Governments should not fall into the trap of deploying protectionist procurement practices in times of economic crisis. Rather, governments should focus on optimizing the performance of their procurement systems.

Economic crisis and stimulus as a good governance opportunity

We believe that crises often present a unique opportunity to address long-term, systemic problems. Today, governments should leverage the momentum from their responses to the financial crisis to make long overdue improvements to their public procurement regimes. As, for the foreseeable future, governments spend an increas-

ing percentage of their GDP purchasing goods, services, and construction, they should attempt to do so while maximizing the performance of their procurement systems. In so doing, states should bear in mind that successful public procurement systems share certain characteristics:

They judge their success in the same manner as successful businesses or savvy consumers, focusing on value for money spent and customer satisfaction.

They maximise competition, which increases the likelihood that the government customer obtains the best prices, the highest quality goods and services, and timely delivery of those goods and services. They appreciate and rely upon the breadth and diversity of the global private sector, and seek to do business – both directly and indirectly (through subcontracting) – with the best and the most-attractively priced firms that offer the most cost-effective talent, facilities, materials, solutions, end products, services, and, ultimately, results.

By carefully articulating their needs, choosing responsible contractors, drafting clear and effective agreements, and managing their relationships, they reduce the risk that contractors will fail to fulfil their bargains in a timely fashion and increase budgetary and cost certainty.

They maximise transparency and accountability. Not only do successful regimes employ formal oversight tools, they often empower non-governmental private sector participants (such as contractors, disappointed offerors, the media, and the public) to supplement the government's oversight regime. In so doing, these States experience higher levels of integrity and lower levels of corruption.

They operate efficiently, by recruiting and training talented business people and then minimizing bureaucracy (employing, for example, uniform rules, procedures, training, remedy-granting clauses, and forms), leveraging technology, and employing proven procurement mechanisms and "best practices."

Employing proven tools to achieve good procurement results

The good news is that the tools required for efficient and effective public procurement are readily available – well-developed legal structures and recognised best practices. The extensive and detail-oriented US federal procurement regulations reflect more than a century of hard-learned lessons. International institutions, such as the World Bank, have developed guidelines for sound public procurement. The EU's procurement directives offer a useful framework for transparent procurement and a host of widely agreed-upon minimum standards. The UN Commission on International Trade Law (UNCITRAL) provides a popular, complete suite of model procurement laws, and the OECD benchmarks for procurement offer a consensus-based, highly evolved assessment tool for best practices in procurement. Other related tools address reducing corruption in public procurement, a critical element in sustaining public trust in government during these emerging economic crisis and stimulus efforts. Fully 140 nations have signed the UN Convention against Corruption, which calls for specific measures to stem corruption in procurement. These best practices, if properly implemented, promise a sound foundation for procurement and instil critical public confidence in governmental expenditures.

Invest in people to obtain value for money

As governments deploy stimulus packages to address economic crises, they should aggressively pursue value for money and demand high levels of customer satisfaction for their investments. In so doing, there is no better investment governments can make than in the human resources that will spend the government's money.

Few nations take this responsibility seriously. Many fall into the trap exemplified by the US Defense Department during the 1990's that, obsessed by its "tooth-to-tail" ratio, willingly jettisoned "shoppers" (or acquisition personnel) in favour of "trigger-pullers" (or soldiers), only to find itself incapable of responsibly managing its critical procurement needs. Indeed, States ignore at their peril what children are taught at an early age: an ounce (or milligram) of prevention (here, a good purchasing decision, or a carefully crafted contract) is worth a pound (or kilogram) of cure (here, trying to salvage a bad bargain).

States must promptly, dramatically, and aggressively invest in their acquisition workforces. They need to identify, recruit, and hire the most talented business professionals, engineers, quality assurance personnel, and attorneys in the marketplace. (As unemployment rises, recruiting talent should prove relatively easy.) States then must then provide these business professionals with the most current, realistic, and skills-based training available. (After all, this type of hiring and skills enhancement initiative is the most direct type of stimulus, and it pays ongoing dividends.) Then, governments should deploy these talented, skilled, incentivised procurement professionals to get the taxpayers the most for their money. No nation can reasonably conclude that additional investments in personnel to improve its performance in any of these disciplines would not pay significant dividends. Rather, most would enjoy dramatically increased return on their procurement investments by strengthening their capacity in each of these critical areas. There is no better time to do so.

Recommendations

For the pending economic stimulus efforts to succeed, procurement systems must perform efficiently and effectively, returning value in exchange for stimulus outlays. To fulfil their fiduciary responsibilities, leaders should:

- Maximise competition for their governments' business among the global economy's most qualified firms.

Accordingly, governments must recommit themselves to the letter and intent of, among others, the WTO's GPA, bilateral commitments, and regional free trade agreements. But mere legal compliance is insufficient; a sustained and public commitment to open procurement markets is essential to avoid a downward spiral into protectionism.

- Strive to purge corruption from procurement.

Governments should press for implementation of the UN Convention against Corruption, elevating their level of engagement from words to deeds (the convention calls for specific procurement practices).

- Build (or restore) capacity in their public procurement systems.

Governments should invest stimulus resources in rebuilding their professional acquisition workforces – aggressively recruiting the best talent, bolstering skills-based train-

ing, improving retention and incentives, and identifying best practices for efficient procurement. These stimulus outlays in acquisition professionalism will generate significant return on investment, both in the short- and long-term.

Now is the time to spend public money wisely. Government purchasing decisions should be calculated to return the greatest amount, and the highest quality, of goods, services, and construction. Restricting markets unnecessarily impedes optimizing value-based results. These difficult economic times offer States a unique opportunity to invest in and upgrade their professional acquisition human resources. Seizing that opportunity will increase public confidence in government, demonstrate responsible fiscal stewardship, and provide lasting benefits through more efficient and effective government spending.

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18. Resist green protectionism – or pay the price at Copenhagen

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This year was supposed to see breakthroughs in global environmental policymaking, and that may still come to pass. However, the severity of the global economic downturn is intensifying protectionist pressures and fears of a resurgence of green protectionism.

Green protectionism could undermine the collaborative spirit needed to find solutions to systemic environmental threats, such as climate change. Policymakers and opinion leaders in industrialised countries need to appreciate that their ambitions for global environmental reform will be frustrated if they do not successfully resist green protectionism during the crisis. Trading partners in the rest of the world will hardly believe that the discretion abused in existing national environmental regulation won't be abused again when border tax adjustments, carbon taxes, or permit allocation schemes are implemented to mitigate climate change. The much-vaunted goals of Western policymakers for climate change will be jeopardised if they indulge in murky, green protectionism now.

Concerning the environment, 2009 was supposed to be a year of great promise

The election of a new US President saw a new Administration take office in January 2009 that is keen on multilateral approaches to addressing climate change. This constitutes a major shift in American policy stance and effectively isolates the few remaining industrialised countries holding out against bold climate change measures. Since taking office there have been no signs that the Obama Administration is backing away from its campaign pledges, indeed last week saw newspaper articles confirming the White House's intention to press ahead with these matters.

These developments in the US take on particular significance given the scheduled December 2009 Copenhagen negotiation on a replacement for the Kyoto Protocol on climate change – an accord that could come into effect in 2012. Even before the global economic downturn, negotiations on climate change-related emissions caps have proved contentious. Unlike the Kyoto Protocol, where developing countries did not make emission-related commitments, a maintained assumption in the current negotiation is that all countries – in particular the fast growing large emerging markets – need to make binding commitments if there is any hope of limiting long-term climate change.

While the principle of "common but differentiated responsibilities" has been accepted in the current climate change negotiations, implying that developing countries would shoulder less of the burden associated with mitigating climate change, the

precise quantum of commitment remains unsettled. Many leading developing countries have taken a very tough line on the acceptable level of emissions caps, if any, arguing that they would constitute an unacceptable restriction on the development of their economies, effectively confining millions to permanent poverty if non-carbon sources of growth cannot be found. Furthermore, the point has been made that the current stock of climate change-inducing gases in the Earth's atmosphere were produced almost entirely by rich, industrialised countries for which they alone, so the argument goes, bear responsibility. Despite these difficulties, however, much commentary just after the American presidential election of 2008 took the view that a negotiating breakthrough could be reached this year.

Less than global solutions and carbon border taxes

Not every Western policymaker, however, has been prepared to wait for the conclusion of the climate change negotiations before taking or proposing measures. Regional (e.g. EU-wide) and unilateral moves by industrialised countries have been mooted and their consequences have caused consternation in governmental and business circles in developing countries and indeed, if the truth be known, in some Western countries too. As explained in the next paragraph, the fear is that measures falling short of global reach will generate substantial pressures to restrict imports from countries whose governments are less aggressively taxing carbon use.

Even though a consumption tax applied to the carbon content of goods and services is probably ideal, difficulties in calculating content arise, especially as many goods are produced in supply chains involving many different stages of manufacture and assembly. As a result, directly taxing producers' use of carbon is seen as the more practical option. However, such taxes effectively increase the price of carbon – and with it the prices of many energy sources. This, in turn, will increase the costs of production of goods and services and worsen the competitiveness of domestic firms vis-à-vis certain rivals located abroad.

To offset this adverse effect on competitiveness some proponents, including the high-profile Lieberman-Warner bill that recently failed in the US Congress, have argued for the introduction of taxes on imports from those jurisdictions with lower carbon taxes. Ultimately, it is feared that unilateral and regional measures will induce defensive protectionist pressures that will manifest themselves in measures to limit imports to the detriment of trading partners in particular from those poorer countries, that to date have expressed less interest in reducing carbon usage. These concerns are exacerbated once account is taken of the potential for protectionist abuses of the discretion given to officials responsible for implementing future carbon taxes and associated border tax adjustments. Developing countries don't want to see low tariffs replaced over time by new border barriers that keep their products out of industrialised countries' markets.

The crisis and green protectionism

Before turning to the impact of the global economic downturn on green protectionism and climate change initiatives, it is worth noting that the various inter-linkages between international trade, commercial policy, environmental policy, and environmental outcomes have long been a concern of policymakers and trade diplomats.

The climate change negotiations probably represent the widest-ranging negotiation on such matters. Still, significant advances were accomplished in the trade-and-environment nexus with the negotiation of various provisions of the WTO, GATT, GATS, the Agreement on Technical Barriers to Trade (TBT), and the Agreement on Sanitary and Phytosanitary Measures (SPS) that governments can take. These accords, reinforced by many similar provisions in regional trade agreements, disavow discriminatory intent in the implementation of environmental measures that have implications for international commerce. The TBT and SPS accords also require scientific evidence to be applied in determining technical, health, and safety standards. None of this is to imply that these matters are settled and have not proved to be controversial; to the contrary some very bitter international disputes have been taken to the WTO for adjudication. Even so, the principles of sound environmental policymaking that are "least distorting" of international commerce have been established, and are particularly relevant when policymakers come under intense protectionist pressure.

The global economic crisis and green protectionism

If the working definition of green protectionism is "the deliberate use of environmental policy initiatives to discriminate against foreign commercial interests, including subsidiaries of companies owned or headquartered abroad," then there have been some very worrying developments in recent months.

These worries do not relate to environmental policymaking per se, rather to cases where the measures chosen and implemented to advance government environmental goals have in fact been influenced by the desire to shield domestic firms and workers from different types of foreign competition. For sure, not every example of green protectionism is stated explicitly (although an example follows below.) Green protectionism often involves the abuse of the discretion required to make sound environmental policy choices. As such, some green protectionism is an example of the murky protectionism that this book has sought to highlight the danger of during the current global economic downturn.

Environmental provisions in national stimulus packages

In order to offset falling private sector demand, many governments have announced and begun implementing substantial fiscal stimuli. Moreover, considerable emphasis has been placed on "green" spending or rather public expenditures that promote national environmental policy goals. While there is nothing wrong in principle with the latter, it does not necessarily imply that all green spending in recent stimulus packages treats imports and domestically-produced goods on an equal footing. The following example, quoted verbatim from the recently enacted US stimulus legislation, bans foreign firms from benefiting from a multi-billion dollar appropriation for high efficiency batteries:

> "[Provided further] [t]hat $2,000,000,000 shall be available for grants for the manufacturing of advanced batteries and components and the Secretary shall provide facility funding awards under this section to manufacturers of advanced battery systems and vehicle batteries that are produced in the United States, including advanced lithium ion batteries, hybrid electrical systems, component manufacturers, and software designers. "

Government procurement is one of the least liberalised areas of international trade; even when overt import bans are not included in national legislation, much envi-

ronmental spending will be effectively uncontestable from abroad. Pressure from domestic constituencies to keep state contracts for environmental products and services uncontested by foreign rivals are a form of green protectionism. The opaque nature of any government stimulus package and procurement regulations makes green protectionism murky protectionism too.

Stimulus packages may also contain additional environment-related subsidies to agricultural producers. These subsidies may not directly target higher output levels or exports and so directly distorting international trade. However, they may prevent insolvency and thereby shift the burden of adjustment on to those farmers and the like located abroad. Moreover, to the extent that discretion is used in the award of green subsidies to farmers that happen to be in sectors where world prices for their crops or livestock have fallen furthest during the current crisis, then this represents another form of murky protectionism.

TBT and SPS

As the global economic downturn has deepened, government officials and traders from developing countries have reiterated long-standing concerns that regulatory standards and testing are being skewed against importers. They fear a new wave of non-tariff barriers are being erected against their exports. Some observers have even recommended to their governments that they refuse to conclude the Doha Round until TBT and SPS standards (and other non-tariff barriers for that matter) erected during the crisis are removed. Retaliation, it seems, can take many forms.

The costs of meeting new standards or new implementation regulations for existing standards (including conformity assessments) are said to constitute a particular burden for exporters from poorer countries. To the extent that these standards (and associated implementation regulations) are influenced by the desire to favour domestic producers, these changes represent a form of murky protectionism. The associated changes are misrepresented as being solely motivated by benign considerations. It is important to appreciate that each nation can play this "game" against every other nation, and the resulting retaliation will limit the contribution of exports to national economic recovery.

Assessing the empirical impact of this form of murky protectionism is particularly difficult, precisely because there are perfectly legitimate rationales for some TBT and SPS. Still, legitimate or not, disputes over these measures can add to the pressure for retaliatory measures. We do know from WTO 2008 records, however, that 90 more TBT notifications were made to the WTO than the trend increases over the previous three years would have suggested. These 90 notifications amounted to a 9% increase over trend. Having said that, SPS notifications in 2008 were 90 below the level expected from trend growth. Of course, these numbers only refer to new standards. The implementation of existing standards may well have been affected by crisis-related protectionist pressures.

A counter-argument that any crisis-induced violations of the TBT and SPS agreements can be taken care of through WTO dispute settlement is not convincing; the time lags are too great. Any green protectionism undertaken now would not, should the perpetrator wish to drag out the WTO proceedings for as long as possible, need to be removed until the end of 2010. The damage to trade would, of course, been done by then and trading partners may not be not be able to resist the temptation to retaliate.

These considerations may well call for reforms to the WTO's Dispute Settlement Understanding, including potentially expanding the scope of sanctions and the speed of investigations, however, securing agreement on such reforms would take time and the middle of a global economic downturn may not be the most auspicious time to launch such an initiative.

The crisis and support for climate change negotiations and unilateral measures

The impact of the global economic downturn on firm viability is also reducing the momentum behind both the climate change negotiations and the implementation of unilateral measures to reduce carbon content, precisely because of fears about the impact on the costs of firms that face competition from abroad. Looking forward two scenarios seem plausible:

- The prospects for a comprehensive deal at Copenhagen are seriously weakened by the ongoing crisis and declining corporate profitability or,
- The pressure for a deal in December 2009 intensifies, and along with it the protectionist pressure to ensure that any resulting cost disadvantages are at least matched by steps to shield affected domestic firms from international competition.

As 2009 unfolds G20 leaders should not become schizophrenic – opposing protectionist responses to the global economic downturn, and then embracing beggar-thy-neighbour measures to shore up support for a climate change deal. Indeed, policymakers should be particularly wary of traditionally protectionist industries being "helpful" in the run up to the Copenhagen conference.

The very high price of green protectionism – A strong climate change deal

Many G20 leaders say they want a climate change deal and expectations in some quarters are high for the Copenhagen summit in December 2009. A climate change deal would involve the introduction of complex new taxes and schemes with substantial discretion needed for proper implementation. It is very naïve to think that developing country governments – whose assent is needed to conclude a climate change deal – will cooperate if they feel that the discretion associated with existing environmental policies in industrialised countries was misused to shut out imports during the current global economic downturn. A developing country veto of a strong climate change deal may well be the price of crisis-induced green protectionism. G20 policymakers need to bear this in mind and instruct their government officials to implement environmental initiatives in a manner that not only puts foreign firms on an equal footing with domestic firms but also is seen to do so. Just like other forms of murky protectionism, being seen to give equal treatment is almost as important as granting such treatment in the first place.

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19. Keep the trade flowing by cutting red tape

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The current economic crisis will lead to the first decline in international trade in 25 years – pushing millions of developing world citizens back into crippling poverty. Recent protectionist responses are likely to deepen the crisis and delay recovery. G20 pledges to foreswear protectionism, or agreements on standstills and surveillance as other suggest in this book are all useful. But the G20 could counter protectionism more directly. It could adopt a proactive, pro-trade strategy of supporting reforms that cut the red tape and reduce the transaction costs facing traders around the globe.

The WTO trade facilitation negotiations offer a very practical opportunity to offset some of the impact of the current economic crisis. The payoff to developing countries which depend heavily on trade could be particularly high.

This chapter explains how the current trade facilitation negotiations can act as a positive catalyst for deep and meaningful reform in this area.

Trade facilitation as an active counter to falling trade

Excessively bureaucratic and outdated border processing systems and procedures as well as inadequate infrastructure result in high transaction costs for traders, long delays and unpredictability in the clearance of goods – often accompanied by high levels of corruption. Red tape equals lost opportunities. Governments lose because slow and inefficient processes encourage noncompliance and fraud, exporters lose because high costs and unreliability make them uncompetitive on regional and global markets, local manufacturers lose because the costs of their imported inputs are too high and unpredictability in supply means they are forced to maintain unnecessarily high and costly inventories, and consumers lose because high transaction costs and inefficiencies translate into additional prices at the shops.

Research suggests that it takes three times as many days, nearly twice as many documents and six times as many signatures to import goods in poor countries than it does in rich ones (World Bank, Doing Business Report 2007). Africa, in particular, fares poorly with the time taken between the submission of customs declarations and ultimate clearance taking four times longer than in OECD countries (World Bank, Logistics Performance Index, 2007). Delays, unpredictability and high trade transaction costs at the border undermine a country's competitiveness, either by taxing imported inputs with deadweight inefficiencies or by adding costs and reducing the competitiveness of exports.

The evidence is overwhelming that attention devoted to eliminating unnecessary red tape, removing opportunities for corruption and improving trade related infrastructure is likely to attract investment and make small and medium sized enterprises more competitive players in the international trading system. For all these reasons

achieving practical trade facilitation reform has become a key development issue in recent years. This has been reflected in the decision to overhaul and modernize the now over 50 year old WTO trade facilitation rules as part of the Doha round. What follows is a brief account of where those negotiations stand and how they could provide a springboard for a G20-facilitated effort to cut red tape during this global economic downturn.

The WTO trade facilitation negotiations: state of play

Since the negotiations began, WTO members have submitted proposals for new rules on the freedom of transit of goods, the fees and formalities faced by traders, and the publication and administration of trade regulations and customs rules, respectively Articles V, VIII and X of the GATT agreement. The proposals cover measures that are considered relatively easy to implement (such as publishing rules and regulations on the internet) to potentially far more complex and resource intensive ones (such as the implementation of electronic single window regimes). Moreover, and perhaps reflecting a growing consensus on the benefits to be obtained from a positive and ambitious outcome, negotiations have been conducted in a spirit of cooperation and compromise frequently not evident in other areas of negotiation.

Whatever commentators might think about progress, or lack of it, in the overall Doha Round, the trade facilitation negotiations have made significant progress and the prospects for securing agreement on a practical range of new disciplines appear to be good. Indeed, in several cases industrialized and developing countries have submitted joint proposals. Trade facilitation is therefore not an issue that splits countries strictly across levels of development, which is important to bear in mind when considering the role of the G20 whose members are drawn from the industrialized and developing worlds.

The key to concluding negotiations on the content of a new accord on trade facilitation will, however, depend in large part on dealing effectively with the remaining concerns of developing and Least Developed Country (LDC) members about the potentially high costs and difficulties they will likely face during implementation. Essentially, developing countries recognize the trade enhancing benefits of implementing the measures under negotiation but want some form of guarantee that the necessary technical assistance and capacity building support will ultimately be made available as and when it is needed.

Dealing successfully with the concerns of developing countries presents some real challenges. While the development community is already providing significant and growing levels of support for trade facilitation reform, they are cautious about specifically linking such support to hard commitments in a new WTO agreement. Many donors have worked hard to develop practical mechanisms for client engagement and dialogue, in keeping with the Paris Declaration principles, and would be reluctant to see these modalities abandoned in favour of expedient but less sustainable and effective mechanisms simply in order to secure agreement. In addition, many donors already have extensive trade facilitation programs and do not want the rather narrow, yet significant, WTO agenda crowding out the sort of deep and comprehensive reform initiatives that are typically financed through existing bilateral and multilateral channels.

The issue therefore is not whether finance for implementation of trade facilitation related reforms would be made available, but whether negotiators can agree on appro-

priate mechanisms that provide developing countries with a sense of genuine confidence that the necessary support will be delivered when and where it is most needed.

Several suggestions on how to manage the implementation process have been tabled, but the technical assistance negotiations have generally lagged behind discussions on specific trade facilitation measures to be included in a new WTO Agreement. The final nature and shape of a suitable mechanism to manage this process is therefore far from clear.

To satisfy all parties the final mechanism will likely need to:

- Provide a sense of confidence that any "hard" disciplines included in the agreement will be balanced and complemented by equally firm commitments on the provision of adequate technical assistance;
- Ensure that implementation of a new agreement complements rather than replaces or duplicates existing bilateral and multilateral mechanisms for designing and implementing trade facilitation reform; and
- Encourage recipient governments to develop implementation plans and timetables and integrate these with national programs to improve competitiveness and reform trade-related institutions to promote growth.

These issues are well recognized and all WTO Members are aware of the importance of effectively dealing with the technical assistance issue. To date however, no agreement has been reached on how to coordinate and manage the process or on how implementation of a new agreement would be specifically linked to the 'Aid for Trade' initiative.

While acknowledging the positive progress made in the trade facilitation negotiations all commentators acknowledge is that trade facilitation is likely to be captive to the wider Doha agenda. As the Doha round is subject to a "single undertaking" – i.e. an all-or-nothing proposition – it is difficult to consider the prospects for trade facilitation independently from the prospects for agreement in other areas of the negotiating agenda. As a result, progress, or lack of it, in other more controversial negotiating areas is likely to have a significant impact on the prospects for a successful conclusion to the trade facilitation negotiations.

What can the G20 do?

What are the practical ways in which the benefits of a new trade facilitation agreement could be realized in spite of delays in concluding an overall Doha Round deal? The first would be to capitalizing on the growing consensus that trade facilitation is a good news agenda for all.

The current global economic downturn should force a rethink of priorities. Governments are increasing public investments so as to counter falling demand and ought to be targeting those projects with large economic payoffs, such as those associated with trade facilitation. While the trade facilitation negotiations are a star performer in the WTO and the case for a new Trade Facilitation Agreement is strong, it is nevertheless always likely to be captive of the wider Doha agenda. If WTO Members want to see some progress out of their years of investment in the Doha round, trade facilitation seems like one of the few candidates without any strong opposing constituency. The question therefore is how, given the seemingly intractable issues to be resolved in other areas of the negotiating agenda, can consensus on a new Trade

Facilitation Agreement emerge? The challenge here is to capitalize on progress in the WTO trade facilitation negotiations to speed up implementation of much needed reforms.

While there are many possible variations on the theme there are essentially only two possibilities thus far articulated.

The first involves securing agreement to separating trade facilitation from the "single undertaking" requirement of the DDA and treating success in the trade facilitation negotiations as a so called "early harvest". However, the negative reaction among large segments of the WTO membership suggests that such an approach is not politically viable. A so called "early harvest" simply isn't going to happen.

A second, arguably more realistic option, would involve speeding up conclusion of the content of a new trade facilitation agreement and then moving rapidly toward effective implementation in advance of a comprehensive Doha deal. Such an approach would front-load the development benefits of the trade facilitation agenda and would capitalize on the fact that many members are already implementing customs and logistics reforms in their own self interest as part of larger programs to improve competitiveness. Moreover, moving toward immediate implementation would test donor willingness to provide adequate technical assistance resources and do much to allay the remaining concerns of developing countries.

Progress in implementation would lay the foundation for rapid approval of any Trade Facilitation Agreement as part of a comprehensive Doha deal. This option effectively postpones the need to secure full consensus on the DDA agenda while not postponing implementation of a range of practical measures where the benefits for all Members are not in dispute.

As a starting point, and where demand from Members was clearly articulated, donors could assist developing country members to prepare practical implementation action plans to both guide the implementation process and to provide a basis for discussions between recipient countries and donors.

Such an approach would of course need to build on existing donor efforts as well as assessments and action plans already in place where they exist.[29] Commitment to support implementation of the needs identified would of course be a matter for discussion between potential donors and recipient countries but would ensure some of the key criteria identified above could be addressed. The development of such implementation action plans would also assist members to better identify and calibrate the timing of binding commitments to their own implementation capabilities.

Two objections might surface about this strategy.

Some might say that implementing reforms undermines bargaining power of one or another coalition on the single undertaking.

However, it is unlikely that that any offensive interests in trade facilitation are so great that a defensive posture would precipitate movement in other, more difficult, parts of the negotiation.

More importantly, trade facilitation is one area where the gains transparently accrue to those that implement reforms.

It therefore makes no sense for any government to hold important reforms hostage to an agreement in Geneva.

This approach would provide a sound framework to guide delivery of trade related

29 A six country case study undertaken in 2006 by the World Bank, the IMF and the WTO noted that none of the countries studied were starting from scratch and that all had reform efforts underway in trade facilitation. In many cases implementation of the measures under negotiation in the WTO could be accommodated by modifying existing donor financed projects.

development spending pledged as part of the Aid for Trade initiative. It would also be seen as a vote of confidence in the capacity of the WTO process to deliver positive dividends for the trading nations of the world and would be a very practical demonstration that the "Development" component of the Doha Development Agenda was more than mere rhetoric.

What precisely would be the role of the G20?

First, G20 members would need to direct their negotiators to give renewed emphasis to quickly concluding the content of a new trade facilitation agreement. While progress to date has been good the negotiations have always been seen as part of the overall Doha process and have therefore lacked a sense of urgency. In this sense the timetable for concluding an overall deal has driven the timetable for the trade facilitation negotiations. If implementation of practical trade facilitation reforms is to have any impact on the speed of recovery from the current economic crisis then a sense of urgency in securing agreement is of the utmost importance.

Second, industrial countries would need to make good on their pledges of increased development assistance financing particularly for the Aid for Trade initiative.

Summary

The sharp global economic downturn should raise the priority given to cutting red tape for traders. Governments everywhere want to maximize the impact of any public investment projects, and trade facilitation measures have already demonstrated they are capable of that. In addition, G20 leaders have committed themselves to keeping borders open to trade and cutting red tape will offset some of the harm done by protectionist responses to the crisis. The benefits of improving trade facilitation are widely accepted, this matter does not divide rich and poor countries.

The G20 should capitalize on the positive developments at the WTO on trade facilitation, doing so in a way that accelerates the implementation of practical measures that cut red tape and lower trade transaction costs without waiting for the Doha Round to be completed. Securing agreement on such an approach would deliver a series of practical benefits to traders struggling to cope with the current global economic crisis.

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Trade was a side issue when G20 leaders met last November. When they meet in April 2009, trade must move to centre stage.

Trade is experiencing a sudden, severe and globally synchronised collapse. Protectionist forces have already emerged, and as the recession gets worse, they will strengthen. The protection, however, is not 1930s-style tariffs. It is murky protectionism - seemingly benign, crisis-linked policies that are twisted to favour domestic firms, workers, and investors. A negative feedback between recession and protectionism is no longer an historical reminiscence of the 1930s; it is a possible - hopefully low probability - scenario in the months and years to come.

In this Ebook, leading trade policy practitioners and experts - including Australian Trade Minister Simon Crean and former Mexican President Ernesto Zedillo - put forth several concrete proposals for April's London Summit. These steps would let G20 leaders get out in front of the crisis and reduce the chance that an avalanche of murky protectionism could hinder the global recovery.

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