A Bright Future for World Trade?

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Q&A
MARCH 6, 2014

SUMMARY  World trade is recovering from a long lull, but risks remain in the form of unforeseen crises, geopolitical tensions, and more.

World trade is recovering from a long lull. At the same time, the international trade agenda, which had taken a backseat during the economic crisis, has been revitalized by a recent deal struck under World Trade Organization auspices in Bali and the initiation of negotiations of large regional trade agreements.

In this Q&A, Uri Dadush, former director of international trade and of economic prospects at the World Bank, explains how the improving economic outlook and international political will are fueling trade’s positive trajectory. Yet he cautions that risks remain in the form of unforeseen crises, geopolitical tensions, and more.

• How realistic are forecasts that world trade will significantly expand over the next twelve months? What is driving the trend?
• How great a risk to trade is the threat that emerging markets will become engulfed in crisis?
• How significant is the trade-facilitation deal reached in Bali in December under World Trade Organization (WTO) auspices?
• How does the progress in Bali relate to ongoing mega-regional trade negotiations on the Trans-Pacific Partnership (TPP) and Transatlantic Trade and Investment Partnership (TTIP)?
• What are the TPP’s prospects in the year ahead?
• What are the prospects for TTIP?
• What risks does world trade face in the longer term?
How realistic are forecasts that world trade will significantly expand over the next twelve months? What is driving the trend?

It is likely that world trade growth will accelerate to easily exceed world GDP growth. That forecast stems from a number of factors, not least the expected easing of the economic crisis.

The aftereffects of a deep recession continue to plague advanced countries—which represent some two-thirds of total world trade—and have accounted for the sharp slowing of trade in recent years. In particular, Europe, which is by far the largest trading bloc, is still struggling to emerge from a sovereign debt and competitiveness crisis in its periphery countries.

The impact on international trade of weak demand for autos, houses, appliances, and all types of manufactures in the United States, Europe, and Japan during the recession cannot be overstated. The manufacturing sector in each of these three economies is central to complex regional production chains: the United States to North and Central America, Europe to its periphery in the east, and Japan to Asia. And these value chains account for a disproportionate amount of trade because components move back and forth between these countries to produce final items.

These economies are likely to have a better year in 2014, which will have a very positive impact in terms of growth in trade.

China is the only large emerging economy that is similarly integrated in value chains (Brazil, Russia, and India, for example, are not). Continued solid growth in China is also critical to the realization of this positive trade forecast.

One of the surprising elements of this crisis is that protectionism was kept to a relatively minimal level, with a few exceptions. World trade was relatively open at the outbreak of the crisis and remains as open today. That is why it seems like a very large part of the slowdown was cyclical in nature rather than induced by a specific policy—and, at least in part, why it is likely that the trade will continue to improve.

Foreign direct investment (FDI) was hit badly in 2009 but since then has recovered very well. This has had an important cumulative effect on trade because FDI is often associated with the opening up of businesses and factories integrated in global value chains.

The rise of the middle class in developing countries, which has continued unabated, also points to a solid trade forecast. These new middle classes are driving demand for world-class products at reasonable prices, infrastructure that works, and government that is accountable. All this places limits on how much politicians can cater to protectionist interests and is therefore fueling trade.

How great a risk to trade is the threat that emerging markets will become engulfed in crisis?

The risk remains contained but is most acute in the countries suffering from severe governance and economic policy shortcomings—Turkey, Argentina, India, and South Africa. If troubles in two or three of these countries were to greatly intensify then there is a possibility of a contagious spread of panic to the relatively better managed emerging markets. Developing countries are suffering in part from their own success: the aftereffects of a period of extraordinarily high growth that caused expectations to outpace realities.

But, I believe that a generalized crisis at a time when advanced countries are recovering and international interest rates remain near record-low levels is unlikely. Continued moderate growth in China is also critical because of that country’s effect on demand for primary commodities, which are a big export item of many emerging economies. Still, most large developing countries are less vulnerable.
to external shocks than in the past with increased foreign currency reserves, flexible exchange rates, and reduced reliance on borrowing in foreign currencies.

**How significant is the trade-facilitation deal reached in Bali in December under World Trade Organization (WTO) auspices?**

The Bali agreement is important because without it, the WTO—which has fostered the laws that regulate world trade and help keep it open and predictable—might have slid into terminal decline or irrelevance. The so-called Doha Round of negotiations that has sought to achieve major multilateral reform of the international trading system remains stalled after twelve years.

While the Bali agreement was not earth shattering, it does represent progress on a major agenda, namely the workings of customs arrangements. Bali also demonstrates how the WTO can retain its relevance in the future by engaging a critical mass of players on a relatively narrow issue and by allowing developing countries the room to implement agreements at their own pace.

Unfortunately, Bali also came at the cost of taking a step backward on agriculture. The deal included a significant exception to the rules that limit trade distortion in this area—members can breach agricultural subsidy limits if they can justify doing so on the basis of ensuring food security for their citizens. Even though there are much more effective ways of ensuring food security than subsidizing agriculture, India’s government pushed this agenda very hard, in part for domestic political purposes.

**How does the progress in Bali relate to ongoing mega-regional trade negotiations on the Trans-Pacific Partnership (TPP) and Transatlantic Trade and Investment Partnership (TTIP)?**

Because of their size and reach, the TPP and TTIP mark significant steps in the cementing of regional arrangements as the preeminent locus of trade negotiations and have triggered interest in a number of similar initiatives, such as Japan-EU negotiations.

The motivation behind these prospective partnerships begins with disappointment over the Doha talks. But it also stems from a need for deeper trade integration on the part of the world’s most advanced economies as well as a desire to establish tighter rules in areas such as intellectual property, state-owned enterprises, and FDI. And geopolitical considerations play a role as well—most importantly a desire of the United States and others to forge a tighter alliance as a counterweight to the rising power of China.

**What are the TTP’s prospects in the year ahead?**

There clearly is considerable momentum behind the negotiations at high levels of the U.S. administration. The Japanese too, particularly given the very difficult situation they now confront in disputes with China, badly want an agreement that would reinforce the structural-reform leg of Prime Minister Shinzo Abe’s economic agenda.

Of course, the TPP was supposed to be concluded at the end of 2013. That deadline has come and gone. And, while the negotiation is advanced, bear in mind that since nothing is agreed until everything is agreed, what matters most are the real sticking points to be overcome or that can otherwise sink the whole agreement. There are plenty of these—from opening up Japanese agriculture, to reducing tariffs on imports of SUVs in the United States, to overcoming resistance to tougher intellectual property provisions. A widely noted lack of transparency in TPP negotiations makes it particularly difficult to assess the prospects for resolving these issues.
The recent abrupt rejection of trade-promotion authority by the U.S. Senate’s majority leader, Harry Reid, a Democrat, could quash all hopes of significant progress on the TPP this year. Trade-promotion authority gives the U.S. president the right to negotiate a trade deal and to send it to Congress for an up or down vote, which means legislators cannot pick the agreement apart. This authority is critical for concluding the TPP agreement because the United States’ partners don’t want to make concessions in one round of negotiations only to have another, even more complex negotiation process involving members of Congress begin.

**What are the prospects for TTIP?**

The transatlantic talks are really only just getting off the ground. The start of negotiations in earnest was delayed when the U.S. government closed down in late 2013. Cold water was also poured over them during the National Security Agency spying scandal, and some of the fraught dynamics created by that episode remain.

The most that can be said about TTIP right now is that a very complex and far-reaching negotiation has begun—and that the negotiations will be especially difficult as they will extend to reforms of regulation that go well beyond the traditional purview of trade negotiators. Areas of greatest difficulty include government procurement, imports of genetically modified organisms (GMOs) and hormone beef, and data security. The gains from tariff reductions and broader liberalization in services and investment are bound to be limited because trade and foreign investment already flows quite freely between Europe and the United States. Still, the remaining barriers, such as those on agriculture, garments, and trucks, will be tough to remove, as they all require politicians to take long-standing vested interests on directly.

Contrary to the aspirations of negotiators on both sides of the Atlantic, striking a deal will take many years and is very unlikely to happen during the U.S. administration’s current term.

**What risks does world trade face in the longer term?**

The long-term outlook for world trade is strong. However, there are three main threats to its continued expansion.

The first is the always-present possibility of a prolonged economic downturn that makes everyone look inward. The absence of social safety nets, as in the case of many developing countries, increases the likelihood that protectionist barriers will be erected in a downturn. Long-term stagnation of wages and of middle-class incomes, as in the United States, can also have a similar effect. This risk became acute in 2008 and 2009, and no one is to say that new vulnerabilities will not surface—perhaps in China, key emerging markets, or a relapse in the eurozone. The world may be much better equipped to deal with the boom and bust cycle than people were in the 1930s, but each financial and macroeconomic crisis is different—and politics often gets in the way of the appropriate response.

The second risk is that geopolitical tensions will intensify. As is seen in the current crises in China-Japan and Russia-Ukraine relations, geopolitical issues often have more to do with security and political influence than trade, but trade is directly affected and is commonly an important factor. It should be stressed, in this regard, that the trend toward mega-regional trade agreements can become either a bridge or a destroyer of bridges.

A potential source of heightened friction, for example, is that the TPP and TTIP exclude nearly all the key rising powers, which also happen to be the most dynamic part of world trade. China—arguably the greatest beneficiary from free trade today—will not pull back from the international marketplace. But the possibility that countries such as Brazil, India, Russia, and Indonesia, largely excluded from the mega-regionals, will become more protectionist or obstructive cannot be dismissed.
The third risk is, paradoxically, the potential negative impacts of the world’s increased interconnectedness. In many cases tighter links strengthen trade, but climate change, which scientists widely expect could have catastrophic consequences, provides the clearest example of how interconnectedness can hurt trade. If some countries, but not others, adopt a carbon tax or a carbon cap and trade system, the failure to collaborate in containing carbon emissions could lead to a situation in which countries that tax carbon raise tariffs to compensate for being less economically competitive. In the worst case, a trade war could be the result.

Globalization requires collaboration across a huge number of issues ranging from data security, e-trade, and Internet commerce to environmental and safety standards, currency and capital control regimes, and so on. Failure to coordinate in one or more of these arenas can easily become an excuse to restrict trade or to oppose closer trade ties. Thus, while the technological and economic forces driving trade forward remain very strong, there are still significant risks, and perhaps surprisingly, most of these risks originate from outside the narrow trade agenda.

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Source http://carnegieendowment.org/2014/03/06/bright-future-for-world-trade/h2m6