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Consejo Argentino
para las Relaciones
Internacionales
Uruguay 1037, 1º piso
C1016ACA
Buenos Aires
Argentina

Tel: ++54 (11) 4811-0071 al 74
Fax: ++54 (11 4815-4742
cari@cari.org.ar

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Trade, Recovery and Sustainable Economic Growth*

Pascal Lamy, Director General de la Organización Mundial del Comercio

It gives me great pleasure to be back in Buenos Aires. This is time it is for a special reasons, the launch of a book on Trade Agreements coordinated by my good friend Nestor Stancanelli and Julio Berlinski at the *CARI*.

Economists have long analysed and helped us understand trade, why nations needed it to prosper, and what governments have to do to reap the gains while managing the costs. The many theories they have developed leave no doubt about the importance of trade to growth and economic development.

But if the economics of trade policy are clear, the politics of trade are highly complex. Trade policy, like so many other areas of policy, has ramifications on how resources are distributed, and this inevitably creates competing interest groups within society. Pressures exerted by such groups mean governments must balance these interests in ways that do not necessarily conform to what economic analysis might prescribe. The public debate that inevitably accompanies contested policy formulation challenges the notion that open trade brings overall societal benefits. At the same time, contested policy provides a fertile field for the growth of urban legends and falsely premised ideas with popular appeal.

This is why I think this book and today's event are important: they foster a public debate on trade and allows an informed debate among the wider public.

Turning to our topic today – how the multilateral trading system manages in times of economic crisis – I think that I have a positive, if still cautious, message to deliver. The world economy has taken a severe battering, as bad as anything in the last 70 years. All countries were affected, although some resisted better than others thanks in part to sound macroeconomic management.

We seem to be emerging from the crisis, but I believe we would be mistaken to think that it's all over and that we can go back to business as usual. We are starting to see signals of recovery but they are still fragile.

We still need to follow through with the financial sector reforms. This was one of the key elements which brought together the leader of the G20, which includes Argentinean President Fernandez de Kirchner. Advancing a global and serious financial regulation is in my view a key test of the ability of the G20 to be the prime forum for economic governance. And this is why I hope this matter will figure prominently in the G20 meeting in Toronto.

We must also manage exit strategies so as to avoid inflation and the dangerous piling up of sovereign debt, while at the same time staying out of the hole from which we are emerging.

And we still have to tackle the serious unemployment problem, which I am afraid, will remain stubbornly high for a while, even if everything else goes well. We cannot be satisfied with a jobless recovery, one which leaves millions behind.

The comparison between what happened to output and growth last year and what we are predicting will happen this year is stark. Output fell in volume terms by -2.3 per cent last year, and trade by a massive -12 per cent. The forecast for output growth in 2011 is a positive 2.9 per cent, and we have just released our estimate of global trade growth, which is a rebound of nearly 10 per cent over 2010. This is from a low base, but it is still a very promising turnaround.

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By historical standards, the economic contraction of the last couple of years was of alarming proportions. For a while there was genuine uncertainty as to how the world economy would extricate itself from what could have become free-fall. Yet when we compare this crisis with that of the 1930s, the speed of the turnaround this time was remarkable. This is no doubt in part because we have learned how to manage the economy better. But I think there is more to it than that. Back then, we did not have institutions for international cooperation like we have today.

I am thinking particularly of trade relations and the WTO. In the 1930s, just like in the recent crisis from which we are apparently emerging successfully, trade was not a proximate cause of economic contraction. But in the 1930s, a contagion of inward-looking trade policy and protectionism prolonged and deepened the recession. That has not happened this time. We live in a more trade-dependent world now and governments certainly thought twice about the implications of turning their backs on trade. But I am sure that a vital factor also at play was the existence of a strong network of international trade rules.

WTO rules draw a line beyond which it is not possible to go without breaking the system, and more importantly in my view, the WTO has created a culture of cooperation. The trade rules have stood to the protectionist pressures. And even if we have seen some protectionist slippages here and there, we have not seen the sort of high intensity protectionism of the 30's. But we are not yet out of the woods. As long as unemployment remains high, protectionist pressures will remain.

We now we need to ensure that this culture of cooperation brings the Doha Round to its completion. With national treasuries overburdened by the weight of the public debt, we need sustainable, non-debt creating sources of growth. And this is precisely why we need trade as an engine for the recovery. We need to ensure that the rules of the WTO, which are a public good, are improved and updated. Failure may be costly on a global scale. Take the example of trade distorting agriculture subsidies – including export subsidies. They are unfair and we all agree that they need to be reformed, but for this we need to conclude the Doha Round.

I also want to mention an area where the conclusion of the Doha Round would mean environmental progress. This is the case of fishery subsidies, an issue which is dear to Argentina. We have a mandate to negotiate the prohibition of certain subsidies which contribute to overcapacity and over-fishing. Present disciplines are inadequate. Scientific studies tell us that over 80% of fish stocks are over exploited. We need action and for that, we need leadership from our membership.

But there is something else that I think we need to take care of, especially in public debate. There has been a growing public sense that globalization is not all that its supporters make it out to be. Part of this anxiety finds its way into thinking about trade and sometimes manifests itself in intellectual debate.

One of the arguments I often hear relates to the interface between macroeconomic policy and trade policy, and in particular, the idea that trade policy can fix current account imbalances.

Current account imbalances are not an intrinsically undesirable phenomenon. But it might be right to worry about them if they become very large among countries with very different macroeconomic policies, institutional structures, and regulatory frameworks. The danger is that imbalances become reflective of "distortions" in policy, for example, an unsustainable fiscal deficit in one country, rather than of differences in savings and investment behaviour by the private sector. In such a situation, imbalances could become a source of economic uncertainty and ultimately, instability.

But fundamentally, current account imbalances simply reflect differences among countries in saving and investment behaviour. Some countries are consuming at a higher rate than they are saving and other countries are doing the opposite. The country that is dis-saving by spending more than it is earning will run a current account deficit while the country that is saving more than it is spending will run a surplus. As financial and capital markets have become more integrated globally, larger current account imbalances reflect an international allocation of capital that, in the absence of distortions in the relevant markets, leads to greater efficiency.

If, however, governments believe that these imbalances are undesirable and are indeed the consequence of underlying problems in the market, then they may be moved to do something about it. This is where the trade problem comes in. There is always the temptation to think that by putting on trade restrictions a country can reduce its trade deficit. Trade restrictions might reduce import demand in the short-term, but they will not fix a phenomenon that has an entirely different provenance –

the savings-investment balance. In fact, trade restrictions probably makes matters worse, not just because the imbalances will not be reduced, but because such action will also negatively affect trade relations. This then, is part of the challenge of ensuring that open markets are not compromised for entirely the wrong reasons.

Let me mention another issue on which I believe vigilance is needed. This is the idea that open trade, particularly among rich and less rich countries, will destroy the social fabric in rich countries. This is not exactly a new argument, and I am probably talking to the converted, but I see it coming back in different guises. The idea is that social standards, labour rights, and environmental quality will be compromised in relatively high standard countries in the headlong rush of competitive pressure in open international markets. This reasoning provides the logic for policies that reduce market opportunities – a shrinkage that might in the first instance look as if it only creates one set of victims, the developing countries, but which actually harms the restricting country as well.

I have not found a lot of empirical evidence to make this case. On the contrary, there are good reasons for arguing that open trade raises standards in the lower-standard country. One is that open trade is generally associated with rising income, and as income goes up so do standards. Another is that consumers in rich countries are sensitive to these matters and that has an influence on suppliers in poorer countries. In the matter of labour and wages, it is clear that relative productivity goes a long way in explaining differences in workers' incomes. Once again, if we allow trade policy to be misappropriated by flawed reasoning, or for that matter by protectionist opportunism, we will compromise the basis for growth and development, and we will be investing in political tensions from which none will gain.

Let me finally also mention another argument we sometimes hear, which is that trade destroys jobs. The problem is that this argument sees only the threat posed by imports to jobs but does not take into consideration how jobs may be created in the export sector as a consequence of trade opening. It also fails to take into account that trade opening can increase the rate of economic growth, and therefore improve the ability of the economy to create new jobs.

I have spoken at length about the dangers of misusing trade policy. Let me finish by looking at the other side of the coin, and I think this is just as important. There has been an intellectual line of argument over the years favouring the view that open trade is the cure to all ills, the sure path to growth and prosperity. Well, I cannot think of any country that has prospered without trade, and I guess here I am again preaching to converts, but this does not mean that just opening to trade is a magic policy potion that ensures success.

Open trade needs a context in which to deliver its benefits. The benefits of trade work in an environment where other conditions are met. These include the necessary investments in infrastructure and in institutions. These include an economy where price signals are actually transmitted to the agents that benefit from such signals, and where the benefits of growing prosperity are widely shared, and not just the preserve of a few. We need to think broadly about the ingredients of success, and how the pieces fit together.

In sum, I believe that the trading system has a vital role to play, including – and perhaps especially – in times of crisis. I also believe that the case for open trade needs to be made and time and time again. And I want to commend the authors of the book today for precisely contributing to this. And finally, I think it is important to remember that trade is no panacea on its own. It is a very useful instrument which needs to be put to work for good together with many other ingredients of public policy.