

The Role of the Multilateral Trading System in the Recent Economic Crisis

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Introductory comments

Distinguished guests, ladies and gentlemen, it is a pleasure for me to be here this evening and to have the opportunity to talk about the relevance of the multilateral trading system as governments everywhere struggle to manage the economic crisis and begin to think about our post-crisis world. I should like to thank my hosts, the University of Warwick, for making this occasion possible, and particularly the Chancellor, Richard Lambert, for agreeing to preside.

The contribution of the multilateral trading system in times of economic crisis

We are faced today with the deepest and most global economic crisis since the latter part of the first half of last century. Indeed, some have pointed out that the trade contraction we have sustained in the last year or so – forecast at some 10 per cent in volume terms in 2009 – has been even fiercer than the shrinkage of trade in the Great Depression. We know that now, as then, trade contraction followed from economic troubles elsewhere in the economy – it was an effect, not a cause of the crisis.

But back then a protectionist trade response prolonged and deepened the depression. This time, governments have so far shown considerable restraint and have largely kept markets open. I say ‘so far’ because I do not believe we are out of the woods yet. In comparing policy reactions now and in the Great Depression, authors such as Douglas Irwin and Barry Eichengreen have shown

how active monetary and fiscal policies have helped to manage today's crisis, whereas these instruments played no such role in the late 1920s and early 1930s.

This policy activism has helped to place a floor on economic contraction and fuelled hopes of recovery in the not-too-distant future. It has arguably also supported restraint in the application of beggar-thy-neighbour trade policy. But I believe a much more important force for good in trade policy has been at work today – namely, the existence of a multilateral system of trade rules under which governments have pre-committed to a set of norms in their policy behaviour. In the last sixty years the trade rules have played a vital role in increasing predictability, reducing uncertainty, underwriting the rule of law and fostering a sense of legitimacy in trading relationships.

In the current climate, temptation abounds to placate those most affected by reduced demand with the temporary but ultimately destructive balm of protection from trade competition. Trade rules are a source of opportunity in times of economic growth and a restraining influence in times of difficulty. It is in this latter role that the rules are serving us particularly well right now.

But we must nurture the commitment to the rules-based system because it will not be self-sustaining without the necessary husbandry. One way of doing this is through policy monitoring and surveillance. Our new monitoring mechanism under the Trade Policy Review Mechanism is playing a positive

role in this regard. It is encouraging that governments are willing to engage in constructive debate over their mutual efforts to maintain markets open. But it is not always easy, and our monitoring reports are showing a certain increase in the application of protectionist measures. Moreover, we encounter difficulty in discerning exactly how far financial rescue and fiscal stimulus packages are frustrating trade opportunities. Governments will need to maintain their resolve and the WTO its vigilance as pressures from rising unemployment persist in many economies.

As we contemplate crisis exit strategies and the shape of the world economy post-crisis, two questions come to mind. One is how different the world will look after the crisis, and the other is how the WTO and our system of global governance more generally should be positioned to ensure the kind of international cooperation that is becoming an ever more vital component of a promising future for all peoples and nations. I should like to say a bit about each of these.

Will the world become less globalized?

A key issue that awaits us post-crisis is whether the world will be less globalized in the future – will we see a process of ‘de-globalization’ provoked by the current crisis? This is not a matter just for intellectual entertainment. It matters for policy and for managing international cooperation. It matters when

we consider how we can secure shared growth and increasing prosperity across the world. Underlying the de-globalization question is a distinction between cyclical and secular forces. Some would argue that the current contraction in economic activity will be revealed to be nothing more than a vigorous downturn in the business cycle and that over time we shall return to the *status quo ante*. In this case the only real challenge is to ensure that any damage and contraction occasioned by the crisis is undone upon exit.

Others adopt what is perhaps a more thoughtful perspective, and argue that the origins of the crisis and its severity will combine to create a turning point that will put us on a different, less integrationist path. This latter perspective must also be informed by a consideration of secular changes that were already under way in the world economy, and which perhaps the crisis will accentuate.

The increasing economic inter-dependency among nations captured by the ‘globalization’ rubric has been driven by a combination of technology, policy, business behaviour, and public attitudes. While all of these factors help to explain economic growth generally, they have contributed especially to global integration through trade, finance and migration. In the heady days of sustained high growth prior to the crisis, one sometimes heard the assertion that globalization was irreversible. We now know this is an optimistic oversimplification. In considering what might be reversed – or at least slowed – in

the shape and intensity of globalization, we need a joined up analysis of: i) the key contributors to globalization; ii) the various impacts of the crisis; and iii) the role of relative growth rates in determining global patterns of economic activity.

Technology. As far as technology is concerned, the story is fairly straightforward. Extraordinary advances in information and transportation technologies have sharply reduced trade costs, generating an intensification of trade and investment across the globe. The contribution of technology is unlikely to diminish in the foreseeable future. We do not ‘unlearn’ technologies and there is no reason to expect the pace of innovation to slow over time.

Trade. But what of other influences on international transactions? When the housing and financial market bubbles burst in the latter half of 2008, this created a massive negative wealth effect (\$10 trillion in the US alone in 2008). The resulting contraction in consumption, fed by households attempting to rebuild wealth through savings, has had a significant knock-on effect on trade.

Trade has contracted much more strongly than output, reflecting the fact that trade growth has become more responsive to GDP growth in recent years. A large part of this story may be explained by the manufacturing model that relies on international production chains, combined with the fact that we

typically measure trade flows in gross terms and output in net (value-added) terms. Moreover, it seems that trade is likely to contract faster than output in downturns because goods production declines faster than services production, and the bulk of GDP is services while the bulk of trade is merchandise. As virulent as the business cycle may be, these factors do not necessarily imply a permanent reduction in world trade.

Demand-driven trade contraction has been aggravated by shortages in trade finance linked to the credit crunch. This is why the WTO and others are carefully monitoring the trade finance situation and why the G20 agreed to a \$250 billion trade finance package at their London meeting. I believe the financial sector, governments and international agencies between them will be able to repair fully this situation in the months to come.

What of possible secular factors that do not take us back to established patterns of trade and output? Two of these come to mind. First, to the extent that we see increased trade protection, the challenge will be for governments to restore trade openness as we exit the crisis. A failure to do this may result in reduced output and lower trade levels over the long-term.

The second factor concerns the reduction of global imbalances. Reduced consumption and increased savings in the US will mean smaller imbalances and may well imply a slower steady state growth rate for trade. This possibility

raises some important questions. One is whether such a rebalancing will reduce opportunities for emerging economies to rely on export-led growth as a development strategy. Another is how far increased domestic demand in some large and vibrant emerging economies such as China, India and Brazil will fill the gap left by the industrial economies.

Financial sector. The financial sector was the origin of the crisis and the likelihood of a return to 'business as usual' is nil. So how will changed conditions in financial markets affect globalization? I have already mentioned trade finance, which I regard essentially as a cyclical factor. But the systematic reduction in leveraging that characterizes the behaviour of nearly all financial institutions will surely reduce financial flows and the price of credit beyond the short-term. In addition, new regulatory structures that are being put on place in many economies will impose a more careful attitude towards risk.

Investment. Capital flows towards developing countries collapsed by more than half as a result of the global credit crunch. If investment flows do not recover, this will have longer-term consequences for capital accumulation and production. To the extent that perceptions of risk have been altered by the crisis, capital may be more scarce in the longer term, but perhaps more appropriately priced.

Migration. Evidence is emerging of reduced net migration and a fall-off of remittances as a direct consequence of the global downturn. How permanent will this be? Public attitudes will be key, and I shall say more about this shortly. Other long-term factors affecting migration are differences in expected lifetime income and quality of life between host and home countries, policy-induced incentives that increase or decrease migration, and demographic push-pull factors. Demographic considerations may favour migration, as populations age in industrial economies, threatening labour shortages and insolvent pension funds.

Business practices. De-globalization may result from changes in the business practices that brought us the global fragmentation of production processes. International production sharing has been driven by differential wage/productivity ratios in alternative production locations. These economic calculations can easily change as a result of shifts in underlying relationships, increased protection, different perceptions of risk associated with alternative locations, and consumer preferences that shift towards national production. In addition, there may be a learning effect as a result of which producers discover unanticipated production or managerial costs associated with off-shoring. Some of these effects may be crisis-related, others less so. Some may be of a permanent nature, and others more temporary.

Public attitudes Virtually all the elements identified above – trade, financial markets, investment, migration and business practices – will be affected by public attitudes towards globalization. Public surveys suggest that attitudes have become more negative over time towards globalization in rich countries, while the reverse appears to be the case in emerging economies. Risk aversion and job uncertainty have a strong positive effect on anti-trade attitudes in industrial countries. The crisis is likely to have accentuated a sense of insecurity about the future, as have the pre-crisis food and natural resource price situation and the swine flu pandemic. The impulse to turn inwards poses real challenges to those governments that understand the benefits of international openness. One response to negative public attitudes is to do more by way of providing social safety nets, but governments also have a responsibility to convince the public of why a retreat inwards is no answer to the challenges of engagement.

The role of the WTO and the system of international governance

As we contemplate the different ways that the world economy may be affected by the crisis, it becomes clear why we need the multilateral trading system more than ever. Even if we believed that all crisis phenomena were cyclical and that we would soon be able to resume ‘business as usual’, we would still need a strong regime of international cooperation to exit the crisis. But when we add the strong likelihood of secular change – that policies and

behaviour in the financial sector will be modified to avoid a replay of the forces that generated the crisis, that ways of doing business may change, that new economic structures and patterns of exchange are evolving, and that public attitudes are likely to exert new influences on governments, this gives us a second reason for reinforced and more effective international cooperation.

There is also a third reason. The exigencies of changing economic, social and environmental circumstances, along with the shared global challenges of addressing development and poverty, mean that the nature and substance of cooperation is always changing too. We know we face new challenges for the trading system, involving new issues such as: i) managing the relationship between trade and climate change; ii) improving cooperation in a world where fundamental changes in supply and demand relationships are emerging in international food and natural resource markets; iii) forging better coherence between regional trading arrangements and the multilateral trading system; and iv) addressing some of the more opaque and intractable non-tariff barriers to trade.

All these issues are important and we must attend to them. But there is something of equal or even greater importance that we must do first. That is to complete the Doha Round. As I have argued before, it is not just that a successful Doha Round offers an attractive global stimulus package and an important signal to the world economy. It is also that systemic integrity

demands that we finish what we started. We cannot credibly embrace new challenges without settling our current agenda. I believe that this view is shared by every government with a stake in international trade and the rules that underpin the trading system. I am optimistic that we will complete the Round successfully in the months to come, and I am particularly heartened by the declaration last week by leaders of major economies at the G8 Summit in L'Aquila of the intention to complete the Doha Round in 2010.

Finally, I would like to make some brief comments on the broader issue of global governance and where I see the WTO and similar international organizations fitting within the system. In the short-term, we are doing as much as we can to cooperate with other agencies to promote institutional coherence. We are involved in multi-agency endeavours such as Aid for Trade and the Enhanced Integrated Framework, both of which seek to empower developing countries to make better use of opportunities offered by the international trading system. We are also involved in multi-agency efforts to ensure the supply of adequate trade finance, and we have engaged in joint analyses of a range of policy issues with the ILO, UNEP, and UNCTAD. This work must continue and expand.

But in the medium term, I see a structure of global governance emerging that we need to strengthen in order to ensure coherence and effectiveness. I believe we should rely increasingly on the G20 to provide political leadership

and policy direction, the United Nations to provide a forum for accountability, and the UN family of international organizations to provide the specialized inputs – the policies, rules, programmes, and resources – essential to the overall system of international cooperation.

In the longer term, we should have both the G20 and the international agencies reporting to the “parliament” of the United Nations. This would constitute a potent mix of leadership, inclusiveness and action to ensure coherent and effective global governance.

Conclusions

I conclude with three observations. First, the current crisis will end but it will have changed the world, against the background of a world already in an important phase of change, and these new realities will challenge the ingenuity and commitment of policy-makers across the globe. Second, we need multilateral cooperation more than ever, including in trade, and in that connection we must attach priority to the completion of the Doha Round. Third, we need a new architecture of global governance to provide a framework for effective cooperation. These are all ideas that cannot be fleshed out adequately in thirty minutes, but I offer them for consideration and debate.

Thank you very much.