World Trade: Good News and Bad News

By

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Trade today reminds me of the story about the man who asks God whether his virtuous life has guaranteed that he will go to heaven. God replies: “I have good news and bad news for you. The good news is that you are indeed going to heaven. The bad news is that you are going there tomorrow.” As we contemplate the future of world trade, which was devastated in the immediate aftermath of the twin crises on Wall Street and on Main Street, we have good and bad news concerning the prospects for a robust, open world economy.

<u>Trade Volumes: Good News</u>

There was much concern because trade volume had collapsed faster than world income. Did this imply that protectionism was breaking out? Were we backing into the 1930s with their spread of protectionism that accentuated the devastation caused by the Great Crash of 1929? Not really. The main proximate reason was instead that world trade had been growing faster than world income in the previous quarter of a century. So, if we went into reverse, trade would fall faster than income.

But why was trade growing faster than income? The principal reason was that production was getting internationalized, with multinationals often shipping products in different stages of assembly around the world. This was a trend facilitated by the progressive dismantling of trade barriers, of course. But it also meant that the measured value of trade to GNP would rise immensely because of the fact that trade is measured by sales. i.,e. by gross value, whereas GNP is the measure of “value added” . Thus, a “basic” unfinished car would be exported from France to Portugal to add a bumper and then exported in turn to Spain to put on lather seats and then to Germany for instalment of The electronic guidance systems. Each time, four times in this example, the basic car value would be counted as part of trade volumes whereas the GNP of the countries together would be going up only by the one-time value of the basic car in France and by the value of the additions made to it in the other three countries.

The internationalization of production creates also a genuine expansion of trade through sourcing of components worldwide. What may have been produced in a vertically integrated production facility is now increasingly in-sourced from foreign suppliers, even though the GNP overall is affected marginally, trade expands far more.

So, as the world economy revives, world trade will return to its trend of growing faster than world GNP. Remember also that trade needs working capital. So, if finance dried up owing to the crisis on Wall Street, that would additionally cause trade to fall. My distinguished colleague at Columbia, Professor David Weinstein, and co-author Mary Amiti, have examined Japanese export experience carefully and found that the decline in bank capital can explain as much as one third of the remarkable decline in Japanese exports in 2008. The good news therefore is that, as the financial sector revives, trade flows will no longer be choked off by unavailability of finance for working capital.

Protectionism: Good News

But do we not then need to worry that protectionism may still cripple the growth of world trade? It is true that, as the WTO has documented, all the G-20 resolutions not to succumb to protectionism, have been followed by some protectionist measures.

Nonetheless, the actual damage to trade is still within bounds, though we must remember that a tsunami starts with a slow surge of the waves. But why has the protectionism been contained? I believe that the answer lies in the interdependence today in the world economy as production and world trade have become globalized. There are far too many firms today who depend on world markets. General Electric, Boeing, Caterpillar are among the hundreds of US firms who have actively lobbied to contain US protectionism: they fear that retaliation by other nations will hurt them.

Liberalizing Trade: The Bad News

But liberalizing trade, i.e. moving forward, is a hard slog. Rarely have democratic nations successfully liberalized during recessions. But we now have an added problem: the virtuous statements on finally closing the Doha Round carry little salience when the biggest rottweiler on the block, the US, is paralyzed on trade. The Democrats in the US Congress, after the last election, are heavily indebted to the labour unions who fear trade. In turn, they straitjacket the President, an eloquent man whose silence on Doha is eloquent instead. So, the news on Doha is bad.