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The Impact of the Financial and Economic Crisis on World Trade and Trade Policy

This Forum is dedicated to a discussion of the effects of the global financial and economic crisis on both international trade and trade policy. What changes could be observed in the volume and structure of trade and what transmission channels were involved? Has the international competitiveness of the European Union and its member countries been affected? What has been the impact of the crisis on trade policy? Are the widespread fears of a revival of protectionism justified? How can trade policy help to overcome the crisis?

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The Impact of the Crisis on EU Competitiveness in International Trade

As one of the economies at the centre of the global crisis the EU is certainly suffering from its impact. This is seen clearly in the trends in trade. The first few months of 2009 have seen a major slowing down of trade, which fell by 21.5% in nominal terms (18% if energy is excluded) compared to the same period in 2008, on top of a marked slowing down in the latter half of 2008. Exports have been particularly badly hit. In this short article I will look in particular at trends in the EU's exports as well as discussing what the crisis and its impact on trade may imply for the long-term competitiveness of EU industry.

It is worth noting from the start that, because of the huge variations in the prices of commodities over 2008, as well as less extreme, but nevertheless important, changes in exchange rates, the evolution of trade can appear to be very different, depending on whether data are expressed in dollar or euro terms and depending on whether they take into account changes in relative prices. For example the WTO figures indicate that EU exports experienced zero growth in real terms in 2008 compared to an 11% increase in nominal dollar terms,[1] while figures from Eurostat in euro indicate an increase of 5.5%.

In this paper I will look at merchandise trade in euro nominal terms, as these are the receipts that count most for the bottom line of businesses operating in the EU. However, using actual euro receipts in a situation of variable commodity prices tends to exaggerate increases in trade flows in 2008 when commodities prices were high as well as the falls in 2009 when prices were low. Recent analysis by CEPII finds that forecast falls in world trade due to the crisis differ by 6.5 percentage points depending on whether or not they take price falls into account. For the EU, where commodities are a relatively low percentage of trade, the difference is lower: 1.4 percentage points (between -8.6% and -7.2%).[2]

These figures indicate that price changes were less vital to the changes in EU trade than those in world trade; however, in order to control for the most variable of commodity prices – that of oil – the data below excludes trade flows in the energy sector (HS27). Although the EU is not a big oil exporter (excluding oil makes much more difference to figures on EU imports) the exclusion of HS27 does impact on the export performance of some member states, as diverse as the Netherlands, Portugal, Lithuania and Cyprus.

Earlier this year, the WTO forecast a slowdown in world trade of 9% in real terms in 2009, with 10% for the developed economies including the EU. More recently the World Bank forecast a slightly higher fall of

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[1] All WTO figures in this paper are from the press release "WTO sees 9% global trade decline in 2009 as recession strikes", http://www.wto.org/english/news_e/pres09_e/pr554_e.htm.

[2] A. Bénassy-Quéré et al.: Economic Crisis and Global Supply Chains, CEPII Working Paper, Paris 2009.

Table 1
Trends in EU Exports (excluding HS27)
(euro million)

	2007	2008	2008 4 mths	2009 4 mths	Change 2008-9, 4 mths (%)	Change 2007-8, full year (%)
EU27	1 178 424	1 229 153	406 999	327 105	-19.6	4.3
France	137 442	144 951	48 130	40 037	-16.8	5.5
Netherlands	77 177	77 301	25 462	21 798	-14.4	0.2
Germany	335 224	355 656	118 756	93 671	-21.1	6.1
Italy	134 982	141 689	46 489	37 262	-19.8	5
UK	124 729	122 340	39 257	32 086	-18.3	-1.9
Ireland	32 044	30 623	10 549	10 831	2.7	-4.4
Denmark	21 392	23 305	7 633	6 609	-13.4	8.9
Greece	4 443	5 213	1 488	1 446	-2.9	17.3
Portugal	7 691	8 679	2 671	2 207	-17.4	12.8
Spain	47 056	49 475	16 074	13 111	-18.4	5.1
Belgium	69 045	67 291	22 622	18 688	-17.4	-2.5
Luxembourg	1 875	1 908	588	518	-11.8	1.8
Sweden	45 763	47 164	16 197	12 005	-25.9	3.1
Finland	27 277	27 616	9 836	5 908	-39.9	1.2
Austria	32 552	33 978	11 283	8 908	-21	4.4
Malta	1 132	1 032	330	265	-19.7	-8.8
Estonia	1 692	1 938	591	423	-28.5	14.5
Latvia	1 593	2 085	592	511	-13.8	30.9
Lithuania	3 864	5 175	1 532	1 064	-30.5	33.9
Poland	21 175	24 982	8 026	5 830	-27.4	18
Czech Republic	13 088	14 911	4 913	3 890	-20.8	13.9
Slovakia	5 601	7 031	2 288	1 705	-25.5	25.5
Hungary	14 084	15 224	5 388	3 631	-32.6	8.1
Romania	6 840	7 928	2 463	1 870	-24	15.9
Bulgaria	3 850	4 237	1 412	973	-31.1	10.1
Slovenia	6 568	7 137	2 346	1 770	-24.6	8.7
Cyprus	244	285	85	88	3.3	16.7

Source: Eurostat.

9.7%, with 9.3% for the euro zone[3] while the OECD forecast a far larger fall of 16.5%.[4] The latter forecast is predicated on a huge fall of over 32% in the volume of world trade in the first quarter of 2009, followed by falls of 9% and 4% in the following two quarters and a timid 1% increase in the last quarter. So far, as we can see from Table 1, the impacts on EU trade in 2009 have certainly been extreme, with exports falling by 20%, in nominal terms, in the first four months. Clearly this may be a short-term slowdown, linked to the running down of stocks, lack of trade finance and the extremity of the shock to the global trading system. Although these impacts are lower than the estimates of the OECD, for the moment, it is not at all clear that the full year figures will see the improvement in the situation which they also forecast.

New Member States Hit Hardest

The impacts of the crisis on trade have not been experienced in the same way throughout the Union. The hardest hit of EU member states in the first four months of 2009 was Finland, whose exports fell by 40% compared to the same period of 2008. Bulgaria, Hungary and Lithuania were all heavily impacted with losses of over 30%. Ireland and Cyprus were the only two member states which experienced export growth, although in the former this was against a fall in 2008 trade levels, a rarity amongst the EU members.

Overall, 2008 was not a catastrophic year for most EU exporters, in spite of the slowdown in the second half of the year as the crisis started to bite. Growth rates for the full year were fairly healthy, though down

[3] Prospects for the Global Economy, http://web.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTDECPROSPECTS/EXTGBLPROSPECTSAPRIL/0,,menuPK:659178~pagePK:64218926~piPK:64218953~theSitePK:659149,00.html.

[4] OECD: Economic Outlook, Paris 2009, http://www.oecd.org/document/18/0,3343,en_2649_34109_20347538_1_1_1_1,00.html#pub.

on previous years. Thus the real impact of the crisis seems to have been felt most keenly in 2009 and will likely be known only once the year has run its course. It needs to be kept in mind that over the period 2000-2008 EU exports increased in nominal terms by 50%. Thus, even if the full year figures were as bad as those of the first four months, it would bring EU exports back to the levels seen in the early 2000s. A 10% contraction would bring trade back to 2006 levels although clearly only in nominal unadjusted terms.

It is notable that, apart from Finland, all of the member states in which trade was most heavily impacted in 2009 are new (post-2005) members. The vulnerability of these countries is of particular concern. Recent analysis of trade data undertaken by CEPII in Paris indicates that the new member states are evolving towards a trade profile that is more consistent with that of other EU members, but they retain some specificities.[5]

One of the key characteristics which that research highlighted was that the new member states have become increasingly integrated into EU production systems in recent years, with increasing trade in intermediate products between the EU15 and the EU10. Companies in the EU10 are now highly dependent on the exports of final products from the “old” EU, particularly Germany, for their own trade. The sharp reduction in German exports thus has repercussions for the trade of the EU10 beyond the figures presented here, which exclude the internal EU trade which is vital to many companies.

Evidence presented in the above-mentioned World Bank report showed that many new member states have experienced significant falls in GDP, which reach double digits in the Baltic States, with correspondingly high contractions in industrial output, reaching -24% in Latvia. The severity of the crisis in these countries risks undermining the viability of many companies and changing the industrial landscape considerably. Only time will tell whether the new European production networks developed over the past two decades will prove resilient to the crisis.

Dependence on Trade in Up-market Products

Beyond concerns of the absolute level of trade there are further, more long-term questions about the market positioning of EU trade and in particular how the global economic crisis will impact on the key sectors on which EU industry relies for its exports. In the above-mentioned CEPII report we undertook a comprehensive analysis of the competitiveness of EU industry prior to the crisis. The conclusions were rather positive – the EU has significant strengths in several key sectors, most notably medium tech goods and up-market products.

Before the crisis this orientation seemed to be serving the EU well. In today’s context, however, it may make the EU in some ways more vulnerable, both to the short-term impacts of the crisis and its longer-term effects. The report found that in 2004, EU exporters had a 31% share of the world market in up-market products (i.e. those that commanded the highest unit prices) compared to only 13% and 14% for Japan and the USA respectively and that the EU’s share was proving more robust than that of its competitors. This reflects the EU’s long-term orientation towards high quality products and luxury goods.

The question that must now be posed is whether this orientation makes the EU particularly vulnerable to the impacts of the recession. Research has highlighted a strong correlation between luxury goods sales and stock market returns,[6] which implies that the short-term impacts of the financial crisis on sales will be significant. Indeed the crisis has already had some high profile casualties, such as Christian Lacroix, the French haute couture label. More worryingly for the medium to long term, the world’s biggest market, the USA, looks unlikely to recover quickly from the crisis. Hopes for a global recovery are resting on other consumers, especially those in Asia. Continued growth in Asia means that, in dollars terms, the increase in consumer spending in Asia in 2009 is expected to more than offset the drop in spending in the EU and the USA.[7] However the nature of this spending may be different. Although there may be demand in China and India for up-market luxury products, the extent of the market will undoubtedly be dampened by the low level of average incomes, which remain far from US or EU levels. It seems unlikely, therefore, that emerging markets could replace the traditional markets for the kind of up-market products in which the EU excels in the near future.

There is also a wider question on the future of the whole luxury goods trade itself. In the popular imagination one of the key reasons for the global crisis was the distortions created by incentive packages in the

[5] L. Curran, S. Zignago: The Evolution of EU and its Member State’s Competitiveness in International Trade, Report prepared by CEPII for the European Commission, DG Trade, 2009, http://trade.ec.europa.eu/doclib/docs/2009/march/tradoc_142475.pdf.

[6] Y. Ait-Sahalia et al.: Luxury goods and the equity premium, Princeton University Discussion Paper #222, 2002.

[7] An Astonishing rebound, in: The Economist, 15 August 2009.

banking sector which promised huge riches on the basis of short-term, often unsustainable gains. The outpouring of public anger at the excessive salaries of failed financiers is a manifestation of a wider unease at the whole system of generous compensation which, in itself, has the side-effect of bolstering the market for luxury goods. Such "conspicuous consumption", along with the high salaries which enabled it, seems likely to fall out of favour in the post-crisis world. This is likely to have major repercussions for the many EU companies which rely on it for their sales. These companies need to rapidly re-assess their strategies if they are to remain competitive in the new context.

However, the EU is not by any means wholly reliant on luxury goods trade. In fact much of its trade is in rather more down-to-earth products. EU industry has its most significant comparative advantages in chemicals, motor vehicles and machinery. In the short term, however, this orientation makes the EU especially vulnerable, especially in the latter two sectors. The motor trade has been one of the worst hit by the current crisis and machinery sales are bound to be hit by a global contraction in investment (a 16.5% annualised fall in the developed world during the last quarter of 2008). In reflection of this, falls in trade in the transport and machinery sectors represented a quarter of global trade contraction in December 2008.

In the medium to long term, these industries will recover. In spite of the recession and fears of global warming, the longer term outlook for the car market is good, especially for the kind of small cars in which many EU companies specialise. Although there is undoubtedly global overcapacity, those that make it through the crisis should be in a good position to benefit from emerging demand. Chemicals and machinery demand should pick up when the key industrial economies pick up. The IMF forecasts that this will be in 2011. Thus, overall, for those EU companies and their suppliers in these sectors who manage to get through the crisis, the long-term prospects are better than for the luxury goods producers, for whom re-orienting their offer is a far more daunting prospect.

Revival of Protectionism?

Finally there is another, more insidious threat to the EU's long-term competitiveness which is very difficult to assess at present. That is the threat that short-term domestic political pressures will lead to protectionist tendencies in its key export markets and/or against its key imports. There are widespread fears of a revival of protectionism, with both the WTO and the World Bank warning of creeping trends towards increasing trade barriers. Clearly the shadow of the protectionism of the 1930s and its catastrophic consequences hangs over the current crisis.

History does not inevitably repeat itself, however, and much of the evidence for increased protectionism so far is anecdotal. In its high profile call to G20 leaders meeting recently in London to avoid protectionism, the World Bank highlighted over 20 protectionist measures imposed in the previous month.[8] Many of these measures were the kind of regular trade policy measures – anti-dumping duties and safeguards – which are routinely imposed every month by some WTO member somewhere even in good economic times. The WTO's figures show that new anti-dumping investigations increased by 17% in 2008, but this follows a fall in the previous year and merely brings the figures back to the level seen in 2006.The EU instigated only two new anti-dumping investigations in the first six months of 2009. This is well below the usual level. Thus, overall it is too early to talk of a return to mercantilist policies. Putting "buy America" clauses in the stimulus package is certainly not helpful to building a coherent global response to the crisis, but it does not add up to a new Smoot-Hawley Act. Most evidence of increased protectionism is anecdotal and well within the limits allowed by the WTO.[9]

Nevertheless a freezing in the recent global trends towards more liberal trading policies does seem a realistic prospect. Indeed recent analysis by CEPII indicates that such a halt to globalisation does help to explain current trade trends.[10] For proponents of the "bicycle theory" of trade liberalisation, such a halt in progress on trade liberalisation would in itself be very bad news, although expecting major efforts towards market opening during an economic crisis is probably unrealistic and may prove ultimately unnecessary. Continuing to move forward is less important than avoiding going backwards.

Conclusion

EU industry faces some major challenges as a result of the current global economic crisis. Although relative price and exchange-rate changes may be magnifying real effects, the nominal falls in exports experienced in early 2009 are worrying in any terms. Although the World Bank and OECD estimates forecast an upturn in

[8] http://www.worldbank.org/html/extdr/financialcrisis/pdf/G20Trade-FactSheet.pdf.

[9] Baldwin and Evenett speak of "murky protectionism" in their recent paper: R. Baldwin and S. Evenett: The collapse of global trade, murky protectionism, and the crisis: Recommendations for the G20, 5 March 2009, http://www.voxeu.org/index.php?q=node/3199.

[10] A. Bénassy-Quéré et al., op. cit.

the global economy in 2010 and 2011, Europe's companies need to survive until then. In addition, there is a whole group of EU companies in the luxury goods market which risk a major structural change in demand for their products. The OECD sees growth in the near future as being led by emerging nations. These nations are not yet the key markets for the expensive goods in which many EU firms specialise.

The EU also faces difficulties in some of its key medium tech industries – most notably cars and machinery. These are products in which the EU historically excels, but which have been hard hit by the crisis. Until consumer and industrial confidence returns there will be a dampening effect on demand in these industries. As with any crisis, a restructuring of industry is inevitable. Major changes in the landscape of the car industry are already visible in the USA. Only time will tell whether all of the big name producers in the EU will emerge from the crisis intact or whether further consolidation of the sector in Europe is inevitable.

Finally, there is another factor which will impact on the economic structure of the EU and other key economies in the short to medium term which could have impacts on the relative importance of trade. This is the economic stimulus packages which are being widely used to support the economy. These packages tend to be oriented towards investment in infrastructure. In particular they are biased towards the non-traded sector rather than traded goods.[11] Given that the WTO estimates that these packages are today worth 3% of world production and certainly considerably more in the most affected countries, shifts in the relative importance of traded and non-traded goods are likely, at least in the short and medium term.

A key question which emerges from this discussion is whether the "heyday" of global trade has passed. Will the restructuring of economies and reductions in access to finance produce only a short blip in the long-term trend towards global trade growth or will the crisis change economies and attitudes so fundamentally that the growth rates with which we have become familiar will be a relic of history? As with many questions raised in this paper, only time will tell, but much depends on how governments react to the crisis. A break in the process of trade liberalisation does not have to be catastrophic, but the trade bicycle needs to be kept stable for long enough to be able to resume smoothly once the economic and political climate allows. This requires a delicate balancing act from governments who need to live up to their international promises and resist domestic pressure for protectionism, while simultaneously re-assuring their voters that they are doing all that is necessary to bolster the economy.

[11] As A. Bénassy-Quéré et al., op. cit. have pointed out.

Hubert Escaith*

Global Supply Chains in Times of International Crisis

The world's economies slowed down abruptly in 2008 against the backdrop of the worst financial crisis since the 1930s. The crisis spread quickly to all developed countries through toxic assets and exposure to the US financial market. The dissemination to emerging economies was only momentarily delayed, but the premise of a new North-South "decoupling" vanished when the contagion spread to the real economy through the trade collapse. The amplitude and simultaneity of the transmission of shocks came as a surprise to many analysts. International supply chains, one of the most salient features of the "new globalisation" were rapidly identified as one of the main factors for this synchronisation of shocks. With unemployment increasing as recession spread in developed countries, public scrutiny began to focus on the delocalisation of investment and jobs that is behind the new productive networks, together with the lack of governance of international finance.

Indeed, the nature of international trade has changed dramatically since 1989. Not only did the Berlin Wall fall, removing one of the main barriers that had split the post-WWII world into two separate entities, but the Brady bonds initiative put an end to the decade-long debt crisis that plagued many developing countries. With the opening of new markets and the sharing of roughly similar economic models, trade be-

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came less a matter of exchanging merchandise across borders than a constant flow of investment, of technologies and technicians, of goods for processing and business services, in what has been called the "global supply chain". Those changes obliged trade analysts as well as the academics engaged in international economics to revise their old beliefs and models.

The international transmission of shocks usually takes two forms, commercial and financial. In previous instances of global crisis, most of the systemic commercial and financial shocks were of a macroeconomic nature. Because of the geographical segmentation of the productive chains, the present crisis also has a systemic microeconomic dimension, the effects of which are still largely unknown as they affect firms that are eminently "heterogeneous", as recognised by "new trade theory".[1] It is a cliché to say that time is accelerating, but it carries a lot of truth in the present situation. In the race between the practitioners – engineering and business schools – on the one hand, and universities, on the other hand, the practitioners are well ahead. And because the practical reality of international business models is developing faster than the elaboration of new analytical paradigms, the crisis hit the global economy in largely uncharted waters.

Guided by "old" economic models, the major developed and developing economies, known as G-20, met the risk of a world-wide depression and coordinated global responses head-on in the early months of 2009. The package, reminiscent of traditional Keynesian recipes, principally addressed the macroeconomic transmission channels through massive fiscal stimulus. Some microeconomic aspects, such as the new financial practices in international banking or the risk of a return to protectionism, were also mentioned, but they remained largely at the level of statements. Indeed, some of the fiscal stimulus packages implicitly or explicitly contemplated some features that raised the fears of "murky protectionism" designed to keep the stimulus money and the jobs at home.

With the risk of global recession diminishing after the second quarter of 2009, the debate has shifted to the exit strategies. The huge fiscal deficits have sustained public consumption in industrialised countries, but private consumption and investment remains depressed. If the danger of inflation seems under control, rebalancing the current account imbalances which characterised the pre-crisis period would create an additional negative shock, as high-spending countries would have to increase their national savings. The alternative medium-term forecasts range from "back-to-business-as-usual" to "deglobalisation" scenarios, producing an alphabetical string of V, U, L or W profiles.

The role of global supply chains in explaining the crisis is derived from this debate, as is their future in a post-crisis scenario. The geographical segmentation of industrial production has played a major role in shaping the international economy in the past 15 years. It was at the root of the emergence of new global players, such as China, and the correlated dramatic reduction in absolute poverty levels. It also allowed some old industrial economies such as Germany or the USA to regain international competitiveness through increased productivity and efficiency.

Supply chains reshaped international trade: the criss-crossing of manufacturing networks led to large investments in transportation equipment and infrastructure in order to accommodate the extensive transit of goods for processing. At the same time, the content of merchandise statistics and the economic significance of trade balances became more and more difficult to interpret.

Off-shoring also altered the social panorama. If the global economic and welfare benefits have been substantial, their distribution remains contentious. While creating numerous jobs in emerging countries, outsourcing and offshoring increased wage disparity in both developed and developing economies, fuelling an active political debate on the pro and cons of globalisation.

Against this background, the present essay explores the particular role of supply chains in transmitting external shocks initiating in the financial sector. In the process, the analysis highlights some implications of financial prudential regulation and re-considers the issue of the global imbalances.

Supply Chains as Transmission Channels

As in previous global financial crises, the international banking system came to a "sudden stop" after September 2008. Two aspects were nevertheless original: the shock emanated from the largest world financial centre instead of initiating in developing countries, and the shock-waves spread very quickly and almost simultaneously to many industrial and emerging countries. Trade, in particular, reacted very strongly to the first signals of recession, and different sectors were differently affected. The sectors most affected by the recession were fuels and minerals (due to the strong

[1] R. Baldwin: Globalisation: the great unbundling(s), Economic Council of Finland, 20 September 2006.

price effect), and machinery and transport equipment (strong demand effect).

With the financial crisis, the sectors producing consumer durables and capital goods were on the front line, as demand for these products relies on credit. In turn, the lower industrial activity brutally reversed the trend in the prices of key primary commodities, which had been rising substantially since 2003. Between the third and the fourth quarter of 2008, the difference in growth rate was 56 and 51 percentage points for iron and steel, and for minerals, respectively (cf. Table 1). The collapse in trade mostly affected merchandise; with the exception of financial transactions, the commercial services were more resilient, other than those related to trade in goods.

Indeed, world trade dropped five times more rapidly than global GDP, supply chains playing their part in explaining the magnifying effect of the crisis on international trade. Some of the mechanisms are purely of an accounting nature: while GDP is computed on a net basis, exports and imports are registered on their gross value. In addition, because supply chains cover various countries, a lot of double counting takes place while goods for processing cross the borders at each step of the production process. But the core of the explanation is to be found in the nature of the 2008-2009 crisis itself.

In previous occurrences of global turmoil, shocks were mainly of a macroeconomic nature. A recession in a foreign economy reduced demand for exports, which in turn depressed activity in the home country. The propagation of such demand-driven shocks through the productive sectors of the home economy can be traced using an input-output model, through traditional input-output modelling. In addition, both financial and real channels are interlinked at the macro level, because credit crunch affects household consumption and firms' investment.

The gradual substitution of trade in goods by trade in tasks that took place during the 1990s has changed this traditional mode of transmission, and added another layer of transmitters which are operating at the microeconomic level. When industrial production is spread across various countries, and all segments of the chain are critical (supplied constrained), a shock affecting one segment of the chain will reverberate through the entire chain. At the level of microeconomics, shocks are moving forward, from supplier to clients, and not backward as in the demand-driven Leontief model (from client to suppliers).

Table 1
Quarterly Growth of Exports of World Manufactures by Product, Q1/08-Q2/09

(Year-on-year percentage change in current dollar values)

Quarter/Sectors	Q1/08	Q2/08	Q3/08	Q4/08	Q1/09	Q2/09
Manufactures	16	19	14	-11	-29	-30
Office and telecom equipment	9	13	8	-14	-28	-23
Automotive products	17	18	5	-24	-49	-45
Iron and steel	17	29	51	-5	-41	-56
Ores and other minerals	29	40	44	-7	-42	-48

Escaith and Gonguet[2] jointly model the financial and real supply-side effects from a complementary viewpoint of monetary circuit and international input-output matrices. In order to produce, individual firms need to obtain a loan from a bank. The bank grants the loan in relation to three parameters: the macroeconomic context, the specific behaviour of the sector of activity in the business cycle, and the specific situation of the firm (credit rating, soundness of the management).

Money created by the bank when according the loan is spent by the firm on wages and other production costs. The money remains in circulation as long as the firm does not sell the products and reimburse the loan. A traditional result of the endogenous money theory is that any increase in the stock of credit money corresponds to an increase in inventories in the national account circuit. Escaith and Gonguet[3] add a late 20th century feature to these classical building blocks[4]: the capital-asset adequacy ratio, a prudential mechanism – such as in Basel I and II – set by the authorities and designed to guarantee the liquidity and solvency of the banking sector. At the level of monetary circuit and I-O tables, which track flows, the adequacy ratio is a stock variable reflecting the accumulation of loans and assets.

Under normal conditions, the ratio is not binding and the circuit is almost a pure flow model. Banks can modulate their assets to accommodate new credits, and client firms can shift to alternative partners when faced with the unexpected failure of one of their suppliers. But shifting to an alternative supplier, when it results from an unexpected event (a shock), always

[2] H. Escaith, F. Gonguet: International Trade and Real Transmission Channels of Financial Shocks in Globalized Production Networks, WTO Staff Working Paper, May 2009.

[3] Ibid.

[4] Even if endogenous money and sectoral modelling seems quite heterodox now-a-days, both monetary circuit and supply-use tables can be traced back to the Physiocrats.

carries a cost. The transmission across sectors and countries of the increased cost of production is modelled using an international input-output matrix (a set of interlinked national I-O matrices), rearranged to track forward linkages.[5]

Results based on an international I-O matrix, covering the USA, Japan, Korea and selected emerging Asian countries, indicate that:

- In 2000 and 2006, Japan was the largest potential exporter of supply shocks, because it was a large supplier of intermediate goods to the other economies.
- Malaysia and Thailand are the largest importers of such shocks because of the high degree of integration of their manufacturing sectors in international supply chains and their reliance on imported inputs rather than domestic ones.
- Between 2000 and 2006, China notably increased its forward international linkages and its domestic backward linkages. It became a large exporter of "shocks" in 2006, at par with Japan, but its vulnerability to an imported shock remained relatively stable because Chinese manufacturers were increasingly relying on domestic suppliers.
- Repatriating the production of manufactured parts to Japan and the USA would lead to an average increase in sectoral production costs of 2%. Albeit this seems a small impact, it should be remembered that for these developed economies, most intermediate consumption is sourced domestically and only a minority of firms actively engage in outsourcing: this average impact would fall disproportionately on a few firms, causing serious disruptions at the microeconomic level. Because these outward oriented firms are also the most dynamic and innovative ones in a given sector, these microeconomic disruptions would have significant negative systemic effects.

The accumulation of micro-disruptions in the productive chain, typical of a recession, disturbs the monetary circuit: production plans take longer to be completed, leading to an accumulation of outstanding loans and a reduction of the creditworthiness of firms. Under Basel II, banks have to adjust their asset holding in order to compensate for the higher risk of their loan portfolio. This is not an issue when financial markets are functioning normally, but in times of global crisis and flight to liquidity not only the risk profile of borrowers deteriorates, but the market value of assets also goes down.

Because assets are priced to market when evaluating the capital adequacy ratio, banks can rapidly be squeezed between the rising risk-rating of their debtors and the shrinking value of their asset portfolio. When such a situation arises, as happened after September 2008, the circuit unravels: banks run for safety, stop extending new credit and even do not renew existing credit lines. The very same pro-cyclical mechanisms that led to the apparition of financial bubbles, with the concomitant asset price inflation and lower perception of risk (meaning lower interest rates and a larger volume of credit), can have a catastrophic outcome when the trend is reversed and a resonance effect between real and financial circuits amplifies the initial supply shocks.

Moreover, the accumulation of supply shocks leads to secondary demand-driven adjustments, either through a price effect (increasing production costs translate into higher retail prices and lower demand) or income effect (lower activity leading to unemployment). The succession of micro waves followed by secondary macro shocks lead to a "W" crisis pattern and can be jointly modelled through international I-O. IRSIC (imported real supply-driven impact coefficient)[6] is well suited to model the secondary demand effects created by an increase in prices: after adjusting the price effect by their respective demand elasticity, Escaith and Gonguet apply a traditional Leontief model to the international input-output matrix. But a similar reasoning can be applied to a demand shock caused by unemployment and lower income.

Supply chains have also a particular role to play in explaining the transmission of underemployment. Even under "just-in-time" management, geographically fragmented networks need to maintain a minimum level of inventories in order to face the usual risks attached to international transportation. When a drop in final demand reduces the activity of downstream firms, their first reaction is to run down their inventories. Thus, a slowdown in activity transforms itself into a complete standstill for the supplying firms that are located upstream. As long as the downstream inventories have not been reduced to their new optimum level, suppliers face a sudden stop in their activity and must reduce their labour force or keep it idle.

This inventory effect magnifies demand shocks and is principally to blame for the initial collapse of trade in manufactures that characterised the world econo-

[5] These Ghosh matrices are similar to the Leontief model, but their robustness for modelling purposes is much weaker. For this reason they are only used as a tracking mechanism.

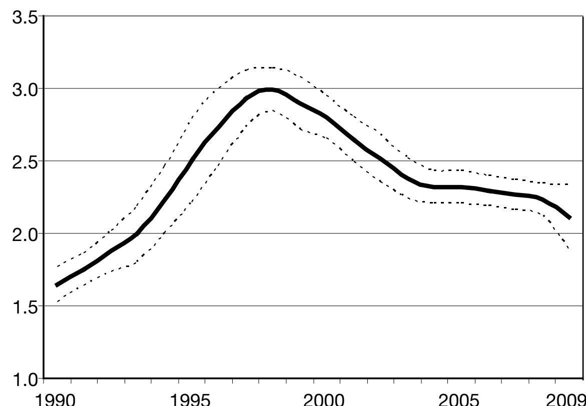
[6] H. Escaith, F. Gonguet, op. cit., p. 15.

my from September 2008 to June 2009. Because the reactivation of the supply chain is only gradual, and final demand (household consumption and firms' investment) has been reduced due to higher unemployment and increased risk aversion, the road to recovery can be a slow and bumpy one. This leads us to the last section of this article: the future of global supply chains in the post-crisis scenarios.

Crisis, Exits and (De)Globalisation

Trade in tasks and the greater interconnection of the global economy have created, as we have seen above, newer and faster channels for the propagation of adverse external shocks. Because production is internationally diversified, adverse external shocks affect firms not only through final demand, but also through a rupture in the flow of inputs received from their suppliers. Indeed, some authors attribute the large drop in trade registered since the end of 2008, with an apparent trade-GDP elasticity close to 5, to the leverage effect induced by the geographical fragmentation of production.[7] Others contest the hypothesis of higher demand elasticity due to vertical integration[8] because it affects only the relative volume of trade in relation to GDP, while elasticity should remain constant in a general equilibrium context. It is probable that the truth lies somewhere between increasing and constant trade elasticity. As seen in Figure 1, world trade elasticity is shaped like an inversed "U", increasing at the end of the 1980s and decreasing in recent years. As elasticity should indeed remain constant in an equilibrium context, this humped shape signals a transition from one steady state to another.

Figure 1
GDP Elasticity of Imports
Rolling Windows of 10 Years



Source: H. Escaith, N. Lindenberg: International Supply Chains and Trade Elasticity in Times of Global Crisis, in: WTO Staff Working Papers (forthcoming) 2009.

The debate about the role of vertical specialisation in shaping globalisation and international trade is central for understanding the present crisis, but even more crucial for analysing alternative exit scenarios. In the second half of 2009, there were signs that the crisis was reaching a bottom. But analysts remained divided on the medium-run prospects, offering a menu of alphabetical potages made of L, U, V and Ws. The last three scenarios are roughly based on a return to normal, after a period of recession that could be short (V), long (U) or bumpy (W). The L scenario is more pessimistic for international trade, as it involves a lasting deterioration from the high levels of globalisation registered during the 1990s and the 2000s. After the collapse of world trade in 2008-2009, and with the rise of murky protectionism as well as a higher risk aversion after the crisis, the risk is that manufacturers abandon global strategies to repatriate their operations domestically, or maintain them within a closer regional perspective. The globalisation process may effectively be expected to slow down in the years to come. A September 2009 report by the OECD, UNCTAD and the WTO prepared before the meeting of G-20 leaders in Pittsburgh states that as most leading economies have invoked "trade defence mechanisms" to weather the downturn, the growing unemployment due to the crisis will continue to fuel protectionist pressures for the years to come.

Indeed, supply chains are very sensitive to even small increases in transaction costs, be they caused by higher tariffs or by oil prices. A series of not-so-anecdotic evidence tends to support this hypothesis. In August 2009, the head of Ernst & Young's supply chains department declared that regulatory changes and also the downturn are forcing many organisations to consider restructuring their supply chains, leading to smaller and more regional supply chains.[9] This deglobalisation is not only linked to the present crisis situation, but may be more structurally caused by the difficulties of decentralising increasingly complex industrial procedures. For example, after an accumulation of delays, and confronted with a series of

[7] K. Tanaka: Trade collapse and international supply chains: Evidence from Japan, VoxEU.org, 7 May 2009; K. M. Yi: The collapse of global trade: The role of vertical specialisation, in: R. Baldwin and S. Evenett (eds.): The collapse of global trade, murky protectionism, and the crisis: Recommendations for the G20, VoxEU publication, 2009.

[8] A. Bénassy-Quéré, Y. Decreux, L. Fontagné, D. Khoudour-Castéras: Economic Crisis and Global Supply Chains, CEPII Working Paper No. 15, July 2009.

[9] Financial Times, 9 August 2009.

difficulties in the production of its latest model, Boeing decided to abandon the original fragmented chain and repatriate key production processes to its main establishments. Other structural factors are also at work: in a future where energy is more expensive and less plentifully available there will be a natural tendency to rely more on regional supply chains.

If this trend is confirmed, the underlying deglobalisation process would hinder the possibilities of a faster recovery for international trade, provoking an L shape. More importantly, it may also prevent poorer developing countries from following the industrialisation path taken by China or Mexico, a powerful strategy for attracting foreign direct investment, creating manufacturing jobs and transfering technologies. Thus this microeconomic debate on the future of global supply chains spills over onto very critical trade and development issues.

Yet, in contrast to this pessimistic outcome, many considerations militate in favour of production networks continuing to extend their global reach. In the short run, abandoning the present global network of suppliers carries a heavy cost for the multinational firms. Off-shoring has been a central objective of many key industries, which heavily invested in their international network. Often, the new plants built offshore are more modern and efficient than the older domestic ones, and selling them to a competitor would create a comparative disadvantage (remember the dilemma of GM when selling Opel). In the longer run, the constant flow of innovations and the extension of the technological frontier are lowering the cost of communication and creating new opportunities for redesigning the international division of labour.

Moreover, from a macroeconomic perspective, the role of supply chains in amplifying trade flows will prove a kind of blessing when it comes to redressing the "global imbalances", particularly the large trade deficit of the US economy. Because the domestic value added content of trade is lower than the gross commercial value recorded in the balance of payments,[10] closing the gap will be faster and, more importantly, cheaper in terms of lost welfare. A back-of-the-envelope calculation shows that the bilateral deficit of the USA vis-à-vis China measured with conventional trade statistics overestimates the imbalances measured in value added content by about 60%.

Thus deglobalisation is probably a distant menace on objective grounds. On the other hand, the 2008-2009 crisis is a structural break, and the world economy will certainly not return to "business as usual". Old giants like General Motors have tumbled, new global players have emerged from developing countries, and the citizens' concerns about the lack of governance of the previous phase of globalisation will have to be addressed.

[10] G. Daudin, P. Monperrus-Veroni, C. Rifflart, D. Schweisguth: Who produces For Whom In The World Economy?, in : OFCE, No. 18, July 2009.

Jean-Jacques Hallaert*

Boosting the Availability of Trade Finance: A Priority in the Current Crisis?

Economists disagree on the role trade finance played in the recent collapse in world trade. In contrast, policy makers seem to have reached a consensus. In a nutshell, their reasoning is that trade finance is the lifeline of international trade. The decline in trade is larger than what would be expected given the drop in global output. So part of the fall in trade reflects a shortage of trade finance, which could amplify and extend the plunge in trade and make the current crisis worse. Hence, boosting the availability of trade finance has to be part of the international response to the crisis. In this paper, I examine the claims underpinning this storyline and highlight the uncertainties on the role trade finance played in the current crisis.

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How Big Is the Trade Finance Shortfall?

International trade presents many risks that trade finance can mitigate. The risk of non-payment may be limited with the use of instruments such as letters of credit. The credit risk can be reduced with the use of export credit insurance. Trade finance also provides liquidity as some exporters, who lack sufficient liquid-

ity to process and acquire goods and services to fulfil export orders, may need loans. However, a large part of trade finance does not involve financial institutions, as trade partners often extend trade credit to each other.[1]

How much of international trade depends on trade finance? There is no solid statistical answer to this basic question. It is often reported that 90 per cent of world trade relies on trade finance.[2] This estimate is of questionable quality and appears too high given the sharp increase over the past two decades in intrafirm trade, which is unlikely to use external financing.[3] If the widely circulated numbers of trade finance reaching US$ 10 trillion and world trade flows US$ 14 trillion are accurate, the share is closer to 70 per cent.[4] The precise share of trade relying on trade finance does not matter much because, indisputably, trade finance is essential to trade. However, the uncertainties on its importance illustrate how poor the quality of data on trade finance is.

If it is so hard to measure total trade finance, needless to say estimating any shortfall cannot be more than a best guess. At the WTO's meeting of experts in November 2008, markets participants' "broad" estimate of the shortfall in trade finance amounted to US$ 25 billion.[5] Four months later, in March 2009, at another WTO meeting, the estimate was revised to US$ 100-300 billion but it seems that there was no consensus: "On the current market situation, *most* participants agreed that although trade flows were decreasing sharply, constraints to trade finance still existed" (emphasis added).[6]

Jumping the Gun or Jumping on the Bandwagon?

Despite the lack of reliable data and the fact that the then estimated shortfall accounted for only 0.25 per cent of trade finance and less than 0.2 per cent of world trade, the WTO succeeded in putting trade finance immediately in the spotlight and in marshalling, as early as end 2008, strong support for trade finance.

Initiatives mushroomed. International and government-backed institutions were mobilised and responded quickly. The capacity of export credit agencies as well as regional and multilateral development banks was increased; new products were launched; co-financing with the private sector was encouraged etc.[7] Moreover, several countries used their official reserves to supply banks and importers with foreign currencies. The international effort to support trade finance culminated in April 2009 when the G20 pledged to "ensure availability of US$ 250 billion over the next two years to support trade finance" and the World Bank announced the Global Trade Liquidity Program, which could support up to US$ 50 billion of trade.

The response was unusual not only in its strength but also in its speed. It started as early as October 2008 (and it could be argued even before), i.e. when the magnitude of the collapse in trade was not even known! Initially there were concerns that the financial crisis (more precisely the credit crunch) that started in 2007 could spread to trade finance. However, at least until the first half of 2008, trade finance was "stable with volumes and rates at normal levels".[8] Signs of possible tension appeared only when the financial crisis morphed into a full-blown economic crisis.

At that time, the political economy was ripe to boost the availability of trade finance. Long before the crisis, many countries had been lobbying at the WTO to find ways to increase the availability of trade finance for developing countries. The Aid for Trade Initiative was seen as providing leverage.[9] The 50 per cent increase in the ceiling of the International Finance Corporation's (World Bank Group) trade finance guarantee in October 2008 was welcomed by the head of the

[1] The various instruments are described by J. Chauffour, T. Farole: Trade Finance in Crisis: Market Adjustment or Market Failure, World Bank Policy Research Working Paper 5003, 2009. Inter-firm credit is discussed in Mitchell A. Petersen, Raghuram G. Rajan: Trade Credit: Theories and Evidence, in: The Review of Financial Studies, Vo. 10, No. 3, 1997, pp. 661-669.

[2] For example see the WTO document WT/AFT/W/24.

[3] See http://crisistalk.worldbank.org/2009/03/assessin-the-trade-finance-situation.html for a more detailed discussion.

[4] According to Marc Auboin: Boosting the availability of trade finance in the current crisis, CEPR Policy Insight 35, 2009, in 2008 trade finance reached US$ 10 to 12 trillion and trade flows US$ 15 trillion. These numbers imply a share ranging from 67 to 80 per cent.

[5] It is interesting to note the precise nature of this estimate: "Market participants gave a broad estimate of the gap in the trade finance market of $25 billion, which was the amount of trade finance that banks kept on their books but could not off-load on the secondary market." (WTO document WT/WGTDF/W/44).

[6] WTO document WT/WGTDF/W/44. A caveat to this estimate was: "... this being roll-over finance, the gap would nevertheless need to be *divided* in terms of net flows by the average maturity of letters of credit, which could vary widely across areas of operation" (emphasis added).

[7] Jean-Pierre Chauffour, Thomas Farole, op. cit. list the initiatives.

[8] Lamy's report to the WTO's Trade Negotiations Committee in October 2008 (WTO document WT/GC/M/116). The new ceiling will be doubled one month later to reach US$ 3 billion.

[9] Marc Auboin: Boosting trade finance in developing countries: What link with the WTO?, WTO Staff Working paper ERSD-2007-04, 2007.

WTO as "Aid for Trade in action".[10] The economic crisis provided extra leverage. Boosting the availability of trade finance was seen not only as an answer to the concerns of developing countries but also as a means to address the global crisis. Lessons from the Great Depression as well as the role played by trade finance in recent financial crises (such as the Asian, Argentinean, and Brazilian crises) were evoked.[11] Supporting trade finance was also branded as part of the international fiscal stimulus. With a high political profile and no strong interest to oppose it, the policy response could only be strong and swift. [12]

Is the Problem with Trade Finance Overestimated?

A precautionary action against anticipated problems has some merit. Nonetheless, the problem with trade finance may have been overestimated. Robert Zoellick claimed that the shortage in trade finance could account for 10-15 per cent of the decline in trade.[13] However, available econometric estimates suggest that the shortfall would need to be much larger than the one reported to contribute that much to the drop in trade flows.[14] Moreover, during the period October 2008-January 2009, when the collapse in trade took place, trade volume declined much more (possibly four times more)[15] than trade finance suggesting that the drop in demand explains the contraction in trade finance. If trade finance contributed to the collapse of trade, its role was limited.

The perception that the supply of trade finance played a significant role in the crisis stems from the fact that the collapse in trade has been so sharp and so much larger than the contraction in global output that it left the impression that something other than the drop in demand must have hampered trade. Because financial problems triggered the crisis, disruption in trade finance was seen as a possible culprit. However, there is no need to invoke a trade finance shortfall to explain the recent plunge in trade.

First, the rise in the fragmentation of production increased the elasticity of trade to income from under 2 in the 1960s and 1970s to about 3.5 in recent years.[16] As a result, trade flows react more in the current crisis than in past crises to changes in global output. Supporting this view is the fact that East Asia, the region most involved in the international supply chains (and thus the region which exhibits the largest elasticity of trade to income), is the region that suffered from the largest fall in trade.

Second, the collapse in trade in goods, which attracts attention, is larger than the drop in total trade because trade in services has been much more resilient than trade in goods. This supports the idea that the initial drop in trade in goods was amplified by a destocking effect (which cannot affect trade in services because services cannot be stored.) Firms, anticipating a slowdown in growth, drew down inventories magnifying the drop in trade. A close analysis of the timing as well as the sectoral and regional pattern of trade flows supports this interpretation.[17]

Third, the plunge in trade is often calculated in nominal terms on a year-on-year basis. This calculation overestimates the decline in *real* trade because the fall in commodity prices has been dramatic since their historically high level of mid-2008.

All these points do not negate the potential role of a trade finance shortage in the plunge in world trade. Rather, they highlight that the decline in trade is not necessarily much larger than the slowdown in global output would suggest. Thus, the importance of the collapse in trade does not suggest that "something else", like a disruption in trade finance, has *necessarily* played a *significant* role.

In sum, the lack of reliable data is so dire that there is no certainty that the decline in trade finance contributed significantly to the decline in trade. It prevents us from solving the familiar causality problem: did the drop in trade cause a contraction of trade finance (a demand shock) or did a shortfall in trade finance contribute to the drop in trade (a supply shock)?

[10] Lamy's report to the WTO General Council in November 2008.

[11] Problems with trade finance are sometimes pointed to as one of the main risks for trade looking forward. For example, in his address at the 2nd global review on Aid for Trade in July 2009, Waleed Al Wohaib of the Islamic Development Bank claimed that international trade is facing "the twin risks of rising protectionism and dwindling trade finance."

[12] On the political economy of boosting trade finance, see also Richard Baldwin: Trade and the London summit outcome, 2009, www.voxeu.org.

[13] Zoellick urges global response, in: Financial Times, 19 February 2009.

[14] Cf. Alun Thomas: Financial crisis and Emerging Market Trade, IMF Staff Position note SPN/09/04, 2009); Marcio Ronci: Trade Finance and Trade Flows: Panel Data Evidence from 10 Crises, IMF Working Paper WP/04/225, 2004.

[15] Jean-Pierre Chauffour, Thomas Farole, op. cit.

[16] Cf. Caroline Freund: Demystifying the collapse in trade, 2009, www.voxeu.org; Douglas A. Irwin: Long-Run Trends in World Trade and Income, in: World Trade Review, Vol. 1, No. 1, 2002, pp. 89-100.

[17] Unpredictable tides , in: The Economist, 23 July 2009.

Filling the Gap with Surveys

To remedy the lack of data, surveys were called to the rescue. The International Chamber of Commerce (ICC) surveyed 122 banks in 59 countries.[18] The IMF and the Bankers' Association for Finance and Trade (BAFT) surveyed 44 banks from 23 countries.[19] The Institute of Development Studies (IDS) surveyed 31 medium and large-scale export-oriented sub-Saharan African firms.[20] The OECD surveyed its members on the measures taken at the national level regarding officially supported export credit.[21] All these surveys were conducted in early 2009 so it is important to bear in mind that the situation may have changed.

According to these surveys, the problem with trade finance is not with its availability but with its cost. Trade finance is somewhat more difficult to get in some regions of the world (mostly in emerging markets), in some sectors (some are perceived as more risky than others), and for some firms. Nonetheless, surveys do not depict an overly dark picture. Very few of the African firms surveyed by IDS face any problems with respect to the availability of trade finance. The Australian government reported to the OECD that it holds regular consultations with market practitioners and that "anecdotal evidence to-date suggest to us that the slowdown or contraction in international trade is leading the slowdown in trade finance and export credit insurance uptake rather than a financial crisis-induced tightening of trade credit and credit insurance preventing willing buyers and willing sellers from doing international trade deals." 47 per cent of banks surveyed by ICC report a drop in the volume of letters of credit while 32 per cent report an increase and 21 per cent no change. In the IMF-BAFT survey, "banks in advanced countries reported roughly the same number of trade finance transactions in the final months of 2008 as occurred at the end of 2007. But emerging market banks report on average a 6 percent decline in trade finance transactions."[22]

This limited decline in transactions may reflect several factors and not necessarily a shortage. Tighter guidelines by banks in light of reassessment of the risks have played a role, but the drop in transactions may also reflect an increase in the cost of trade financing and a drop in the aggregate demand for trade financing due to the contraction of trade.[23] Although 57 per cent of banks surveyed by the IMF-BAFT explain the drop in the value of trade finance transactions that took place between October 2008 and January 2009 by less credit availability, 73 per cent mention a fall in the demand as a reason and 43 per cent the fall in price of transactions, which is likely to reflect the drop in commodity prices.

For some exporters trade finance may be available but unaffordable. Surveys clearly show that that the price of trade financing shot up. The main reasons for this price increase appear to be a perceived increase in the risks of default, a rise in banks' cost of funds, higher capital requirements, and a decline in the value of collateral (e.g. linked to the drop in commodity prices).

In this context, a policy that only targets the quantity of trade finance would most likely fail. If banks are reluctant to lend because of perceived risks, boosting availability of trade finance is unlikely to result in lending. As Malcolm Stephens, a former Secretary General of the Berne Union, pointed out in his analysis of trade finance during the Asian crisis, "the traditional role of export credit agencies is to support trade and to facilitate trade. They are less effective in, somehow, trying to create or initiate trade, especially, in circumstances where neither importers nor exporters are really willing (or able) to trade with each other."[24]

A policy that targets the risks would have more impact. According to Robert Zoellick, under the Global Trade Liquidity Program, the "World Bank would underwrite the riskiest part of the lending, while private banks would provide the bulk of the less risky elements."[25] Although likely to be more successful, this kind of initiative raises the potential issue of moral hazard.

[18] https://www.thebenche.com/forum/benche-news/4108-rethinking-trade-finance-2009-icc-global-survey.html.

[19] http://www.aba.com/aba/documents/press/IMFBAFTSurveyResults20090331.ppt.

[20] Cf. John Humphrey: Are Exporters in Africa Facing Reduced Availability of Trade Finance?, Brighton 2009.

[21] http://www.olis.oecd.org/olis/2009doc.nsf/LinkTo/NT00000EEE/$FILE/JT03261582.PDF.

[22] Cf. Thomas Dorsey: Trade Finance Stumbles, in: Finance and Development, 2009, Vol. 46, No. 1, 2009, p. 18 f. There are signs that the situation somewhat deteriorated during the period October 2008 - January 2009.

[23] It is difficult to untangle the reasons for the decline in demand for trade financing. The drop in demand due to lower trade flows can be offset by the increase in demand for the protection offered by trade finance in light of increased risks. Banks report such an increase in demand for protection in the ICC survey.

[24] Malcolm Stephens: Export Credit agencies, Trade Finance, and South East Asia, IMF Working Paper WP/98/175, 1998.

[25] Financial Times, op. cit.

Is There a Need to Change the Rules of the Game?

Policymakers may also tackle the reasons for the increased risk aversion and cost of funds. According to some bankers, changes in the regulations could help. They argue that Basel II has a pro-cyclical effect on the supply of credit and affects particularly trade finance, most notably trade finance with emerging markets. This complaint is not new but, recently, it has been voiced more forcefully, notably at the WTO export meetings.[26] Moreover, it has been relayed by Robert Zoellick (who publicly complained about a regulation that tripled the amount of capital needed to back trade finance)[27] and Pascal Lamy (who wrote to the General Manager of the Bank for International Settlements and to the chairman of the Financial Stability Forum). However, only 1/3 of the 15 banks that responded to the IMF-BAFT question on the impact of Basel II on their capacity to provide trade finance indicated that it had a negative impact. 27 per cent reported it had a positive impact and the remaining banks that it had no impact.

In the current crisis, calls for changing the rules are frequent. They go beyond the G20's call for "regulators to make use of available flexibility in capital requirements for trade finance". For example, in December 2008, the European Commission introduced temporary changes in the set of Commission State Aid Guidelines on short-term export credits. It increased the flexibility of an existing "escape clause" so that official export credit agencies can cover short-term transactions in the OECD in cases where the private market fails to do so.[28] In January 2009, the participants in the OECD's Arrangement on Officially Supported Export Credits decided to adjust some of the disciplines of the Arrangement with a view to facilitating the financing of projects. These modifications allow the provision of officially supported export credit at more favourable terms and increasing the limit of the share of officially supported export credit in intra-OECD project finance. Then, in June 2009, OECD countries agreed to boost official backing for exports of renewable energy and nuclear power equipment by offering more generous terms.[29]

These changes are rather limited but a lesson from past crises is that pressures to use officially backed export credit to protect or stimulate national exports are considerable in a period of worldwide recession. This was the case during the Great Depression. The experience was bad and led to the creation of the Berne Union and "apparently convinced the GATT founders that export subsidies exacerbate international political tensions and should be eliminated".[30] During the 1970s crisis, world leaders pledged to refrain from resorting to protectionism. Today's leaders do the same. However, they do not follow their predecessors who also pledged to avoid competition in official trade credit. The concern about competition in official trade credit was so great in the 1970s that, in order to prevent it, OECD countries negotiated an Arrangement on Officially Supported Export Credit. When international trade faced another contraction in the early 1980s, export subsidies came back in the form of tied aid and mixed credit. [31]

The rules currently in place were designed to prevent the mistakes of previous crises, namely a competition in export subsidies (through favourable terms) that not only distorted international trade and domestic protection but also proved to be fiscally expensive. They act as a safeguard and no race for export subsidies has taken place in the current crisis. However, agricultural export subsidies and the lingering dispute Airbus-Boeing are a reminder that the temptation to help domestic firms' exports is not a thing of the past. Moreover, pressures on policymakers to help domestic firms may increase if the recovery is not vivid enough to reverse rapidly the rise in unemployment. The system may need more flexibility, but the lessons from history should not be forgotten.

Conclusion

Panic stemming from a sharp and sudden decline in trade flows, memories of the Great Depression and of the role of trade finance in recent financial crises,

[26] See for example the summary records of the WTO experts meetings (WTO documents WT/WGTDF/W/38 and WT/WGTDF/W/40) or Andrew Hopes: Basel II has become an obstacle to trade flows, in: Financial Times, 18 November 2008.

[27] Financial Times, 19 February 2009, op. cit.

[28] OECD survey, op. cit.

[29] http://www.oecd.org/document/40/0,3343,en_2649_34169_42168680_1_1_1_1,00.html and http://www.oecd.org/document/10/0,3343,en_2649_34169_43152266_1_1_1_37431,00.html.

[30] Richard Baldwin: The Economics of the GATT, in: Peter Oppenheimer (ed.): Issues in international Economics, Stocksfield, UK 1980; Oriel. Marc Auboin: Boosting trade finance ... , op. cit., discusses the WTO's agreement on subsidies and countervailing measures and their link with OECD rules.

[31] John E. Ray: The OECD 'Consensus' on Export Credit, in: The World Economy, Vol. 9, No. 3, 1986, pp. 295-210, provides the history of the negotiations leading to the OECD Arrangement. The intense debates on export-credit subsidies that took place in the first half of the 1980s in both the UK and France are summarised in I. C. R. Byatt: Byatt Report on Subsidies to British Export Credits, in: The World Economy, Vol. 7, No. 2, 1984, pp. 163-178, and Patrick A. Messerlin: Export-credit Mercantilism à la Française, in: The World Economy, Vol. 9, No. 3, 1986, pp. 385-408.

as well as a favourable political economy, explain why policymakers strongly and rapidly supported trade finance.

However, the trade finance shortfall and its contribution to the fall in trade flows are likely to be overestimated. Lack of reliable data is so dire that it is difficult to know if a drop in the supply of trade finance contributed to the decline in trade or is only due to the drop in demand for trade finance. Trade finance is somewhat harder to get in some parts of the world or for some firms but, on aggregate, available evidence suggests that it is unlikely to have contributed significantly to the plunge in international trade.

The cost of trade financing is more of a problem than its availability. If the rising cost is due to increased risk aversion, boosting the supply in trade finance is likely to be ineffective. Rather than trying to increase the supply of trade finance in particular, policymakers should help credit flows in general to come back to normal. Two main reasons support this strategy. First, the access to intermediated trade finance appears to be less a constraint for exporters than pre-export financing, which is very similar to a working capital loan.[34] Second, firms constrained in their access to institutional credit are likely to face difficulties in extending trade credit. Fixing the financial system will ease the credit constraint and help boost inter-firm trade credit that accounts for a large share of trade finance.[35]

Moreover, boosting the supply of trade finance is risky. Relaxing the rules limiting the competition of government-backed exports credit on the ground that more flexibility is needed to provide more trade financing could make resisting pressures to help domestic exporters more difficult. Moreover, in many countries, the recession and large fiscal stimulus packages are leading to ballooning fiscal deficits and public debts. In this context, boosting the availability of trade finance is probably not the best use of scarce public resources and encouraging export credit agencies to take more risks could result in fiscal contingent liabilities.

[34] Cf. John Humphrey, op. cit., Jean-Pierre Chauffour, Thomas Farole, op.cit.

[35] For analyses of this mechanism, see Mitchell A. Petersen, Raghuram G. Rajan, op. cit.; Inessa Love, Lorenzo A. Preve, Virginia Sarria-Allende: Trade Credit and Bank Credit: Evidence from Recent Financial Crises, in: Journal of Financial Economics, Vol. 83, No. 2, 2007, pp. 453-469..

Claude Barfield*

Protectionism and the Global Economic Crisis

The impact of protectionism – both outright and "murky" – on world trade will be highly dependent on the future course of the economic crisis. If the "green shoots" of an economic recovery blossom and bear fruit, then the (thus-far) moderate upsurge of protectionist government actions is likely to fade; if on the other hand, the world should plunge back into a "double dip" recession then all bets would be off.

Certainly, the absolute numbers chronicling the world economy from 2007 through 2009 are stark. World output slowed appreciably from 3.5 percent growth in 2007 to 1.7 percent in 2008. Then, for the first time since World War II, the World Bank predicts that in 2009 world GDP will decline (2.9 percent in the latest projection). Similarly, a decline in foreign direct investment flows began in 2008 and is projected to deepen in 2009, dropping some 30 percent in year-over-year numbers.

Trade figures were no exception to the negative trends. World trade by volume grew 6 percent in 2007, then by only 2 percent in 2008. For 2009, the projection is for an unprecedented decline of 11 percent.[1]

As noted above, what is important is what happens next to the world economy and world trade. And on this question, economists differ. In a widely cited succession of analyses starting in April 2009, Barry Eichengreen and Kevin O'Rourke set out to demonstrate that "globally we are tracking or doing even worse than the

* American Enterprise Institute, Washington DC, USA.

[1] The trade and economic numbers are taken from the following sources: World Bank: Global Economic Development, Washington DC 2009; World Trade Organization, World Trade Report, Geneva, Switzerland 2009.

Great Depression." They present data for industrial production, global stock markets and trade volumes to support their thesis. At the same time, Eichengreen and O'Rourke also track governmental policy responses in the 1930s in contrast with the recent 2007-2009 period.[2] Here, they find major differences, most particularly with central banks quickly and dramatically lowering discount rates and expanding the monetary supply; and elected governments undertaking expansionary fiscal policies and accepting fiscal deficits for the duration of the crisis. In their most recent analysis (September 1), the two economists concede that industrial production now "shows clear signs of recovering", "global stock markets have mounted a sharp recovery" and the "downward spiral of global trade volumes has abated." Still, they remain agnostic as to the future, arguing that "final demand" may not support the increased production and that consumer spending, particularly in the USA, may "remain weak" causing new inventory buildup, production cutbacks, and ultimately a double dip recession.

In contrast, another distinguished economist and historian of the Great Depression, Allan Meltzer, in a recent commentary decries the "greatly overstated and highly misleading" comparison of today's economic situation with the experience of the Great Depression.[3] Arguing that the United States is a key barometer and that the recession is likely to end this year, Meltzer points out that, utilizing the 1937-1938 "double dip" depression as illustrative, the 2007-2009 downturn has been much less devastating (though larger than most postwar recessions). He notes that since 2007 US industrial production has fallen only about 17 percent, compared to 32 percent in the earlier period; real GPD dropped only 3.8 percent, compared to 18.2 percent; and unemployment has climbed to 9.5 percent, compared to the earlier figures of 20 percent. Though he holds that most stimulus packages have been irrelevant and contain the seeds of long-term growth-depressing deficits and regulatory excess, Meltzer agrees with the consensus of "most economists" that the recession will end soon ("Keynesian economists always fail to recognize the regenerative forces of the market economy.")

In the end, while they differ greatly in their analytic focus, Eichengreen and O'Rourke on the one hand, and Meltzer on the other hand, all found it plausible that the worst is over for the world economy – and that the pressures for protectionist measures may ease over the next several years. That being the case, it is still important to describe and understand the nature of modern protection and its impact thus far on world trade.

Protection Tools

What follows is a brief review of the evidence thus far of new protectionist measures, both traditional (tariffs, WTO-legal trade remedies) and representative examples of so-called "murky" protectionist actions (subsidies, government procurement barriers).

Tariffs and Other Border Measures. As is well known, many WTO members, particularly developing countries, have applied tariffs that are substantially below the rates they have legally bound in GATT/WTO negotiations. This "policy space" theoretically could give them considerable leeway to raise border tariffs by a large margin: one study has estimated that full utilization of the "water" in the WTO tariff rules could nearly double existing MFN tariffs. Some countries (India, Argentina) have taken limited advantage of this flexibility. But by and large, to date there has not been large-scale use of the policy space afforded by the differential between bound and applied tariffs. A recent study by Olarreaga and others, based on the experience of the post-WTO world (1995-2008), predicts modest tariff increases in 2009 of about 8 percent.[4] Similarly, in agriculture, a recent paper by Tim Josling and Stefan Tangerman notes that to date policy responses to the economic crisis have been "mild."[5] There have been a few tariff increases and the reactivation of export subsidies by several nations; but this has been offset by tariff reductions, decreasing export taxes and removing import bans in other cases. It should be noted, however, that, pending changes as a result of the Doha Round negotiations, most trade distorting measures in agriculture – domestic subsidies – and many export subsidies are still legal and thus not included in the current evaluations.

WTO-Legal Trade Remedies: Anti-dumping and Safeguard Measures. Various World Bank and WTO reports have chronicled the increased use of anti-dumping and safeguards measures over the past eighteen months as the financial crisis has deepened into a worldwide recession. The most thorough and complete accounting has been undertaken by trade

[2] B. Eichengreen, K. H. O'Rourke: A Tale of Two Depressions, September 1, Voxeu 2009, http://www.voxeu.org.

[3] A. Meltzer: What happened to the "Depression"?, Wall Street Journal, 1 September 2009.

[4] M. Olarreaga, L. Foletti, M. Fugazza, A. Nicita: Tariff Changes, in: S. J. Evenett, B. M. Hoekman, O. Cattaneo (eds.): The fateful allure of protectionism: Taking stock for the G8, The World Bank and CEPR, London 2009.

[5] Ibid., T. Josling and S. Tangerman: Agriculture.

economist Chad Bown of Brandeis University, utilizing a global antidumping data base constructed with support from the World Bank, the UK Department of International Development, and Brandeis University.[6]

Bown has found that the worldwide downturn has demonstrated once again the strong link between economic bad times and increased use of trade remedies (antidumping and safeguards are highlighted here). He has found that product-level use of trade remedies jumped 34 percent from 2007 to 2008, and that the first quarter of 2009 was 22.3 percent higher than the first quarter of 2008. In addition, for the first half of 2009, the actual *imposition* of trade remedies upon completion of investigations was 30.5 percent higher than the first half of 2008. Further, there were several other striking findings regarding changes in trade remedy actions after the onset of the global crisis in late 2007. First, there was a huge increase in the number of actions pursued by developing countries: over 70 percent of the new actions from the beginning of 2008 to the present time were instituted by developing countries – often against other developing countries. Second, China has become the target of choice for many countries, both developed and developing. For country-specific antidumping, safeguards, and countervailing actions, China was the target roughly 40 percent of the time (and 70 percent of the time in 2009).

Finally, Bown also noted a spike in the use of safeguard actions as the financial crisis spread in 2008. Eight safeguard actions were initiated in the second half of 2008, with 15 more being added in the first half of 2009. He projects that 2009 may end up with the highest number of safeguard actions since the WTO was established in 1995; and in contrast to other peak years (2000, 2002), the steel industry will be joined by other industries as the target for such actions.[7]

Bown calculates that the value of imports targeted by trade remedy actions among G-20 nations amounts to just under .5 percent of total imports. However, he also notes that the small first-order effects can be deceptive, in that a sizable literature has demonstrated that trade remedy tools can be utilized to generate anti-competitive effects, particularly in concentrated sectors such as steel and chemicals. Further, there is the danger of a cascading impact, as when several countries react to one country imposing trade remedy duties in order to prevent trade deflection.

"Murky" Protection

Murky protection can take many forms. Trade economists Richard Baldwin and Simon Evenett utilize a broad, practical definition: "abuses of legitimate discretion which are used to discriminate against foreign goods, companies, workers, and investors."[8] Examples are wide-ranging and could include manipulation of health and safety regulations, licensing restrictions, "green" policies that both subsidize and protect domestic industries in the name of environmental goals, and discriminatory standards, among others. Given the space constraints for this essay, the following analysis will be confined to two examples of actions taken in pursuit of a particularly difficult and complex rationale for national discretion: policies publicly aimed at stemming or mitigating the world financial/economic crisis as it impacts domestic industries. Specifically, what has unfolded with regard to automobile industry subsidies and national government procurement policies. In both instances, while there are many culprits, the United States has become the chief object for analysis and criticism.

Sector Subsidies: *the Automobile Industry*. In June 2009, GM formally filed for bankruptcy, and the US government became its major stockholder after a bailout amounting to over $50 billion. While not alone in bailing out its automobile industry, the United States' action, because of its scale, break with US national precedent, and likely duration, changed international rules and practice for sectoral intervention for the foreseeable future. President Barack Obama proclaimed that he had "no interest in running GM…our goal is to take a hands-off approach and get out quickly." Yet, as virtually all outside observers have noted, the US government to date has no discernable exit strategy and is likely to control GM for some time. Thus, inevitably what had been private market decisions will become government-to-government negotiations: as examples, GM originally announced its intention to build roughly 50,000 subcompact cars in China, only to be forced to recant by combined pressure from US labor unions and US government overseers; pressure is also being exerted to distort and curtail elements of the North American market for auto parts by rewarding

[6] Global Data Base: http://www.brown.edu/-chbown/global_ad/.

[7] These facts were taken from the following: C. P. Bown: Antidumping, Safeguards, and other Trade Remedities, in: S. J. Evenett, B. M. Hoekman, O. Cattaneo, op. cit.; C. P. Bown: The Global Resort to Antidumping Safeguards, and other Trade Remedies Amidst the Economic Crisis, forthcoming; S. J. Evenett, B. M. Hoekman (eds.): Trade Implications of Policy Responses to the Crisis, VoxEU. org, e-book, 2009; C. P. Bown: Protection Continues Its Climb, Global Data Base, 23 July 2009; F. Erixon, R. Sally: Keynes at Home, Smith Abroad, Wall Street Journal, 8 September 2009.

[8] R. Baldwin, S. J. Evenett (eds.): The collapse of global trade, murky protectionism, and the crisis: Recommendations for the G-20, A Vox.EU. org publication, 2009, p. 4.

beleaguered US parts manufacturers over Mexican and Canadian companies.[9] In each instance, protests and, ultimately, potential retaliatory actions will come after China, Mexico or Canada or other nations have exhausted talks with Washington – not Detroit.

While following separate paths – and not entirely influenced by the US – many other countries have intervened to aid their auto sectors, or are actively planning such interventions – including (not unexpectedly) Canada and Mexico; and various EU countries, including France, Germany, Britain, and Italy. Hiding behind the US action, French president Nicholas Sarkozy stated: "The situation in Europe means that you cannot accuse any country of being protectionist when the Americans put up $30 billion (he undercounted: author) to support their automotive industry."[10]

What does this portend for WTO subsidy rules? First, without getting into the weeds of WTO legalese, it is fairly certain that many of the government actions violate current subsidy tests, including making a "specific" financial contribution that confers a definite benefit to the receiving party, and causes "serious prejudice" to imports from foreign firms.[11] Second, and of equal importance, given the fact that so many WTO members have mounted extensive and broad automobile industry bailouts, there is little likelihood that they will challenge other nations' subsidy programs by bringing a WTO case.

This being the case, economists Brunel and Hufbauer offer a plausible outcome – one that is ominous for WTO disciplines: "As auto bailouts and aid continue and intensify without WTO challenges, the world auto industry could gradually leave the realm of WTO discipline. This would set a dangerous precedent. If an important industry, like autos, can take itself out of WTO disciplines, the world trading system will be seriously weakened."[12]

Government Procurement and Buy National (America): Many countries have provided stimulus packages to aid their industries and citizens in the face of the global economic crisis and recession. To many legislators – not steeped in trade law – it was natural to argue that public money appropriated to these ends should not be allowed to "leak" out of the domestic economy.[13] While "buy national" provisions have long existed in many provincial or city laws and regulations, the United States led the way for national policies to mandate this rule. In January 2009, the US House of Representatives passed a stimulus bill that provided a 25 percent competitive margin for US iron and steel companies for all expenditures under the bill. After strong objections were raised by the EU and Canada, and after a mild protest from the Obama administration, the final version of the legislations both expanded the purview of the provision to *all* manufacturing sectors and provided a stipulation that the rule "be applied in a manner consistent with US obligations under international agreements."[14] In effect, what this meant was that nations that had signed the WTO Agreement on Government Procurement (12 EU countries plus 12 other nations) were exempt. All others – including such major trading nations as China, India, Brazil and Russia – were subject to restrictions.

A number of nations have either moved to retaliate with mirror "buy national" proposals or have threatened action – including China, Mexico and Canada (despite the possibility of exemption), the EU, and Japan, among others. It is difficult, if not impossible, to measure the actual trade effects of buy national regulations. In the United States, for instance, the issue has moved down to state and local governments, who have scrambled to insulate themselves against the possible denial of stimulus funds for projects that might include even a small percentage of foreign parts or components.

For exemptions, there is only an onerous and time-consuming process of petitioning individual US government agencies that have responsibility for that particular project.

Anecdotal evidence, however, points to a shift – particularly with regard to steel, chemicals and machinery.

[9] For details on the US automobile bailout, see: P. Levy: The Global Problems with the GM Boondoggle, ForeignPolicy.com, 29 May 2009; C. Brunel, G. Hufbauer: Money for the Auto Industry: Consistent with WTO Rules?, in: Policy Brief, February 2009, Peterson Institute for International Economics, Washington D.C.; S. J. Evenett, F. Jenny: Bailouts: How to discourage a subsidies war, in: R. Baldwin, S. J. Evenett, op. cit.; J. L. Gattuso: General Motors Bankruptcy: Exit Strategy Needed, Web Memo, 28 May 2009, The Heritage Foundation, Washington DC 2009.

[10] Quoted in R. Baldwin, S. J. Evenett, op.cit., p. 5.

[11] For more detail on WTO subsidy rules and autos, see C. Brunel, G. Hufbauer, op. cit.

[12] Ibid, p. 10.

[13] A theory even endorsed initially by US Vice President Joseph Biden: C. Barfield, P. I. Levy: In Search of an Obama Trade Policy, International Economic Outlook, August 2009, American Enterprise Institute, Washington DC.

[14] For details surrounding the passage of the US Buy American provision, see: E. Gamberoni, R. Newfarmer, in: R. Baldwin and S. J. Evenett, op. cit; G. C. Hufbauer, J. Schott: Bad for Jobs: Worse for Reputation, in: Policy Brief, 2009-2, Peterson Institute for International Economic Policy, Washington DC.

As is the case with sectoral manufacturing subsides, it may very well be that no WTO member will challenge another WTO member over buy national provisions of stimulus packages. There are two reasons for this: one, many nations either have, or are contemplating, similar restrictions; and two, a WTO case would demand substantial legal resources, would take a long time before a final decision, and would present tricky legal questions regarding the dividing line between sovereign domestic rights and WTO obligations for national treatment.

What Is To Be Done?

For reasons laid out in the body of this essay, in the short term one should not expect recourse to the WTO, including the WTO dispute settlement system, for many of the trade-distorting actions that have emerged during the crisis. First, much that has taken place is not formally WTO-illegal: viz, antidumping and safeguard actions, increasing applied tariffs, some subsidies, some services restrictions, and some buy national provisions. Second, as we have seen with the most egregious subsidies for the automobile industry, many nations have launched aid programs and so will be reluctant to attempt actions against their trading partners. And third, while the crisis has highlighted the dangers from tariff "policy space" and from misuse of antidumping rules, the current Doha Round will certainly not take up these issues (or even additional subsidy restrictions) as part of its end-game agenda.

In the end, though the sentiment and phrase have become hackneyed and subject to ridicule, "naming and shaming" is the best (indeed only) recourse to counter existing and future trade distorting measures taken allegedly in the name of ameliorating the effects of the economic downturn. The G-20, for all its fault and questionable legitimacy, should continue to speak out against further protectionist actions. The work of the WTO and World Bank in analyzing and exposing protectionist measures should be stepped up and awarded even more resources.

In the end, however, the hope must be that individually and collectively, the major trading nations will "muddle through" and adopt enough sensible macroeconomic measures to stem the negative economic tide and return to economic growth sometime in 2010.

Simon J. Evenett*

Systemic Consequences of Crisis Era Protectionism

Drawing upon the latest evidence concerning contemporary protectionism, the purpose of this paper is to examine the implications of such discrimination against foreign commercial interests for the performance of existing WTO accords during the recent crisis, the case for more binding multilateral trade rules, and for other significant potential forms of international collective action, including measures to reduce current account imbalances ("global imbalances" as they are often referred to) and to mitigate climate change. As it is premature to declare the global economic crisis over, the assessment presented here is necessarily an interim one. Still, it may be of interest to policymakers and to analysts as some policy options upon reflection turn out to be hollow and the consequences of other policy options are now a little clearer.

The remainder of this paper is organised as follows. In the next part the principal characteristics of contemporary crisis era protectionism are described. This account helps identify the policies that have been resorted to the most by governments in the past year, with implications for any assessment of the effect of WTO rules during the current crisis. The latter matter plus other implications of the crisis for the multilateral trading system and for the Doha Round negotiations are discussed in the third part. The penultimate part discusses the implications of the murky protectionism witnessed during this crisis for significant non-trade-related negotiations taking place between states. Some concluding remarks follow.

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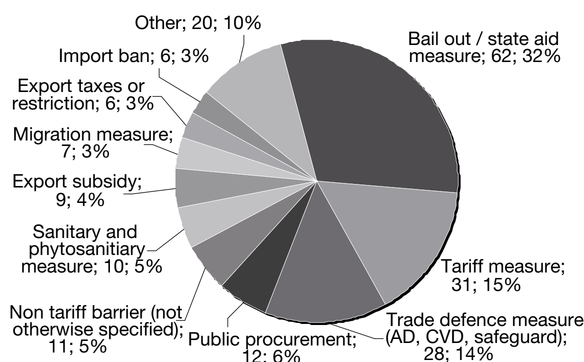
The Emerging Features of Crisis Era Protectionism

The evidence reported in this section draws from the second report of the Global Trade Alert that was released in mid-September 2009.[1] That initiative has conducted over 425 independent evaluations of state measures taken since November 2008 (when G-20 leaders pledged to eschew protectionism), and examined whether there was any evidence of asymmetric treatment of foreign commercial interests (broadly conceived to include not just trade, but also foreign investments, overseas migrants, and intellectual property deployed abroad) and which trading partners are affected by such measures. The initiative did not confine itself to state measures that looked suspicious (from a protectionist point of view). All of the reports of these investigations can be downloaded from www.globaltradealert.org. Moreover, the evidential base created enables carefully constructed summary statistics to be calculated, facilitating interpretation of contemporary crisis era protectionism.

Figure 1
Top 10 Implemented Measures used to Discriminate against Foreign Commercial Interests since the first G20 Crisis Meeting



Source: Broken Promises: A G-20 Summit Report by Global Trade Alert. Table 2.4.

Of the state measures investigated 280 have been implemented and the rest had been announced and are pending implementation. Of the implemented measures, 192 were found to almost certainly discriminate against foreign commercial interests. Another 48 state elements are likely to have discriminated against foreign commercial interests. Given there may be omissions in the Global Trade Alert database (not least because of the insistence of proper verification of a state measure for its inclusion in the database), then it would not be at all surprising if the actual number of beggar-thy-neighbour policies implemented since the first crisis-related G-20 summit exceeded 250.

Of the pending state measures, 134 were found to be almost certainly discriminatory if implemented. Given that the number of discriminatory measures implemented every quarter in 2009 is roughly 70, then this suggests there is half a year of protectionism already in the pipeline.

While the full economic impact of contemporary protectionism will take much longer to come to light (not least for data availability reasons and the time necessary to conduct high quality research), some idea of the scale of the relevant effects can be discerned by the number of discriminatory measures taken and the number of trading partners, sectors, and tariff lines affected by those measures. For each measure in the Global Trade Alert database careful attempts were made to identify these dimensions of harm. The findings are not reassuring. Few products, economic sectors, and jurisdictions have emerged unscathed by crisis era protectionism: fewer than 5 per cent of product categories (four digit tariff lines), 20 per cent of economic sectors, and a tiny number of trading jurisdictions have yet to be affected by any beggar-thy-neighbour state measure.

The types of protectionist measures used during the current economic crisis are of systemic interest. To date, the most prevalent form of discriminatory measure that has been implemented are state aids, bailouts, and other forms of financial assistance to companies. Such assistance extends far beyond the financial sector, where the bailouts have been prominent. In total, approximately 30 per cent of implemented measures fall into this category. Tariff increases, which were the most prevalent form of protectionism employed during the Great Depression, are to date the second most used category. Trade remedies currently stand in third place, although they are likely to take first or second place once the protectionist measures in the pipeline are implemented.

Implications of Crisis Era Protectionism for the WTO

There are many aspects of the current crisis that bear upon the WTO. The first question that surely arises is whether WTO disciplines have been adhered to in the crisis. Another slightly different question is whether

[1] Simon J. Evenett (ed.): Broken Promises: A G-20 Summit Report by Global Trade Alert. Available free at: http://www.globaltradealert.org/gta-analysis/broken-promises-g20-summit-report-global-trade-alert.

WTO rules have "held the line" on crisis era protectionism. The first question ought to be a matter of fact, the latter requires a counterfactual. This section begins by discussing both of these questions.

It would be very difficult to argue that there has been widespread violation of multilateral rules during this crisis, at least those rules compliance with which is easier to establish. The paucity of dispute settlement cases that have arisen is consistent with this conclusion, but is not central to its demonstration. In the recent crisis, developing countries have tended to resort to tariff increases whereas industrialised countries have resorted to bailouts, both have resorted to trade remedies and public procurement measures. Indeed, because of the very gaps between their bound and applied tariff rates, many developing countries[2] have had the freedom to raise their tariffs significantly and some have.

The resort to trade remedies by many countries has sparked some disagreements but not widespread claims of violation of the relevant WTO accords, an outcome that reflects more the weaknesses in the latter rather than any probity on the part of governments. Similar arguments can be made concerning the generous financial support offered by many governments to national industries. In the case of public procurement, the existing WTO accord is a plurilateral one to which a minority of the WTO's membership have signed up.

More generally, the resort to bailouts and the like and to "buy national" public procurement policies can be interpreted as deliberate attempts to circumvent existing multilateral trade disciplines during the crisis. Once this crisis is over and these matters have been evaluated in the round analysts may decide that the WTO's rules were evaded rather than tested in any serious sense.

The foregoing observations are also relevant for assessing the counterfactual claim that, in the absence of WTO rules, protectionism would have been worse during the crisis. One needs to be careful evaluating such a claim especially before the crisis is over and the full set of policy choices is known. It is also worth remembering that there are many different WTO rules, some of whose effects may have been very subtle. For instance, the general requirement in trade in goods that countries employ tariffs as the sole instrument of discrimination may well have had two opposing influences. The first influence is positive in that any attempt to raise such a transparent policy instrument as tariffs is likely to be spotted by trading partners who may react, so discouraging the tariff rise in the first place. The opposite effect is that such a rule may have encouraged governments to use a non-transparent alternative to tariffs instead. Likewise, have tariff bindings limited tariff increases or created incentives to substitute other forms of protection for tariffs?

The long-recognised possibility that governments can substitute tariffs for other forms of protection, including opaque forms of protection, has another important implication for the role that the WTO can play during systemic economic crises. The very facts that (i) the WTO accords are at any one point in time a set of binding rules that cover only a subset of the beggar-thy-neighbour tools available to governments and (ii) that multilateral trade negotiations, when successful, have tended to incrementally expand the scope of WTO rules implies that in a future economic crisis there will always be government policies that are beyond the scope of tough WTO rules that can be used to tilt the playing field towards domestic firms. This should dampen the spirits of anyone seeking to tie down successfully governments' protectionist instincts during systemic economic crises with binding multilateral accords.

Even if binding rules could be agreed there is the threat that they would be essentially repudiated *en masse* by large sections of the WTO membership during an economic crisis. Experience from the European Union's state aids regime is instructive here. This regime is, or at least before the crisis was, widely-regarded as having tough disciplines on financial assistance to firms backed up by exacting notification requirements and monitoring by the European Commission. As the global economic crisis deepened, faced with a growing number of the European Union member states insistent on offering financial assistance to domestic firms, the European Commission found itself marginalised, facing the prospect of fighting almost all of its member states and losing. Here losing would probably have meant the permanent emasculation of the entire state aids regime and a big reduction in the European Commission's prerogatives. Instead, the European Commission acquiesced to a Temporary Framework to govern the exceptions that it now routinely grants to the member states to offer financial assistance that distorts the Common Market. Whether and when the temporary aid offered to European firms will be removed is an open question. This example demonstrates that there are probably limits to what analysts should expect of a rules-based re-

[2] Other than the recently acceded countries, such as China.

gime during severe economic circumstances, such as a crisis.[3]

For all of the above reasons it probably makes sense to devote more attention to making sure that there are multilateral rules that influence – and limit the harm done by – discrimination taken during times of economic duress and that encourage the eventual removal of crisis-related discriminatory measures. Such rules might not only limit the deviation from core WTO principles and open markets but also build confidence in trading partners that any deviations will follow anticipated paths. Again, however, caution is needed. To the extent that such rules "bite too much" they may encourage substitution into discriminatory government measures that are less regulated by WTO rules or not regulated in the first place. The curse of piecemeal rules – itself a function of ever-lengthening negotiating cycles amongst other factors – strikes again.

As for the Doha Round, while its completion would be seen as reaffirmation of a commitment by policymakers to keep markets open, it was never designed to make a contribution to fighting economic crises. Having said that if, for whatever reasons, because of the crisis policymakers perceive that the cost of not completing the Doha Round has risen and become intolerable, then there may be a link between the economic crisis and the Doha Round. Whatever Doha Round deal is eventually agreed should be evaluated on the basis of its impact on international commerce and WTO members' welfare during normal economic circumstances, although no doubt some might argue that any contribution of exports to economic recovery could be accelerated by completing the Doha Round. These arguments highlight the complexities in the relationship between the current global economic downturn and the lengthiest multilateral trade negotiation, the Doha Development Agenda.

Implications of Crisis Era Protectionism for Other Key International Negotiations

Two features of much contemporary protectionism will reduce the likelihood of successful international negotiations and accords in the area of macroeconomic adjustment and climate change mitigation. The first feature is the discretion that is often inherent to the implementation of much sophisticated modern regulation where decision-makers have to balance competing arguments, supposedly on the basis of technocratic expertise and evidence.

The second feature is the uncertainty over the form and extent of the harm done to trading partners from the abuse of such discretion. These aspects of "murky protectionism" have come to the light during the crisis, in particular with the application of state aids, bailouts in general, trade remedies, and stimulus packages. Trading partners, in particular developing country trading partners, are likely to discount claims made in future negotiations that any state measures that can affect foreign commercial interests will be implemented in a non-discriminatory manner.

Indeed, the argument may go a step further, as it arguably has in the run-up to the Pittsburgh G-20 summit of government leaders. One of the goals of several Western governments, including that of the United States, was to establish informal mechanisms to encourage and monitor the elimination of so-called current account imbalances, both positive and negative. This proposal is seen as encouraging China, Germany, and Japan to alter macroeconomic policies so that their current accounts fall in size. China has already signalled its opposition to the creation of an informal mechanism if there is any suggestion that associated deliberations could subsequently provide the pretext for trade sanctions. Mistrust that develops because of protectionist application of non-trade policies reduces the likelihood that international cooperative instruments that can be similarly abused are created.[4]

In the past year the current accounts of many of the leading economies have adjusted towards zero, suggesting that traditional macroeconomic adjustment may be doing the job that any G-20-created mechanism would anyway. These considerations and others suggest that the medium and longer-term harm generated by crisis era protectionism lies elsewhere, most likely in the already contentious climate change negotiations. Matters are bad enough already with India and China arguing that they do not see why they should accept constraints on their economic development to clear up the harm created by those nations that industrialised before them.

To add to such climate justice arguments are concerns that national and international initiatives to mitigate climate change will result in the creation of new policy instruments to measure and tax the carbon content of goods sold in a given jurisdiction, even if those goods have been produced in another country. Having experienced crisis-related murky protectionism at the

[3] Note that this statement does not imply that binding rules must be useless ("have not bite") during an economic crisis. Nor does this statement imply that binding rules never deliver.

[4] Of course, a face-saving alternative for the West could be agreed whereby the mechanism established is effectively toothless. The key point remains that agreement to further develop such a mechanism would be opposed by countries suspicious of its protectionist application.

expense of their commercial interests, many governments are entitled to ask some very hard questions before agreeing to allow national measures to levy additional taxes on imports. This will complicate any climate change negotiations adding to the substantial number of vexing questions facing senior policymakers.

Of course, failure to agree a replacement for the Kyoto Protocol at this December's Copenhagen conference or later may encourage some jurisdictions to take matters into their own hands and introduce national or regional climate change initiatives that tax imports (and domestic production) on their carbon usage. France and the United States are contemplating such steps at this time. Reactions to the discussion – let alone implementation – of these unilateral schemes have been very negative in certain leading developing countries, reactions that have been coloured by the murky protectionism applied during the global economic downturn.

While a scenario whereby such unilateral schemes are the subject of contentious dispute settlement cases at the WTO need not occur, at present there is very little to prevent a downward spiral quickly developing. Each party may feel that once the stakes are large enough – as they surely are with respect to the consequences of climate change and the measures taken to effectively mitigate it – then all restraint is lost and expectations adjust accordingly. Once again the fallout from contemporary protectionism will need to be carefully managed if no more damage is to be done to the world economy.

Concluding Remarks

Having described the principal features of the protectionism implemented during the current global economic downturn, the argument was advanced here that the consequences of such beggar-thy-neighbour policies are neither limited to a small number of countries nor to the multilateral trading system. There is no need to resort to exaggerated historical parallels (comparing current protectionism to that of the 1930s) to make this argument.

In terms of implications of the current sharp global economic downturn for the WTO here cold water was poured on arguments that crises reinforce the case for expanding the set of multilateral rules. Without disagreeing with the case on conceptual grounds for expanding WTO disciplines, certain recurring practical matters intrude – such as the tendency for WTO accords to expand in scope in a piecemeal fashion and the fact that this allows apparently never-ending possibilities for substituting discriminatory public policy instruments that are constrained by WTO rules with those that are not. In a similar vein, as far as fighting economic crises is concerned it was argued that little should be expected from the Doha Round negotiations, although this by no means covers all of the interrelationships between the Doha Round and the current economic crisis.

The price of implementing often rushed, poorly-conceived state measures that tilt the playing field against foreign commercial interests will be paid for many years. The harm done by distorting national resources at home will be compounded as memories of crisis era protectionism poison the potential for fruitful international cooperation in macroeconomic adjustment and in mitigating climate change. Our current government leaders should expect to be judged harshly by history. Far from being clever they have complicated what was already a difficult geopolitical alignment between the major powers.

Georg Koopmann*

The Economic and Financial Crisis, the Crisis of Trade and Trade Policy, and Aid for Trade

The current economic and financial crisis is also a crisis of international trade and of international trade policy, with the latter in particular concerning multilateral trade policy in the context of the World Trade Organisation (WTO). Against this background, the Aid for Trade (AfT) initiative for developing countries (DCs), which was launched in December 2005 at the WTO's Ministerial Conference in Hong Kong, ap-

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pears to have the potential to help re-energise world trade as well as revive the ailing Doha Round of multilateral trade negotiations. It may likewise serve to institutionally strengthen the WTO, which is seen as sinking into insignificance in tandem with the decline of world trade.[1] At the same time, there is also a risk of AfT itself becoming a casualty of the crisis. It is feared that the initiative might lose momentum in view of mounting public budget pressures.[2] Against this, the Organisation for Economic Co-operation and Development (OECD) and the WTO jointly hold that "aid for trade is needed now more than ever, to provide much needed additional stimulus, averting the worst consequences of the economic downturn, while addressing underlying vulnerabilities to get the enabling environment for growth right – assisting producers in partner countries to effectively participate and compete in local, regional and international markets".[3] Indisputably, better international cooperation in the trade arena is needed to match the kind of cooperation found over fiscal and monetary responses to the global economic crisis.

In the following, the possible role of AfT in this context will be analysed proceeding in four steps. After a brief anatomy of the international trade crisis, the AfT initiative will be introduced and its rationale, theoretical underpinning and actual design discussed. Next is a presentation of the main stakeholders in AfT and their interests and strategies. Finally, the question of the effectiveness of AfT will be addressed.

Anatomy of the Current Trade Crisis

After a long period of uninterrupted and overproportionate growth (compared to growth in the domestic economy), the expansion of foreign trade came to an abrupt halt in 2008. In 2009, world trade is expected to fall by about 10 per cent in real terms, which is more than three times the estimated overall economic contraction of nearly 3 per cent this year. Following two quarters (4/2008 and 1/2009) with unprecedented declines in cross-border exchange, trade figures for the second quarter of 2009 show first signs of a slight recovery. Economic growth also appears to have resumed, led by countries in Asia.[4] However, it is still unclear how long it will take to exit from the crisis on a sustainable basis. Moreover, unemployment continues to be on the rise, reflecting the fact that a turnaround in the labour market typically lags well behind any pick-up in output. Hence, the full social and political effects of this development are still to be felt, with governments remaining under heavy pressure to shield domestic markets against foreign competition.

The *crisis of trade* just described seems to have three major causes and implications:

- The global *financial crisis* has led to a steep reduction of financial flows among trading partners. As a consequence, trade finance – "the oil that runs the machinery of international trade" (Pascal Lamy) – has dried up. The shortage of trade finance has in particular hurt emerging economies and thus North-South trade, which in the recent past has developed into the most dynamic international trade flow.
- The global *economic crisis* ensuing on the financial turmoil essentially reflects a sharp contraction of demand across all major world economies which has left strong marks in foreign trade. The trade effect is magnified by the fact that a growing amount of international exchange occurs within border-crossing value-added chains. Each dollar or euro of exports therefore contains more imports than previously. Such production networks increasingly also involve DCs. In consequence, contracting consumption in high-income countries has an amplified effect on exports from DCs.
- The *crisis of trade policy*, which is linked to the protectionist pressures fuelled by growing job losses noted before, also affects the volume and direction of international trade. In the wake of the economic downturn, trade protectionism has clearly been rising. In contrast to conventional trade-restrictive measures, such as the imposition of import tariffs, the protectionism which is currently gaining ground is rather "murky" or "invisible". It takes forms as diverse as anti-dumping investigations, technical barriers to trade intentionally misused or "buy-local" schemes. Moreover, some of the measures contained in the economic stimulus packages of governments favour domestic goods and services at the expense of imports. Undeniably, this policy has a certain "chilling" effect on international trade.

[1] Cf. M. Klein, D. Kamenev: Die WTO in der Krise, in: Wirtschaftsdienst, Vol. 89, No. 8, 2009, pp. 534-539.

[2] Cf. S. Evenett: Rapporteur's Report, OECD Policy Dialogue on Aid for Trade, Paris, Organisation for Economic Co-operation and Development, 3-4 November 2008, p. 5, http://www.oecd.org/dataoecd/33/28/41967394.pdf.

[3] OECD and WTO: Aid for Trade at a Glance 2009: Maintaining Momentum, p. 21, http://www.wto.org/english/res_e/booksp_e/aid4trade09_e.pdf.

[4] Cf. Asian Development Bank: Asian Development Outlook 2009 Update: Broadening Openness for a Resilient Asia, Bangkok September 2009, http://www.adb.org/Documents/Books/ADO/2009/update/default.asp.

The AfT programme possibly offers one way to master the crisis of trade and of trade policy outlined above.

Rationale and Design of Aid for Trade

AfT is both a trade and a development programme. It would perhaps be more aptly termed Aid for Trade for Development, as it is not trade *per se* which is to be supported, but rather trade inasmuch as it is conducive to economic and social development. Politically, AfT therefore seeks to build a bridge between the trade and the development community. More concretely, it involves assistance to DCs in the negotiation, design, implementation and assessment of trade-related microeconomic and macroeconomic policies. Microeconomically, AfT aims at enabling firms and households to benefit more from international trade and cope with its consequences. At the macroeconomic level, its objective is to "mainstream" international trade into domestic economic development and poverty reduction strategies. The policies concerned take place at the national, regional, bilateral and multilateral levels. They comprise measures, regulations and (the creation/improvement of) institutions, which have a direct bearing on trade, as well as complementary policies with an indirect trade impact. Institutionally, the WTO is the "nerve centre" of the AfT initiative, where all actions come together.

Viewed from the perspective of international political economy, the principal rationale underlying the AfT initiative is to make trade liberalisation and the prescription of binding rules for trade policy in recipient DCs politically feasible and to prevent protectionism and backsliding in this area. AfT would thus form a catalyst of trade reform or an antidote against observed DC trade reform "fatigue". This is in line with the "bicycle theory" of trade policy according to which "the best way to keep trade open is to keep opening trade".[5]

Normatively, the AfT programme is grounded in the "international approach" to economic development, which in contrast to the "domestic approach" emphasises the importance of outward-oriented as against inward-looking growth and development strategies. Accordingly, opening up the domestic economy to foreign trade, investment and competition, and thus integrating it into the international trading system, is a prerequisite and indeed the prime determinant of income growth in DCs. At the same time, it is acknowledged that "behind-the-border" policies – complementary to trade liberalisation – are necessary to actually promote economic and social development. Measures typically named in this context include:

- institutional reforms to guarantee stable property rights, prompt enforcement of legal obligations (contracts) and well-functioning bureaucracies;
- customs reforms to contain transaction costs (and corruption) and thereby "facilitate" international trade;
- tax reforms, *inter alia* to make up for the loss of revenue from tariffs;
- provision of social safety nets to compensate those who lose their jobs due to import growth;
- labour market reforms to promote mobility of workers/employees within and between industries;
- education and training programmes *inter alia* to create qualified manpower in export-oriented industries;
- technological support programmes to improve companies' ability to compete against imports and on export markets in areas with higher value-added;
- appropriate macroeconomic and exchange-rate policies to secure international competitiveness.

The positive growth and development effects of liberalising trade would therefore crucially depend on the presence of other variables and their interaction with trade and its liberalisation. The empirical literature specifically points to the strength of domestic institutions, measures to tackle corruption, the importance of education and human capital, macroeconomic stability and the structure of trade (in particular export diversification) as explanatory factors.[6] It is precisely in these areas that AfT comes into play.[7] Importantly, too, the international approach advocates "strategic liberalisation", as it emphasises the time pattern of trade policy and its coordination with the complementary policies listed above. This holds especially with regard to institutional development, i.e. the establishment of market-creating, market-regulating, market-stabilising

[5] Pascal Lamy, the WTO's Director General, in his address to the Doha Round Trade Negotiations Committee on 24 July 2009, http://www.wto.org/english/news_e/news09_e/tnc_dg_stat_24jul09_e.htm.

[6] Cf. R. Kneller, C. W. Morgan, S. Kanchanahatakij: Trade Liberalisation and Economic Growth, in: World Economy, Vol. 31, No. 6, 2008, pp. 701-719; A. L. Winters: Trade Liberalisation and Economic Performance: An Overview, in: Economic Journal, Vol. 114, Issue 493, 2004, pp. F4-F21.

[7] Cf. A. Agbohoroma, M. Busse, S. Falatik, R. Hoekstra, J. Königer, G. Koopmann, C. Kühne, N. Roloff: Aid for Trade: Making Trade Effective for Development – Case Studies for Kenya, Tanzania and Uganda, Hamburg 2009, Hamburg Institute of International Economics and PricewaterhouseCoopers.

Categories of Aid for Trade Proposed by WTO Task Force

1. *Trade policy and regulations*. This includes training of trade officials, analysis of proposals and positions and their impact on national stakeholders, technical and institutional support to facilitate the implementation of trade agreements and the compliance with rules and standards.
2. *Trade development*, e.g. investment and trade promotion, support in different trade sectors and trade finance, market analysis and development.
3. *Trade-related infrastructure*, including physical infrastructure to connect domestic and foreign markets.
4. *Building productive capacity*, meaning investments in industries and specific sectors so that countries are able to diversify production and exports.
5. *Trade-related adjustment*. This category comprises complementary measures absorbing some of the costs linked to tariff reductions or declining terms of trade to make developing countries benefit from trade liberalisation.
6. *Other trade-related needs*.

and market-legitimising institutions, which takes time.[8] Hence,the succession of trade liberalisation steps would have to be in accordance with the stages of institution-building in DCs, in order for AfT to effectively become Aid for Trade for Development.

The actual design of the AfT exercise is a tripartite composition of

- trade development
- trade policy/regulation
- adjustment to trade.

The AfT categories proposed by the WTO Task Force on Aid for Trade (see box), which was created pursuant to the Hong Kong Ministerial Declaration, can be condensed into these three activity fields of AfT. Accordingly, "trade development" would comprise the build-up of capacity to develop and competitively produce goods and services facing expansive demand on regional and international markets as well as the facilitation of trade through the provision of trade-related physical infrastructure (roads, ports, storage, telecommunications, energy networks etc.) and of trade finance (the "lubricant" of international trade), the alleviation of customs procedures (including the fight against corruption) and the analysis of foreign markets, standards development and promotion of sales abroad.

"Trade policy/regulation", on the other hand, refers to the creation of human, institutional and physical capacity in DCs receiving AfT to

- design and enforce effective national trade policies and trade-related regulatory policies, thereby creating a suitable environment for increasing the volume and value-added of exports, diversifying export products and markets and increasing foreign investment to generate jobs and trade;
- participate successfully in international trade negotiations such as in the WTO or in the context of bilateral/regional trade agreements;
- effectively implement the results of such negotiations at the national level, i.e. transpose the respective agreements into domestic legislation and create the necessary administrative and institutional framework, e.g. for the protection of intellectual property rights in international trade.

With regard to the last point, the experience of the Uruguay Round in the AfT area is worth recalling. In the Uruguay Round of multilateral trade negotiations, which was conducted under the General Agreement on Tariffs and Trade (GATT) from 1986 to 1994 and led to the foundation of the WTO in 1995, a sizable gap emerged between the ability of DCs to implement new multilateral trading rules and the willingness of industrialised countries (ICs) to help DCs meet the ambitious requirements they were faced with.[9] Whereas the cor-

[8] Market-creating institutions would enforce property rights and secure the rule of law; market-regulating institutions would correct market failure; market-stabilising institutions would help to promote price stability, smooth business cycles and prevent financial crises; and market-legitimising institutions would care for social security etc., in order to maintain the basic economic system. For details, cf. H.- R. Hemmer, A. Lorenz: Grundlagen der Wirtschaftsempirie, Munich 2004, Vahlen.

[9] As pointed out in the literature, the costs associated with implementing WTO agreements can be significant not so much because of the disciplines themselves, but because of supplementary investments needed to apply the rules. Cf. B. Hoekman: Strengthening the Global Trade Architecture for Development: the Post Doha Agenda, in: World Trade Review, Vol. 1, Issue 01, 2002, pp. 27-28. Such costs typically arise when the removal of "behind-the-border" barriers to trade is at stake, in areas like health, safety and technical standards, customs administration, services, intellectual property, government procurement, foreign direct investment, competition, taxation, environment and labour. Trade policy reforms in these areas typically involve sweeping institutional changes; they are technically and administratively difficult and demand considerable financial and human resources, e.g. a minimum of capacity across government agencies for implementation and enforcement. This is in stark contrast to conventional "border measures," like tariff cuts, which in principle can be enforced "with the stroke of a pen". Cf. R. Sally: Trade Policy, New Century. The WTO, FTAs and Asia Rising, London 2008, Institute of Economic Affairs, pp. 88-89.

responding obligations assumed by DCs were binding, covering areas as diverse as goods, services and intellectual property, the assistance offered to DCs by ICs in complying with the commitments was typically couched in terms of "best endeavour," i.e. non-binding declarations of intent.[10] It was this contradiction which ultimately gave rise to new aid schemes in the form of Trade-Related Technical Assistance (TRTA) and Trade-Related Capacity-Building (TRCB). Prominent examples are the Integrated Framework for Trade-Related Technical Assistance (IF) for Least-Developed Countries (LDCs) and the Joint Integrated Technical Assistance Programme (JITAP) for a number of African countries, which were agreed on in the second half of the 1990s.

The TRTA/TRCB agenda was moved forward with the opening of the Doha Round in 2001 and broadened into the current AfT programme in the aftermath of the 2005 Hong Kong Ministerial. A major innovation in this context, brought forward by the AfT Task Force in 2006,[11] was the addition of "adjustment to trade" to the package. "Adjustment to trade" involves measures to support the adaptation by enterprises and households to developments in trade and trade policy. Such developments or "shocks" may cause substantial transition costs associated with the restructuring of production, retraining of labour, loss of fiscal revenue or erosion of trade preferences due to non-discriminatory multilateral liberalisation. In fact, trade openness has often not been accompanied by mechanisms for compensating inevitable losers in the process and boosting the opportunities of potential winners.[12] Specific trade-related industrial and social policies, which aim to protect the most vulnerable and facilitate the transition of enterprise and labour to expanding sectors of the economy, would therefore have to form an integral part of trade reform and of AfT too.

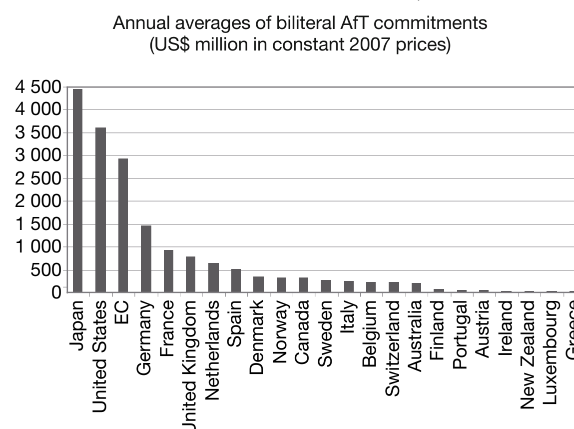
[10] Cases in point are the WTO agreements on Sanitary and Phyto-Sanitary Measures, on Technical Barriers to Trade, on Customs Valuation and on Pre-shipment Inspection, the General Agreement on Trade in Services, the Agreement on Trade-Related Intellectual Property Rights and the Understanding on Dispute Settlement, all of which contain such "best endeavour" provisions.

[11] The recommendations of the WTO Task Force on Aid for Trade were endorsed by the WTO's General Council in October 2006. For details, cf. Recommendations of the Task Force on Aid for Trade, http://www.wto.org/english/tratop_e/devel_e/a4t_e/implementing_par57_e.htm.

[12] In Latin America, for instance, few countries appear to have implemented broad adjustment programmes to address disruptions to local industries and labour markets resulting from trade liberalisation. Cf. A. Estevadeordal, P. Giordano, A. Jessen, J. Luna, K. Suominen: Lessons Learned. Delivering Aid for Trade in Latin America and the Caribbean: The Role of the Inter-American Development Bank, in: D. Njinkeu, H. Cameron (eds.): Aid for Trade and Development, New York 2008, Cambridge University Press, p. 237.

Figure 1
Bilateral Donors in Aid for Trade, 2001-2007

Annual averages of biliteral AfT commitments
(US$ million in constant 2007 prices)



EC = European Community.

Source: Own calculation based on OECD Creditor Reporting System, http://stats.oecd.org/WBOS/Index.aspx?DatasetCode=CRSNEW.

Stakeholders, Interests and Strategies

Stakeholders in AfT come from the public, private and non-governmental sectors. They comprise:

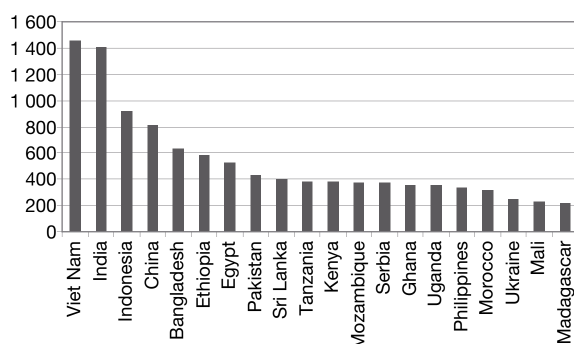
- individual donor countries or country groupings;
- individual recipient countries or country groupings;
- inter-governmental organisations (IGOs), in particular the WTO, the World Bank (including Regional Development Banks/RDBs) and the International Monetary Fund (IMF), which play an intermediary role between donors and recipients, together with other IGOs, like the United Nations Conference on Trade and Development (UNCTAD), the United Nations Development Programme (UNDP), the International Trade Centre (ITC) and the OECD;
- the private sector, which includes firms, business membership organisations (BMOs) and households, as well as non-governmental organisations (NGOs) and labour unions.

Individual countries or governments are the most important providers and recipients of AfT. In 2007, bilateral donors accounted for more than three fifths of total AfT.[13] Increasingly, AfT is also being provided by DCs (South-South cooperation) as well as in the context of triangular cooperation involving North and South donors and South recipients. Countries like Chile, China, Singapore and Thailand are among the

[13] Cf. Report to the TPRB from the Director-General on the Financial and Economic Crisis and Trade-related Developments, Geneva 2009: World Trade Organisation, p. 23, http://www.wto.org/english/news_e/news09_e/trdev_14apr09_e.htm.

Figure 2
Recipients of Aid for Trade, 2001-2007

Annual averages of committed AfT receipts
(US$ million in constant 2007 prices)



Source: Own calculation based on OECD Creditor Reporting System, http://stats.oecd.org/WBOS/Index.aspx?DatasetCode=CRSNEW.

most prominent South donors, passing on their own experiences with trade liberalisation to fellow DCs. However, when comparing the absolute sums of AfT funding, DCs have played only a limited role as AfT donors to date. As Figure 1 shows, the largest bilateral providers of AfT are Japan, the United States and the European Community.

Figure 2 lists major countries receiving AfT.[14] It appears that Asian economies, in particular Vietnam and India, have been the prime beneficiaries of AfT so far. African countries, on the other hand, tend to rank relatively low among the top AfT recipients. This is surprising in so far as donors seemingly focus their AfT on LDCs, most of which are located in Africa.[15] To some extent, the relatively low AfT share per LDC simply reflects a smaller average country or population size. Another possible reason is a limited "absorption capacity" for AfT in LDCs. Last but not least, the LDCs' most urgent needs may be not so much trade-related, but rather refer to nutrition and social programmes; such basic needs would accordingly crowd out some AfT.[16]

Among the IGOs, the WTO and the World Bank are the dominant "players" in AfT. The WTO's direct financial involvement in AfT is very limited. The WTO, too, is not a development agency. Its core role remains anchored in the functioning of the multilateral trading system. In this context, however, it has a particular interest to ensure that the growing trading opportunities created by multilateral liberalisation are effectively used, and to support its weaker member countries in this regard as well as in coping with the adjustment requirements which trade expansion entails.

AfT forms part of the Special and Differential Treatment (SDT), which the WTO accords to DCs.[17] At the same time, it represents a new, proactive SDT approach. Traditionally, SDT mainly consisted of exceptions for DCs to common multilateral rules or "disciplines" and obligations. Depending on the stage of development, these countries enjoyed, and still enjoy, privileges regarding (1) the protection of their domestic markets ("infant industry" protection), (2) their access to IC markets (tariff preferences) and (3) the multilateral negotiation process, where they were not obliged to grant "concessions" on a *quid pro quo* basis. However, the downside of these privileges was a relatively passive role and isolated position of DCs in the multilateral trading system.

AfT offers a way to change this, as it seeks to help DCs assume multilateral obligations and actively engage in multilateral negotiations, while at the same time assisting them in building international competitiveness and mastering structural adjustment. In this context, it has also been proposed that the poorest DCs be granted a statutory entitlement to technical support for the commitments they enter into.[18] In a similar way, adjustment assistance to trade – representing the third core area of AfT, as noted above – could be institutionalised. Both measures could serve to avoid permanent "opt-outs" from multilateral commitments. In sum, AfT has the potential to fundamentally transform SDT, and in the final analysis to render the "positive discrimination" of DCs in the multilateral trading system superfluous.

[14] Not listed are Afghanistan, Iraq and Turkey. These countries are statistical outliers biasing AfT due to special circumstances which in the cases of Afghanistan and Iraq relate to the respective wars and in the case of Turkey to the construction of the Istanbul Metro. For details, cf. WTO and OECD: Aid for Trade at a Glance 2007, 1st Global Review, Geneva and Paris 2007, p. 27.

[15] For instance, among the existing trade-related assistance programmes, the most prominent one, i.e. the Integrated Framework, is even exclusively directed at LDCs.

[16] Cf. W. Martin, A. Mattoo: The Doha Development Agenda: What's on the Table?, Policy Research Working Paper No. 4672, Washington DC 2008, The World Bank Development Research Group, p. 14.

[17] In this context, it has been pointed out that "while it is clear that developing countries benefit from freer trade, it is equally clear that their capacity to do so is different from that of developed countries. Developing countries generally have a more limited ability to take advantage of new opportunities and to bear adjustment costs. Special and differential treatment makes sense and should be made more effective and operational" (UN Millennium Project Task Force on Trade: Trade for Development, London and Sterling, VA 2005, Earthscan, p. 264).

[18] Cf. WTO: The Future of the WTO. Addressing Institutional Challenges in the New Millennium, Report of the Consultative Board, Geneva 2004, World Trade Organisation, p. 67.

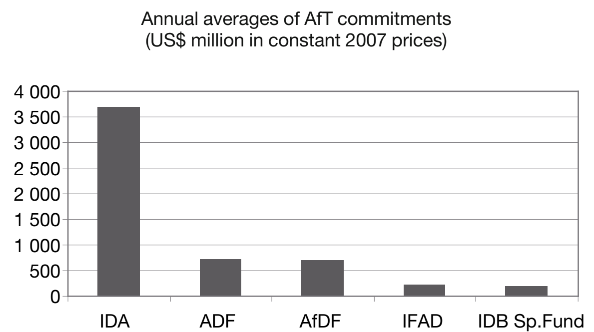
In the future, AfT may also form a core element of a third pillar in a new architecture of the WTO, alongside multilateral negotiations on market access and rules, on the one hand, and litigation or dispute settlement, on the other hand. AfT represents what has been called the WTO's "missing middle", i.e. its non-negotiating, non-juridical, deliberative functions. The record to date on AfT indeed suggests that WTO member countries can sustain over a number of years interest in and deliberation upon a matter of common interest that is distinct from the WTO's conventional functions. In this perspective, the AfT initiative even seems to have the potential to exert an important influence on the future trajectory of the multilateral trading system. However, for the WTO to effectively promote the case for AfT, and in particular to secure the commitment of other official agencies or international organisations in this area, it appears to be critical to provide a compelling rationale that the trade-related aspects of general development phenomena, such as the need for adjustment to structural change or the prioritisation of infrastructure and private-sector development, are either being overlooked at the moment or are worthy of differential treatment. Otherwise, it is held, there might be a risk that non-WTO parties involved in a deliberative process like AfT could regard the recommendations from the international trade community as special pleading.[19]

In contrast to the WTO, the World Bank has a big financial stake in AfT. As can be seen from Figure 3, the International Development Association (IDA, the World Bank Group's concessional lending arm) is by far the largest IGO donor in AfT. The four other top multilateral AfT donors include funds of the three leading RDBs – in Africa, Asia and Latin America – and the International Fund for Agricultural Development, a specialised agency of the United Nations established in response to the food crises of the early 1970s that primarily affected the Sahelian countries of Africa.

Trade-related activities of the World Bank include lending, technical assistance, training and analytical work. The World Bank is also engaged in capacity building in foreign trade; it facilitates the sharing of best practices by major donors and supports a development-friendly multilateral trading system. Overall, its trade-related lending was around US$1.4 billion in 2008, involving 51 projects, 12 of which had a regional focus.[20]

Figure 3
Multilateral Aid for Trade Donors, 2001-2007

Annual averages of AfT commitments
(US$ million in constant 2007 prices)



IDA = International Development Association;
ADF = Asian Development Fund; AfDF = African Development Fund;
IFAD = International Fund for Agricultural Development;
IADB Sp. Fund = Inter-American Development Bank, Special Operations Fund.

Source: Own calculation based on OECD Creditor Reporting System, http://stats.oecd.org/WBOS/Index.aspx?DatasetCode=CRSNEW.

The private sector is a prominent stakeholder in AfT from two perspectives:

- it is a major beneficiary of AfT activities
- it is a key agent in making AfT effective.

This dual role of the private sector in AfT is epitomised in business membership organisations (BMOs) which are the private sector's institutional backbone in DCs. BMOs are formed through collective action and although they bear risks (e.g. rent-seeking), they come with a series of positive characteristics, such as their networking and intermediary function. They are potential recipients of AfT from donor countries and international organisations, while at the same time acting as lobbyists, facilitators and multipliers/catalysts in this area. BMOs may thus also perform an "internal" AfT function within the respective country. In principle, BMO activities span the main stages of the AfT exercise, i.e. needs assessment and diagnostics as well as implementation and evaluation of the effectiveness of implementation, and they cover the main kinds of capacity building (human, institutional and infrastructural) on which AfT concentrates.

The role of BMOs in AfT has been analysed empirically in the case of the three original member countries of the East African Community (EAC) – Kenya, Tan-

[19] Cf. S. J. Evenett: Aid for Trade and the "Missing Middle" of the WTO, St. Gallen, 24 October 2008, p. 13 (mimeo).

[20] Cf. World Bank: Projects Overall Trade Lending, 2008, http://go.worldbank.org/9IUA3EW6V0, 13.04.09.

zania and Uganda.[21] It is shown that BMOs in East Africa face a variety of constraints preventing them from exploiting their potential. The main challenges pointed to in the analysis concern the areas of human resources and skills, organisational and financial management, and impact and monitoring systems. It is concluded that AfT projects can be crucial for BMOs in the EAC region to play a major role in trade and development.

Making Demand and Supply Match in Aid for Trade

In general, the question of AfT effectiveness concerns the process of matching up the supply-side with the demand-side of the AfT equation. This involves the assessment and prioritisation of trade capacity needs, their integration into national and regional development and poverty reduction strategies, the responses by donor countries and finally the collaboration between donors and recipients to get trade-related capacity building projects off the ground. AfT, coming on top of other Official Development Assistance (ODA), as called for by the WTO Task Force on Aid for Trade, could indeed be effective in tackling both market and governance failures in DCs, thereby promoting genuine development.

This is also indicated by an empirical investigation using country and sector specific data for 120 DCs over the period 1973-2006.[22] It is shown that AfT reduces the costs of trading, which is an important investment climate indicator and one which is particularly relevant for importing and exporting. It is also found that AfT indeed fosters exports, although the relationship is non-linear and the effect depends on a careful specification of the types of aid and exports. At the same time, it is stressed that domestic policies and institutions are likely to be even more important determinants of trade and development than specific types of aid.[23]

Foreign trade has in many cases not been adequately addressed in countries' development plans and Poverty Reduction Strategy Papers (PRSPs), while trade and commerce ministries appear to rarely formulate cogent strategies to improve international competitiveness. The "mainstreaming" of trade into development is commonly constrained by both scarcity of resources, which compete for different uses (e.g. trade versus health or education), and conflict or lack of coordination among ministries and other state agencies.[24] AfT is therefore also called for to secure better coordination among the various government agencies engaged in trade and trade-related policymaking.

In this context, it appears to be critical for DCs to gain "ownership" of AfT in the core areas of trade policy/regulation, trade development and adjustment to trade indicated above. Country ownership, whereby "partner countries exercise effective leadership over their development policies and strategies, and co-ordinate development actions",[25] is one of the guiding principles of the Paris Declaration on Aid Effectiveness, in conjunction with alignment, harmonisation, managing for results and mutual accountability.[26] Accordingly, the "package of assets" or "bundle of institutional arrangements",[27] through which the AfT initiative seeks to better integrate DCs into international trade and the trading system, should be put into effect under the aegis of recipient countries. This approach is also reflected in the PRSPs, which emphasise the importance of national development planning.[28] In fact, the success of AfT ultimately depends on recipient countries' ability to set the preconditions for economic development, i.e. the right legislation, policies, institutions and infrastructure.[29]

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[21] Cf. A. Agboghoroma et al., op. cit., chapter 4.

[22] M. Calì, D. W. Te Velde: The Effectiveness of Aid for Trade: Some Empirical Evidence, Trade Hot Topics, Issue No. 50, 2008.

[23] "Good quality skills and infrastructure, appropriate technology and sector policies and a market friendly investment climate tend to be mostly domestically shaped and aid for trade may provide a helping hand. Aid is not a substitute rather a useful complement to appropriate domestic actions" (M. Calì, D. W. Te Velde, op. cit., pp. 5-6).

[24] This situation is often mirrored in donor countries, where finance ministers may undervalue trade while development ministries may have insufficient resources at their disposal or have a low standing in the Cabinet.

[25] Cf. Paris Declaration on Aid Effectiveness, Paris 2005, p. 3, http://www.oecd.org/document/18/0,2340,en_2649_3236398_35401554_1_1_1_1,00.html.

[26] According to the Paris Declaration on Aid Effectiveness, *alignment* means that "donors base their overall support on partner countries' national development strategies, institutions and procedures;" *harmonisation* refers to "donors' actions (that) are more harmonised, transparent and collectively effective;" *managing for results* stands for "managing resources and improving decision-making for results" while *mutual accountability* holds "donors and partners accountable for development results" (Cf. Paris Declaration on Aid Effectiveness, op. cit., pp. 4-9).

[27] A. Suwa-Eisenmann, T. Verdier: Aid and Trade, Centre for Economic Policy Research, Discussion Paper No. 6465, London 2007, p. 15.

[28] Cf. K. Brolén, K. Wilska, M. von Bornsdorff: Aid for Trade: From Policies to Practice. The Cases of Mozambique, Tanzania, Vietnam and Zambia, Helsinki 2008, p. 337.

[29] Concerning trade-related infrastructure, in particular, it is also deemed to be important to address questions of policy consistency across countries, and to prioritise cross-border linkages. Cf. A. Estevadeordal et al., op. cit., p. 250.