

# TRADE POLICY, PROTECTIONISM, AND THE GLOBAL ECONOMIC CRISIS

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In March 2009 the Centre for Development and Enterprise and Business Leadership South Africa hosted a dinner discussion with senior business and government leaders and leading South African and international experts about trade policy and the spectre of protectionism amid the current economic crisis. Three experts were invited to lead the discussion:

- Robert Lawrence, professor of economics at the John F Kennedy School of Government at Harvard University, and a member of the Harvard Panel of Advisors to the South African Treasury;
- Peter Draper, head of the Development through Trade Programme of the South African Institute for International Affairs; and
- David Unterhalter, professor of law at the University of the Witwatersrand and chairman of the Appellate Body of the World Trade Organisation.

## INTRODUCTORY REMARKS

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*Ann Bernstein, executive director, CDE*

For two generations, the United States has led the global economy and promoted a more open international trading system. It is alarming that signs of increasing protectionism are emerging in America in the wake of the economic crisis.

During his election campaign, President Barack Obama attacked the North American Free Trade Agreement (NAFTA), and his initial dealings with Canadian and Mexican officials suggest that his administration will have protectionist leanings. It is significant that in his first meeting with a foreign president, Felipe Calderon of Mexico, one of the issues on the agenda was 'global standards'.



I share the view of a former president of Mexico, President Ernesto Zedillo, that this is a form of protectionism. He points out that just as developing countries start to compete with richer countries, so voices in the industrialised world start calling for global standards on labour, environment and social policy. It is also worrying that the stimulus package passed by the US Congress contains provisions that favour American firms. One clause, for example, states that steel used in expenditure on new infrastructure must be made in the United States.

There is a real risk that this resurgent American protectionism will stimulate other nations to respond in kind. In fact, this may be happening already. The British prime minister, Gordon Brown, speaks eloquently about free trade when he is outside Britain, and then promotes 'British jobs for British workers' at home. South Africa is not immune to this virus. For example, we have the 'Buy South African' campaign, and we promote local procurement, yet we rail against the European Union and the United States for their protectionist policies and practices.

'A serious commitment to open trade is needed to mitigate the effects of the crisis and accelerate the recovery'

What amuses me about the 'Buy South African' campaign is that many of the people who support and fund it do so sitting in their imported suits from Italy. As for the unionists who support this call, their t-shirts are not made in South Africa, nor are their shoes.

Protectionism is a dangerous game. It is one of those policies that is not only negative in itself, but causes wider negative consequences. In this context, it is important to remember – as the head of the WTO pointed out just the other day – that South Korea used export promotion policies to move from a GDP lower than that of Bolivia or Senegal 50 years ago to being the world's largest ship-builder and fifth largest car manufacturer today. So trade really does matter.

Protectionism is politically popular. But it will make the economic crisis longer and deeper. The ways in which the United States and other industrialised countries deal with trade issues will play a key role in how quickly and how strongly the global economy recovers from the crisis. How South Africa approaches its trade strategy in response to the downturn is also vital. Will we impose our own form of protectionism even as we call on richer countries to remove their trade barriers? And what impact will that have on our own prospects for sustained growth?

In my view, a serious commitment to open trade is needed to mitigate the effects of the current economic crisis and to accelerate the recovery process. The alternative is that we risk spiralling into trade wars that could impede growth in South Africa and the rest of the world for years to come.



## LET'S NOT REPEAT THE MISTAKES OF THE GREAT DEPRESSION

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*Robert Lawrence*

If we look back at the Great Depression, we see that three fundamental errors were committed at that time. The first was the failure to adopt expansionary fiscal policies. The second was a failure to reconstitute the banking system. The third was the huge tariff hikes in the United States, which caused retaliatory tariff rises throughout the world. There is little dispute that these tariff wars caused a major unravelling of global trade, and made the depression much worse.

We are now moving in many parts of the world on the fiscal front. The United States has a fiscal package in place, and China is taking steps towards one. We are doing our best to reconstitute the financial system. In terms of the trading system, at one level we are in a much better position than in the 1930s because we have an effective rule of law for global trade. It is highly unlikely that countries will raise tariffs overtly in the way they did in the 1930s, when the United States raised its tariffs by about 60 per cent across the board.

But there is a lot to be concerned about. Firstly, we are seeing a massive increase in the participation of governments in many economies: governments are taking over financial institutions, and supporting manufacturing firms. Under these circumstances, there will inevitably be pressures on governments to try to keep the money in their fiscal support packages 'at home.'

To be fair, the stimulus provisions finally passed in the US Congress made it clear that the United States would not contravene its WTO obligations. However, there are many loopholes in these rules. For instance, only the developed countries have signed the WTO agreement on government procurement.

Therefore, the United States is within its rights under WTO rules to discriminate in government procurement against imported products from developing countries. There

is also a lot of wiggle room in the WTO, because many tariffs are much lower than the legal maximum 'bound' tariff rates. So technically they can raise the tariffs without legal consequences. Likewise, there is room for countries to increase their agricultural subsidies without contravening their WTO obligations.

'We really need to bring the Doha Round of trade talks to a conclusion'

All this means that we really need to bring the Doha Round of trade talks under the WTO to a conclusion. Given current threats, completing the Doha Round is more urgent than ever. When signed, the Doha Agreement would cut subsidy levels, bound rates, and many tariffs across the board. The tariff formulas contained in Doha would provide transparency and predictability. Every member country would know how the others would set their tariffs. So, under Doha, trade negotiations would become much more efficient and equitable, and outcomes would become much more foreseeable.

It is really worrying that the United States does not yet have a position on the Doha Round. Obama has yet to appoint a special trade representative. Worse, even prior to this economic



crisis, there was a strong feeling among the American public that the trade agreements were not working in America's interest. What little enthusiasm the United States had for the trade agreements before the crisis has now waned considerably. Many of the new members of Congress were elected on 'fair trade' positions. But I'm still hopeful. Obama was elected because he said he wanted the United States to re-engage with the world, and participate in multilateral initiatives. He will therefore find it very difficult not to go along with the Doha Round.

Even if we avoid a serious resurgence of protectionism, I am still really concerned about both the world and the South African economies. We have a lot longer to go in this crisis, a lot more to see. The South African economy is already very vulnerable. The current account deficit is dangerously large. The Harvard Group, of which I am a member, has tried to highlight the importance of exports in sustaining South Africa's economic growth, and with commodity prices subsiding there will be severe constraints.

'We have a combination of a relatively weak state and certain constituencies who want protectionist interventions. This is a worrying mix.'

I began by talking about the 1930s. The long-run implication of the 1930s was that many developing countries developed the impression that the global economy was an extremely hostile place. What we saw was countries around the world turning inwards, believing that they had to control their own fate through planning, import substitution strategies, and fragmenting the global economy. Those decisions really harmed the developing world. Since those kinds of approaches began to be abandoned by Latin American and African countries around 20 years ago, those regions have made a lot of progress – especially over the past seven years. We're finally seeing evidence that Africa and Latin America are participating positively in the global economy, and are enjoying good growth. So my concern is that the year into which we are moving will be a very dangerous one. We could retreat into protectionism again just at the time when we were beginning to see some really positive signs in these regions.

## SOUTH AFRICA NEEDS COHERENT AND TRANSPARENT TRADE POLICIES

*Peter Draper*

Even before the current economic crisis, there was a shift in South Africa's trade policy. In the 1990s, first under Trevor Manuel and later under Alec Erwin, unilateral trade liberalisation was very much on the agenda. We were very bullish, even exceeding our commitments under the Uruguay Round. We also carried forward liberalisation through a series of bilateral negotiations. The most significant of these was the agreement with the European Union.

This trajectory has been reversed. We're in an anti-liberalisation backlash. How far it will go remains to be seen. That will probably depend on which factions come to dominate the tripartite alliance after the election. In any case, government no longer talks about trade liberalisation, but about industrial policy. What exactly industrial policy means is not clear to me – and I'm not sure it's clear to the people who are driving the debate. In my view,



there are significant capacity problems in government, not least among those charged with implementing industrial policy. So we have a combination of a relatively weak state and certain constituencies who want protectionist interventions by the state. This is a worrying mix. And it is one of the main reasons why I am against the current emphasis on using fiscal policy – in other words, taxpayers' money – to try to stimulate the economy, particularly when the monetary policy toolbox has hardly been exhausted.

The Department of Trade and Industry (DTI) has established a Trade Policy Reference Group, which has been meeting mostly behind closed doors. This raises a serious concern about the lack of transparency in our trade policy. The combination of a weak state and industry groups aiming to pursue their interests through un-transparent processes is a recipe for bad policy-making. There should be no reason why certain industries should get to meet the DTI in secret. In my opinion, if discussions about trade policy are not in the public domain, the potential is there for collusive processes and for ad hoc protectionism. That's a red flag for South African trade policy-making, particularly where taxpayers' money is concerned.

'We need transparency and a whole-economy perspective'

The National Economic Development and Labour Council (NEDLAC) document on South Africa's response to the global economic crisis is a perfect example of the kind of closed door processes which I would like to see brought out into the public domain, and properly debated. This document is pretty inconclusive. I'm not sure if there is a coherent policy line in the document, but what there is seems to reinforce the worrying tendencies I've already mentioned: recourse to various instruments of protection, including tariff increases. There is also an emphasis on using regulations to protect certain sectors that are in trouble, but there is no mention of exactly which sectors – perhaps that will be the outcome of the next phase of the process. Just like the Trade Policy Reference Group, it seems to me that the NEDLAC document sets the scene for jockeying between different business interests to get protection and a slice of the state subsidy pie.

To sum up, I would like to emphasise that if we want to avoid confusion, inefficiency, and the possibility of increased corruption in our trade and industrial policy-making, we need transparency, and a whole-economy perspective. We need to know exactly what the criteria would be for supporting this sector over that sector.

I would like us to adopt an Australian kind of approach to protection. What they did back in the 1980s was to set up a Transparency Board. If a company wanted tariff protection, it had to go through this board, and make its case publicly. Anybody could object, and the merits of the case were thoroughly debated in the public domain. In some cases, the board did protect the company because it was obvious there was a national – and not just a firm-level or sectoral interest – at stake.



## HOW TO KEEP MULTILATERALISM ALIVE

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*David Unterhalter*

Ever since World War Two, the trend of international relations has always been towards creating and perpetuating multilateral institutions. Of course, alongside multilateralism were a number of cross-currents, which included a multiplicity of bilateral trade agreements, and a very significant focus on regional trade as the important attribute of how integration should take place.

Now I think we have reached a point where there is at once a significant level of agreement on the value of multilateralism and a significant level of agreement that, because of the shifting power relationships in the world, there has to be a reformation of existing multilateral institutions.

The WTO is a very good example of a multilateral rule-based system that was negotiated through successive rounds. Some of the negotiations were very ambitious, particularly the Uruguay Round, which not only committed signatories to freer trade but also created a system of dispute settlement. This meant that international trade relations became subject to sanctions for non-compliance. I think the system has been pretty successful so far in cementing the rules and ensuring they are complied with.

However, the Doha Round has been very difficult to negotiate. The WTO was once a club of three or four very powerful trading nations; everyone else was more or less bullied into shape and then given some small concessions. In those days, once the big powers had decided on the round, the round was decided. The world has completely changed since then. There have been significant changes in the distribution of trading power across the world. Now India, China, Brazil, to some degree South Africa, matter enormously in trade negotiations.

Hence the complexity of getting a trade round completed has increased exponentially, and hence the difficulty of completing the Doha Round. In our current post-Uruguay, pre-Doha world, we have a multilateral system that is highly functional, but its legislative capacity for change is significantly compromised.

If we can't move forward multilaterally, what's left? One possibility is enhanced bilateralism – a greater entrenching of regional trade blocs. A worse possibility would be a reversion back to unilateralism, protectionism, and a wholesale descent to the bottom, which economists warn would be catastrophic for us.

Looking at the longer run, I think we need to be ambitious and include more areas of co-ordination in multilateral institutions and resist either bilateralism or, worse still, unilateralism. What we should do is to continue to develop multilateralism within existing institutions and possibly in new ones that cannot be held to hostage by those countries that are most difficult to reconcile with the proposals on the table. We need to expand

'The United States has a deep interest in a trading system based on the rule of law'



multilateralism to include new areas of co-operation, including co-ordination of financial regulation and competition law.

One attractive option for keeping multilateralism alive in a very challenging and increasingly complex world economy is 'variable geometry' – those countries that can agree in a multilateral context to move matters forward should agree to do so, leaving the door open for those who cannot agree to come in later.

Under variable geometry, the benefits of multilateralism are advanced for those who are willing at a particular moment to sign on.

As for the short term, some people now speculate that trade disputes within the WTO will increase significantly. I don't see that as a failure, as long as countries still act within the rules, and comply with the outcomes of the WTO's disputes-settlement system. What would be a terrible failure would be if countries unilaterally change the rules, and fail to comply with WTO rulings. Then the system would fall apart, and we would have lost something very important.

Finally, on the Doha Round and the United States, we are indeed at a significant juncture. The Obama administration has not been clear on a number of issues, and there is a huge lobby within the United States that is disaffected with the rules-based system of international trade. It matters tremendously that the United States continues to play a positive and ambitious role within the rules-based multilateral system. Obama has to be seen to lead. If his administration gives in to localised interests that would like to pursue protectionist policies, we would have lost the most significant force for multilateral good in the world.

'The Uruguay Round, which today looks like a spectacular achievement, was at the time regarded as somewhat disappointing. The Doha Round will look a lot better when it's signed'

## DISCUSSION

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### ■ Are we going to get a Doha Round agreement this year?

*Robert Lawrence:*

I don't know. I don't think anyone has a clue how things will develop. I certainly want to endorse the perspective that David Unterhalter gave us on the importance of the rule of law and multilateralism.

I'm actually optimistic that we will get a completed Doha Round fairly soon, because I think the United States has a deep interest in a trading system based on the rule of law. After all, the Bush administration, which was generally unwilling to adhere to multilateral disciplines, nonetheless adhered to the rules in the WTO. The reason why the United States came into compliance with the WTO was not idealism but national interest. This is what gives me hope for the Doha Round. The United States would sometimes like to violate the law, and indeed



does so on occasion, but in general, as the dominant economy, it has a strong interest in a global rule of law. Multilateral agreements save negotiating effort, are good for our trade performance, and are good for America's international image.

In the current economic crisis, the world would be much better off signing an acceptable Doha agreement as soon as we can. It doesn't have to be perfect. We should remember that every big global agreement looks disappointing at first, when it is judged in light of the demands that the various parties are making. The Uruguay Round, which today looks like a spectacular achievement, was at the time regarded as somewhat disappointing. We are the same moment with the Doha Round. It will look a lot better once it's signed.

*Peter Draper:*

I think there is close to zero prospect of the Doha Round coming to agreement this year, but that does not mean that it is dead. I believe the basic architecture for the Doha Agreement is in place, and that what we lack is political will among all the key powers, particularly the United States. But the United States is not the only problem. China, for instance, has been close to invisible in the negotiations. And aspects of the proposed agreements are also challenging for countries such as India, Brazil, and South Africa. For instance, the non-agriculture market access (NAMA) formulas on the table would present South Africa with serious political challenges because these would require both developed and developing countries to cut tariffs across the board on industrial and manufacturing goods.

'We actually cannot afford the pessimism. One way or another, this deal has to be done'

*David Unterhalter:*

There is a lot of pessimism around the Doha Round at the moment, but one needs to get this into perspective. We were very close last year to getting the Doha Agreement signed, but negotiations fell apart at the end of the day over a relatively minor issue between China and India that could not be resolved.

We actually cannot afford the pessimism. One way or another, this deal has to be done – whether in a 'light' form or a full agreement really does not matter. The alternative is that we start to question what we already have in the Uruguay Round. We have to keep moving forward, however small the increments by which we do so. If we fail to do that, the risk to the system generally is extremely high.





- In this global economic crisis every country is concerned about protecting its national interest. How do we ensure that this doesn't create a domino effect of protectionism?

*David Unterhalter:*

First, everyone should realise that protecting open trade and multilateralism is in their interest. And, in fact, developing countries actually have a much higher stake in a rules-based system than the most powerful trading countries. If developing countries had to take on the United States or Japan on a unilateral basis, national interest and power would simply assert themselves, and developing countries would consistently lose out. So people should realise that there really isn't a viable go-it-alone option. You have to ask yourself, if your trading partners are going to try the same self-interested strategy that you are tempted to adopt, what's going to happen in the end? The answer is that there will be a reversion to unilateralism and tariff wars. Everyone will lose, and poorer countries will lose most. That does not seem to me to be in anyone's interest.

'There is a lot of room for self-interest to be articulated within the current system'

Second, it's important to realise that there is a lot of room for self-interest to be articulated within the current system. It is worth learning some lessons from the countries that are enormously adept at using the rules for their own advantage. I don't think South Africa does enough of this. Too often, we take an entirely haphazard and passive approach. We should have a very cohesive and strong trade authority in this country that is willing to use the wiggle room in the rules, and to engage in disputes from time to time to defend our national interest.

*Robert Lawrence:*

I am very attracted to David Unterhalter's point about variable geometry as a way of reconciling self-interest and multilateralism, and so avoiding a descent into protectionism. The WTO could allow some obligations to be assumed by the willing while leaving other countries out. For instance, many developing countries believe that intellectual property protections are not in their interest. Maybe they are, and maybe they aren't, but the question I would raise is: why is it necessary for every country to sign on to intellectual property protection? Likewise for foreign investment rules, rules against export subsidies and labour standards. Why not let those countries which want to sign on do so, and let the others join in when they're ready?

I don't think developing countries are reluctant to endorse the rule of law, particularly if the rules are used to control developed countries. However, there is a big debate about the degree to which the rules provide developing countries with what they believe they need in the way of policy space. But, as we've been saying, one size does not have to fit all. The brilliance of the WTO system is that it allows variable tariffs. I think it should evolve in the same direction when it comes to rules.



## ■ How should Africa work towards regional trade integration?

*Robert Lawrence:*

Grand designs for African regional integration are not credible at this point. African countries are far too enthused with the European model of integration, particularly the notion that they should sign up to ambitious customs unions, and far too unenthused with the Asian model of regional integration. The Asian model is very pragmatic. It is much less focused on treaties and rules, and much more focused on concretely facilitating trade by improving infrastructure and making customs systems work efficiently.

*Peter Draper:*

I completely endorse Robert Lawrence's view. To come back to the point that I made about weak states trying to implement regulation-intensive processes, I think our fetish for customs unions and common markets is inappropriate for our region. We just don't have the political will or the bureaucratic capacity to create a functioning African version of the European Union. I think we could learn a lot from the Asian model of integration.

## ■ How can we protect jobs during the current crisis?

*Robert Lawrence:*

Creating jobs is better than protecting jobs. And the way to create jobs is to stimulate South Africa's tradable sectors – labour-intensive manufacturing and service sectors, including tourism. The best way to stimulate those sectors is to have an appropriate exchange rate, which will occur if you have relatively loose monetary and relatively tight fiscal policy.

In terms of protecting jobs, do you really save employment when you protect individual jobs? If I use tariffs to save the jobs of the people who are making fabric,

what do I do to the people who make clothes? There are downstream effects every time the government chooses to save a job. It often has the consequence of hurting others, either consumers or other producers who use the protected product as an input. I'm not saying there is no role for transitory protection, but I think you must be very wary of assuming that when you protect jobs, you have actually increased employment overall.

'You must be very wary of assuming that when you protect jobs, you have actually increased employment overall'



- Should South Africa protect some industries that do not have the size or know-how to compete with imports?

*David Unterhalter:*

South Africa's performance in regulating and supporting industries has been very patchy. We keep creating fresh regulatory and industrial policy powers, but we haven't recruited the skilled personnel to run these kinds of institutions effectively. Until we get in the necessary people, we won't be able to run coherent industrial and tariff policies.

*Robert Lawrence:*

South Africa's tariff structure is much too complex. It should be radically simplified. Within a simplified system, it would be acceptable to make room for some employment safeguards and infant industry protections as long as these are created transparently and according to clear and objective criteria.

'There can and should be different levels of participation within a single scheme of multilateral agreements'

However, the major thrust of industrial policy should not be about giving subsidies or trade protection to favoured industries.

Industrial policy should be about the government providing the necessary public goods which private industries cannot provide for themselves. If you want to have a vibrant call centre, services or export industry in South Africa, and you have second-rate internet systems, you are never going to succeed. Likewise, if you want the tourism sector to grow, but your national airline is a protected monopoly charging high prices, then tourists are simply not going to arrive.

In general, governments should be very cautious when industries ask for subsidies or tariff protection. But they should be very enthusiastic when industries ask the government to provide the necessary public goods and services that will allow those industries to thrive.

## CONCLUDING REMARKS

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*Michael Spicer, CEO, Business Leadership South Africa*

This discussion has been among a group of like-minded people who generally see the benefits of free trade. But that view is not necessarily widely held in the broader society, where protectionism attracts a lot of support. That's why we need to have more discussions such as this. We need to stimulate more debate about trade policy, tease out different viewpoints, and hopefully end up with policies that better suit both our national self-interest and the global interest in returning to growth as soon as quickly as possible.

As a contribution to stimulating the kind of debate we need, I'm going to summarise the key messages of the evening:



## ■ Global lessons

The world cannot afford to revert back to the old system of bilateralism, or – worst still – unilateralism. It is in the national interest of every country – and particularly developing countries such as South Africa – to avoid a descent into trade wars and to defend and extend the multilateral, rules-based trade system

One size does not have to fit all. There can and should be different levels of participation within a single scheme of multilateral agreements. The benefits of multilateralism can then be advanced for the willing, without permanently excluding those countries that are not yet ready to sign a particular agreement.

Ultimately, the United States and a few other major trading powers have to lead the drive to protect and extend multilateralism and free trade. Without political will in the major capitals to complete the Doha Round, this won't be achieved, and the world economy will be gravely set back.

## ■ Lessons for South Africa

We need to avoid the protectionist pitfalls in some of the stimulus packages created in other countries. If discussions about trade policy are not in the public domain, the potential is there for collusion and unwarranted and damaging protectionism.

Good trade and industrial policy-making requires transparency, and a whole-economy perspective. Employment safeguards and infant industry protections only make sense when they are created transparently, and according to clear and objective criteria. Even then, it is doubtful that they are preferable to growth policies based on openness, liberalisation, competitiveness, and productivity enhancement.



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