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Global Future Council on International Trade and Investment

Strategic Brief for the G20 Summit in Hamburg, Germany

Depart from global trade cooperation at your peril

At the beginning of 2017, amid great uncertainty about the world economy, this Global Future Council identified three potential futures for international trade: a "good" scenario in which governments keep markets broadly open while acting domestically to address the sources of popular discontent over globalization; a "bad" scenario of rising negative rhetoric and unilateral, albeit limited, trade action; and finally, "ugly" unconstrained trade wars that needs no further description.

Six months on, we are veering towards the "bad" track, though anti-trade language from some quarters has been countered elsewhere with pro-openness appeals and initiatives, including the G7 commitment in Taormina, Italy, in May to "keep . . . markets open and to fight protectionism". Nevertheless, our trajectory remains one that could potentially lead to increased trade conflict and weakened international frameworks, leaving countries less well equipped to jointly tackle a future economic downturn.

This briefing note sets the stage for how to think about trade and investment issues ahead of the July G20 summit in Hamburg, Germany. As the self-styled pre-eminent forum coordinating global economy policy-making, G20 economies' orientations towards the global trade and investment system are highly consequential. It makes the case that an uncoordinated pursuit of national policy goals risks blundering into economic chaos. It also outlines five key principles on the value of the global trade system, despite its imperfections, and pleads for tempered approaches to the push-back against the existing international order.

Why the legitimacy of globalization is under fire

Legitimacy rests on beliefs about associated outcomes and process. The international trading system is under fire on both scores. Many claim the current rules are unfair, reflecting the voice of a few powerful countries and interests, and failing to create a "level playing field" – though views differ sharply about in whose favour the field is tilted. Opinions similarly differ about the reach of trade rules; some feel that regional and multilateral obligations unduly constrain the legitimate exercise of national sovereignty, while others favour integration that is deeper still.

The outcomes of the open global economy have also been mixed. Globalization has not lifted all boats. While worldwide poverty reduction has been impressive, the world's poorest have been unable to share fully in these gains, particularly those in the least developed countries. Many advanced economies, meanwhile, face increasing inequality and sluggish productivity. Significantly, 42% of countries ranked on the World Economic Forum Inclusive Development Index saw their scores decline over the past five years even as GDP per capita increased, attesting to the validity of public concern over the distribution of wealth and opportunities. The global trading system is hardly alone in having its legitimacy questioned. Trust in national institutions, and confidence in their ability to advance better living standards for all, has been crumbling as well.

Why open markets for trade and investment still matter

Despite these challenges, it is worth reiterating the central case for trade as a tool for sustainable development, while working on boosting its legitimacy and minimizing its negative impacts. Open global markets for trade and investment support the productivity gains that come with greater competition, specialization, scale and smoother cross-border movement of ideas and know-how. Decades of decreasing trade costs, the result of policy reforms like tariff cuts and technological improvements in logistics and telecommunications, led until recently to a rapid increase in global trade in goods and services. In turn, joining international production networks has helped drive growth rates up and poverty rates down in many developing countries, most notably China.

For consumers, the results have been greater choice of new products and services and lower prices. This is particularly significant at the lower end of the income spectrum, since the poorest tend to spend more of their incomes on food and merchandise, so every dollar counts. One estimate for 40 economies found that open trade boosted the purchasing power of low-income households by about two-thirds, while increasing that of rich households by about a quarter. Interestingly, the pro-poor bias of purchasing power gains from trade is strongest in advanced economies; raising the cost of imports would hurt poorest households in these nations the most.

In theory, trade helps drive growth by encouraging efficient resource allocation within and across economies; in other words, pushing the most productive firms and sectors to expand while the least productive ones shrink or close.[1] However, this means some workers will be hurt by increased trade, even as countries gain overall. Without effective domestic policies designed to address the needs of those displaced – whether by trade or other factors such as technological progress, weaker competitiveness or other policy shortcomings – the negative impact on communities can be harsh and long-lasting, as has been documented in parts of Europe and the United States.

Closing markets in response to this may be sorely tempting, but it would be a mistake. One country's targeted protectionism is another's blocked market, and a compromised global growth engine more generally, as trade barriers tend to invite retaliation in kind. Trade-distorting practices and policies that bar imports or offshoring in some sectors might keep a few factories open, at the cost of higher domestic prices and weaker productivity growth resulting from decreased specialization, competition, and scale. With workforces ageing everywhere outside Africa, productivity growth, which has already been worryingly low, is essential for maintaining and improving living standards. So, while the outcomes of economic globalization may be far from perfect, there is still much to commend.

G20 economies should commit to keeping markets open, but as a means, not an end. Open and fair trade should be recognized as a tool to drive growth, innovation and productivity, boost consumer purchasing power and help reduce poverty. At the same time, global leaders must commit to domestic policies and practices aimed at leaving no citizen behind, and continue to assist countries with inadequate means to manage the downsides of globalization.

What global trade rules do for businesses, consumers and the planet

On process, we remain convinced that the optimal governance of international trade and investment requires clear rules rather than a series of one-off deals. The decades of market-opening described above have been entrenched at the World Trade Organization (WTO). And while bilateral and regional rules are a key part of the global trade and investment architecture, they are no substitute for the WTO, which serves as its foundation.

Trade rules, and in particular multilateral trade rules, minimize fragmentation and inefficiencies that hurt bottom lines for companies, workers and consumers. Consider a company in Texas that makes car seats for Ford and General Motors containing seat-folding mechanisms that are assembled in Mexico using capacitors imported from Asia. Instead of being able to purchase from the lowest-cost or most innovative source, if the firm were restricted to sourcing components domestically, or from a select handful of countries, or only from companies that its government had export deals with, its choices would diminish and its costs would rise. The result would likely be more expensive car seats, costlier cars and, quite likely, less investment in Texas, Mexico and Asia.

Imagine a world without predictable trade rules. Farmers in Missouri or Kansas would hesitate to borrow money to ramp up beef and wheat production in response to high demand in China if that market could be slammed shut without reason or notice. The prospect of intellectual property theft or displacement by subsidized competition would discourage innovation and investment.

More than 50% of US wheat production, 75% of cotton production gets exported. Over 40% of US agriculture exports go to Canada, China, and Mexico alone.

Source: https://www.ers.usda.gov/data-products/ag-and-food-statistics-charting-the-essentials/agricultural-trade/

1 The Council notes that other factors and policies also impact competitiveness and associated resource allocation.

A world with no or minimal international guidelines, efforts at regulatory coherence and mutual recognition for the standards countries impose for public health and safety would be chaos for exporters and importers. Inconsistent product standards add costs and complexity that SMEs, in particular, find difficult to navigate. An apple-grower in Australia would have to make sure that her orchard's fruit met different arbitrary, rather than science-based, criteria for pesticide residue levels, for each and every market she wanted to export to. Given that SMEs formally account for more than 50% of total global employment and create about four out of five positions in developing countries, simplifying their owners and managers lives is time well spent.

International cooperation on some trade-related issues is also critical to mitigate the tragedy of the commons. For example, many governments around the world subsidize the expansion of their domestic fishing fleets or fuel to power these, even though many global marine fisheries are perilously close to collapse. No two or three governments alone ending these payments, while commendable, will be enough to solve the collective action problem. Governments need to act multilaterally through the WTO.

G20 economies should keep the door open to cooperative approaches on trade and investment that instil level playing fields, safeguard the common good and minimize costs to business – especially SMEs – and consumers.

Don't ditch the WTO – improve it

As with the mixed review on outcomes, however, the WTO and the global trade and investment architecture are not beyond fault. The WTO rulebook has struggled to keep pace with a rapidly shifting global economy. Most WTO rules were finalized in April 1994, about six weeks before Jeff Bezos founded the company we know as Amazon.com. The institution's widely respected dispute settlement mechanism takes too long to resolve cases; more resources would help to reduce the backlog. The monitoring and surveillance function could also be more effective to ensure everyone sticks to the agreed rules. There is also some truth to claims that trade agreements are not adequately enforced, that the WTO rule book still allows governments to engage in murky protectionism or, conversely, that it constrains policy action in ways that were never openly agreed at the negotiating table.

For the reasons outlined above, the solution is not to marginalize the multilateral trading system, but to invest time and energy in improving and updating it. For instance, governments could find ways to incentivize the proper notification of policies to the WTO in a timely fashion, perhaps by using counter-notifications to ramp up peer pressure. The rulebook itself needs to keep up with evolving business needs, alongside identifying opportunities to contribute to sustainable development. Other reform areas could be discussed, too, but only by those sitting at the table. It is difficult to have a conversation when someone has left the room.

WTO Members have shown themselves able to strike issue-specific, commercially meaningful agreements, such as a deal on trade facilitation that recently came into force. By some estimates, it will cut the costs of trading by up to 15% – key to helping SMEs participate in international trade – and could add as much as $1 trillion to the global economy.

One area where governments could usefully pursue agreement is on digital trade and e-commerce, where a modicum of consensus on what constitutes good e-commerce-related policies – such as on e-signatures or electronic payments – would improve the digital transaction environment to the benefit of all business and consumers. Simplified, modernized, interoperable trade rules can enable SMEs to be an engine of domestic and global growth. To be inclusive, of course, such rules will need to be matched by a commensurate focus on skills, training and other factors to accelerate use of and access to the digital economy.

G20 economies should invest in updating and improving global rules for trade and investment to meet the challenges and needs of ensuring sustainable development in the 21st century and ensure that opportunities are generated for all businesses. Common approaches identified in bilateral trade agreements could provide the basis for incremental advances multilaterally.

Global trade works best when countries act at home

While governments often blame international strictures for unpopular policies, the panoply of international trade and investment rules affords national governments considerable space for independent policy action. Indeed, if many citizens in advanced economies perceive that the trade and investment system has not translated into benefits for society as a whole, it is in substantial measure due to shortcomings in domestic policies in areas such as education, retraining, infrastructure, or social safety nets.

For example, the Republic of Korea devotes 3.74% of government spending to public research and development, more than double the OECD average. And Sweden, despite having entrusted many of its external policies to the European Union, has been able to curb income inequality and fund active labour market policies, as well as labour-force-participation-enhancing childcare, because it has been willing to maintain relatively high and progressive levels of taxation, among other demand-and-supply-side economic policies.

Ironically, while a substantial – if not the dominant – source of the negative reaction to economic globalization emanates from developed countries, it is the world's poorest economies that are least equipped to implement mitigation strategies, and will also be most affected by the "bad" trade scenario currently unfolding.

G20 governments should build on past pledges to exchange best practices on policies that ensure broad-based economic growth and reduce economic inequality. A domestic policy and institutional environment that fosters inclusive growth is needed to ensure the benefits from trade, technological innovation and growth are widely shared. While addressing domestic needs, G20 economies also need to consider how to support those least able to help themselves, including through Aid for Trade.

A call to action

In this briefing note we encourage G20 economies, and more broadly global leaders and communities worldwide, to commit to:

- Keeping markets and trade open, not as an end but as a means to keep supporting growth, competitiveness and economic opportunities
- Maintaining cooperative approaches on trade and investment that instil level playing fields, safeguard the common good and minimize costs to business – especially SMEs – and consumers
- Improve the functioning of the World Trade Organization, both on process and outcomes, to update global rules for trade and investment that meet the needs of all businesses and consumers in the 21st century
- Advancing to policies at home that translate the gains from trade, innovation and technological advancement into broad-based economic growth and reduced inequalities
- Supporting the use of trade as a means to end extreme poverty

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