



Beyond Doha

Freer trade is under threat—but not for the usual reasons

DURING a summer when the economic shadows darkened so dramatically, few paid attention to the collapse—yet again—of the Doha round of global trade talks. Champions of liberal trade, such as this newspaper, wrung their hands, but no one else cared much. The failure in Geneva, where the World Trade Organisation (WTO) is based, seemed something of a sideshow.

In a global survey of business executives, conducted for this special report by the Economist Intelligence Unit, a sister company to *The Economist*, over half the respondents regarded the Doha round as minimally or not at all important, and only 10% thought it very important. One in ten saw protectionism as the biggest threat to the world economy, but far more were worried about recession, inflation and the financial crisis.

At first sight that seems a reasonable judgment to make. With so many barriers already removed, the immediate economic stakes in the Doha round are modest: gains of some \$70 billion a year, according to one recent estimate, little more than 0.1% of global GDP. Add in the likely boost to productivity growth and the eventual impact will be higher, but it is still hard to argue that the Doha round, taken in isolation, could dramatically change the world's fortunes.

That is partly because the negotiations were about "bound" tariff rates—the maximum permitted by global trade rules. But most countries have already slashed their tariffs unilaterally to well below the bound rates—and it is actual trade barriers, not the highest permissible ones, that businesspeople worry most about (see chart 12). Tellingly, the scale of corporate lobbying around the Doha negotiations has been much lower than in previous global talks, such as the Uruguay Round.

Nor is it hard to see why many companies discount the risks of protectionism. Rich countries, particularly America, have grumbled a lot about trade with China, but nothing much has happened to obstruct the spread of commerce. Congress has threatened to punish China's currency policy with tariffs and to "get tough" with other supposedly unfair trade behaviour,

but no laws have emerged. Globally, the use of anti-dumping duties, a popular protectionist tool, has fallen. With supply chains so integrated, it is tempting to conclude that multilateral negotiations are no longer necessary and new trade barriers have become implausible.

Tempting but wrong. In an increasingly integrated world, multilateralism matters more than ever. The inability to get a Doha deal done is a worry not because of the modest amount of freer trade forgone but because of the symbolic importance of the talks and the reasons for the impasse. This trade round is the first international forum in which big emerging economies, such as India, Brazil and China, have played an influential role. Failure to reach agreement thus bodes ill for future multilateral co-operation of any sort.

If the talks continue to flounder, negotiating momentum will shift to (far less desirable) regional and bilateral trade deals, of which there are already some 400 in place or under negotiation. The WTO itself may be weakened. India signed a regional trade deal with the ASEAN group of Asian countries less than a month after the Doha talks fell. If countries lose faith in multilateral negotiations as a means to achieving better market access, they may turn to litigation to reach their trade goals.

Perhaps most worrying, the Doha impasse in part reflects the intellectual shifts that this special report has described. The July summit failed because of China's and India's insistence on maintaining the right

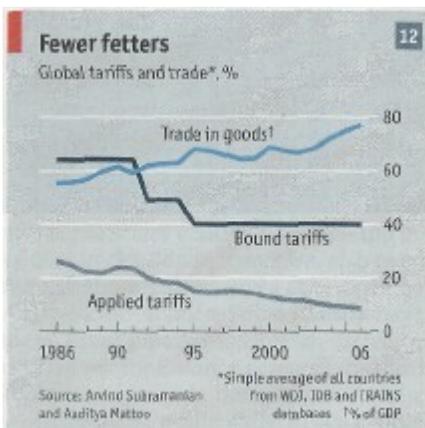
to impose "safeguard" tariffs to protect their own farms in case of a sudden surge in food imports. India, which has over 200m farmers, has long been reluctant to expose them to international competition. China, which had kept a low profile throughout Doha's six years of tortured talks, swung behind India's position at the last minute, worried about food security in the wake of the commodity-price surge.

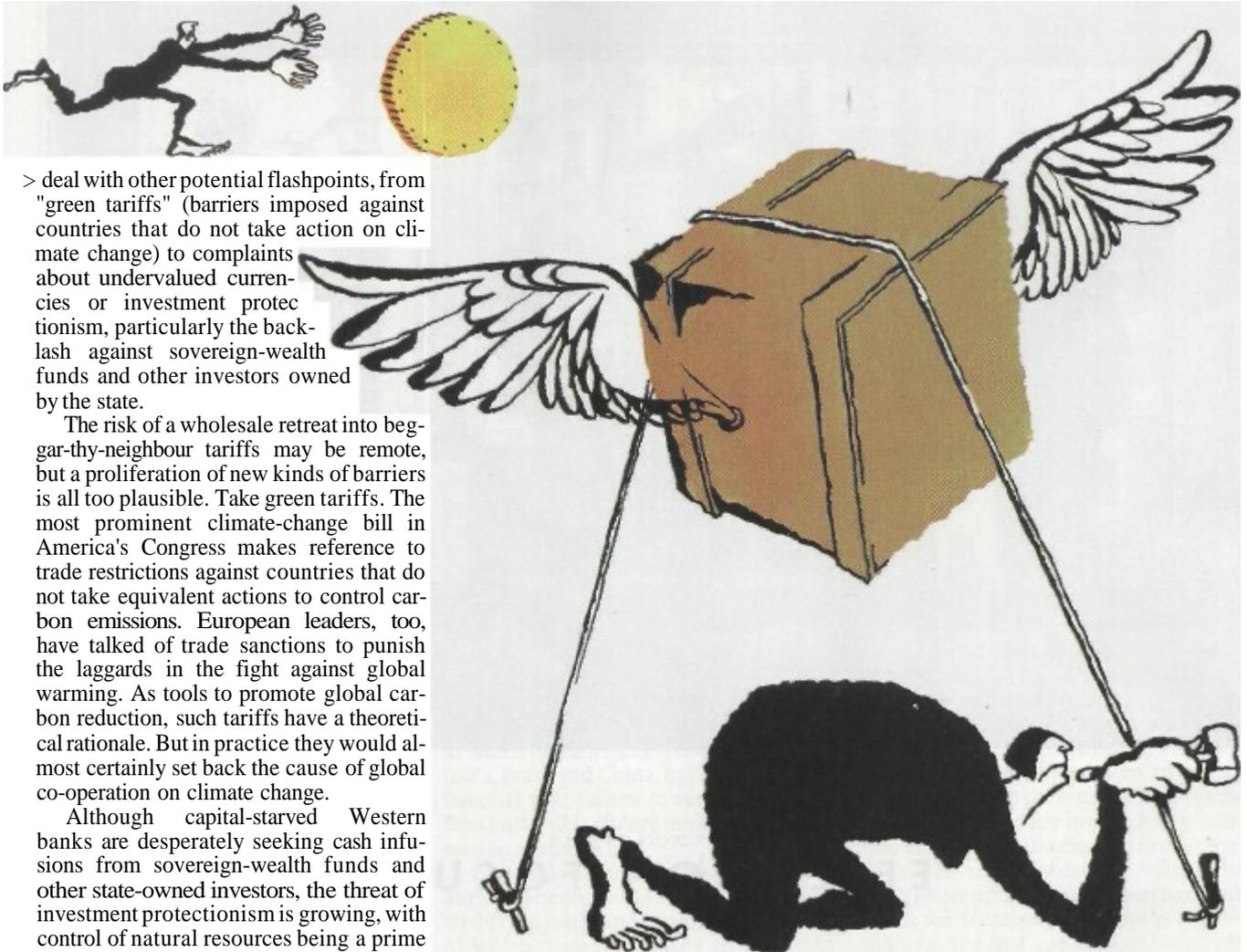
Security-conscious

The centrepiece of the Doha trade round is freer trade in farm goods, a shift that will benefit poor countries disproportionately. But the round was launched in 2001, well before the commodities boom, so its main emphasis was on government policies that kept prices artificially low, such as production and export subsidies in rich countries. Today, the main concern is policies that push prices up: unilateral export bans, subsidies for consumers and the pursuit of biofuels. The fear is about security of supply. Food self-sufficiency has become a political rallying cry.

That instinct is plainly misguided. The food with the most volatile price over the past year is rice, precisely because it is the least traded. Freer trade in food is the best way to ensure stable access and prices. But an efficient global market needs strictures against unilateral barriers to exports as much as imports, and the WTO's current rules do little to control export restrictions. Nor are current trade rules much use for controlling the use of regulations to boost biofuels. Fixing that requires multilateral talks of a different sort.

The irrelevance of the global negotiating agenda to today's trade concerns goes beyond agriculture. In a provocative new paper, Aaditya Mattoo of the World Bank and Arvind Subramanian of the Peterson Institute argue that global talks should concentrate on fears over "security"—of food, energy, environment and income. They point out that there are strikingly few rules governing trade in oil, the world's single most important commodity. The WTO prohibits export quotas, but not the production quotas on which the OPEC oil cartel is based. More broadly, the "WTO, at least in its present form, is ill-equipped to





> deal with other potential flashpoints, from "green tariffs" (barriers imposed against countries that do not take action on climate change) to complaints about undervalued currencies or investment protectionism, particularly the backlash against sovereign-wealth funds and other investors owned by the state.

The risk of a wholesale retreat into beggar-thy-neighbour tariffs may be remote, but a proliferation of new kinds of barriers is all too plausible. Take green tariffs. The most prominent climate-change bill in America's Congress makes reference to trade restrictions against countries that do not take equivalent actions to control carbon emissions. European leaders, too, have talked of trade sanctions to punish the laggards in the fight against global warming. As tools to promote global carbon reduction, such tariffs have a theoretical rationale. But in practice they would almost certainly set back the cause of global co-operation on climate change.

Although capital-starved Western banks are desperately seeking cash infusions from sovereign-wealth funds and other state-owned investors, the threat of investment protectionism is growing, with control of natural resources being a prime worry. Many commodity-rich countries are becoming increasingly jittery about China's thirst for direct control of natural resources. Faced with a surge in applications for foreign direct investment from China, most of them in the mining industry, Australia is now "closely examining" those that involve government-controlled entities and natural resources.

A new study for the Council on Foreign Relations by Matthew Slaughter of Dartmouth College and David Marchick of the Carlyle Group points out that in the past two years at least 11 big economies, which together made up 40% of all FDI inflows in 2006, have approved or are considering new laws that would restrict certain types of foreign investment or expand government oversight. A "protectionist drift", they conclude, is already under way. If state-based investors play an ever bigger role in global capital markets, that protectionist drift may become irresistible.

Many of the politicians' fears about foreign investors are surely misguided. Most sovereign-wealth funds are run by professional managers to maximise returns, and international codes to improve their transparency are in the process of being drawn up. Countries already have plenty of rules

to prevent foreign control of strategic assets. And provided that markets are competitive and well regulated, it does not make much difference who owns the firms concerned.

A question of leadership

At a macroeconomic level, however, it is reasonable to fret about the growing clout of state-based investors, not least because most of this money will be held by a small group of (authoritarian) countries including China, Saudi Arabia and Russia. China is piling up foreign-exchange reserves so fast that if it were to put them into American shares instead of bonds, it would already be buying more than all other foreigners put together. As Brad Setser of the Council on Foreign Relations points out in a new report, concentrated ownership by authoritarian governments is a strategic as well as an economic concern, particularly for America.

Both the risks of this new protectionism and the odds of it being countered depend heavily on the relationship between America and the biggest emerging economies. As the Doha malaise has shown, active American leadership, although no lon-

ger sufficient, is still necessary for multilateral progress. Yet the politics of trade has become increasingly difficult in America, compromising the country's ability to take the lead. Support for more open markets is weaker than almost anywhere else in the world. According to this year's Pew Global Attitudes Survey, only 53% of Americans think trade is good for their country, down from 78% in 2002. Several other surveys in America suggest that supporters have become a minority. In other countries support is far higher. Some 87% of Chinese and 90% of Indians say trade is good for their country, along with 71% of Japanese, 77% of Britons, 82% of French and 89% of Spaniards.

America's popular disillusionment has been accompanied by a growing intellectual one. Several well-known American economists, including Paul Krugman, a professor at Princeton and prominent New York Times columnist, Alan Blinder of Princeton and Larry Summers, a Harvard economist and former treasury secretary, have begun to doubt whether increased globalisation is good for the American middle class. Rather than improving typical Americans' living standards, they sug-



> gest, global integration may be causing wage stagnation, widening inequality and greater insecurity.

Mr Blinder worries that offshoring—the outsourcing of services to countries such as India—will pose problems for tens of millions of Americans over the coming decades. Mr Krugman, who pioneered research in the 1990s that found trade played only a small part in explaining wage inequality, now believes that the effect is much bigger, because America trades more with poorer countries and more tasks can be traded. Mr Summers has similar concerns, arguing that the increasing mobility of global capital limits the government's ability to act as firms move away from America in search of low-tax regimes.

These economists all eschew protectionism as a solution, arguing instead for domestic changes, such as health-care and education reform as well as greater redistribution through the tax system. But they have helped change the terms of the political debate in America—a shift that has not been lost on policymakers in the emerging world, many of whom are irritated by

America's double standards. One Indian official talks of an "intellectual climate change" and a "betrayal" by globalisation's erstwhile champions.

Middle-class Americans' living standards have stagnated over the past few years and income inequality has widened. Globalisation could be a culprit, because the integration of hundreds of millions of workers from emerging economies increases the global supply of labour and presents less skilled American workers with more competition. But academic analyses suggest that this effect is modest compared with other factors, such as the decline of trade unions and, particularly, technological innovation that has raised the demand for skilled workers.

Nor is there much evidence to support the revisionist view. In a recent Brookings paper Mr Krugman searched for statistics to show that trade now plays a bigger role in wage inequality but failed to find them. Several other new studies point in the opposite direction. A paper by Runjuan Liu of the University of Alberta and Dan Trefler of the University of Toronto shows that the

effect on American workers of outsourcing service work to India and China has been tiny and, if anything, modestly positive.

In a recent book, "Blue-Collar Blues", Robert Lawrence of Harvard University shows that the chronology of America's widening income inequality makes it hard to blame trade with poorer countries. Low-skilled workers lost out in the 1980s, long before trade with China surged. Most of the latest rise in inequality is due to the soaring incomes of the very rich. A study by Christian Broda and John Romalis of the University of Chicago argues that trade with China has helped reduce inequality in living standards, because poorer folk benefit disproportionately from lower prices for manufactured goods (though higher commodity prices have recently been pushing in the opposite direction).

But whether or not the evidence justifies it, America's intellectual climate has shifted. Advocates of globalisation are on the defensive, particularly in the Democratic party. That, alas, augurs badly for the new kind of multilateralism that the world economy urgently needs. •

Shifting the balance

More than a new capitalism, the world needs a new multilateralism

JUST under ten years ago, during the emerging-market financial crises, Time magazine ran a cover headlined "The committee to save the world". It showed Alan Greenspan, then chairman of the Federal Reserve; Robert Rubin, the treasury secretary; and Larry Summers, his deputy. Inside was a breathless account of how this trio of Americans had saved the world economy from calamity by masterminding IMF rescue packages for cash-strapped Asian countries through weekend meetings and late-night conference calls.

Today the threats facing the global economy are graver than they were a decade ago, yet it would be hard to know whom to put on such a cover. Wall Street is at the centre of the mess, so America's stature and intellectual authority has plunged. Rather than staving off defaults in Asia, Mr Paulson, today's treasury secretary, and Ben Bernanke, chairman of the Federal Reserve, are battling to prevent the implosion of their own financial system. Instead of dictating tough terms to Asian governments, they have been begging Congress

for public **money** to deal with Wall Street's most toxic securities.

But even as the crisis spreads far beyond America, few others have so far shown much sign of leadership. Europe is rife with Schadenfreude at America's travails but its politicians have been slow to recognise the scale of their own problems. China, the biggest, most resilient emerging economy and the one with the deepest pockets, has stood quietly on the sidelines. The IMF provides useful analysis but has no political clout.

The only institutions that have co-operated, and creatively so, are the rich world's central banks. Even as many politicians have grandstanded and pointed fingers, the ECB, the Fed, the Bank of England and others have tried to stem panic by flooding financial markets with liquidity, lending eye-popping sums of money against all manner of collateral.

Unfortunately, central bankers—however creative—cannot sort out this mess with injections of liquidity alone. That is because it is a crisis of solvency as well as

liquidity. The bursting of the biggest housing and credit bubble in history has caused a banking bust that will probably turn out to be the biggest since the Depression, affecting many countries simultaneously. Across the rich world banks are short of capital; many are insolvent. As they deleverage, they will force down asset prices and weaken economies that are already stumbling, so the mess will only worsen. Uncertainty and panic have already amplified the problem as banks hoard cash.

The urgent task is to prevent a grave multi-country banking crisis from becoming a global economic catastrophe. That ought not to be too hard. Thanks to the growing importance of emerging markets, the world economy has become more resilient to trouble in its richer corners. Capital is plentiful outside Western finance. Now that commodity prices have tumbled, the rich world's central banks have plenty of room to cushion their weakened economies with lower interest rates. And although public-debt burdens are already heavy, notably in Italy, Europe's govern-1



*ments, like America's, have enough public funds to prevent a capital-starved banking system dragging their economies down.

This has already started to happen, most strikingly with the American government's \$700 billion plan to take over mortgage-backed securities. But other governments too are stepping in. Five European banks were nationalised or bailed out with public funds in the last week of September. Several European governments have guaranteed the deposits and in some cases the debts of their banks.

Yet these disparate rescues are likely to be more expensive and less effective than a more co-ordinated policy that reaches beyond the financial system alone. The panic in the markets would be stemmed if the rich world's governments agreed on a common approach for stabilising and recapitalising banks. Equally, a co-ordinated interest-rate cut would boost confidence and make economic sense: the inflation threat is receding simultaneously across the rich world.

Any such policy co-ordination must include the big emerging markets as well. By boosting domestic spending and allowing its currency to appreciate faster, China could counter deflationary pressures in the rest of the world economy and help support growth in Europe and America just when this is needed most.

There are precedents for high-profile international economic co-operation, notably the Plaza and Louvre Accords in the 1980s. Designed, respectively, to push the dollar down and to prop it up, these agreements met with mixed success. Today's problems are deeper, and the number of parties is larger. But if there were ever a time for a new multilateralism, this, the biggest financial crisis since the 1930s, is surely it.

Learning the right lessons

A successful multilateral strategy to staunch the crisis would also make it more likely that the world will rise to the second challenge: learning the right lessons. Too many people ascribe today's mess solely to the excesses of American finance. Putting the blame on speculators and greed has a powerful appeal but, as this special report has argued, it is too simplistic. The bubble-and the bust-had many causes, including cheap money, outdated regulation, government distortions and poor supervision. Many of these failures were as evident outside America as within it.

New-fangled finance has its flaws, from the procyclicality of its leverage to its fiend-

ish complexity. But the crisis is as much the result of policy mistakes in a fast-changing and unbalanced world economy as of Wall Street's greedy innovations. The rapid build-up of reserves in the emerging world fuelled the asset and credit bubbles, and rich-world central bankers failed to counter it. Misguided monetary rigidity caused financial instability. Much though people now blame deregulation, flawed regulation was more of a problem. Banks set up their off-balance sheet vehicles in response to capital rules.

It is the same story with the spike in food and fuel prices over the past year. To be sure, commodities markets can overshoot—but rather than pointing the finger at speculators, governments should look in the mirror. Rich countries' biofuel policies pushed up the cost of food. Poor countries' food-export bans and fuel subsidies compounded the problems. In many ways today's mess is a consequence of policymakers' misguided reactions to globalisation and the increasing economic heft of the emerging world.

If markets are not always dangerous and governments not always wise, what policy lessons follow? In the aftermath of the crisis the battle will be to ensure that finance is reformed—and in the right way. The pitfalls are numerous. Banning the short-selling of stocks, for instance, makes for a good headline; but it deprives markets of li-

quidity and information, the very things that they have lacked in this crisis. Even if the easy mistakes are avoided, improving supervision and regulation is hard. Financial regulators must look beyond the leverage within individual institutions to the stability of complex financial systems as a whole. Wherever the state has extended its guarantee, as it did with money-market funds, it will now have to extend its oversight too. As a rule, though, governments would do better to harness the power of markets to boost stability, by demanding transparency, promoting standardisation and exchange-based trading.

Over-reaction is a bigger risk than inaction.

Even if economic catastrophe is avoided, the financial crisis will impose great costs on consumers, workers and businesses. Anger and resentment directed at modern finance is sure to grow. The danger is that policymakers will add to the damage, not only by over-regulating finance but by attacking markets right across the economy.

That would be a bitter reverse after a generation in which markets have been freed, economies have opened up—and prospered. Hundreds of millions have escaped poverty and hundreds of millions more have joined the middle class. As the world reconsiders the balance between markets and government, it would be tragic if the Ingredients of that prosperity were lost along the way. ■



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