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The Financial Crisis and International Trade – The Consequences for Developing Countries

Summary

The introduction of an array of protectionist measures in reaction to the global financial crisis obliges us to continue to closely monitor the development of protectionism and to implement measures to counteract it.

Despite the introduction of various protectionist measures during and as a result of the global financial crisis, world trade recovered more quickly than initially expected. Increased demand for imports from developing countries significantly contributed to the rapid recovery of trade.

Although compared with the Great Depression of the 1930s considerably fewer protectionist measures have been introduced in the course of the current global financial crisis, an increase in worldwide trade barriers is nonetheless observable. This becomes especially obvious when not only conventional tariff and non-tariff restrictions to trade are considered, but also the more subtle, hidden protectionist measures ("*murky protectionism*"), such as rescuing firms to safeguard national interests or manipulating currencies.

Despite all their public commitments to open markets, the G20 countries are the worst perpetrators of protectionism. Germany and other EU Member States, as well as Russia, Argentina, India and Brazil, have imposed the bulk of the protectionist measures.

Although less than 1 percent of the international movement of goods is actually affected by crisis protectionism, this low percentage should not obscure the consequences of these trade restrictions for individual goods that seriously affect some countries.

The largest exporters – China, the EU and the USA – are hit most by the new trade barriers. Overall, developing and emerging countries are affected by about two-fifths of the decline in exports that is caused by protectionism. Although the *Least Developed Countries* (*LDCs*) are not the countries most affected by the crisis, a total of 141 protectionist measures have been introduced that also harm these countries.

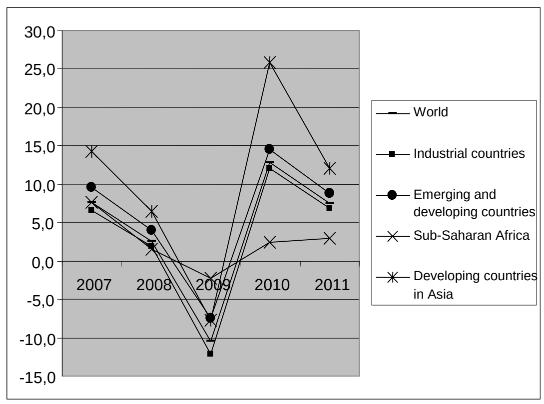
In the future, in light of the risk of a further deterioration of the world economic situation and the danger of a currency war, still greater attention should be paid to protectionist measures and their prevention with regard to developing countries – in particular, because trade is of central importance for their economic development.

- Crisis protectionism underscores the significance of the World Trade Organization (WTO), and especially how problematic the foreseeable collapse of the Doha Round is that would considerably reduce the leeway for WTO-compliant trade distortions and reversals of market deregulation as a result of this – or future – crises.
- The WTO's multilateral trade rules should be collectively reinforced so as to more effectively prevent "*murky protectionism*". For example, the WTO principle of national treatment should be strengthened and the WTO Subsidies Agreement should be reconsidered.
- The monitoring and control of protectionist measures through independent supervisory institutions like the WTO should be further improved.

The rapid recovery of world trade

Following the global financial and economic crisis, world trade recovered more quickly than expected (Figure 1). After the volume of world trade fell by 10.9 percent in 2009, in October 2010 it again surpassed the pre-financial-crisis level (of August 2008) by 0.8 percent. Although this represents a positive development, the financial crisis nevertheless considerably delayed the upswing in world trade. According to World Bank estimates, without the financial crisis, the October 2010 level would have been 13.6 percent higher. Furthermore, the level in October 2010 was below the pre-crisis peak levels of April 2008 (World Bank 2011, 50).

Figure 1: Variation in the export volume of selected countries 2007-2011 (Percentage variation compared with the precious years)



Source: IWF, World Economic Outlook Database as of 28.07.2011: Predictions, 2011 Estimates

Whereas generally the volume of exports recovered rapidly, there are conspicuous differences between the country categories: The developing countries' exports have bounced back more quickly than those of the industrialized countries. In October 2010, the export volume of high-income countries had reached approximately 98 percent of the pre-crisis volume of August 2008. In contrast, exports from developing countries were some 16 percent higher in November 2010 than in August 2008 (World Bank 2011, 5).

Developing countries as the motor of world trade

The developing countries' increased demand for imports of goods – especially raw materials – constitutes the main reason for the greater volume of world trade. Around 50 percent of the increased global demand for imports comes from the rapidly growing developing and emerging countries. Due to the industrialized countries' setbacks in growth, South-South trade has clearly increased. Imports from high-income countries now lie some 14 percent below, and those of developing and emerging countries 7 percent above, their long-term trend growth (World Bank 2011, 5, 54).

The volume of exports in Sub-Saharan Africa (SSA) fell less than exports fell in comparison to other regions as a consequence of the crisis. On one hand, SSA is not much integrated into world trade. On the other hand, the reorientation of trade towards China and other emerging countries in Asia and Latin America contributed to SSA's relatively rapid trade recovery. This is because in comparison to many western industrialized countries, these emerging countries boast high growth rates and therefore also exhibit high demand for the developing countries' exports, especially their raw materials.

Post-crisis trade measures

Although as a result of the global financial crisis, an array of trade measures has been introduced, their number is still considerably smaller than it used to be in the course of the Great Depression. In the 1930s, countries used trade barriers to seal off their markets so tightly that world trade shrunk by two-thirds within just a few years. One of the most important insights from this era is how disastrous protectionism is for the revival of world trade. For this reason, one of the main motivations for the multilateral trade negotiations and the accord on the *General Agreement on Tariffs and Trade* (GATT), the predecessor of the WTO, was the avoidance of trade wars. The existence of the WTO, as well as the agreements in the G20 framework, have prevented a protectionist race. But the WTO has not been able to prevent new, subtle types of protectionism ("*murky protectionism*").

Experts have variously assessed the dimensions of the new trade barriers erected during the crisis: The especially detailed analyses by Global Trade Alert (GTA), an independent monitoring service for trade policy, detected substantially more protectionist measures than did other analyses. For example, reports by the WTO, the OECD (Organisation for Economic Cooperation and Development) and UNCTAD (UN Conference on Trade and Development) concluded that although some protectionist measures had been introduced, in the course of the crisis, protectionism was generally limited (OECD / WTO / UNCTAD 2010) – whereas GTA experts observed a surge in protectionist measures as a result of the global crisis (CEPR 2010). For instance, from November 2008 to November 2010, a total of 692 trade restrictions were introduced worldwide. Since 2009, between 100 and 134 trade barriers have been put up each quarter. By way of comparison, with a total of 50 protectionist measures in the fourth quarter of 2008, that year there were markedly fewer trade restrictions. Even the revival of world trade since midyear 2009 has not reduced the number of new trade barriers. Most frequently affected are steel and iron imports, and products of the chemical, and textile and garment industries.

Contrary to their public commitment to open markets, most of the trade barriers have been erected by the G20 countries. Germany and the EU as a whole, as well as some developing and emerging countries such as Russia, Argentina, India and Brazil are among the worst perpetrators. That shows that the "beggar-thy-neighbour" measures instituted during the crisis do not constitute a North-South phenomenon (CEPR 2010, 37–38).

Creeping protectionism

An explanation for the varying conclusions about the extent of world trade barriers is that, especially during the crisis, there was an increase in unconventional and subtle protectionist measures that are more difficult to quantify. For example, the GTA study does not count only tariff and nontariff trade restrictions, it also includes other instruments that damage foreign commercial interests, including selective firm rescuings to safeguard the national interest, currencymanipulation subsidies and rules pertaining to local content (e.g. the notion of a "*Buy-American*" clause for iron and steel to be used in infrastructure measures that benefit from the US-stimulus package). In trade terms, this type of discrimination is called "*murky protectionism*". By way of example, the industrialized countries dispensed many kinds of state aid that undercut fair competition.

Even if only a relatively small share of total world trade was affected by the crisis of 2008, protectionist measures can have serious repercussions, especially for particular sectors. On the one hand, according to the WTO, less than 1 percent of the international trade in goods has so far been affected by additional trade barriers. What is more, protectionist measures had a relatively small effect on the great trade collapse of late 2008 because, according to an analysis by Henn and McDonald (2010), the volume of world trade only dropped by 0.25 percent (USD 35 bill.). New trade restrictions also hardly affected the revival of world trade. But on the other hand, this low total percentage obscures the consequences of trade restrictions for certain goods. The latest analyses show that trade in some goods has taken a hit of at least 5 to 9 percent (Henn / McDonald 2010). In addition, protectionist measures produce negative dynamic effects that, if they are not quickly done away with, have distorting effects on trade in subsequent years. Furthermore, not only should the trade-distorting effects of these protectionist measures be calculated, they should also be compared with their alternative, that is, trade liberalization: Based on estimates by Henn and McDonald (2010), the implementation of trade policy measures (industrial customs and measures for the agricultural sector) following the conclusion of the Doha Round could have the effect of increasing global trade in goods by 1 percent.

The impact on developing countries

Trade barriers are mostly directed at China, followed by the EU and the USA. Goods from China in particular are often burdened by tariff increases and anti-dumping measures (CEPR 2010). Apart from China, no other developing or emerging country is on the list of the top ten most-affected States. But according to estimates by Henn and McDonald (2010), developing and emerging countries suffer from a total of round two-fifths of the downturn in exports resulting from crisis protectionism.

Although the LDCs are not among the most affected countries, a total of 141 government measures were introduced from November 2008 to November 2010 that have harmed the commercial interests of the poorest countries. Trade barriers were directed against all the LDCs except Tuvalu; Bangladesh, Tanzania, Yemen, Senegal and Sudan were the LDCs that were most affected.

Whilst no one group is solely responsible for protectionism directed at LDCs, most of the measures were caused by G20 members and developing countries (Table 1). Both sets of statistics are sobering: the first underscores the G20's failure to uphold its moratorium on protectionism, and the other is hard to square with the poorer nations' expressions of South-South solidarity (CEPR 2010, 33–36).

Table 1: Protectionist measures directed at LDCs

	Quantity of measures directed against LDCs
Wordwide (including LDCs)	141
G20 Members	101
Non-OECD Members	108
Non-OECD G20 Members	70
LDCs	4

Source: CEPR (2010, 34)

The WTO after the crisis

The global financial crisis has clearly shown that the WTO's rules concerning "murky protectionism" are much weaker than they should be. This especially goes for those WTO principles such as non-discrimination of domestic and foreign businesses (national treatment) that are intended to prevent this form of protectionism. The introduction of protectionist measures in the course of the crisis therefore raises questions such as whether the WTO principle of national treatment should be strengthened and whether the WTO Subsidies Agreement should be revisited (Evenett 2009). These forms of trade restriction lead to greater asymmetry between developing and industrialized countries, because most developing countries cannot afford comprehensive subsidies. Since the poorer countries cannot compete when it comes to subsidies, they can only resort to tariff instruments that in turn are subject to strict WTO rules. New WTO rules related to "*murky protectionism*" should reduce this asymmetry.

Even if we disregard "murky protectionism", many of the new trade restrictions do not contravene existing WTO rules because these leave a lot of leeway for "lawful derogations" of trade. Many countries have not yet reached the upper limits of the applied rates and therefore may raise their rates a good deal without exceeding the "*bound rates*" set by the WTO. Therefore, the economic crisis forces us to reconsider the value of the Doha Round: Through the reduction of binding tariff rates, the elimination of export subsidies and the specification of other trade rules, the leeway for WTO-compliant trade distortions would be considerably reduced. In addition, in the context of this or future crises, the Doha Round could prevent market openings being rolled back. This argument is all the more important for developing and emerging countries whose economies are heavily dependent on exports.

The prospects: future risks

Even if exports from developing countries have rebounded and the extent of protective measures has not yet spun out of control, there is ample reason to continue to carefully monitor the future development of international trade policy. On the one hand, the industrialized countries' demand for exports from developing countries could drop again. If, for instance, the global economic situation should deteriorate once more, the demand for exports from developing countries would slump again. This danger exists in light of the current debt crises and because the financial markets in some industrialized countries are fragile and their growth rates are still low – which is why developing countries should strengthen regional trade and diversify their export partners. But there is also a series of factors that could favour additional protectionist measures. For instance, the International Monetary Fund (IMF) warns of a competition in currency devaluation, which some countries want to use to procure trade advantages. Other risk factors include prolonged high rates of unemployment in many industrialized countries, big differences in economic growth and increasing imbalances of payment in various regions and countries.

The danger of protectionism warrants the additional strengthening of multilateral trade rules. Yet, almost no one still believes that the Doha Round will come to a successful end any time soon because the differences between the positions of some big countries are just too large. WTO members no longer aspire to a comprehensive Doha agreement this year. They hoped to finalize a smaller package at the WTO Ministerial Conference in December. But it did not turn out to be easier to reach agreement on the smaller package than to conclude the entire Doha Round and the conclusion of a small packaged has already been declared as out of reach for 2011. Whatever the future of the Doha Round and the post-Doha WTO will look like, a move towards a strengthening of multilateral trade rules that is necessary for the comprehensive prevention of protectionism is currently not in sight.

Looking to the future, there are therefore grounds for increased vigilance with respect to protectionism measures. This necessitates the improvement of monitoring and control of protectionist measures: As in other areas of global economic governance, consolidated supervisory organizations like the WTO will have to continue to monitor protectionist tendencies.

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