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WORLD TRADE: HAVE WE REACHED PEAK GLOBALIZATION?

A GUIDE FOR THE DEBATE BETWEEN BELIEVERS AND SCEPTICS OF THE BENEFITS OF INTERNATIONAL TRADE

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As bad news is mounting concerning the health of the world trade system, one has to wonder: have we reached a peak in the globalization process? Is there still an appetite to continue to promote international integration via the expansion of trade in the context of preferential or multilateral trade agreements? Or, have the tides changed so that we are going to witness a retreat from globalization in parallel with the observed slow-down of international trade?

Optimists argue that a debate about the future of globalization is a waste of time. According to this perspective, growing economic integration and interdependence is inevitable, driven by technology, unilateral trade liberalization and negotiated trade agreements. They may be right in terms of long-term trends, but one cannot forget that the same perception dominated the intellectual debate in the beginning of the 20th century. In 1909, Norman Angell (a Nobel Peace Prize winner in 1933) published a pamphlet, that later became a popular book (*The Great Illusion*), where he argued that economic interdependence had become so pervasive in Europe, that war was very unlikely. Two world wars and policy mistakes around the Great Depression, showed that predictions about a growing international economic integration are not always correct. Accidents do happen.

Today, we are witnessing a series of “accidents” in the making. In Geneva, the “slow train” of the multilateral trade round (the Doha Development Agenda, DDA, negotiations) seems to be once again facing the danger of derailment. July ended on a sour note, as the WTO Director General (Roberto Azevêdo) recognized that WTO Members were unable to meet the deadline of establishing a “clearly defined” work program for issues hampering the conclusion of the DDA. This does not bode well for the upcoming 10th WTO Ministerial in Nairobi. There is still some time until the Ministerial, but hope is fading that some major DDA results could be achieved by then. For example, the expectation that the Trade Facilitation Agreement (agreed upon at the Bali Ministerial in 2013) would enter into force by the Nairobi Ministerial is fast becoming “mission impossible” – the rules require that two thirds of the 161 WTO Members formally accept the protocol to insert the TFA into Annex 1A of the WTO; by August 6th, only 12 Members had accepted the protocol.

Interestingly enough there were also some reasons for commemoration on the multilateral front. On July 24th, the expansion of the Information Technology Agreement (ITA II), covering roughly 201 products that account for more than US$1.3 trillion yearly in trade flows, was agreed upon. This is an important achievement since it will gradually bring duty-free trade in information technology products impacting almost 7 percent of global trade. This agreement illustrates how trade liberalization can still be accomplished at sectoral level when there is a critical mass of willing partners in the WTO. The benefits of this plurilateral agreement will be extended to all WTO members on a most-favoured-nation basis.

In another piece of good news, the package of accession of Kazakhstan to the WTO was formally adopted on July 27th. After almost two decades of negotiations, Kazakhstan is now on track to become the 162nd member of the WTO by the end of 2015. The basic message is that other functions of the multilateral trade regime continue to operate in spite of the DDA “coma.”

Still, July was not kind to those that believe that there is scope for further substantive liberalization via trade deals. The latest round of the most ambitious North-South preferential agreement being negotiated, the Trans-Pacific Partnership (TPP), failed to reach closure. Preferential trade negotiations, like the TPP, mean different things to different researchers. Some emphasize the fact that every step towards preferential trade liberalization implies discrimination against non-members and detracts from the focus on the first-best (but slow moving) multilateral route. Others see preferential trade agreements as “laboratories” for deeper economic integration that can pave the way for improving multilateral governance over time. There is an element of truth in both perceptions. The political reality, however, is that the USA, the main “champion” of the multilateral trade system in the post-WW II era, has now shifted its attention to two key mega-preferentials: the TPP and the Transatlantic Trade and Investment Partnership (TTIP). The TPP provided the best hope for concrete outcomes in the near future. Now this is in question.

The Obama administration fought hard to secure Trade Promotion Authority in June. This measure, popularly known as "fast-track," streamlines the passage of trade agreements through the US Congress by eliminating the possibility of amendments and by setting deadlines for congressional action. The political capital spent by Mr. Obama, in going against a large number of senior politicians in the Democratic party that are sceptical of the benefits of trade agreements, was rationalized as a necessary condition to finalize the TPP negotiations. The TPP is the first "new generation" mega-regional of the 21st century. Negotiations started in 2011 and now cover 12 countries, accounting for roughly 40% of global GDP and encompassing more than US$2 trillion trade in goods per year. In addition to its economic relevance, TPP is often characterized as a main piece of the Obama administration's strategy of a rebalancing towards Asia. It has the clear geopolitical objective to reassure trading partners that the US is ready to engage in the Pacific basin and that it will not take China's economic rise as a sign of its inevitable economic dominance in the region.

The good news is that, even though the TPP deal was not reached at the Maui meeting in the last week of July, most observers agree that the final structure of the agreement is well defined and that participating countries are close to a deal. The bad news is that the main points of contention (market access for dairy products, rice and sugar; trade disciplines for state-owned enterprises; rules of origin for sourcing components from non-TPP countries; and protection of intellectual property rights, in particular, the timeframe for data exclusivity for biologics test information) are difficult topics for many of the countries involved. The even worse news is that the political calendar in the US suggests that unless quick progress can be achieved in the coming weeks, the Congressional debate on TPP in the US will overlap with the caucus and primary season for the upcoming Presidential election. Not a good omen for rational debate about trade agreements.
The prospects for significant progress in the near term both for multilateral and preferential trade initiatives do not seem bright. The only silver-lining is the completion of ITA II. If we add to this realization, the fact that the growth of global trade has slowed down significantly over the last few years, the question of globalization reaching a peak becomes even more relevant. Merchandise trade had been growing on average 7% per year in the two decades before the onset of the global financial crisis. Since 2008, however, trade growth has been anaemic and in some years below the expansion of world output (for example, 3.3% for global GDP versus 3.1% for global trade volume in 2014).

There are some cyclical factors that help explain this slow-down. For those that believe in "secular stagnation" (that long-term potential growth for the world economy has declined driven by lower technological progress, demographic trends, growing inequality, debt overhang, and instability associated with low real interest rates), the trade slow-down is part of a new normal for the world economy. Weak aggregate demand and uncertainty (dragging down business investment which tends to be trade-intensive) would explain the low growth in trade of the last few years.
There is, however, an additional troubling development going on. The long-run elasticity of trade with respect to world GDP that used to be above 2 in the 1990s seems to be now much lower, suggesting that trade has become less responsive to GDP growth. The shortening of supply chains to better cope with environmental and geopolitical risks, increased recourse to trade protectionism in some markets, the domestic integration of the Chinese market leading to increased local content in exports, and the evolving shift towards services in the world economy are some of the usual suspects driving this trend.

It is too early to announce that we have reached a peak in globalization. One could even argue that we are in a moment of resetting global structures of production and that opportunities associated with "e-commerce" and lower transaction costs for small-and-medium enterprises to engage in international trade may soon reverse these trends. One message, however, stands: if there is no political will to continue to pursue trade liberalization, either unilaterally or in the context of trade negotiations, the specter of a less integrated world economy may become a self-fulfilling prophesy.

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