

WINNING THE ARGUMENT ON TRADE

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Let me begin my lecture to mark this graduation event by a quote from Charles Dickens' 1859 novel 'A Tale of Two Cities'.

'It was the best of times, it was the worst of times. It was the age of wisdom. It was the age of foolishness. It was the epoch of belief. It was the epoch of incredulity....'

Those words date back more than 150 years ago, and yet they also may capture well the times we are living. We have been going through a period of rapid technological change, and institutions like the World Economic Forum forecast that the pace of change and its impact will heighten. Innovation is definitely part of 'the best of times' but the new industrial revolution we are witnessing is very disruptive, for businesses and workers alike, as their assets and skills become stranded much faster than before or expected. This produces deep anxiety. New products, services and means of communication are embraced, but they also bring out new questions of ethics, often related to protection: is what is technically possible also permissible?

Since recently, this technological upheaval has been supplemented in the West by another form of disruption, that of profound political upsets. There have been sharp and volatile swings in political preferences. Watching elections and referendums play out over the last year or so in Britain, the US, Austria, the Netherlands or France has been anything but boring!

The dividing lines that have defined political debates for decades between 'left' and 'right' are vanishing and, instead, another cleavage is taking its place: that between the adherents of 'open' and 'closed' societies. This new cleavage exhibits different dimensions: cultural, social, economic. Economically, it is between those who, on balance, seize globalisation as an opportunity, and others who consider it a threat to their livelihoods and their way of life.

This 'open vs. closed' dichotomy is deep-seated. If you go back in history long enough though, it is not altogether novel. There have been regular clashes between more liberal and more nationalist ideologies and there have been globalisation episodes that have come to an end. Globalisation – just like capitalism – is not a force of nature. It is made by man and it can be undone by man. Globalisation was on the rise between 1870 and 1913. The world of 1913 was remarkably free and in several ways freer than that of 2017. But by 1939, the world had changed beyond recognition as compared to 1913.

Globalisation encompasses several facets: foreign direct investment, financial capital flows, labour mobility, the flow of data and ideas, and, obviously, trade in goods and services. Given the brevity of my talk, I will focus on what I know best, which is trade. However, I admit that other facets of globalisation, like labour mobility, are definitely as rich analytically and fraught politically.

The title of my talk today is 'Winning the argument on trade'. I have chosen it under the assumption that for the audience I have before me here there is no need to enter into a long discussion of whether trade is good or bad. The argument on 'trade' and 'open' societies for that matter is well worth winning.

For most economists, this question is a no-brainer. Trade generates efficiency and competition, hence prosperity. There is a strong link between a country's openness and productivity. No country in the world has been able to make the jump from developing to developed country without first opening up. The biggest winner of trade is the consumer and especially the low-income consumer. Moreover, the gains from trade are larger than the merely material: there is, in the longer term, a link between free trade and freedom.

And yet, all the same, here and across the North-Atlantic, openness and trade liberalisation have proven a hard political sell, though on this side of the pond at least anti-trade sentiment may well have peaked, which some attribute to

the fact that anti-trade rhetoric now is associated with virulent American nationalism, something many Europeans do not identify with.

However, trade has definitely become much more political than it used to be and winning the argument on trade in public opinion and elections is therefore a challenge. Protectionism is poor economics, but it may be clever politics. Later on in my talk, I will concentrate on this issue and review the main sources of resentment against trade and how to deal with them.

But, prior to that, there is another, factual, query we should address: is there, on the international trade front, currently something serious to worry about? There may be frictions between governments, but what is actually happening on the ground? Is trade indeed coming to a halt or declining? Is protectionism growing?

On the first query, as far as trade in goods and services are concerned, the long-term picture is not fully conclusive, but the ratio of world trade to world output appears to have levelled off. Whereas since 1990 trade tended to grow twice as fast as GDP, that ratio has been flat since 2008. For 2017 and 2018 trade is expected to recover, broadly at the pace of world GDP. To be more specific, the WTO's point estimate for this year's trade growth is 2,4% as against 2,7% for GDP. So, yes, trade may be stalling and, in any event, globalisation no longer drives world growth.

But let us not oversimplify and worry needlessly. The fact that trade relative to economic activity has become flat is not a problem per se. It all depends why. Trade is a means to an end, not an end in itself. Firms trade because they find it more efficient than buying goods and services at home. But if conditions change, it may be better to re-start production at home and shorten and simplify the supply chain. As a consequence of higher wages in Asia or difficulties in manufacturing or logistics, we have seen several cases of multinationals repatriating or near-shoring their activities. It is quite possible that thanks to technological changes, such as 3-D printing, it may make more sense in future to produce in developed countries than in far-away places. More generally, as the price of labour may determine less and less where goods are produced – which incidentally could become a huge challenge for

some African and East-Asian countries – production will move closer to consumers. Trade may then decline compared to output, but so what?

By contrast, when the slowdown of trade is policy-induced, caused by new barriers thrown up by governments, then we have a problem. So therefore the other question: Is protectionism in the world growing or not?

To cut a long story short, it has been on the rise, but so far mildly; and a lot depends on how you define protectionism, because trade-restrictive measures do not always equate to protectionism.

The WTO secretariat, monitoring the trade policy of its 164 members, has reported since 2008 a steady climb in the number of discriminatory trade-related measures. Usually, a good part is repealed after a while, and obviously not every measure carries the same weight, but, on balance the stock of measures has been going up.

Such measures come in three shapes: first, increases in import tariffs and national preferences in government purchases; second, non-tariff barriers arising from differing regulatory requirements; and third, trade defence measures like anti-dumping and anti-subsidy duties, and safeguards.

In developed countries, and also China, industrial tariffs - agriculture is another cup of tea – are no longer a big issue, standing on average at around 5%.

Government procurement, definitely in America, is by contrast increasingly protectionist.

However, a much bigger concern are non-tariff barriers and trade defence measures. But here the discussion also wades quickly into treacherous political waters.

Trade and regulation tend to be uneasy bed-fellows, as the on-going debates on files as varied as chlorinated chickens, pasteurized milk, GMOs, cloning, hormone beef, banking regulation, data flows or car safety show. A country's regulations are not designed in the first place to hinder imports, but frequently that is what they do. The dividing line between the right to regulate and protectionism is often difficult to draw.

In a similar vein, people say they are in favour of free trade as long as it is 'fair'. It is a statement that is frequently being made in Washington circles these days. But what is fair? WTO law allows to defend oneself against 'unfair' dumping and subsidies, which is why several WTO members take issue with the WTO secretariat's inclusion of trade remedy decisions in its list of protectionist measures. But obviously, what some see as reasonable anti-dumping duties, others will describe as punitive.

Ladies and Gentlemen,

To win the argument on trade, you need to know the main views of your opponents, demonstrate where they are wrong and offer convincing remedies where they have a point.

I believe that there are in the public discourse of recent times in developed countries four broad arguments against trade to distinguish, at different levels of depth and specificity to trade. Obviously, the more operational and trade-specific these objections are, the more they constitute a task for those in charge of writing and applying trade rules. But that does not dismiss trade policy practitioners from thinking actively about the more diffuse sources of unease as well.

The first argument to mention runs deepest. The resentment against foreign trade is embedded in the broader feeling of discontent characterising the present *Zeitgeist*. Many ordinary people feel that things move too fast, that the market is unfair, that the whole system is stacked in favour of the elite and big corporations. They turn against the establishment and foreigners. Populists spoon-feed them the politics of anger, anxiety and national identity, which translates, *inter alia*, into anti-trade.

This malaise has perhaps begun to subside in recent months, but it is nonetheless pervasive and hard to handle. There are no quick fixes. Any effective response will surely have to include faster growth that reaches those who are hard to employ, like the old, the young, and minorities, and a greater sense of – there you go again – fairness, in taxation and redistribution, labour markets, and investments in social and educational infrastructure, especially in areas confronted with high levels of immigration.

The second argument is more traditional and therefore more familiar. Trade brings gains, but the people who cannot adapt, lose out. Low-skilled workers have hardly enjoyed any rise in real wages for many years and feel insecure about their jobs. For that they blame trade, especially with emerging economies. However, numerous studies have found that the rise in inequality and job instability have far more to do with technological innovation and automation than trade. It is just that trade is a more convenient scapegoat.

This technological disruption, which I already referred to at the beginning of my talk, will continue unabated and cause further rupture in employment. In almost every developed economy, what you now observe is the dwindling of middle-income jobs, typically in manufacturing and clerk-type work in traditional services. The middle starts missing, while both lower and higher-paying jobs are increasing.

However, for this set of adjustment problems, the right policy responses have been tried and tested, especially in Scandinavia. It is more a matter of political will. You need a solid social security safety net and active labour market policies that re-train redundant workers for new jobs. It is stupid to oppose the gains from innovation and trade, but is unwise as well unfair to leave the losers to their own devices.

The third anti-trade argument, mainly of European vintage, is not so much calling for protectionism, but is advocating what has been coined 'precautionism'. Here the reasoning is that trade undermines the environment, public health, culture, even democracy. Led by NGOs, the sceptics consider that big business will force governments to adopt unduly loose regulations, putting profits before people and the planet.

The response to these concerns has got to be better regulatory practice, with a systematic consultation of stakeholders and a transparent impact assessment of the economic, social and environment effect of any proposed regulations. It is the only way to separate fiction from fact. I concede, however, that this is less straightforward than it sounds, because we appear to have entered a period where truth hardly matters and, where science is looked at with suspicion, as a tool in the hands of the mighty.

The fourth set of arguments is more downstream and operational and therefore up the street of trade economists and lawyers. Put at its simplest, here the complaints are that trade rules are either wrong, outdated, or flouted. Trade as such is not at issue, but rather some of the rules framing it. However, if those rules do not get overhauled, so the reasoning goes, better close our markets.

Recurrent criticisms run along the following lines:

To start with, the multilateral trade system, as shaped by the rules and rulings of the WTO, is seen by some as making undue inroads into Members' economic sovereignty through the organisation's judicial branch. The WTO's dispute settlement system, a key element of the organisation's effectiveness, is argued to be in need of curtailment, as it has allegedly usurped power by interpreting WTO law beyond the permissible, thereby restricting Members' capacity to act, for example in the field of trade remedies.

Another gripe that is often voiced is that for the system to work satisfactorily, transparency on Members' rules and actions is absolutely essential, but that the WTO is unable to adequately enforce it, giving ample room to 'cheats', i.e., Members who do not notify correctly their trade-relevant measures.

A third bone of contention is that there is not enough differentiation in the rights and obligations of developing countries. WTO rules distinguish between developed countries, LDCs, and developing countries, but within the latter group is it impossible to introduce a sliding scale of obligations in function of a Member's prosperity, enabling rich and emerging developing countries to get off relatively light.

A final problem is that the WTO risks becoming an anachronism, thereby losing relevance, as it is proving incapable of dealing with more modern questions of trade. Negotiations in Geneva have been mired for many years now in divergences on old issues that were tabled more than twenty years ago, leaving topics like trade and investment, trade and labour, trade and the environment, trade and human rights unaddressed, thereby becoming popular themes for bilateral Free Trade Agreements.

These criticisms pose a big challenge, because they tend to undermine the legitimacy of the multilateral system as embodied by the WTO and its enforceable rules. And legitimacy is crucial, for otherwise the preparedness to abide by the disciplines collectively agreed will start to evaporate.

If WTO Members would start walking away from their obligations, the scene would quickly be set for trade wars, i.e., unilateral measures triggering tit-for-tat retaliation, causing not only trade to shrink – as in the thirties of the previous century - but also sending waves of uncertainty through the world economy.

Each of these grievances can be tackled, at least in part, through pragmatic, ad hoc, incremental, initiatives.

However, the argument is heard frequently that ultimately these problems are systemic and require more profound reform. This may well be true, but then the question becomes: reform in what direction? Towards more effective global governance, or rather towards restoring national autonomy, taking back control, to put it in Brexit terms? Towards more systematic cooperation with other international organisations, since the WTO is regularly asked to perform a role for which it is not naturally suited? Towards a finer differentiation of disciplines among developing countries?

These deeply political questions point to the tension between the exigencies arising from growing interdependence and the desire to preserve national autonomy and policy space. They also highlight the difficulties global cooperation and institutions have to come to grips operationally with questions like fairness.

To students of the history of the European Union, though, such issues have a familiar ring as they have also presented themselves at each of the stages of integration the European Union has gone through, starting with the customs union, then the internal market and subsequently economic and monetary union. The fundamental question always boils down to the same: what common rules or constraints are necessary to make the system work properly?

Ladies and Gentlemen,

Let me bring my talk to a close. The argument on trade is well worth winning and it can be won. But for that to happen, trade, and the rules-based system needs able and eager spokespersons, people who understand the gains from trade and the need to deal with its side effects. It is my sincere hope that the graduates here in Berne today will become and remain such spokespersons, whatever walk of professional life they will choose, public or private, national or international.

I thank you for your attention.