



# Managing Trade Policy During The Economic Crisis

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The global economic crisis has triggered rapid responses by governments worldwide to counteract its domestic effects, through fiscal stimulus packages, expansionary monetary policies, and financial bailouts. Ad hoc trade policy measures are increasingly being put in place. All countries share the responsibility of preserving a stable and predictable trade policy environment. To this end, trade policies must contribute to maintaining an open trading system consistent with WTO principles.

At their last meeting in London on April 2, 2009, national leaders of the Group of Twenty (G-20) released a Joint Statement outlining a global plan of recovery from the current crisis. Regarding trade policy, the G-20 nations committed not to “repeat the historic mistakes of the protectionism of previous eras” and to refrain from raising new barriers to investment flows and trade in goods and services, imposing new export restrictions or implementing World Trade Organization (WTO) inconsistent rules, and minimize any negative impact on trade and investment due to domestic policy actions, including fiscal policy as well as government actions to help the financial sector.

Moreover, the leaders expressed their commitment to a balanced conclusion of the Doha Development Round.

With the sharp decline in global merchandise trade volumes, expected to fall by 9 percent in 2009, countries have resorted to an array of measures to counter the detrimental effects of the crisis on their respective economies (see Gamberoni and Newfarmer, 2009). Because this decline is a consequence of a deterioration of global demand, trade measures are not an effective response to this problem. On the contrary, policies that contribute to an open and stable trading system are the best policy option for the world community, especially in the current context.

## Principles for trade policy responses during a crisis

*The Great Depression taught us that the absence of international rules and an enforcement mechanism weakens global cooperation.* International organizations such as the GATT/WTO, the IMF, and the World Bank were created to provide an avenue for cooperation and coordination through sets of rules agreed upon by members of the organizations. Rules

play an important role in providing stability and confidence, especially in times of crisis. These organizations support countries' stabilization efforts and ensure consistency and transparency by enforcing agreed upon rules that cannot be reneged by countries unilaterally and that are expected to be respected and observed internationally.

***Rules such as nondiscrimination and transparency and WTO tariff commitments (bindings) constrain actions of individual governments in an economically beneficial manner.*** They do not, and should not, constrain countries from promptly reacting to unforeseen circumstances such as the current world crisis. In fact, in the current crisis, countries' policy responses have been more rapid than during the Great Depression (Eichengreen and O'Rourke, 2009). Initiatives adopted have included measures to support domestic recovery and to provide international organizations with more resources to address the needs of countries affected by the crisis. International organizations have actively supported these initiatives and responded accordingly.

***In the trade arena concerns still remain.*** Falling domestic and international demand and international prices, which are part of the normal dynamic of a recession, may increase pressure on governments to adopt measures to counteract these negative effects. WTO rules seek to limit governments' temptation to respond to these pressures by using trade measures, and avoid a deepening of the crisis by containing a possible chain reaction of an increase in trade barriers. In addition, rules provide policy flexibility to allow governments to implement timely and coherent responses, if certain conditions are met. But flexibility must be coupled

with a clear understanding of the available policy options, who will benefit from each measure and how, who will be negatively affected by each measure, and what are the consequences for poverty and income distribution.

In the case of trade policy it must be demonstrated that measures will contribute to reaching the defined policy objective. Questions to be analyzed include the following:

- whether the measure is expected to generate greater benefits than the trade distortion costs
- how long the measure needs to be in place in order to produce the expected effects
- whether the measure is the least restrictive option for trade
- how to ensure that the measure will be administered in an objective and impartial manner, promote a smooth adjustment to the new situation created by the crisis, be temporary, and satisfy transparency requirements.

## **WTO rules and the crisis**

***WTO rules provide an important stabilizing framework for trade policy.*** Under the pre-WTO multilateral trading system (the GATT), governments used many creative means such as the Multi-Fiber Arrangement, voluntary export restraints, and other nontariff measures to bypass agreed rules when global demand fell. The improved WTO rules-based system has proven to be a stronger stabilizer in the current crisis than actions taken in downturns in the 1970s and 1980s. The rules shelter governments from vested interests seeking protection and provide a framework through which to address requests for raising barriers to imports.

*The indiscriminate use of trade measures in an effort to allocate demand to domestic producers would exacerbate the current crisis.* Even if import restrictions provide temporary relief to the country imposing them, they may also *lead to a domino effect*—a similar response by other countries could worsen the effects of the crisis. The short-run cost of trade measures is not felt immediately by domestic constituencies but by trading partners’ industries and workers, *reducing the interest of countries to cooperate.* Potentially discriminatory and nontransparent trade-related conditions attached to policy responses (for example, “buy national” provisions in stimulus packages) may *not necessarily fall within the scope of WTO agreements,* and thus may escape the surveillance of affected members and last longer than necessary because countries have no legal obligation to repeal them.

*The WTO allows for trade policies to be used to assist domestic industries that are hurt by imports or foreign competitors’ subsidy programs.* If governments determine that trade policy is an appropriate policy response, abiding by WTO legal requirements and transparency obligations in the use of trade remedies such as antidumping measures, countervailing duties, and safeguard measures will help minimize adverse spillover effects on the open multilateral trading system that has gradually been constructed over the last 60 years.

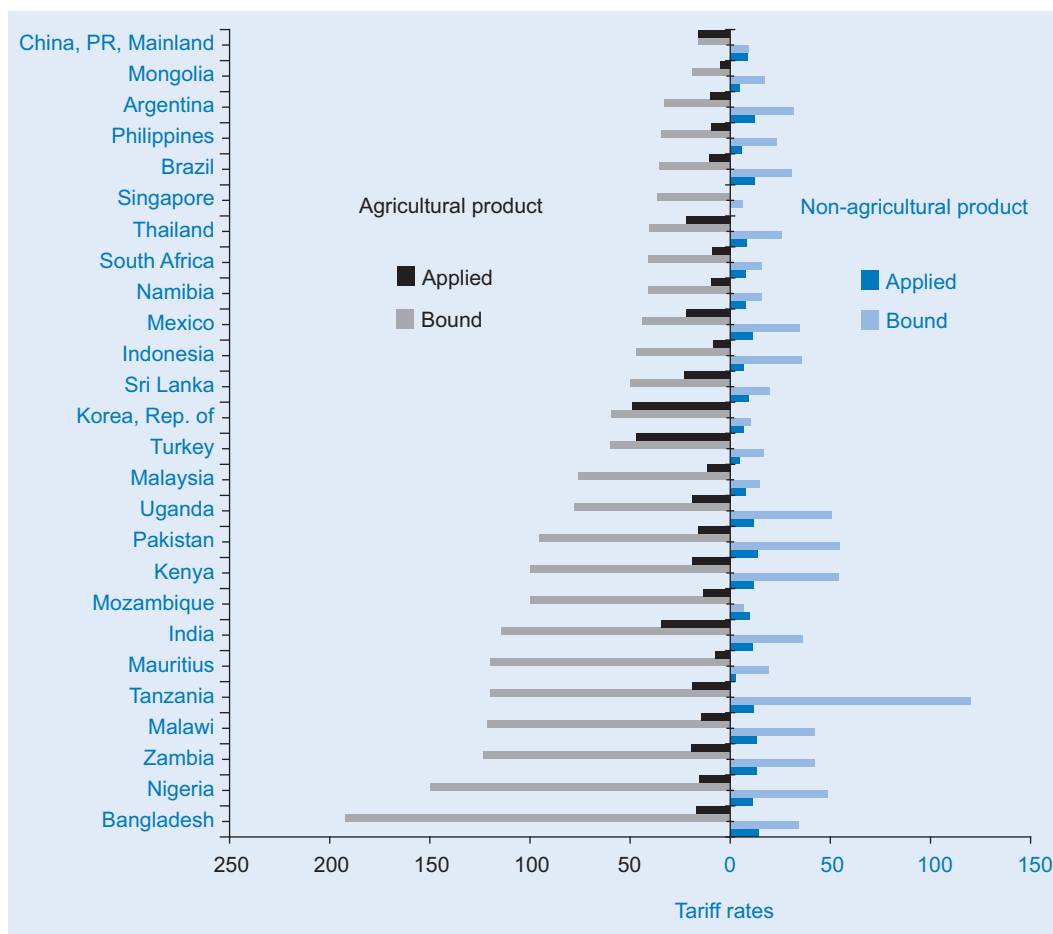
In the current crisis, it is not surprising that *antidumping measures* have increased. The number of antidumping investigations worldwide increased by 31 percent in 2008 compared with 2007, and the number of antidumping duty cases increased by 19 percent in the same period (Bown, 2009). Developing countries’

share in the total number of investigations initiated against other developing countries, especially China, has increased significantly.

The WTO allows countries to adopt *safeguard measures*, meaning an increase in tariff rates for a specific product above bound levels, if imports seriously injure or threaten to injure domestic industries. In principle, these measures must be applied on an MFN basis. When measures are applied for more than three years, affected partners need to be compensated. WTO members have used safeguard provisions less often than other trade remedies. Only six new safeguard measures have been adopted since the crisis erupted—by Egypt, India, Indonesia, Japan, the Philippines, and Turkey. If the recovery of the world economy takes longer than expected, use of these measures may expand. According to the WTO, an increase in safeguard actions usually occurs only about a year after a major shock affects an industry or economy.

*Many countries have bound tariffs above applied rates in the WTO and thus may raise duties up to the bound level at their discretion.* Since the establishment of a multilateral trading system through the GATT and later the WTO, countries have negotiated tariff bindings that commit them not to increase tariff rates above a certain level. For many countries, in particular developing countries that acceded to the WTO early on, there is a significant discrepancy between the tariff bindings and the actual applied tariff rates (Figure 1). This gives countries the flexibility to increase their applied tariffs without violating their WTO commitments. If this right is exercised by all countries, tariffs worldwide effectively could double from their current levels. Bouet and Laborde

**Figure 1: Applied and Bound Tariff Rates: Selected WTO Members.**



Source: WTO.

(2008) estimate that this would result in a further contraction of world trade by 7.7 percent and reduce world real income by \$353 billion. Although these figures may overestimate the impact because regional trade agreements limit the scope for increasing tariffs (Francois, 2008), this would run counter to the efforts undertaken to stimulate the international economy.

*To contribute to a more stable and predictable international environment, countries can agree not to invoke their freedom to increase applied tariff rates.* WTO members could agree not to increase their applied tariff rates for a period of three years, or until the Doha Round

negotiations have resumed and its results implemented. Although it may be difficult to translate this recommendation into a legally binding commitment, it would provide concrete commitments by governments to avoid protectionist measures. WTO members would still have recourse to other WTO-compatible mechanisms to tackle the current crisis.

*Using the WTO safeguard system is preferable to ad hoc increases in applied tariffs.* If countries with applied tariffs below their bindings want to increase protection for a domestic industry, they should apply the procedural requirements laid out in the WTO agreement on safe-

guards. This will help ensure that a public and transparent assessment is made of the pros and cons of imposing import protection, that there is indeed a situation where imports cause or threaten serious injury, and that the intervention is temporary. The use of safeguards would help ensure support for a transparent and fair global trading system.

### **Global cooperation to overcome the crisis**

There are a number of initiatives that countries can undertake unilaterally to promote export competitiveness. For example, countries can reduce fees at customs for exports, improve the duty drawback system, extend customs duty payment deadlines, and creating special “fast track” channels for exports destined for key markets.

Multilateral channels such as the WTO assume even greater importance in providing effective coordination as countries work together to face the common threat of a deteriorating global economic climate. Among the possible global initiatives to provide stability to trade flows and inject certainty in the system, the conclusion of the Doha Round negotiations stands out as the most significant. Others initiatives that can be implemented in the short run include the following:

***Refrain from impeding the flow of goods and services through nontariff measures or by hampering trade facilitation.*** This crisis provides a good opportunity, in particular for developing countries, to devote greater attention to reducing trade-related transaction costs by increasing transportation efficiency and modernizing customs and border procedures. Reducing trade costs by improving trade facilitation and related infrastructure

could substantially increase trade volumes (Hoekman and Nicita, 2009). Countries could also implement concrete initiatives related to trade facilitation based on their proposals submitted in the framework of the Doha negotiations, supported by Aid for Trade.

***Implement the duty free and quota free provisions for least-developed countries.*** This measure was agreed at the Hong Kong Ministerial meeting in December 2005 and is still on hold for some countries. The crisis is a good opportunity for all WTO members, especially all G-20 members, to implement it. This initiative could be complemented by a simplification of the rules of origin applicable to the products of least-developed countries benefiting from these provisions—such as providing a value-added requirement of no more than 10 percent across all products and opening the alternative of satisfying either a value-added rule or a simple change-of-tariff-heading rule (Brenton, 2006).

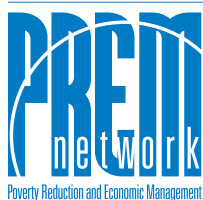
***Do not increase agriculture subsidies.*** The European Union, the United States, and Japan can substantially raise agricultural subsidies without violating their current WTO commitments. Developed countries could contribute to keeping markets open by committing not to increase their subsidies for agricultural production above pre-crisis levels. The Doha Round could have reduced this threat if negotiations had been completed as planned. For instance, the European Union recently announced new export subsidies for certain agricultural products that were supposed to be eliminated as a result of the Doha Round negotiations.

***Prepare for the post-crisis world economy.*** Before the crisis, technological changes and policy reforms made the

world much more integrated. Supply chains became global and trade in services grew faster than trade in goods and became a dynamic dimension of world trade, contributing to the transformation of production processes. While the countries that were most integrated have been hit hard by the fall in global demand (income), so have the countries that are much less integrated and diversified. It is important for countries to maintain a medium- and long-term perspective and continue their efforts to improve their competitiveness. In addition to policies that can reduce trade costs, governments must assess other policy areas that require attention, in particular, improving innovation and educational systems, and the overall regulatory environment, especially in the services sector.

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