TRADE, POLICY AND THE ECONOMIC CRISIS

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Introduction

Explaining the "trade collapse"

Trade-related responses to the crisis

The effects on trade of crisis response measures

Policy implications

Policy recommendations

Further reading

Overview

This report highlights trade policy conclusions and recommendations from a major study undertaken by the OECD's Trade Committee in response to the financial and economic crisis that started in 2008.

The 12.5% fall in global trade in 2009 is explained by several factors: the collapse in demand, the drying up of trade finance, a larger fall in demand for highly traded goods (such as machinery and transport equipment) relative to less traded goods and services, and the vertically integrated nature of global supply chains.

Early resort to protectionist measures has been relatively muted and does not play a significant part in explaining the fall in trade – only about 1% of world imports were affected by new trade restricting measures. The rapid and coordinated G20 response to ensure adequate trade finance was available for viable transactions seems to have been effective.

Given their sheer size, stimulus measures taken to rescue sectors of systemic importance (such as banking) or to preserve jobs (as in the automobile industries) or to stimulate growth (such as consumption tax reductions) or "buy national" measures may be more significant in terms of their potential impact on trade than direct trade policy measures.

But dollar for dollar, direct trade restricting measures have the most strongly negative impacts on both trade and growth: simulations suggest a USD 1 increase in tariff revenues results in a USD 2.16 drop in world exports and a USD 0.73 drop in world income. Simulations also suggest that USD 1 of stimulus spending behind the border can increase a country's own GDP by USD 0.64 on average while world trade could increase by USD 0.08, but the effects on the real GDP of other economies are mixed. These estimated overall impacts depend critically on the nature of the stimulus. Stimulus measures that discriminate between domestic and foreign goods and firms and sector specific measures are clearly less effective. Measures that are most supportive of both trade and growth are non-discriminatory demand stimulus and labour support. Coordination of stimulus measures ensures that benefits are larger and more widely shared.

Open markets and the restoration of a level playing field will be a necessary condition for a sustained recovery; this means addressing policies with both direct and indirect impacts on trade.

This report recommends:

- An immediate roll-back of the most trade distorting measures, continued resistance to protectionist pressures, and an ambitious and balanced conclusion of the DDA that will deliver further market opening
- That governments step back from the exceptional measures taken to support trade finance as conditions normalise
- Removal of discriminatory provisions from all stimulus measures
- Restoration of competition policy disciplines and withdrawal from the banking sector when the time is judged right with the international coordination needed to avoid regulatory arbitrage.
- Under current conditions economy-wide demand-side measures to address demand shortfalls and active labour market policies to address unemployment are preferred
- International coordination of "exit" from extraordinary measures as economic conditions permit; further attention is required both to address specific needs in less developed countries and persistent global macroeconomic imbalances.

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Introduction

The economic and financial crisis of 2008-2009 has prompted an unprecedented level of international cooperation, embodied in deep monetary easing and large fiscal stimulus. The G20 meetings of November 2008, and April and September 2009 produced a synchronised response founded on firm commitments and anti-protectionist pledges, in a continuously broadening international economic agenda. In this way, OECD countries have so far avoided the major policy mistakes of past crises, such as the protectionist response of the 1930s. Many of the measures taken to stimulate R&D, boost infrastructure spending, lower the tax burden on low-income earners and scale up and strengthen active labour market policies will help contain the long-term damage of the crisis for material living standards and welfare.

The process of recovery is incomplete, however. GDP and income levels are unlikely to return soon to their initially projected path. Recent OECD estimates put the permanent GDP loss at about three percentage points on average across the OECD, because of long-lasting elevation of risk *premia* that will raise the cost of capital, as well as persistently higher structural unemployment (OECD, 2010a). The danger going forward is that trade restrictions could build up incrementally, slowly stifling trade and ultimately weakening the effectiveness of the anti-cyclical measures that have been introduced. Protectionist sentiments are likely to increase with persistent unemployment and mounting pressure on government finances. Once put in place protection becomes entrenched and is increasingly difficult to undo, particularly when it prompts retaliatory action by trading partners.

Moreover, some time will be needed to address fully the two complex factors that underpinned the crisis. To recall briefly, the financial crisis, and the subsequent credit crunch and recession, were triggered by rapid credit expansion and under-pricing of risk facilitated by:

- Major weaknesses in the operation of financial regulatory and supervisory frameworks, including ones that contributed to the build-up of leverage and risk appetite.
- The current account imbalances that had built up during the past decade and which, through major outflows from surplus countries, helped fuel the rapid credit expansion in deficit countries, allowing them to postpone hard policy choices (Obstfeld and Rogoff, 2009, OECD 2009b).

In seeking to identify the trade policy implications of the crisis, and its aftermath, a number of elements need to be addressed: the impact of the crisis on trade; the nature of trade-related policy responses to the crisis; and the impact on trade of those policy responses. Each of these elements will be considered in turn. What they confirm and underline is the need to see trade policy as an integral part of the overall framework of domestic policies – macroeconomic and structural – that are necessary to generate growth and development.

Explaining the "trade collapse"

At the end of 2008 and in early 2009 world output experienced its sharpest drop since the Great Depression of the 1930s and global trade fell more sharply than during the Great Depression. In Q1 2009 real GDP in the OECD area was down 4.8% and volumes of exports and imports by respectively 15.7 and 15.3%. In Q2 2009 the crisis started easing; real GDP in the OECD area fell by 3.2% and volumes of exports and imports were down by respectively 14.7% and 12.8% and the easing continued into the third and fourth quarters. For the OECD area as a whole, percentage year-on-year reductions in volumes of exports and imports exceeded those in real GDP by a factor of approximately 3 (OECD 2010b).

The fact that proportional reductions in trade flows have been much deeper than reductions in output - dubbed the "trade collapse" - has triggered concerns that there might be particular factors affecting trade during the crisis, including worries about protectionism. In fact, other economic downturns have also been associated with steep falls in trade and there are a number of reasons why trade can fall more sharply than output even in the absence of a trade-related set of problems.

The severity of the 2008-2009 trade reductions was not unprecedented in terms of individual country experience. France in 1993, Japan in 2001 or the US in 1965 had monthly growth rates of trade with negative values of 20% or more (Araujo and Oliveira Martins 2009). The

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drop in trade can be explained by a combination of three main factors: a collapse in demand, the drying up of short-term trade finance, and compositional factors related to a disproportionate fall in output and trade of goods that make up a larger share of trade than of GDP. Structural factors linked to global supply chains also played a role but high synchronisation seems to be the only feature that unambiguously distinguished the 2008-2009 crises from the past ones.

These findings indicate that to date there is no evidence that would suggest that protectionism was a major factor behind the trade collapse. The findings also point to the importance, as policy concerns, of facilitating trade (through the availability of trade finance) and of managing the unwinding of global imbalances. However, this is not to suggest that the risk of protectionism is not still a major consideration.

Trade-related responses to the crisis

Direct trade policy instruments have not dominated the policy responses to the crisis. Rather, commitments to stay open to foreign products and services, together with concerns to keep global supply chains open, seem to have helped countries to resist protectionist pressures, alongside the disciplines stemming from the WTO's rules-based system. The WTO (WTO 2009, WTO- OECD-UNCTAD, 2010) finds that the share of the value of trade covered by new trade-inhibiting measures amounted to one percent of total world imports. The share of some sectors in the affected imports is much higher, however, reaching 36% and 29% respectively for the agricultural sector and the base metal industries. This suggests that trade policy during the crisis has had very specific targets, following patterns already observed in the past. The geographical distribution of new restrictions has also followed patterns already observed before the crisis. Measures both facilitating and restricting trade have been introduced but no strong pattern emerges concerning the profile of countries choosing one direction over the other.

In contrast with direct trade policy instruments, government intervention behind the borders in order to restore economic growth has been extensive; a priori, this is where we might expect the impact on trade to be greatest. The world's largest economies have been the most active in implementing recovery measures, both because they were the hardest hit and because they have the greater capacity to implement measures during a period of difficulty.

Policy measures directly affecting trade

A relatively small number of countries have raised *tariffs*, usually in very specific sectors such as steel, footwear and for some agricultural commodities. Virtually no country has resorted to a general increase in tariffs across multiple sectors, but tariffs were increased selectively in some countries, among them the United States, Canada, Turkey, Brazil, India, Indonesia the Russian Federation and South Africa. In many cases countries increasing tariffs have used the margin between their bound and applied rates. Developing and emerging countries generally have more scope to increase tariffs in this way because the gap between their bound and applied tariffs tends to be greater. Around half of the restrictive actions introduced outside the OECD area have involved new import duties (Gamberoni and Newfarmer, 2009). On the other hand, China, India, Indonesia and the Russian Federation also reduced some tariffs while Mexico applied a general decrease. A few cases of introduction or re-introduction of export subsidies also occurred.

In the course of the crisis, a significant number of non-tariff measures were activated to restrict trade, such as the tightening of licensing requirements, safeguard measures or export restrictions. There was an increase in anti-dumping activity, following a period of gradual decline from 2001 to 2007 and this may be indicative of a general rise in trade tensions. Developing countries accounted for almost 80% of all anti-dumping initiations for the period October 2008-October 2009, which mainly targeted other developing countries (WTO, 2009).It is estimated that anti-dumping, safeguard and countervailing duty action introduced by G20 countries have, together, affected less than 0.5% of total merchandise imports of G20 countries.

Measures aiming to facilitate access to export credits were taken in many economies, such as Brazil, the EU and India. Following the April 2009 G20 meeting, where a USD 250 billion

pledge was adopted in the area of short-term trade finance, 36 countries agreed at the OECD to worldwide export credit support to help boost trade and investment.

Measures with indirect bearing on trade

Measures taken behind the border are generally intended to stimulate demand, ease the pressure on the supply side of the economy and provide emergency injections to financial and other sectors at risk.

In response to the crisis, *tax measures* have been adopted in the OECD economies amounting to some two percentage points of GDP, but with considerable heterogeneity. Tax cuts of more than 2.5% of GDP were adopted by Australia, Canada, Denmark, Iceland, Spain, Sweden and the United States, while Hungary and Ireland were forced to consolidate and raise income taxes. Countries have also used monetary policy instruments in order to accelerate recovery from the crisis. Exchange rate adjustments were substantial and all major central banks cut interest rates in order to ease the flow of credit and investment in the markets.

Direct and indirect *subsidies to particular sectors* have been frequent, with one-third of OECD countries (Australia, Canada, France, Germany, Italy, Korea, Portugal, Spain, Sweden, the United Kingdom and the United States) offering some type of financial support for their automotive industries, and many countries engaging in activist interventions to forestall plant closure through managed bankruptcies and government sanctioned mergers, as well as demand-side measures such as car scrapping schemes.

Emergency interventions in the banking sector were necessary to stem the spread of systemic damage and help restore normal functioning of financial markets. Virtually all OECD countries expanded deposit insurance guarantees of bank debt and provided injections of capital. The gross value of this financial intervention (including guarantees) amounted to over 50% of GDP in several countries (Ireland, Sweden, the United Kingdom and the Netherlands) about 30% in the United States and more than 10% of GDP for about half of the OECD countries. Some countries took extraordinary measures including infusion of public capital into the financial sector. These included Ireland, the Netherlands, Portugal, the United Kingdom and the United States. Moves to purchase and/or ring fence toxic assets were undertaken or announced by Germany, Ireland, Korea, Switzerland, the United Kingdom and the United States (OECD, 2010b).

In response to the crisis, a number of countries – and in particular, local government authorities - have incorporated preferential treatment in public procurement in the stimulus packages. In the United States, the American Recovery and Reinvestment Act of February 2009 prohibits the use of recovery funds for a project unless all of the iron, steel and manufactured goods used in the project are produced in the United States. But the law requires that this prohibition be applied in a manner consistent with US obligations under international agreements, and it provides for a waiver under certain circumstances.[1] In Russia, a Decree of December 2008 gives preference to domestic producers, setting a 15% price advantage until 31 December 2010 in the procurement of a range of goods and services. China changed its government procurement legislation in 2007 to make it more restrictive, although a statement issued in June 2009 clarified that foreign companies operating in China would be treated the same as Chinese companies.

The effects on trade of crisis response measures

A major protectionist response to the economic crisis seems to have been avoided. This is not to say, however, that particular sectors are not subject to increased restrictions, nor that protectionist forces will not grow as unemployment continues to rise, as moves are made towards fiscal consolidation and as retaliatory temptations come into play. This section therefore seeks to throw some light on the potential impacts on trade of both trade policy instruments and trade-related measures of the sort recently introduced and at risk of implementation. The analysis draws principally on model-based simulations undertaken using the GTAP model to investigate the potential effect of different policy instruments on GDP and trade of the country taking the measure and on trade and GDP of partner countries. The stylized and static nature of the analysis and the caution which should accordingly be used in interpreting the results are fully explored and explained in OECD 2010b.

Direct trade policy instruments

The economic simulations show the highly negative effects of increased border protection. Border measures, both on the import side and the export side, are found to have the largest negative effect of all measures considered. On average, one dollar worth of increased tarif revenue leads to a 2.16 dollar drop in world exports and to a 0.73 dollar drop in world income.

Moreover, an import barrier while reducing exports from partner countries also reduces own exports – and even more so. Because import barriers raise domestic prices, through higher costs for intermediate inputs and through lifting the general price level for consumer products, export products also become more expensive and lose market share in the face of international competition. While the sectors being shielded by higher import barriers may benefit from increased prices, overall domestic production in the implementing country will contract – each dollar of increased border protection leads to a drop of GDP of 66 cents. In other words a tax on imports is a tax on exports. Border protection harms the fragile economic recovery by hampering the flow of resources to uses where they can earn the highest return.

While it may be argued that tariff increases up to the bound rate are WTO-consistent and therefore, by implication, acceptable, such increases are no less distorting. It is estimated that if all countries were to follow this path, global trade would fall by USD 809 billion and global GDP would shrink by 0.65% (Bouet and Laborde, 2009).

In the current phase of fragile economic recovery, low-income economies may find themselves disadvantaged by their inability to implement policy packages that support their domestic industries and may be tempted to assist them through border measures. However, raising tariffs if other countries implement fiscal stimulus packages increases the damage to the tariff-raising country, because it closes itself against imports that become cheaper in the wake of fiscal stimuli implemented elsewhere.

Four particular features of the current context are exacerbating the negative effects of increased border protection, or the potential for such protection (OECD, 2010b):

- the focus of border measures on sectors already highly protected, thus worsening pre-existing distortions;
- the uncertainty created by tariff adjustments within the applied-bound gap, leading to negative effects that may be greater than standard welfare analysis would suggest;
- a tendency to resort to increased specific tariffs or complex tariffs (with fixed and ad valorem components) which are more damaging for trade;
- and, notwithstanding the effect of global supply chains in possibly dampening protectionist sentiment, the disproportionate effect of increased tariffs in sectors with highly integrated global supply chains. Tariffs on intermediate inputs that typically cross borders several times, become additive and higher tariffs on inputs impose punitive costs on downstream users, like car industry consumers of steel.

The trade effects of non-tariff measures are harder to assess, though estimates can be made and, again, the potential costs are high. It is estimated, for example, that if OECD indicators of product market regulation were to revert to their 2003 levels, international trade could fall by about 20%, and GDP per capita by some 2% in the long run (OECD, 2010a).

Measures with indirect bearing on trade

No behind-the-border measure is, dollar-for-dollar, as destructive of trade and GDP as import protection. On average, across all the simulations, it is found that one dollar worth of stimulus increases a country's own GDP by USD 0.64. While the effects on other economies are mixed, the average effect is a reduction by USD 0.21 and on average, world trade increases by USD 0.08 for each dollar of stimulus. The nature of the trade and other effects depends importantly, however, on whether stimulus comes from the demand side or the supply side and whether or not the stimulus is targeted by sector.

Demand-side measures (whether economy wide via broad government expenditure or generic consumer tax reductions, or sector-specific, via consumer subsidies or tax reductions) have two channels of transmission. The first channel is through trade. A domestic measure that stimulates consumption will tend to raise import demand, leading to higher exports from partner countries. At the same time, the demand stimulus has an upward effect on prices of production factors in the country implementing the measure. This translates into higher export prices and lower competitiveness through an appreciation of the real exchange rate. Demand-side measures therefore tend to have a certain "anti-own export bias". The second channel is through investment. The country implementing the measure will typically see increased returns to capital as a consequence of the stimulus. This attracts capital from abroad and lowers investments in countries that do not engage in the stimulus. The simulation of a US stimulus (through lower consumption taxes equal to one percent of GDP) sees US GDP rise by 3.86% and investment by 0.92%. Other countries' exports increase and US exports fall by -0.11%.

The simulation results show significant negative spillover effects from unilateral policies, thus providing a strong case for multilateral coordination of policies of general support – both in designing them and in developing exit strategies. A simulation of a generic consumption tax reduction involving the EU-25, the USA, Japan and China, shows that if one country implements the policy, but the others do not, the own pay-off is 3.03 (additional national income per dollar of consumption tax reduction) but the pay-off for the other economies is a negative -0.33. If, however, all countries implement the policy, they will receive a pay-off of 2.71 on average.

Further simulation results show that demand-side measures that are sector-specific, such as a tax reduction for domestically produced goods, can lead to economy-wide efficiency losses and lower world trade volumes. The better option is a demand-side stimulus that allows consumers to decide themselves where to spend the transfers generated by the policy. While a sector-specific demand stimulus can generate a boost in output in that sector, it also generates an expenditure bias towards that industry, hence potentially leading to slowdown in other sectors of the economy.

Supply-side measures (which tend by nature to be sector-specific in the form of subsidies or tax reductions for production factors labour and capital) show simulation results that are unambiguously negative on partner countries' GDP. Supply-side measures boost output in one country and drive other suppliers from the market through a reduction of production costs in the implementing country. A direct consequence is the risk of retaliatory border restrictions or of a mutual subsidy spiral benefiting the factor owners in the subsidised sector but wasteful from an economy-wide perspective.

Most simulated supply-side measures also record a negative effect on own exports. This is explained by the fact that while the sector selected for stimulus may well see its exports rise, as a result of the subsidy, other sectors witness a decline. Drawing resources into the target sector tends to bid up factor prices in the economy as a whole, which makes the country's exports more expensive relative to those of other countries.

A simulation of supply-side support for the motor vehicle sector applied simultaneously in the EU-25, USA, Japan and China shows that the strongest across-the-board positive effects occur when industry-specific assistance is given in the form of a direct subsidy to labour. Own and partner GDP and own and partner exports all respond positively. A direct capital subsidy under otherwise the same conditions performs much less strongly and is negative for a partner's GDP and own exports.

Indeed, supply-side simulations generally show particularly negative effects if the subsidy (or tax reduction) is afforded only to capital. If the price of capital is lowered relative to that of labour, a substitution towards more capital use occurs, and this can be detrimental to employment.

Underpinning the results of the economic simulations is empirical support for the fact that sector-specific assistance measures can be inimical to needed structural reform and innovation. Sector specific supply-side measures create rents in the sector being stimulated that tend to become incorporated in the value of fixed assets which makes it more difficult to

reverse the policy once growth has resumed. While OECD investment instruments, as well as EU and WTO rules, provide for emergency measures in response to a crisis, if measures are not withdrawn sufficiently rapidly they could have long-lasting distorting effects on firm dynamics and competition, thereby hampering structural change and reducing long-run productivity (OECD, 2010a).

Particular considerations arise from the supply-side support given in many countries to the banking sector. There are some concerns that such support could harm competition, distort the pricing of risk and delay required restructuring. Risks of distortion are evident at three levels: within the sector in particular countries, given the tendency to focus support on very large institutions, considered to pose a systemic risk, rather than on smaller players; between the banking sector and other areas of economic activity within a particular country, given the scale of support given to banking institutions; and between the banking sector in different countries, given the potential to discriminate between foreign and domestic institutions, although most major economies extended eligibility to foreign banks. Of course, these risks should be assessed in the context of the positive knock-on effects on the stability of the banking system in general, thus ensuring the availability of trade finance and the cross-border effect of having extended the support to foreign-owned operators.

Pressure can be expected to continue to include "buy national" provisions, either in bailout packages or in governments' own procurement in the context of infrastructure projects. Again, there is the potential for inefficiency and discrimination, with a high risk of retaliation. Although some countries may be protected from discrimination by virtue of their membership of the WTO plurilateral agreement on government procurement, a number of major economies, such as Brazil, China, Mexico and South Africa, are not members. Moreover, the agreement has limited ability to discipline discriminatory purchasing by sub-national authorities, often accounting for a large share of government expenditure.

It should be stressed in concluding this section that the trade impacts referred to are likely to be understated rather than overstated to the extent that they do not take into account possible effects on trade in services or on flows of foreign direct investment; they do not attempt to measure the "dynamic" effects of trade restrictions; and they do not allow for the cumulative effects - quantitative and systemic - of the interaction of different measures, as for example when the distorting effects of preferential trade agreements are compounded by "buy national" provisions that exempt the products and services of PTA partners.

Policy implications

The implications for trade policy of the foregoing analysis need first to be seen within the context of the broad policy goals set out by G20 leaders:

> *We need to shift from public to private sources of demand, establish a pattern of growth across countries that is more sustainable and balanced, and reduce development imbalances. We pledge to avoid destabilising booms and busts in asset and credit prices and adopt macroeconomic policies consistent with price stability, that promote adequate and balanced global demand. We will also make decisive progress on structural reforms that foster private demand and strengthen long-run potential. (G20, 2009)*

Embodied within these goals are two underlying policy challenges faced by virtually all OECD countries: the correction of global current account imbalances and the restoration of sustainable fiscal positions. Fiscal adjustment will be complicated by the fact that the current worsening of fiscal positions has strong structural components, including lower potential growth and the disappearance of exceptionally high tax revenues, meaning that consolidation will have to go well beyond a mere removal of recent fiscal stimulus (OECD, 2010a).

In the face of these challenges and in the course of what may be a protracted period of adjustment, open markets and strengthened WTO rules will have a crucial role to play in moderating some particular tendencies that in the period of crisis-recovery are likely to reduce and distort international trade.

Open markets for goods and services will be needed to help counter the trade-reducing effects of fiscal consolidation. They can do so by helping the necessary rebalancing to take

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place in the most efficient way possible, ensuring that consumers and businesses have all the choices and opportunities that an integrated world economy brings (OECD, 2010b), and by helping foster the growth that economic recovery must entail (OECD, 2007). Trade liberalisation and rules-strengthening play a central role in encouraging innovation – and hence growth – by promoting the transfer of skills and technology, particularly where trade is accompanied by foreign direct investment; by generating economies of scale, enabling R&D outlays to be more easily recovered; by helping protect intellectual property rights, thus raising the private returns on innovation; and, above all, by encouraging competition and hence productivity (Melitz and Ottaviano, 2005).

The trade link to productivity improvement is of overriding importance. The unprecedented fiscal expansion in response to the global financial crisis and associated debt, only add to the existing long-term imperatives for increased productivity growth arising from demographic ageing and greenhouse gas abatement and other costs. Productivity growth can help service the debt now accumulating from fiscal deficits, as well as offset the effects on future income of withdrawal of governments' stimuli from consumer spending (Productivity Commission, 2009).

Open markets will be needed to ensure that global supply chains continue to drive efficiency and growth. There are some indications that the growth in vertical fragmentation that has driven rapid trade growth since the early 1990s, may not continue at the same pace. Three factors are at play: concerns about the negative environmental effects of current trade and consumption patterns; possibly diminishing marginal returns on fragmentation as coordination costs rise; and disruption to the supply chain as a result of the restructuring taking place in the aftermath of the crisis. Open markets have a key role to play in helping sustain the dynamism of global supply chains, and thereby contributing to increased efficiency and more vigorous growth by:

- Minimising the risk of cumulative distortion arising from increased border tariffs on intermediate inputs.
- Promoting harmonisation around international technical standards to which firms in fragmented markets must conform.
- Addressing the danger that restrictive rules of origin will disadvantage low-cost suppliers within the chain.
- Encouraging trade facilitation, enabling suppliers to respond quickly to developments further down the value chain.
- Fostering the liberalisation of environmental goods and services and so help in allaying environmental concerns linked to trade.

Open markets will be needed to help foster complementarity between preferential trade agreements (PTAs) and the multilateral trading system. In the aftermath of the crisis, and with the prospect of continuing high levels of unemployment, the temptation to engage in preferential trade agreements – which have become the main focus of trade diplomacy –may become even greater. In the fall out from the crisis, PTAs may be seen increasingly as a way of addressing sharpened concerns about the political economy of trade (concentrated losses and dispersed gains) by enabling, hand-picked, PTA partners to exclude sensitive sectors from liberalisation, secure full reciprocity from each other, avoid MFN commitments and hence free-riding by third parties, while addressing concerns about a perceived race to the bottom in labour and environmental standards. PTAs are widely recognised, however, as being second-best to multilateral liberalisation and while preferential agreements can complement the multilateral system they will only do so if that system is itself robust – strengthening trade rules and bringing down MFN barriers so that the distorting effects of PTAs are held in check (Heydon and Woolcock).

Open markets will be needed to ensure that trade can support recovery in growth and employment. Open economies achieve higher levels of economic growth, contribute to net job creation, help to raise real wages, and ensure lower prices and wider choice of products and services. During the crisis unemployment has risen sharply as output and trade fell; relatively high unemployment levels are expected to persist for some time, lagging renewed

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growth in GDP. At the same time, governments will need to consolidate their fiscal positions in the wake of recent high levels of spending. In these circumstances, the economic opportunities associated with more open markets are more urgently required than ever. At the same time, the temptation for governments to yield to calls for protection of particularly vulnerable sectors can be strong. To do so risks undermining the recovery and for the reasons already explained may well have the opposite effect intended, protecting jobs in some sectors only at the expense of other jobs in more competitive export sectors of the economy.

Strengthening future resilience to external shocks will also call for heightened attention to investment in infrastructure, which tends to be good for growth and good for trade. Green growth strategies can be an important element of building resilience, through targeted investments in a "low carbon economy" that relies on global markets to ensure a reliable flow of goods and services from where they are most economically and environmentally sustainable to produce to where they are needed. At the same time, it will be important to avoid the emergence of new forms of "green protectionism".

Policy recommendations

Set out below is a set of recommended policy guidelines, offered as a step towards agreement on shared policy objectives called for by G20 leaders (G20, 2009). The checklist is constructed on the basis that there is a strong convergence between policies that are good for growth and employment and those that are good for trade. Indeed, trade policy to be effective needs to be placed within the overall framework of sound economic management, seen more through the prism of the domestic economy (Sally, 2008), and backed by a strong culture of evaluation (Messerlin, 2006).

In the policy guidelines that follow, there is no attempt to suggest optimal sequencing. Indeed in many cases simultaneous implementation would be desirable. There is nevertheless a presumption that those measures, such as import restrictions, which the preceding analysis has found to be particularly damaging to both trade and GDP, would be unwound before less distorting measures, such as generic demand-side stimulus.

To manage effectively the aftermath of the global financial crisis, it will be necessary to:

1. ***Roll back the most obvious trade-restricting measures, while resisting further protectionist pressures***, in particular, by eschewing:
   - Increases in applied tariff rates up to their bound ceiling, *i.e.* covering WTO legal measures as well as illegal measures (OECD, 2009).
   - Non-tariff restrictions imposed through import licensing, buy-local initiatives or onerous, opaque and discriminatory technical standards.
   - Green protectionism.
   - Policy packages with compounded restrictive effect, such as tariff increases combined with a sector specific consumption subsidy.
2. ***Actively promote multilateral trade liberalisation through the Doha Development Agenda***, so as to "lock in" liberalisation commitments and provide increased market access.
   - With a particular focus on the liberalisation and expansion of trade in services, given their resilience in the face of recession and given the role of financial services in fostering innovation and growth.
3. ***Maintain support for trade finance until conditions normalise***, as agreed among OECD Members, consistent with international obligations and sound underwriting principles, while also seeking to:
   - Step back from the exceptional, emergency measures in an orderly fashion, avoiding the creation of distorting subsidies and ensuring restoration of the level playing field.
   - Improve the collection and dissemination of bank data on trade finance to improve

readiness to deal with a trade finance problem should one arise, in the future.

4. ***Strengthen competition policy disciplines*** while avoiding overly tight product market regulations, in order to facilitate resource reallocation, business start-ups and access to networks.

5. ***When the time is judged right, remove financial support from the banking sector*** and implement better regulation in a coordinated way across countries in order to ensure a smooth exit and minimise regulatory arbitrage, and without unduly constraining the benefits that can come from liberalised financial services. In particular:

   - Encourage stronger capital standards, complemented by clear incentives to mitigate excessive risk-taking practices, within a framework of strengthened oversight, transparency and accountability (G20, 2009).

6. ***Design pro-trade stimulus measures to be non-discriminatory*** by not favouring one sector of the economy over another (unless there are clear systemic problems); not favouring domestically-owned firms over foreign-owned firms; and not discriminating between domestically produced and imported goods and services. Where it is considered necessary to give targeted support this should be on the basis of an agreed set of principles (OECD, 2005), whereby support is:

   - Time-bound with a clear exit strategy and credible termination date in order to avoid the creation of rents and the development of vested interests.
   - Accompanied by "pay-back" and a restoration of competition so that rents and sectoral protection do not become entrenched.
   - Decoupled from production, with incentives to adjust and innovate.
   - Aimed at redeploying displaced workers.
   - Compatible with general safety net arrangements.
   - Cost-effective.
   - Transparent and accountable.

7. ***Focus trade-related policies*** on where they will be most effective, remaining consistent to the fullest extent possible with the principle of non-discrimination.

   - Where the problem is a shortfall in demand, as in the current situation, demand-side measures should be favoured over supply-side measures (and economy-wide demand-side measures, enabling consumers to decide where to spend the transfers generated, should be preferred to sector-specific demand-side measures).
   - Where the problem is unemployment, as in the current situation, lowering the tax burden on labour (particularly by lowering the income and social security tax burden on low-income workers) should be the favoured supply-side option, backed by the implementation of active labour market policies.

8. ***Coordinate internationally*** the implementation, and the gradual phasing down, of economy-wide measures, while seeking to avoid premature policy reversal that could put at risk or delay economic recovery, while recognising that exact policy settings will differ from country to country.

9. ***Sustain and strengthen development assistance*** in general and Aid for Trade in particular in order to assist low- and middle-income countries in the current environment of economic uncertainty and disrupted trade.

Further reading

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[1] In February 2010 the United States and Canada announced that they had reached agreement on government procurement (subject to domestic approval processes) including permanent and reciprocal commitments under the WTOs Government Procurement Agreement with respect to provincial, territorial and state procurement. The agreement also provides for additional reciprocal guarantees of access on a temporary basis by Canada on a range of construction contracts in Canada's provinces and territories and by the US in relation to state and local public works projects under the ARRA of 2009.

For more information

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