

## Trade Protectionism and the WTO: A New Challenge under the Global Financial Crisis

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Andrew L. Stoler<sup>1</sup>  
Executive Director  
Institute for International Trade

### Introduction

Thank you for inviting me to make a presentation at this very important Eighth Forum on WTO and Shenzhen. I have enjoyed a long and productive relationship with the Centre here that I hope will continue into the future.

The ongoing global financial crisis has shaken the international trade system to its roots. Our shared economic prosperity has been threatened to a degree not seen since the Great Depression. Global GDP and international trade collapsed at the beginning of the year and we feared the worst in terms of the potential for damaging trade protectionism.

The value of China's WTO Membership has never been more clear. As one of the most important exporting countries, China is particularly exposed to protectionism and participation in the WTO system has undoubtedly saved the Chinese economy from what could have been damaging foreign protectionist actions.

### Early 2009 – Looking over the Brink

In order to fully appreciate the extent to which the global trading system of the WTO has been challenged in this difficult period, we need to put the impact of the global financial crisis on international trade in context. Earlier this year, I gave a speech in Australia that tried to set this context. It was a genuinely frightening series of facts that I recounted in my speech. The world had not seen anything this bad for eighty years. According to statistics from a WTO report, global trade was expected to decline by 9 percent in 2009.

As the economists say, the fall-off in trade was synchronized and it was clear that we were all in this together. United States imports were down by 51 percent compared to 2008 and Chinese exports fell

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<sup>1</sup> Member, Advisory Committee of the Shenzhen WTO Affairs Center and former Deputy Director-General of the World Trade Organization.

by 26 percent in the same period. For the first time since the 1930's, we expected to see a drop in real global output.

According to published reports, by April of this year more than 20 million people in China had lost their jobs – mainly due to the collapse of China's exports. 650,000 Japanese lost their jobs in the year to December and a Japan research institute estimated unemployment would rise above seven percent in the current cycle – with two million people losing their jobs on top of the 2.7 million Japanese already out of work. As Japan's economy went into free fall, Australian economists calculated that the value of our exports to Japan would fall by more than \$20 billion.

The international transport sector was severely impacted. Air cargo traffic globally was down 23 percent in December compared to a year ago – led by a 26 percent fall in the Asia-Pacific region. Another measure that received a lot of attention is the Baltic Dry Index – a measure of the cost of shipping bulk cargo by sea, published by the Baltic Exchange in London – the leading world marketplace for brokering shipping contracts.

Movements in the index can be tracked to global demand for manufactured goods. Between June and November of 2008 the Baltic Dry Index fell by 94 percent. The cost of shipping a container of goods from Shanghai to North America – if you exclude charges for freight and handling – had fallen to close to zero. The busy port of Singapore was a crowded parking lot for unused container ships.

Everyone was hurting badly early this year and in a context where many predicted that events would track those witnessed in the Great Depression of the 1930's, the risk of increased protectionism was very real.

## **Serious warnings for serious policy-makers**

One very important institution that the world has today that it did not have in the 1930's is the World Trade Organization and its system of rules for the international trading system. The contractual system of the WTO is a kind of global insurance policy against a revival of 1930's levels of trade protectionism. But the WTO insurance policy is imperfect in a number of ways and the imperfections mean that it is possible for most countries to adopt much higher levels of trade protection without breaching their obligations under the WTO. Tariff bindings, for example, are normally set at levels considerably above "applied rates". In Australia, for example, the bound tariff level for automobiles is 40 percent ad valorem, but the applied rate is just 10 percent. This means that Australia could quadruple its level of protection for autos and still not be in trouble at the WTO.

Nobody wants to see the mistakes of the 1930's repeated so it is important that key players in the global economy should devise an effective mechanism that provides for rapid identification of potentially harmful trade actions and serves to pressure governments tempted to protectionist actions. This is why at the Washington Summit of the G20 countries in late 2008, leaders pledged to "refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions or implementing WTO inconsistent measures to stimulate exports. In part for the reasons noted earlier, this political level pledge was not enough. In the months following the Washington Summit, a majority of G20 countries introduced new trade measures which raised levels of protection in their markets.

Effectively containing protectionist tendencies is a difficult task. An important part of the problem is that containing protectionism requires both a meaningful political-level commitment to open markets and a surveillance mechanism to guard against departures from the commitment.

In the period immediately preceding the early April G20 London Summit, a colleague and I were tasked by the Centre for Economic Policy Research to contribute to a publication that would contain a series of recommendations for the G20 leaders when they met. Our contribution focussed on the need for effective surveillance of harmful trade measures. In our part of the publication<sup>2</sup> we suggested a plan for an effective G20 political commitment and a surveillance mechanism that would be meaningful.

In our article, we argued that the dissuasive effect of surveillance relies for its force on governments' wish to cooperate in the restoration of global growth: rapid recovery needs cooperation and, even if the economic risks of free-riding are small for smaller economies, the foreign policy costs of being an identified non-cooperator are too high for almost all. If you are an optimist, you might also hope that the publicity generated by the surveillance mechanism would also equip private exporting and other import-competing interests in national economies to fight the costs that protection would impose on them.

Surveillance of potentially harmful measures already exists in the WTO (with regard to WTO rules and more) and in the flood of daily print and Internet media. The latter, especially, appears to influence parliamentary and executive intentions on trade as evidenced by the climb-down in the U.S. Senate over 'buy-American' provisions in the Obama stimulus proposals and the debate in Europe on subsidies for automobile production.

In 2009, we argued for a high profile notification system where interested parties could notify measures that appeared to be inconsistent with the standstill commitment governments would be expected to undertake. We said we thought that no other action should be necessary. The pressure generated through this highly public process should be sufficient to pressure the "offending government" into not taking the planned protectionist measure.

In our article, we suggested that a notification to the surveillance mechanism should be triggered by a measure that is judged inconsistent with a common sense standstill commitment to be adopted by G-20 members and other countries willing to participate. As I explained earlier, we know that a measure need not be inconsistent with a government's WTO obligations to be capable of harming international trade and, in any event, the surveillance mechanism should not aim to supplant WTO notifications or dispute settlement. A common sense standstill would also allow non-WTO members like Russia to be part of the surveillance mechanism.

This recession posed new and surprising problems not encountered in earlier cyclical downturns. For that reason, as a part of a plan to avoid harming world trade actions and to make the surveillance mechanism operable, we argued that the G-20 should adopt a "real" standstill in their use of protective and market-disruptive measures.

A "real" standstill commitment would not be like the watery promise the G-20 made in November 2008 not to take steps inconsistent with their WTO obligations. A real standstill – coupled with the

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<sup>2</sup> Andrew Stoler and Peter Gallagher, "G20 Surveillance of Harmful Trade Measures", in *The Collapse of Global Trade, Murky Protectionism and the Crisis: Recommendations for the G20*, (London, Centre for Economic Policy Research) 2009, pages 65-68.

surveillance mechanism - would provide maximum assurance that the desire to stimulate growth extended beyond the borders of the world's largest economies. The G-20 should commit to for some initial period (say until December 2010) to implement:

1. No increases in any MFN applied rate of duty other than for technical adjustments (completion of HS transpositions, for example);
2. No increases in any customs fees, excise duties or consumption taxes applying to imports;
3. No new export subsidies in any form (as defined by the Hong Kong Ministerial Declaration);
4. No new export restrictions or export taxes;
5. No new buy local preferences at any level of government for goods or services contracts; and,
6. No new regulatory or technical requirements that would have the effect of reducing market access for foreign services suppliers or introducing or increasing discrimination against foreign services suppliers.

## What happened at the London G20 summit?

I think that the outcome of the London G20 Summit was in fact quite a good outcome. In paragraph 22 of the communiqué, the leaders made the following commitments:

- We reaffirm the commitment made in Washington: to refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing WTO inconsistent measures to stimulate exports. In addition, we will rectify promptly any such measures. We extend this pledge to the end of 2010;
- We will minimize any negative impact on trade and investment of our domestic policy actions, including fiscal policy and action in support of the financial sector. We will not retreat into financial protectionism, particularly measures that constrain worldwide capital flows, especially to developing countries; and,
- We will notify promptly the WTO of any such measures and we call on the WTO, together with other international bodies, within their respective mandates, to monitor and report publicly on our adherence to these undertakings on a quarterly basis.<sup>3</sup>

These G20 commitments are significant in a number of respects. First, as we suggested in our article, the commitment is not to raise new barriers, whether or not they are consistent with countries' WTO obligations. Second, there is an important commitment not to engage in financial protectionism which obviously could have effects as damaging – or more so – than trade protectionism. Third, the G20 agreed to adopt a surveillance procedure through WTO notifications and periodic public reports by the WTO. I never expected the G20 to adopt our proposal wholesale, but this was a pretty good outcome.

## How well has the system worked?

One way to judge how well the post London surveillance system is working is to look at the periodic reports now issued by the WTO Secretariat. The most recent "Report to the Trade Policy Review Body from the Director-General on the Financial and Economic Crisis and Trade-related

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<sup>3</sup> For the record, commitments were also made in respect of trade facilitation and supporting trade finance.

Developments”<sup>4</sup> provides a mixed picture of the situation as of the middle of July. By way of a summary, the report states:

“In the past three months [from 1 March to 19 June], there has been further slippage towards more trade-restricting and distorting policies but resort to high intensity protectionist measures has been contained overall, albeit with difficulties. There have been signs of an improvement in the trade policy environment in the form of more governments introducing trade-liberalizing and facilitating measures, but there is no general indication yet of governments unwinding or removing the measures that were taken early on in the crisis.”

So there is a judgment that “high intensity protectionist measures” have been contained. This is good news. The bad news seems to be that there have been many instances of “low intensity” protectionist measures since the onset of the crisis. In fact the Director-General reports that the number of new trade-restricting or distorting measures announced or implemented in the March to mid-June period exceeded the number of new facilitating or trade liberalizing measures by a factor of more than two to one.

Remember the first version of the American stimulus package? On the face of it, the program appeared to be full of trade-distorting and possibly WTO-illegal “Buy America” provisions. In this connection, the WTO DG’s report notes that the paucity of data available – especially specifics on how such programs are to be implemented – makes it a particularly difficult challenge to monitor the impact on trade of national stimulus programs. It is not just the Americans who are tempted to insert “buy local” requirements in these programs. The Secretariat report cites several new campaigns along these lines in the past several months – often at the level of local governments.

One very important measure of a trend toward protectionist action is the extent to which governments pursue contingent trade protectionism through antidumping, countervailing and safeguard measures. There does seem to be a rise in the number of these actions. In 2008, 151 contingent trade actions were initiated by WTO members and 92 of these measures affected Chinese exports. That represents a 44 percent increase in one year. Inside this gross total, the number of antidumping actions rose by 29 percent, the number of countervailing actions was up by 36 percent – but the number of safeguard initiations rose by an incredible 175 percent.

In the first semester of 2009, there were 15 initiations of safeguard actions, compared to just 3 in the first semester of 2008. Of the 15 initiations, 9 (or 60 percent) were taken by India. India was also responsible for 5 out of the 6 product-specific safeguard measures initiated in the first semester of 2009 under the special mechanism in China’s accession protocol. India has also been a significant user of antidumping measures in the period. In the second semester of 2008, India finalized 6 antidumping actions – all of which targeted exports from China. Only the United States took more antidumping actions against Chinese exporters in the second half of 2008 (11 measures).

While the trend toward protectionism in antidumping, countervailing and safeguards is worrying, the absolute volumes of trade affected by these actions tends to be rather marginal and the increases we have seen should not be considered as “high intensity” protectionism. Also, the WTO’s dispute settlement mechanism has proven to be very effective at disciplining those countries whose measures are not properly founded.

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<sup>4</sup> World Trade Organization document WT/TPR/OV/W/2, 15 July 2009.

We do, unfortunately, have one very serious example of trade protectionism that has darkened the picture in this period. The decision by the American President to impose safeguard measures on imports of tires from China pursuant to so-called "market disruption" provisions was a very bad decision that sent a very bad message. Although China agreed in the context of its accession to the WTO to a transitional safeguard mechanism, I am sure that nobody in 2001 imagined that safeguards would be imposed in a case like the tires case where not one of the ten tire manufacturers in the United States requested or supported this action. We have to hope that we do not see more unjustifiable protectionist actions like this – particularly from the United States.

We all know that services trade is increasingly important to the economies of developed and developing countries alike. It seems that so far, the global financial crisis has not triggered any major protectionist developments in terms of international trade in services. While some countries seem to have delayed plans to further liberalize foreign access to their service sectors, there is some evidence that certain governments have even further liberalized services trade in this period.

In India, the Reserve Bank has decided not to change its policy on foreign banks operating in the country – postponing the second phase of India's "Roadmap for Presence of Foreign Banks in India" which was supposed to have been implemented in April of this year. The reason for the postponement was the current global financial turmoil and the RBI's concerns regarding the financial strengths of banks around the world.

Here in China, there have been examples of further liberalization in the services sector this year notwithstanding the financial crisis. For example, on May 1, Chinese authorities lifted restrictions on foreign ownership, capital start up investment and outbound bookings, making it possible for foreign travel companies to own more than 51 percent of a Chinese travel agency and to open up new branches. These liberalization measures added to the regulations released by the China National Tourism Administration and the Legislative Affairs Office on 18 March 2009 that lifted the threshold on annual sales volumes for the establishment of a travel agency in China.

## **Some tentative conclusions**

The global economic outlook at the beginning of 2009 was frightening. World trade and output were falling at rates not witnessed for eighty years and it is not unlikely that if we had not seen the kind of coordinated response from the G20 countries and others that the situation could have been far worse. It is especially instructive to see how important the major economies deemed it to be to undertake anti-protectionist commitments and – through the WTO – to establish a monitoring system to oversee the implementation of these commitments.

World trade is not booming, but it has at least stopped declining. Whether international trade picks up strongly in the near future and whether growth in trade can be sustained will depend upon a number of factors. Obviously key to the re-growth of trade will be avoidance of "high intensity" protectionist measures. Here, notwithstanding the recent tires safeguard action in the United States, we have some cause for optimism. It seems reasonably clear that, in general, the multilateral rules continue to be well-respected by WTO Members and are helping to contain protectionist pressures.

However, the tires safeguard case shows us that it is still too early to conclude that the threat of protectionist actions is behind us. A number of large economies are being supported in large part by massively expansionary monetary and fiscal policies. Sooner or later, these policies will need to be

unwound and with most stimulus packages near their limits, trade barriers might still be seen as a way to protect jobs.

Here in China, the economy has bounced back strongly – supported by an explosive growth in bank lending. Many economists believe that this rapid increase in lending is unlikely to have all been prudent. If the loans turn bad with over-extended projects or as a result of too much surplus capacity in some sectors, the authorities might be tempted to resort to trade measures.

As I pointed out earlier, notwithstanding the G20 commitments, nearly all WTO governments have the ability to raise tariffs to much higher levels than their current “applied rates” without falling afoul of their obligations under WTO and I think we need to worry about the potential for a creeping “legal protectionism”. There is only one way to counter this risk and that is to reduce bound tariff rates significantly so that the “water” is eliminated in the current tariff structures of WTO Members.

Reducing bound tariff rates can only be accomplished through the finalisation of the much-delayed multilateral negotiations of the WTO Doha Round. Finishing the Doha Round soon, with significant tariff reductions, would be a big help to correcting the imperfections of today’s WTO “insurance policy”. And improving the WTO system through a completed Doha Round would be the best way to guard against a return to trade protectionism in difficult circumstances such as those we face in the current global climate.

Thank you very much for your attention.