Global Economic Crisis and Trade Policy

Shcherbinina R

15 June 2010

Outline

- The causes of global economic crisis
- Channels of transmission
- The impact of crisis on global trade
- Global crisis and trade credit
- Rising protectionism
- Outlook
- Role of trade policy

Global Economic Crisis

- In order to assess the role that can be played by trade policy one has to understand the causes of the crisis
- Causes: Common elements: high credit growth, asset price appreciation (house price boom) large capital flows. New elements: increased financial integration, greater financial complexity, weakness in regulation and supervision
- Channels: Financial and trade linkages

Channels of transmission

- Financial: As the crisis emerged in the US subprime, it spread to other US financial markets
- International transmission: liquidity; banks with exposure to US, freezing of credits markets
- Solvency: financial meltdown
- Trade not a channel for contagion of the crisis, but casualty.

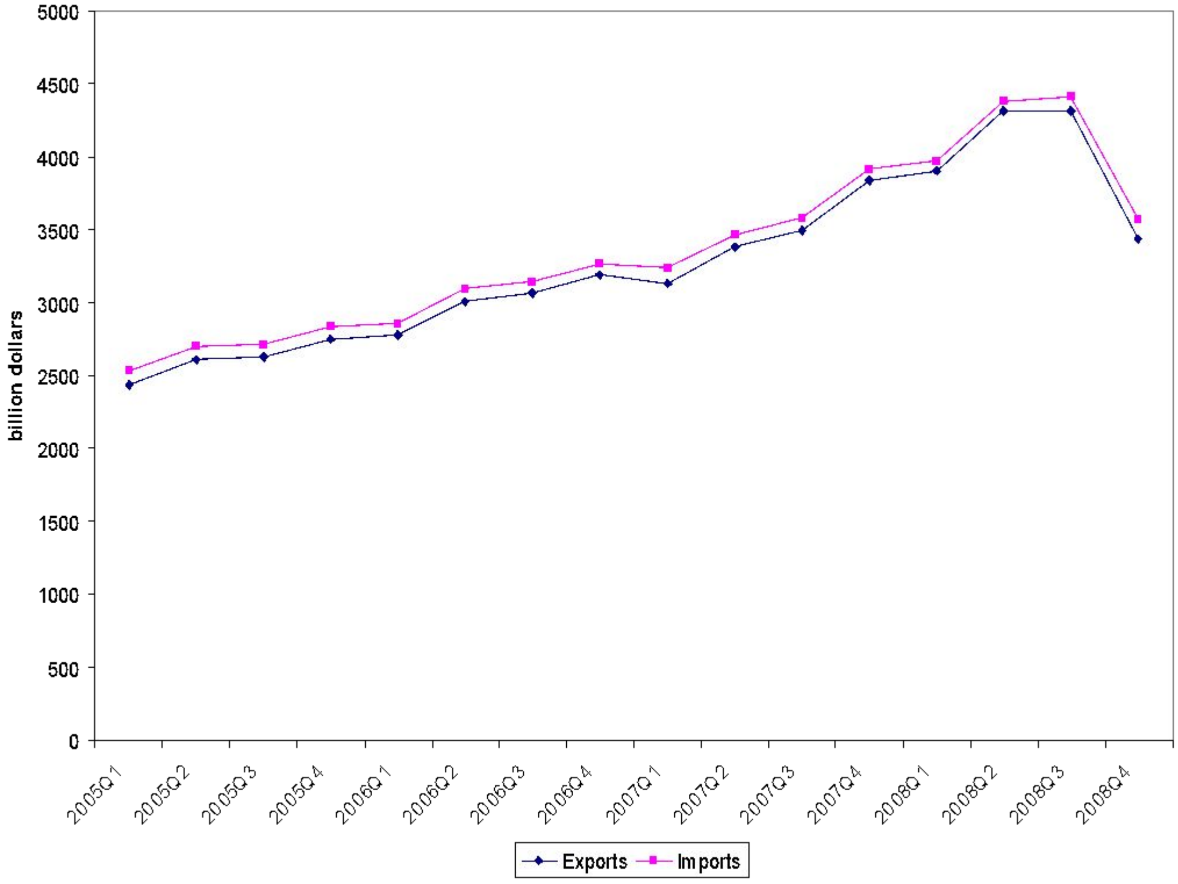
Impact on trade

- Although the current crisis is a financial crisis and is transmitted through the financial channel internationally, it has an impact on both the supply-side and demand-side of trade.
- Supply-side impact: Trade has collapsed due to drying up of trade finance; collapse of vertical integration; disruption in international capital markets
- Demand-side: collapse of demand in advanced economies has a significant impact on emerging market economy exports

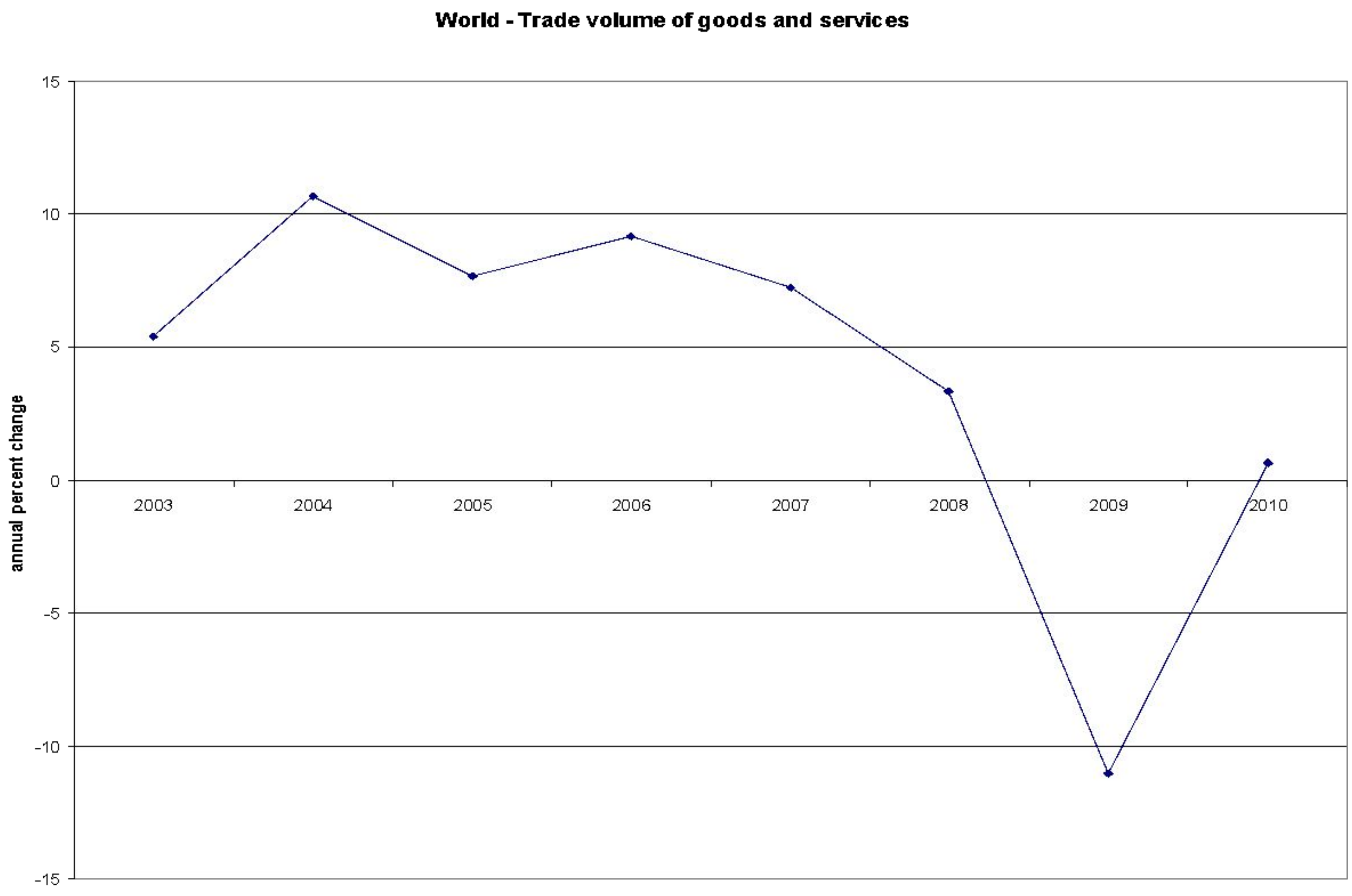
Impact on trade

- Until mid-2008, slowing of OECD demand offset by strong growth in exports of capital- and high-tech products
- Capital good producing economies: Japan, Germany, Taiwan, China and US-most affected by collapse of investment
- GDP collapse in Japan 12.1 %, 21% in Korea and 25% in Taiwan and China

Quarterly world exports and imports, 2005-2008



Impact of Global Financial Crisis on Trade



Global crisis and trade credit

- Global financial crisis might have reduced the trade finance (WTO, 2008)
- G20 meeting on 2 April 2009: ensure $250 billion for trade finance to promote trade and investment over 2 years (through export credits and investment agencies)
- **Supply-side failure: sharp fall in trade finance in advanced economies; increase in credit prices**
  - Possible explanations: herd behavior (S-T); global consolidation and concentration (L-T)
  - “perception that domestic local banks were no longer in a position to be reliable counterparts, and the absence of possibilities to "securitize" outstanding loans, convinced international banks that, despite an existing demand, the level of risk had become too high relative to its remuneration” (WTO, 2008).

Response to Global Crisis: Rising Protectionism in Developed Countries

Country	Date	Sector	Protection type	Description
Britain	Jan-09	Auto-industry	Investment	Low-interest loans ($1.4 bn).
USA	Dec-09	Auto-industry	Investment	Low-interest loans for General Motors, Ford and Chrysler ($17.4 bn)
	Feb-09	Construction	Trade	Buy American.: only US-produced iron, steel and other manufactures can be used for projects funded by the stimulus Package (but applied consistent with US international obligations).
Russia	Dec-08	Auto-industry	Trade	Raises custom duties from 25% to 30% on all imported vehicles
			Investment	Low-interest loans for domestic automakers ($6 bn).
European Commission	Dec-08	Imports	Trade	Imposes duties on preserved fruits (from China) and on some iron and steel products (from Belarus, China and Russia)
France	Jan-09	Auto-industry	Investment	Low-interest loans in exchange for keeping factories in France ($7.8 bn). Drops condition (Mars-09)
Japan	Mars-09	Auto-industry	Investment	Low-interest loans ($2.0 bn).

Response to Global Crisis: Rising Protectionism in Developing Countries

Country	**Date**	**Sector**	**Protection type**	**Description**
China	Nov-08	Exports	Trade	Restores GATT permissible rebate of indirect taxes on exported goods.
	Dec-09	Imports	Trade	Ban on Irish pork, Belgian chocolate, Italian brandy, British sauce, Dutch eggs and Spanish dairy products
	Jan-09	Auto-industry	Investment	Consumer subsidies and reduction of sales taxes (10% to 5%) for fuel-efficient vehicles.
India	Nov-08	Steel	Trade	Raises tariffs on steel.
	Jan-09	Chinese toys	Trade	Ban on toys imported from China
	Feb-09	Aluminum	Trade	Raises tariffs on aluminum imported from China.
	Feb-09	Exports	Trade	Increases GATT permissible rebate of indirect taxes on exported goods.
Mercosur	Dec-08	Imports	Trade	Raises the Common External Tariffs by 5 points on average.
Brazil	Jan-09	Imports	Trade	Reintroduces government licenses for 24 imported goods (wheat, plastic, copper, iron, aluminum, transport equipment...).

Road to Recovery

- Emerging markets economies are key to global recovery
  - Decoupling theory: A survey of the decoupling debate (Kose, et al 2008) reveals that during the last period of globalization (1985-2005) there has been convergence of business cycles fluctuations among the group of industrial and emerging markets. While these groups have become more integrated within themselves they have become more disconnected from each other.
  - As in the case of the current crisis the emerging markets were not initially affected (except Eastern Europe that is highly exposed to the financial crisis through its mainly foreign owned banking system). In this case, the transmission of the crisis from advance economies to the emerging markets through trade linkages were caused by the collapse of demand in advanced countries.

Road to Recovery

- The idea that EMEs are decoupling vis-à-vis advanced economies has been quite widespread until the onset of the crisis; however, more recent developments have discredited this view.
- Despite the improvement in the fundamentals of many EMEs (after the 1990s crises) and the decline in their vulnerability, it seems clear that EMEs are suffering the consequences of the crisis.
- The World Economic Outlook and the Global Financial Stability Report have highlighted important heterogeneity among the group of EMEs but the increase in the risk aversion (and uncertainty) has hit all of them.

Road to Recovery

- Given the weight of these emerging market economies in world output and trade, they have a significant role to play in terms of recovery.
- Although emerging economies and developing countries as a group are expected to experience sharp decline in GDP, they will still have positive growth rates unlike advanced economies, except the NIA (Hong Kong, Singapore, Korea and Taiwan).

Road to Recovery

- According to IMF estimates Developing Asia is the only region that is expected to have strong growth (4.8%) in 2009.
- Developing Asia: China (6.5% in 2009, 10.2% in 2011) India (4.5% in 2009, 6.9% in 2011).
- Claessens et al 2009: A recovery without credit-
  - Financial downturns tend to last longer than economic recessions
  - Episodes of credit crunches and equity price busts last twice as long as recessions and house price busts last more than 3 times as long
  - For recessions with credit crunches, real economy picks up while credit is still contracting.

Conclusion

- If the theory of creditless recovery holds: it is mainly going to be driven by consumption.
- Given by the increasing weight of emerging market economies, they will be the key players in recovery: as consumption is restored in these economies, demand will be restored
- As exports are a significant driver of growth in these economies and in some cases more than 40% of the value added of exports are imported:
- Protectionism is the wrong approach to recovery. It is only a short-term solution.

Conclusion

- It is important that emerging market and developing economies have access to advanced economies both for their imports and exports.
- Subsidies in the form of low cost loans distort relative competitiveness of EME exports
- EME access to imports: NTBs
- Availability of trade finance is crucial to restore confidence in the market