Trading Up or Trading Down?

Emerging Markets' Changing Interests in the

By Pravin Krishna and Matthias Matthijs

Post-World War II discussions in 1945 concerning the international economic order were strongly influenced by the view that restrictions on commerce and preferences in trade relations had contributed to the dramatic economic downturn of the 1930s and the subsequent outbreak of war. With the lessons of the Tariff Act of 1930 or "Smoot-Hawley" and the destructive "beggar thy neighbor" policies (where some countries use protectionist tools like currency devaluation and trade barriers mainly at the expense of other countries) of the Great Depression fresh in mind, the victors aspired to the establishment of a liberal and inclusive multilateral trade system. Free trade, "one of the greatest blessings a government can confer on a people," as 19th-century British historian Thomas Babington Macaulay once remarked, was to spur economic growth and gradually spread its benefits all over the world.

World Trade System

To maximize developing-country membership and participation, the General Agreement on Tariffs and Trade (GATT), signed in 1947, provided for "special and differential" treatment of developing countries (referred to, in international relations jargon, as the countries in the "South"). This meant that developing countries were automatically granted the benefits of any tariff reductions undertaken by the developed countries of the Organisation for Economic Co-operation and Development or OECD (the "North") without needing to offer any reciprocal tariff reductions of their own.

Nevertheless, for many decades, the share of global trade involving developing countries remained relatively small. Most developing countries grew slowly; many took advantage of their special status within the GATT to establish egregiously protectionist trade regimes, restraining their own trade and hampering their growth prospects. Lacking the promise of reciprocal reductions in trade barriers, liberalization undertaken by the developed countries unsurprisingly ignored the products of greatest interest to the developing world—notably agriculture and textiles—which further limited any progress in developing countries' trade participation.

The three most significant multilateral trade negotiation rounds of the postwar period—the Kennedy Round in the 1960s, the Tokyo Round in the 1970s, and the Uruguay Round, 1986 to 1994—were mostly concluded once a deal was struck between the United States and the countries of the European Economic Community. Lacking real economic clout, developing countries were of little relevance in the final proceedings.

After the Wall Came Down

Since the Berlin Wall came down in 1989 and the Cold War was buried along with the Soviet Union in the early 1990s, much has changed in the global economic, political and technological landscape. Falling transportation and communication costs, the spread of neoliberal ideas, lower barriers to trade and expanding global production networks have allowed for a much larger contribution to world trade by the South.

Between 1990 and 2010, China and India both experienced double-digit growth in their exports, averaging around 15 percent annually. Middle-income economies such as Brazil, Indonesia, South Korea, Thailand and Turkey grew their exports at nearly 10 percent annually. Overall, low- and middle-income countries more than doubled their share of global trade—from roughly 20 percent in 1990 to more than 40 percent in 2010.

In parallel with the increased importance of the South in world trade, South-South trade flows have also increased substantially. Specifically, the share of exports from low-income countries going to low- and middle-income markets has nearly doubled (from around 22 percent to more than 40 percent of the total), and the share of exports from middle-income countries to low- and middle-income markets has also increased from around 30 percent to nearly 50 percent. Furthermore, overall trade shares of those countries have risen much faster than the growth in their output.

What are the political and economic implications of this shift in the pattern of international trade? The answer to this question will vary, depending on which perspective one takes—in particular, whether one is exploring the issue from the point of view of the North or the South or the world trade system.

But before turning to those different viewpoints, it is worth pointing out that, as trade theory predicts, lower trade costs have enabled all nations to further specialize in the goods and services of their comparative advantage. Market participants everywhere in the global economy continue to find more innovative ways to generate production efficiencies and deliver lower-cost goods, benefiting consumers worldwide. But the political economy of trade also teaches us that—even though the overall gains from trade outweigh the losses—the benefits tend to be widespread and dispersed, while the costs tend to be concentrated and specific to producers in particular industries.

As long as these producers remain better organized politically than consumers, trade liberalization remains a tough political sell. The fact that the South has a much larger share in world trade now than in the early 1990s has done nothing to change that. Indeed, it might have made political economy questions of distribution, of winners and losers—both within and between countries—more salient than ever.

North vs. South: Differing Perspectives

Since the recent global financial crisis, beginning in 2008, the economic performance of the high-income countries has differed considerably from that of the emerging economies, with the United States and the countries of the European Union suffering the most to get back to pre-crisis trend levels. The countries in the South, however, while slowing down somewhat in 2009, have rebounded much faster since 2010 and have continued to experience robust economic growth.

From the perspective of a fragile and slowly recovering American economy, a feeble Japan and a continental European economy mired in sovereign debt, the South's demand for the North's exports has acted as an important buffer and played a key part in driving the global economic recovery. In addition, various monetary experiments with quantitative easing conducted by the U.S. Federal Reserve System, the Bank of England, the Bank of Japan and the European Central Bank have led to appreciating currencies in such countries as Brazil, South Korea and even China—further allowing the major economies of Germany, Japan and the United States to recover through exports.

The view from the South regarding trade has been largely positive too. Since 1990, the North's growing demand for goods produced in the developing world has enabled the rapid economic transitions of large developing countries such as Brazil, China and India from being minor players in the global trading system to—especially in the Chinese case—economic

powerhouses with significant sway in international trade negotiations. As various parts of the global production chain have relocated, for efficiency reasons, from the North to the low-wage production networks of Asia and Latin America, the South has seen faster growth. This has greatly improved living standards, boosted internal demand and lifted millions out of poverty.

China joined the World Trade Organization (WTO) in 2001 and Russia in 2012. Today, all four fast-growing BRIC countries (Brazil and India complete the group) are important players in the multilateral trading system, considerably changing the dynamics of the WTO.

The View From Geneva

From the perspective of the Geneva-based WTO, the world trade system has proceeded on two divergent tracks over the last two decades. On the one hand, WTO member countries began a new round of trade negotiations, the Doha Round, launched in Qatar in November 2001. Emphasizing the particular interests of developing-country members, especially in attempting to finally get to the long-ignored issue of liberalization in the agricultural sector (the Doha Development Agenda), this multilateral round of negotiations has nevertheless failed to achieve successful closure. On the other hand, member countries, both from the North and the South, have deviated from the WTO's nondiscriminatory principles and entered into preferential agreements with each other (numbering in the hundreds).

The emergence of the South as a significant player in world trade and, separately, the growing importance of South-South trade had implications for both the multilateral round of trade negotiations and the pace with which the trade system has moved in the direction of preferential trading agreements. At Doha, developing countries participated with greater vigor and interest than in previous rounds but negotiated with an acute awareness of their own growing economic might. A set of negotiated concessions between all the members (referred to as "Doha lite"), which could have been agreed upon, was nevertheless abandoned. Developed countries, recognizing that developing-country markets now offer greater economic opportunities, held out for larger concessions from the South, especially on manufacturing (sometimes called "Doha heavy").

Both sides have negotiated with their gaze partially deflected from the multilateral process and toward bilateral processes instead. Also, countries in the North have sometimes found it easier to sign agreements with each other and potentially advantageous to negotiate bilaterally with individual countries or small groups of countries in the South than to substantially engage the multilateral process. Indeed, they have used the threat of proceeding on the bilateral track to bend the multilateral process in their preferred direction. As then-U.S. Trade Representative Susan Schwab pointedly noted in June 2006, "Everyone knows that if there is no Doha Agreement, we are perfectly capable of moving ahead on the bilateral track."

During President Barack Obama's second term in office, his administration has been pursuing both a Transatlantic Trade and Investment Partnership (TTIP) with the European Union and a Trans-Pacific Partnership (TPP) with countries in the Asia-Pacific region, significantly diminishing its emphasis on the Doha Round. Developing countries have found bilateral agreements increasingly appealing as well, especially because South-South agreements may be entered into via the Enabling Clause of the GATT, whose requirements are far less stringent than the restrictions imposed by GATT Article XXIV on North-North agreements.

Post-War Trade Lessons

The key question facing the emerging countries of the South is whether they stand to benefit more from bilateral deals with Europe and the United States—where they still negotiate from a position of relative weakness—or whether they can find common ground in breathing new life into a quasi-moribund Doha Development Agenda.

While bilateral deals with the North or among themselves offer the attractiveness of speed and expediency, there is no doubt that a more comprehensive and durable multilateral deal at the WTO offers the most secure guarantee for continued growth and prosperity for all.

One of the lessons of the Great Depression was that trade blocs can cause trade wars. We can only hope that both the North and the South take this lesson to heart. ■

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