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International Trade and Emerging Markets Since the Crisis

Razeen Sally

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African perspectives. Global insights.

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Programme head: Catherine Grant catherine.grant@saiia.org.za

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ABSTRACT

The global economic crisis has sparked the short-term divergence of economic performance between the West and emerging markets, thereby accelerating their convergence in the long-run, and is particularly evident in globalising Asia. Governments' responses to the biggest deglobalisation since the Great Depression did not precipitate a descent into 1930s-style protectionism. Domestic crisis interventions – a combination of bank bailouts and expansive macroeconomic policies – took priority. Traditional protectionism hardly increased and borders remained open. However, crisis interventions and a return to 'big government' leave the West with crippled public finances and more restrictions on competitive markets, and threaten to spill over into creeping protectionism of the subtle, non-tariff, regulatory variety. The new patterns of protectionism are similar to developments in the 1970s and 1980s rather than the 1930s. Barely contained by World Trade Organization (WTO) rules, the danger is that they will slow down recovery and reglobalisation in the next decade.

US and EU trade policies have been passive and defensive, reflecting domestic weakness. In particular, the US has abrogated its traditional leadership role in international trade, thereby leaving a vacuum. Now one of the 'big three' in the world trade order, China's unilateral liberalisation has stalled, corresponding with more industrial policy interventions, but has not resorted to large-scale protectionism. India, Brazil and South Africa broadly reflect this pattern, although, unlike China, they are second- or third-tier emerging powers. Russia, still outside the WTO, is more protectionist.

The short-term challenge is to arrest the slide into 'big government' at home and creeping protectionism abroad. The medium-term challenge is to get back on track with trade and foreign direct investment liberalisation and domestic structural reforms – substantial unfinished business from before the crisis struck. However, second-generation reforms to tackle these barriers are much more complex and politically sensitive than first-generation reforms. Reforms are primarily a matter for unilateral action by and competitive emulation among governments. International policy co-operation in the WTO, G20 and other forums can reinforce these reforms, but not too much can be expected of cumbersome global governance, let alone regional governance, mechanisms.

ABOUT THE AUTHOR

Razeen Sally is director and co-founder of the European Centre for International Political Economy, Europe's leading trade policy think-tank. He has a PhD from the London School of Economics, where he is a faculty member. He has held adjunct teaching, research and advisory positions at universities and think-tanks in the US, Europe, Africa and Asia. His research and teaching focuses on global trade policy and Asia in the world economy. He has written extensively on the World Trade Organization, free trade areas, trade policy in Asia and the history of economic ideas, especially commercial policy theory. He consults for governments, international organisations and businesses in Europe and Asia, and comments regularly on international economic issues in the media.

ABBREVIATIONS AND ACRONYMS

ASEAN	Association of South-East Asian Nations
BRIC	Brazil, Russia, India and China
EU	European Union
FDI	foreign direct investment
FTA	free trade agreement
G20	Group of 20
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GTA	Global Trade Alert
IMF	International Monetary Fund
IT	information technology
MERCOSUR	Mercado Común del Sur
MNE	multinational enterprise
NTB	non-tariff barrier
OECD	Organisation for Economic Co-operation and Development
RMB	renminbi (Chinese currency)
SACU	Southern Africa Customs Union
SADC	Southern African Development Community
SOE	state-owned enterprise
UK	United Kingdom
UNCTAD	United Nations Conference on Trade and Development
US	United States
WTO	World Trade Organization

INTRODUCTION

World trade is recovering from its steepest fall since the 1930s, part of the biggest deglobalisation seen since the Great Depression. The good news is that rampaging 1930s-style protectionism has not returned; indeed new crisis-related protectionism has been remarkably restrained. Nonetheless, protectionism has resurfaced, creeping out of the thicket of domestic crisis interventions and the apparent return to 'big government'. Trade liberalisation had already stalled around the world before the crisis, which predictably, increased all-round defensiveness.

The global economic crisis has also ushered in a dramatically different political and economic environment, compared to the benign pre-crisis conditions. The gap between the West and emerging markets has narrowed. An anaemic recovery and pervasive gloom cloud the West, where talk of American decline and Eurosclerosis is back in fashion. In contrast roaring growth and sunny optimism light up emerging-market skies, especially in Asia, where China and India shine brightest. Skies are also lightening in parts of Africa and Latin America, notably Brazil, and Russia has rebounded after a deep recession.

This paper attempts to make sense of the post-crisis state of play in international trade, by taking a forward look at emerging markets and global trade policy. After describing the political and economic context for international trade up to 2007/8, the paper summarises the crisis-induced deglobalisation and its differential impact on the West and emerging markets. The West and emerging markets are compared in a survey of the global economic climate, following macro and microeconomic interventions to combat the crisis and the apparent return to 'big government'. This is followed by an assessment of crisis-related protectionism, and then a 'review of the troops': the major players in global trade policy, starting with the US and EU, and covering Japan and major emerging markets (China, India, Brazil, Russia and South Africa). Finally, the World Trade Organization (WTO) and Group of 20 (G20) are discussed and observations are made about the regional and global economic governance of emerging markets.

THE 'GOLDILOCKS' GLOBAL ECONOMY BEFORE THE CRISIS

The pre-crisis global economy enjoyed golden conditions. In the quarter century prior to the crisis, economic growth, globalisation and prosperity increased at the fastest rate in history. Between 1980 and 2008 the growth of global foreign direct investment (FDI) outpaced both international trade, which increased sevenfold, and the world's gross domestic product (GDP). The global stock of outward FDI increased from $579 billion in 1980 to $16,206 billion in 2008, when the number of transnational companies was estimated at 82 000, with 810 000 affiliates representing sales of $30 trillion.[1]

The global economy had its 'Goldilocks' moment in the half-decade after 2002. Growth, trade and FDI soared to greater heights, and financial globalisation soared even higher. Comparative advantage worked in textbook fashion: labour-abundant Asia rose, powered by the opening up and global integration of China and, to a lesser extent, India. China became deeply enmeshed in East Asian manufacturing supply chains linked to final markets in the West. In a China-led commodity super-cycle, resource-abundant Latin

America, Africa and the Middle East did well, and the capital- and technology-abundant West also prospered.

Modern globalisation has two engines: technology and policy liberalisation. Technological innovation has slashed the transaction costs of trade by shrinking physical distance, which the information technology (IT) revolution – a combination of the Internet and mobile phones – has obliterated altogether. Advanced IT has created new global manufacturing supply chains and new, highly tradable services sectors.

However, technological innovation has not occurred in a vacuum, but has been enabled by internal and external policy liberalisation. Internal liberalisation has reduced or eliminated regulations in product, capital and labour markets, thereby liberating the 'animal spirits' of competition and entrepreneurship. This was the essence of the Reagan, Thatcher and European single market revolutions in the 1980s and early 1990s. External liberalisation has lowered barriers to cross-border trade and investment. In the 1980s and 1990s developing countries liberalised massively and integrated into the global economy, followed by the ex-Soviet economies from the early 1990s. In developing countries, average tariffs fell from about 30% in 1985 to just above 10% in 2005. Corresponding reductions occurred in non-tariff trade barriers, FDI restrictions and restrictions on trade in services. The Washington Consensus reigned, reaching its apogee in the late 1990s. According to Jeffrey Sachs and Andrew Warner, in 1980 around a quarter of the world's population lived in open economies and, by 1993, a majority of humanity lived in (more or less) open economies.[2] Today, if China and India are added, that figure is closer to 90%.

Finally, the geopolitical environment was conducive to growth. America became the sole superpower in the 1990s, replacing Cold War bipolarity. And global economic institutions, especially the International Monetary Fund (IMF), World Bank and WTO, were at the height of their powers. In this global economic and geopolitical context, in the two decades leading to 2008, Brazil, Russia, India and China (BRIC) and other large emerging markets (such as Indonesia, Mexico and South Africa) undertook massive external liberalisation. They became more globalised, with increasing trade volumes, trade-to-GDP ratios, growing shares of world trade and export of value-added products, and increasing FDI inflows and outflows. And, to varying degrees, these countries enjoyed catch-up growth. The Organisation for Economic and Co-operation Development (OECD) found that those countries (Brazil, Russia, India, Indonesia, China and South Africa) and sectors that opened up the most enjoyed the largest growth spurts. One notable example is the export-oriented manufacturing in China, much of it driven by openness to inward investment. Another is the emergence of globally competitive services providers in India, especially in a young, lightly regulated IT sector.[3]

Nevertheless, in emerging markets and other developing countries, protection levels – tariffs, non-tariff barriers (NTBs), FDI and services restrictions – remain considerably higher than those of developed countries. Much less progress has been made on second-generation reforms (in behind-the-border, trade related regulations and institutions) than on first-generation reforms (mainly border barriers).[4]

THE GLOBAL ECONOMIC CRISIS, DEGLOBALISATION AND RECOVERY: DIFFERENT EFFECTS ON THE WEST AND EMERGING MARKETS

The financial crisis that exploded in September 2008, preceded by the credit crunch that started a year earlier, transformed a benign global, political and economic context into something more malign. The ensuing contraction in global growth was reinforced by even sharper contractions in trade, FDI, financial flows and other globalisation channels. The world suffered its worst deglobalisation since the Second World War. Contrary to some predictions, Asia and other emerging markets did not decouple from the West, but were also dragged down. Then, towards the middle of 2009, contractions in growth, industrial output and trade bottomed out, followed by a halting global recovery.

The crisis has induced both divergence and convergence between the West and emerging markets. Although post-crisis economic performance has diverged markedly, it has accelerated the catch-up or convergence of emerging markets with the West in the long-run. The diverging economic performance has its roots in the crisis itself. The West suffered a financial crisis, which translated into a deeper than normal recession and a slower than average recovery.[5] The picture was very different in emerging markets, particularly in Asia. Unlike the West, Asian and many other emerging markets did not suffer a financial crisis, as their banks and balance sheets (household, corporate, government and external) were reasonably solid. Instead, these markets suffered from a trade or deglobalisation crisis, as the financial crisis, originating in the West, spread to the 'real economy' and demand for exports collapsed. However, these markets rebounded much more quickly than the West.

China led the Asian bounce-back, helping to lift other East Asian countries out of the crisis, and India recovered fast as well. In 2010, China and India grew at 10% and 9% respectively, and developing Asia at over 9%. Brazil and Indonesia grew at over 7% and 6% respectively. Russia and South Africa are the major emerging market exceptions: the former had dodgy household and corporate balance sheets going into the crisis, suffered a deep recession in 2009 and grew at 4% in 2010; the latter grew at 3% in 2010. In contrast, advanced economies grew at only 2.7%.[6]

In 2009, trade volumes for emerging and developing economies suffered a smaller contraction than for advanced economies and are enjoying a faster recovery: they are expected to increase by over 13% in 2010, compared with an estimated 10–11% increase for advanced economies (see Table 1 on page 8). FDI contracted sharply in 2009, recovering modestly in 2010. In 2009, FDI inflows to developing countries decreased by 24%, compared with a 44% decrease to developed countries (see Figure 1 on page 8). FDI flows to China and India remained buoyant in 2009, with a small decline on record inflows in 2008. In contrast, FDI inflows to Russia, South Africa, Indonesia and Brazil contracted strongly (see Table 2 on page 9), although FDI inflows and outflows for these emerging markets look set to increase in 2010.[7]

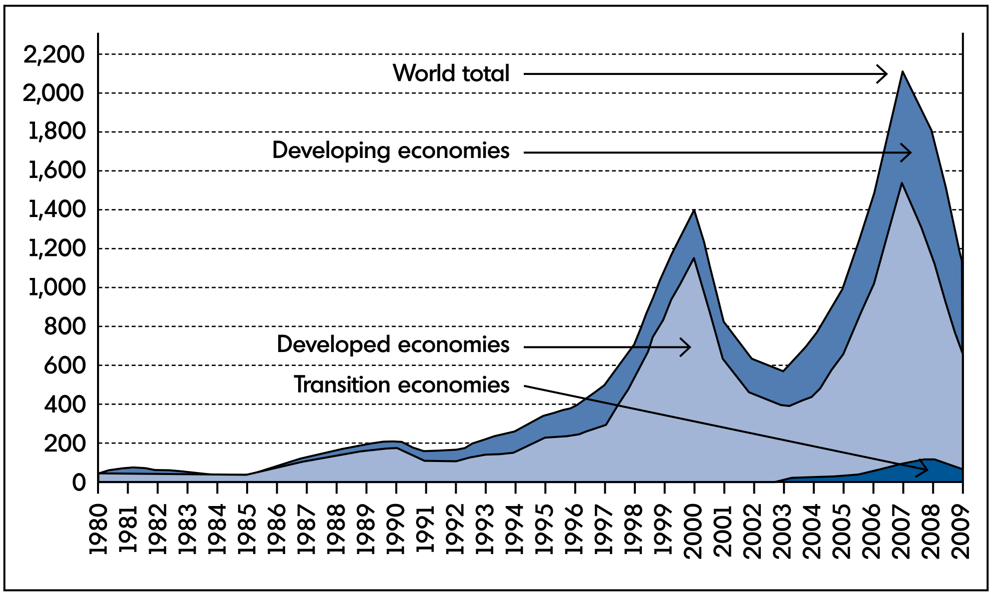
Thus, the crisis seems to have accelerated the shift of economic gravity to emerging markets, particularly to the East (i.e. Asia), giving rise to sunny Asian optimism, which contrasts sharply with Western gloom. The widespread sentiment is that Asia has recovered from the crisis in striking V-shaped fashion, just like its recovery from the Asian crisis a decade ago. There is even revived talk of Asian decoupling, which is dangerous panglossianism: the global economic outlook remains uncertain and probably faces turbulent times ahead, which Asia and other emerging markets cannot escape.

Table 1: Growth in world trade volume of goods and services

	2008		2009		2010		2011	
	Import	Export	Import	Export	Import	Export	Import	Export
Advanced economies	0.4	1.9	-12.7	-12.4	10.1	11.0	5.2	6.0
Emerging/ developing economies	9.0	4.6	-8.2	-7.8	14.3	11.9	9.9	9.1

Source: IMF, *World Economic Outlook: Recovery, Risk and Rebuilding*, October 2010, p. 2, http://www.imf.org/external/pubs/ft/weo/2010/02/pdf/c1.pdf

Figure 1: FDI inflows ($ billion), global and by groups of economies, 1980–2009



Source: UNCTAD, *World Investment Report 2010: Investing in a Low-Carbon Economy*, Chapter 1, p. 2, http://www.unctad.org/en/docs/wir2010_en.pdf

THE ECONOMIC OUTLOOK: BAD NEWS FOR THE WEST, BETTER NEWS FOR EMERGING MARKETS

What about post-crisis economic policies in emerging markets and the West? How do they compare? Even before the crisis, pro-market reforms had slowed down around the world, and scepticism about the liberalisation and globalisation policies associated with

Table 2: FDI Flows in major emerging markets

	FDI	2007	2008	2009
Brazil	Inflows	34.6	45.1	25.9
	Outflows	7.1	20.5	-10.1
China	Inflows	83.5	108.3	95.0
	Outflows	22.5	52.1	48.0
India	Inflows	25.0	40.4	34.6
	Outflows	17.2	18.5	14.9
Indonesia	Inflows	6.9	9.3	4.9
	Outflows	4.7	5.9	2.9
Russia	Inflows	55.1	75.5	38.7
	Outflows	45.9	56.1	46.1
South Africa	Inflows	5.7	9.0	5.7
	Outflows	3.0	-3.1	1.6

Source: UNCTAD, *World Investment Report 2010: Investing in a Low-Carbon Economy*, http://www.unctad.org/en/docs/wir2010ch1_en.pdf

the Washington Consensus was on the rise. Major emerging markets fit this pattern, as although reforms were not reversed (with the notable exception of Russia), their forward momentum stalled. Governments became more defensive about further liberalisation, and marginal liberalisation reversal occurred. Symptoms included FDI restrictions to protect national champions in strategic sectors, and export controls on agriculture and other commodities to combat food and fuel inflation.

The crisis triggered a bigger shift in ideas and policies against free markets and in favour of government interventionism. It marked the close of a 30-year chapter of freer markets and limits on government intervention and the opening of a new chapter of bigger government.

So far, government interventions have been more evident in domestic economic policy than in trade policy. Domestic crisis interventions are bunched into two key areas: huge bailouts and associated subsidies, especially (but not confined to) financial services, which are concentrated in the West; and fiscal stimulus packages, usually combined with loose and unorthodox monetary policies, which are spread across the OECD and developing countries.

Headline fiscal stimulus measures include the Economic Recovery Act in the US, which initially released $787 billion of extra public spending,[8] and China's $585 billion package. Fiscal stimulus packages, i.e. discretionary fiscal spending, amount to about 3.5% of GDP in the OECD.[9] In 2009, fiscal crisis measures amounted to approximately 10% of OECD GDP, taking into account automatic stabilisers (the extra demand created by bigger public spending on welfare and other payments in a downturn). They have been supported by near-zero interest rates, central bank purchases of government debt and other emergency monetary policy measures. But financial bailouts have dwarfed macroeconomic interventions. The total economic stimulus and financial sector support amounts to an estimated $12 trillion in the US and $18 trillion in the EU. In 2008, financial bailouts in high-income countries cost 28% of GDP (and in the UK close to 75%), which is akin to public financing of a large-scale war.

In China, state-directed bank lending dwarfed direct government stimulus spending. Overwhelmingly channelled through state-owned banks to state-owned industrial firms, it cost about 10 trillion yuan ($1.5 trillion) in 2009, equivalent to roughly one-third of China's GDP. However, given the country's solid public finances, this spending took the fiscal deficit to a modest 3% of GDP and public debt to about 20% of GDP in 2009. Most high-income countries are not as fortunate. In the OECD, the average fiscal deficit is estimated to have risen to 9% of GDP in 2009 (and even higher in the US and the UK). US and EU public debt is projected to rise to above 70% and 120% of GDP respectively over the next decade.[10]

The new conventional wisdom holds that massive bank bailouts were necessary to avert financial Armageddon, and so was shock-and-awe fiscal stimulus to boost aggregate demand and stave off another Great Depression. Bank bailouts were unavoidable in the extreme conditions of late 2008, as were the extra-loose monetary policies needed to inject a superdose of liquidity, to avoid a repetition of the fatal contraction of money supply in the early 1930s. However, it is highly debatable whether massive fiscal pump-priming – Keynesianism on steroids – was necessary. Sceptics doubt the effectiveness of discretionary spending. First, fiscal packages appear to have little effect on GDP, as measures often kick in too late or are spent in a way that adds little economic activity. Second, the fiscal multiplier is far lower than governments expected, especially in complex, open economies (in which some of the extra demand leaks abroad through imports). The multiplier effect of non-defence spending is likely to be much less than one, the level at which GDP expands more than government spending.[11] Third, the wreckage of public finances by fiscal stimulus packages is not only a worrying prospect – it is already reality, but recent packages also reinforce unsustainable deficit trends (overall and in social security systems). In the OECD, public debt is projected to reach absurdly high levels in a few years. Oceans of public debt will mean higher taxes and real interest rates, in addition to inflationary threats (given governments' temptation to inflate their way out of debt repayments). Collateral damage will include the crowding out of capital for emerging markets and more expensive capital.

The microeconomics and politics of financial bailouts and profligate macroeconomic policies are at least as vexing. *Bien pensant* policymakers and commentators – social engineers in Washington, Whitehall, Brussels and other European capitals, *bona fide* engineers in the Chinese Politburo, saltwater economists in US academia, recent Nobel laureates, columnists and editorial writers in the *New York Times* and the *Financial Times* – think that well designed government interventions can fix market failures in finance and the macroeconomy. That is the *raison d'être* for the return to 'big government' since the crisis. But it is stupefyingly naïve to expect intrusive financial regulation and bigger public expenditure to be well targeted and effective, yet avoid arbitrary interventions, wasteful pork-barrel spending and long-term entitlements. These are all inevitable and portend more discretionary power for politicians and bureaucrats, indiscriminate subsidies, rent-seeking and corruption. Such short-term crisis interventions will have medium-term consequences that will stifle private sector incentives to save, invest and innovate. They will restrict competition, raise costs for businesses and consumers and cramp individual property rights; ultimately they will curtail economic freedom.

This process is already underway. In the US, in the first 18 months of the Obama administration, it is visible in a battery of microeconomic interventions under cover of the fiscal stimulus package and other major pieces of legislation and regulatory initiatives, notably on health care, financial markets, industrial relations, antitrust and climate change. In China, fiscal stimulus and state-directed bank lending fortify already subsidised and protected state-owned enterprises (SOEs), increasing their market and political power at the expense of the unsubsidised (and much more productive) domestic private sector. As the Chinese saying goes, 'the state advances as while the private sector retreats'.

This is tantamount to a halt to, indeed a creeping reversal of, market reforms. It should not be forgotten that one of the engines of the recent era of globalisation and growth was the internal liberalisation of product and factor markets: the hallmark of the Reagan revolution in the US, the Thatcher revolution in the UK and the single market revolution in the EU. New distortions to competition are bound to harm prospects for medium-term recovery and reglobalisation. Although this applies generally, prospects are bleaker in the West than in emerging markets. The financial crisis and subsequent crisis interventions have burdened the West with parlous public finances and new restrictions on competition, which will have long-lasting consequences. Major emerging markets, with the exception of Russia, have much healthier balance sheets, but retain significant restrictions to competition. Still, their burden is lighter, and they are better positioned to recover and reglobalise after the crisis.

TRADE POLICY, EMERGING PROTECTIONISM AND THE 1970S' PRECEDENT

Will domestic crisis interventions spill over into trade protectionism? There is an optimistic answer – and a contrasting pessimistic one.

The optimists believe in 'Keynes at home and Smith abroad' (otherwise known as 'embedded liberalism' in international relations jargon), which is one aspect of the post-crisis conventional wisdom dear to the hearts of Keynesian and other social engineers. To prevent a slide into protectionism, greater government macro and microeconomic interventions at home are needed to stimulate recovery and preserve social stability. However, this should proceed in tandem with open markets abroad, which require robust international policy co-ordination (sometimes labelled 'global governance').

This idea is based on a contradiction. First, 'big government' at home, with its discretionary power and panoply of competition restricting regulations, will inevitably spill over into protectionism. It is childishly innocent to believe otherwise; Keynes at home is Keynes abroad. After all, Keynes turned to protectionism in the 1930s, not least to make activist fiscal policy work in a closed economy setting.

Adam Smith saw this link in the 18th century. To him, protectionism is the overspill of government pandering to rent-seeking activity by merchants and manufacturers. Thus the 'clamorous importunity of partial interests' makes governments lose sight of 'an extensive view of the general good'. Hence legislatures should be 'particularly careful neither to establish any new monopolies of this kind, nor to extend further those which are already established. Every such regulation introduces some degree of real disorder into the constitution of the state, which it will be difficult afterwards to cure without occasioning another disorder.'[12]

For Jan Tumlir, former chief economist and in-house philosopher at the General Agreement on Tariffs and Trade (GATT), the source of the problem is overactive governments who are in cahoots with domestic organised interests. Cumulative interventions distort prices, rigidify economies and make public and private actors more resistant to adjusting to external change. The predictable corollary is a fear of trade and the resort to import protection. Thus 'protectionism is the inherent logic of the redistributive state working itself out externally', which is how Tumlir accounted for 20th century protectionism, in the 1920s, 1930s, 1970s and 1980s.[13]

More worrying than a short-term contraction of aggregate trade and demand in the wake of the crisis, are the medium-term, competition restricting consequences of 'big government', including protectionism.

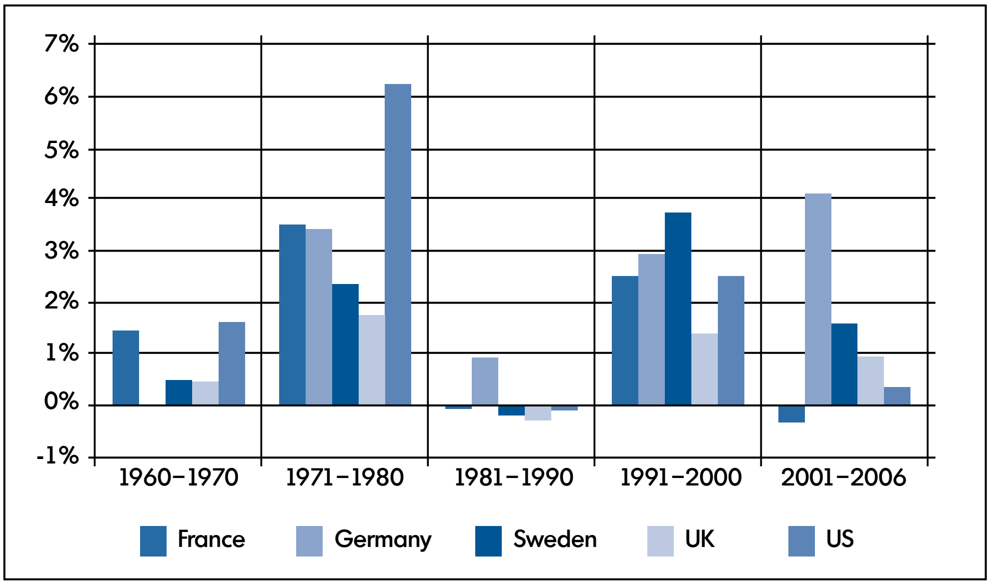
Historical parallels exist and, while fashionable to make comparisons between the recent crisis and that of the 1930s, it is only appropriate in one sense. Then, a financial crash metastasised into the Great Depression, which also sparked massive government intervention, starting with intrusive and protectionist financial regulations that caused global finance to fragment into national enclaves. The recent crisis, given its financial origins, has led to a bigger fall in output than any other post-1945 recession. Recovery will probably take longer, and the danger is that over-regulation of financial markets will cause global finance to fragment once again.[14] Even so, danger signs are not as alarming as they were in the 1930s, as today's global integration of finance is more advanced, and post-crisis financial reregulation is shaping up to be much less draconian.

However, in one other important respect, the comparison with the 1930s is highly misleading. Then, tit-for-tat trade protection rapidly followed the Wall Street Crash, and the world splintered into warring trade blocs. This has not happened today and is unlikely to happen anytime soon. Indeed, up-front, crisis-related protectionism today is remarkably restrained (of which more later). Multilateral trade rules, international policy co-operation and market-led globalisation provide defences against a headlong descent into 1930s-style protectionism.

The more appropriate comparison is with the 1970s. Then, a series of shocks (notably the collapse of the Bretton Woods system and oil price hikes) ended a long boom and triggered more government intervention. New labour market and capital market regulations were introduced, subsidies were sprayed at vulnerable sectors, fiscal stimulus packages were rolled out, and governments slapped on price and wage controls to combat inflation. These measures not only exacerbated the initial crises and prolonged stagnation, but also spawned protectionism: industry after industry, coddled by government support at home, demanded protection from foreign competition. The result was new protectionism and managed trade of the 1970s and 1980s.

Voluntary Export Restraints, Orderly Market Arrangements, anti-dumping duties and other, mostly non-tariff barriers, followed sector bailouts at home. The US and the European Community were the main culprits. Cars, steel, airlines, semiconductors and consumer electronics were affected.[15] All these measures had a contracting effect on global trade in the 1980s, which became the lost decade for trade in the West (see Figure 2 on page 13). The trade-to-GDP ratio shrunk in major Western economies and contributed to overall slow GDP growth, which also happened across the developing world.

Figure 2: Annual average growth of trade as part of GDP



Source: WTO, International Trade Statistics, database (own calculations), http://stat.wto.org/Home/WSDBHome.aspx?Language=E

The new protectionism was creeping protectionism. Unlike 1930s-style protectionism, it was not a frontal declaration of a trade war with tariff hikes, blanket quotas and draconian foreign exchange controls. It was more subtle, deploying non-tariff regulatory barriers such as subsidies, public procurement restrictions and onerous standards requirements, and did not spiral out of control, but unfolded slowly and insidiously. It lasted over a decade and a half, created overcapacity in several industrial sectors and delayed global recovery and globalisation. This is the danger the world faces today, not a melodramatic 1930s scenario.

However, the 1970s scenario needs two qualifications, both related to today's China-led, emerging market phenomenon. First, the new protectionism of the 1970s and 1980s was largely a Western response to new competition from Japan and four other, relatively small, East Asian emerging markets (South Korea, Taiwan, Hong Kong and Singapore), whereas today competition from emerging markets is much more intense and more geographically spread out. Competition in manufacturing still comes from East Asia, revolving around China, but adding to global competition in agriculture and services are Brazil, India and other emerging markets. This strengthens complementary trade and investment linkages, especially through vertically integrated supply chains, but also increases protectionist temptations in vulnerable sectors.

Second, much talk today is about global imbalances, the spectre of currency wars and their spillover to trade protectionism. China, Japan, Germany and the petro-states of the Middle East account for massive current account surpluses, mirrored by sizeable current account deficits elsewhere, especially in the US. US complaints about an allegedly grossly undervalued renminbi (RMB) and persistent Chinese current account surpluses have become shriller. China stands accused of protectionism using currency manipulation, which is said to constitute an export subsidy. Via its current account surplus, China is charged with adding to global imbalances, at a time when Western demand is depressed, and when the US, in particular, is attempting a shift from consumption to savings. If other countries succumb to the temptation of devaluing their currencies, a round of competitive devaluation ensues, the prelude to currency wars, which in turn threaten a new round of trade protectionism.

The US House of Representatives has passed a bill to slap trade sanctions on China as retaliation for its currency manipulation. Fred Bergsten, Paul Krugman, Martin Wolf and other luminaries have called for trade or capital market sanctions if China does not fall in line. Ahead of the G20 Summit in Seoul in 2010, the US proposed numerical targets (of ±4% of GDP) to limit current account imbalances.[16]

Large and persistent currency undervaluation and current account surpluses, especially for a country as large and as important as China, may be a source of global instability and exacerbate protectionist pressures. It is reminiscent of the currency wars in the 1930s (when some countries stayed on the gold standard while others left it), which triggered more trade protectionism than the Smoot-Hawley tariff.[17] But today the spectre of currency wars has not (so far) triggered a new round of protectionism, and the negative consequences of currency undervaluation and current account imbalances are probably (and perhaps vastly) exaggerated.

Conventional American reasoning on this set of issues has deep flaws, with dangerous policy inferences. The RMB may be undervalued, but no one knows what the right market exchange rate is or should be, with estimates of undervaluation ranging from 0–50%. An obsession with nominal exchange rates is also misleading. The assumption of a straightforward, mechanical translation from an undervalued currency to a current account surplus is highly questionable, especially in China's case. Processing trade (imports of raw materials and components for assembly, and export of finished goods all over the world), which accounts for half of China's overall trade, blunts the effects of currency swings. A large and sudden RMB revaluation could be very destabilising for the Chinese export economy, and not make a corresponding dent in the US current account deficit (given that US production is highly unlikely to substitute for Chinese labour-intensive exports). American consumers and firms who use Chinese inputs would suffer through higher prices.

Underlying economic policies relating to savings, investment and consumption probably have a greater effect on external imbalances than exchange rate valuations, as do other structural factors. China's double transition, the rural-to-urban migration and fast-paced industrialisation, combined with a condensed demographic dividend (a large increase in the working age ratio, speeded up by China's one-child policy), gives it huge, long-lasting comparative advantage in labour-intensive exports. Since the 1990s, this has been accompanied by a reorientation of production and trade in global supply chains, as China has become the premier assembly hub for manufactured exports. China runs deficits with other East Asian countries and surpluses with Europe and the US because of processing trade. Correspondingly, other East Asian countries have seen their trade surpluses increase with China and decrease with the West. All this suggests that most of China's trade surplus, which is the biggest chunk of its current account surplus, is not the result of unfair trade, but rather the result of modern, thoroughly normal, global integration. This raises the question: is an obsession with national current account imbalances warranted in a world of 21st century globalisation characterised by processing trade and vertically integrated global supply chains?[18]

A Chinese move to gradually revalue the RMB alongside domestic structural reforms might ease global imbalances and protectionist pressures, although large imbalances will persist for the normal, structural reasons mentioned above. But the American obsession with the RMB and the Chinese current account surplus is both misguided and dangerous. Its analysis belongs to a world that predates modern globalisation, and its headline prescriptions (trade and/or capital market sanctions) are crudely mercantilist.

Emerging protectionism

At first glance the Keynesian optimists, not the Smithian pessimists, are right: the world has not hurtled into tit-for-tat protectionism, which is a big and very welcome surprise, considering the scale of growth contraction and deglobalisation in 2008/9.

The good news is documented in the WTO's updates on new trade measures. New protectionist measures have appeared (what the WTO refers to as 'policy slippage'), but are remarkably mild. They affect just over 1% of world trade in goods (1.2% of world imports and 1.8% of G20 imports at the last count), while protectionism in trade in services has not increased noticeably. New protectionism is concentrated in sectors that have long been protected: textiles, clothing, footwear, iron, steel, consumer electronics and agriculture. Trade remedies increased in 2009, as happens during economic downturns, but declined in 2010. Finally, up to one-third of new trade measures have been liberalising, including tariff reductions, removal of export restrictions and FDI liberalisation in several developing countries.[19]

There is one caveat: the WTO focuses on established and commonly understood trade instruments covered by WTO disciplines, especially import and export tariffs, quotas and licenses and trade remedies. It notes a range of non-border measures such as government procurement restrictions, technical standards and potentially trade-distorting subsidies. However, it does not take a stand on financial bailouts, saying that their discriminatory impact on international trade is still unclear.

Global Trade Alert (GTA) paints a more alarming picture, counting nearly 650 trade-discriminatory measures from November 2008 to June 2010, with G20 governments responsible for just over 60% of them. GTA estimates that 22 far-reaching protectionist measures alone affected over 10% of world imports in 2008. Unlike the WTO, GTA includes financial bailouts in its figures and, by November 2009, estimated that one-third of new protectionist measures were bailouts to financial services, automobiles and other sectors. Trade remedies accounted for one-fifth and tariffs for 14% of new protectionist measures. China remains the biggest target, followed by the EU-27 and the US. No other emerging market figures in the list of top 10 targets (see Table 3 on page 16)[20]. Russia is probably the worst single offender, with a significant increase in protection since the crisis started. However, the EU-27, tops the list in terms of the number of new protectionist measures imposed. Argentina, China, India and Indonesia – but not Brazil and South Africa – also figure in the list of top 10 offenders (see Table 4 on page 17)[21].

Table 3: Crisis-era protectionism: targets

	Number of discriminatory measures imposed on target		Number of pending measures, which if implemented, would harm target too	
Top 10 targets	This report (June 2010)	Increase from previous G20 meeting (2nd GTA report)	This report (June 2010)	Increase from previous G20 meeting (2nd GTA report)
China	283	183	125	48
EU-27	266	na	80	na
USA	213	127	46	27
Germany	204	120	56	26
France	188	110	46	22
UK	181	109	44	24
Italy	175	105	50	27
Belgium	170	92	42	21
Japan	168	90	47	24
Netherlands	163	92	42	24

Note: Unfortunately when the second report was prepared, data on the total number of times the EU-27 nations were harmed was not collected, hence frustrating direct comparisons between early June 2010 and early September 2009. Data on the EU-27 was reported from the third report on due to requests from users. Moreover, individual member state information in this table may indicate the extent how often some European trading nations have been harmed since the Pittsburgh Summit.

Source: Evenett S, 'Executive summary', in *Unequal Compliance: The Sixth GTA Report*, p. 5, http://www.globaltradealert.org/sites/default/files/GTA6_Exec_Summary.pdf

To sum up, the good news about remarkably mild traditional protectionism (mainly border barriers) is counter-balanced by worrying signs of non-traditional, non-border protectionism.

Top of the latter list is financial mercantilism, and the one aspect of home government pressure (whether formal or through nods and winks) on bailed-out and other banks to lend local; in other words, to lend at home at the expense of foreign lending, such as through foreign subsidiaries. Cross-border lending has shrunk during the crisis, for example West European banks lending to Eastern Europe, but the extent to which this is the result of home government pressure is unclear. A second, related aspect of financial mercantilism is pressure from home governments and regulators to concentrate more financial trading activities at home, with the accompanying restrictions on cross-border trade. One example is an EU directive that requires non EU-based private equity and hedge funds to establish a physical presence in the EU in order to trade. Finally, regulatory proposals in the US, EU and elsewhere may result in a *cordon sanitaire* being stretched

Table 4: Crisis-era protectionism: offenders

<table>
<tr><th></th><th colspan="4">Metric, country in specified rank, number</th></tr>
<tr><th>Rank</th><th>Ranked by number of (almost certainly) discriminatory measures imposed</th><th>Ranked by the number of tariff lines (product categories) affected by (almost certainly) discriminatory measures</th><th>Ranked by the number of sectors affected by (almost certainly) discriminatory measures</th><th>Ranked by the number of trading partners affected by (almost certainly) discriminatory measuers</th></tr>
<tr><td>1</td><td>EU-27 (146)</td><td>Venezuela</td><td>EU-27 (55)</td><td>EU-27 (168)</td></tr>
<tr><td>2</td><td>Russian Federation (73)</td><td>Kazakhstan (719)</td><td>Algeria (54)</td><td>Argentina (161)</td></tr>
<tr><td>3</td><td>Argentina (41)</td><td>Nigeria (599)</td><td>Nigeria (45)</td><td>China (161)</td></tr>
<tr><td>4</td><td>India (31)</td><td>EU-27 (437)</td><td>Venezuela (38)</td><td>Indonesia (152)</td></tr>
<tr><td>5</td><td>Germany (29)</td><td>Russian Federation (421)</td><td>Kazakhstan (36)</td><td>Russian Federation (142)</td></tr>
<tr><td>6</td><td>UK (24)</td><td rowspan="2">India (347)
Indonesia (347)</td><td>Russian Federation (34)</td><td rowspan="3">Finland (132)
Germany (132)
South Africa (132)</td></tr>
<tr><td>7</td><td>Indonesia (22)</td><td>Ethiopia (32)</td></tr>
<tr><td>8</td><td rowspan="2">China (19)
Italy (19)</td><td>Ethiopia (345)</td><td>Indonesia (32)</td></tr>
<tr><td>9</td><td>Argentinia (336)</td><td>India (31)</td><td rowspan="2">Belgium (131)
Brazil (131)</td></tr>
<tr><td>10</td><td>Austria (17)</td><td>China (335)</td><td>Germany (27)</td></tr>
</table>

Note: There is no single metric to evaluate harm. Different policy measures affect different numbers of products, economic sectors, and trading partners. GTA reports four measures of harm. The EU-27 refers to the sum of all the measures taken by the 27 national governments of the European Union and the measures taken by the European Commission. To be included in this total, a state measure must have involved discrimination against the commercial interests of another state, including potentially another member of the European Union.

Source: Evenett S, 'Executive summary', in *Unequal Compliance: The Sixth GTA Report,* p. 6, http://www.globaltradealert.org/sites/default/files/GTA6_Exec_Summary.pdf

around mammoth banks deemed too big to fail, with alarming implications for global competition as well as moral hazard.

Financial mercantilism is clearly a work in progress, and it is too early to judge its protectionist impact. However, it has potential to escalate and cause great harm and threatens the renationalisation and fragmentation of global finance, which would damage market globalisation generally and, with it, the welfare of rich and poor countries.

In the wake of the crisis, several other, non-traditional, protectionist instruments were deployed: industrial subsidies, restrictions on migrant workers, FDI restrictions, and standards.

First, industrial subsidies, which have gone overwhelmingly to the automobile industry in the US and EU and have been sprayed more liberally at SOEs in several capital intensive sectors in China. In the OECD, subsidies to auto firms have been in the form of direct support and scrappage schemes (subsiding the trade-in of old cars for new ones). In the OECD and China, direct support has gone to domestic firms and could well fall afoul of WTO disciplines on trade-distorting subsidies.

Seond, public procurement or 'buy national' restrictions, such as the 'Buy American' provisions in the US fiscal stimulus package and the seemingly retaliatory 'Buy Chinese' provisions in China's fiscal stimulus package, which spread to many Chinese provinces.

Third, restrictions on migrant labour in both developed and developing countries, such as US restrictions on H-1B visas for foreign nationals working in bailed-out banks. No such equivalent measure exists in the EU, but labour migration to the EU has fallen significantly, and some governments have resorted to 'local jobs for local workers' rhetoric (as is the case in the UK).

Fourth, FDI restrictions or investment nationalism, which has not been a major global problem so far, as new FDI restrictions are bunched in energy-related sectors. North America, Europe and Australia are anxious about emerging market, sovereign wealth funds and the overseas expansion of SOEs, particularly from China. Chinese FDI restrictions have clearly increased in the last few years, but the United Nations Conference on Trade and Development (UNCTAD) notes that, although below the trend between 1992 and 2004 (when 92.5% of investment measures were more favourable to FDI)[22], 70% of new FDI measures were liberalising in 2009.

Fifth, standards protectionism, with anecdotal reporting that points to a more restrictive application of technical and food safety standards on imports since the crisis started. China banned several European agricultural products. India imposed tighter standards on imports of iron, steel, yarn, soya bean oil and aluminium, in addition to import bans on Chinese toys, cellphones and poultry. Indonesia imposed pre-shipment inspection requirements on over 500 goods, which could only enter through six seaports and all international airports.[23] The WTO also notes a marked increase in technical barriers to trade notifications in 2008/9.[24] As these are all areas in which officials have considerable discretionary powers, it is predictable that this leeway would be used to tighten the screws on imports in a severe economic downturn.

The climate change agenda is set to be the Trojan Horse of new standards protectionism. The EU already has an emissions trading scheme, and equivalent schemes were working their way through US and Australian parliaments, but are now stalled. Such cap-and-trade schemes will impose substantial compliance costs on energy-intensive sectors at home, which will increase the pressure to impose similar costs on cheaper, carbon-intensive production elsewhere that is not subject to carbon reduction policies, conjuring the spectre of trade sanctions on free riders, in particular China. Retaliatory threats revolve around border tax adjustments, such as tariffs on carbon-intensive imports, but climate change protectionism could include green subsidies, which discriminate in favour of domestic renewable energy providers, and all sorts of discriminatory standards. For example, the EU's Renewable Energy Directive contains a technical regulation that insists on a 35% saving on greenhouse gas emissions from biofuels entering the EU market, which effectively discriminates in favour of French and Spanish producers of rapeseed oil, at the expense of cheaper East Asian competition.[25]

Predictably, the WTO and G20 have been quick to claim the credit for restraining traditional protectionism. However, this does not ring altogether true, as members violate 'every other day' the G20's pledges not to increase protectionism.[26] WTO disciplines may, at the margin, have restrained border protectionism by OECD members and newly acceded members like China and Vietnam, given strong GATT disciplines on tariffs and other border barriers. However, they have certainly not restrained most developing countries' protectionism, even on tariffs. Most developing countries have high bound tariffs in the WTO and could quite legally raise much higher applied tariffs.

Something else is at work. The credit for restraining traditional protectionism should go in the first instance to markets and globalisation and only in the second instance to multilateral trade rules, international policy co-ordination and assorted summitry in the G20 and other international forums. Global market integration has imposed spontaneous disciplines on governments and businesses, which realise that up-front protectionism raises business costs, invites retaliation, excludes them from the benefits of globalisation and damages wealth and welfare at home. This applies particularly to global supply chains, such as the manufacturing supply chains with production centred in East Asia, which suffered disproportionately from trade contraction in the first six months of the crisis. However, protectionism did not increase in these sectors, and supply chains remained intact, ready for the upturn that followed.

More worrisome is the non-traditional regulatory protectionism in the pipeline, especially subsidies and standards, on which WTO disciplines are weak to non existent. These measures are not covered by the Doha agenda and, given the parlous state of WTO negotiations, it will be a long time (if ever) before the WTO strengthens rules on subsidies, FDI, government procurement, cross-border movement of labour and standards. As these measures are more opaque than border-based protection, governments and organised interests may well resort to them more frequently, not least to evade existing WTO disciplines. If not contained, the danger is that they will spread gradually to cover bigger swathes of international trade. That is the 1970s scenario to worry about.

In brief, the medium-term consequences of the financial crisis and domestic crisis interventions are likely to be far worse in the West than in emerging markets. However, while the prevention of traditional protectionism is good news, equally worrying news is the creeping non-traditional protectionism.

A REVIEW OF THE TROOPS

This section looks at the major players in trade policy and their response to the crisis, starting with the US and the EU, followed by the major emerging markets and Japan.

United States

America is down and diminished, though not out. On foreign policy, President Obama's rhetoric on soft power and multilateralism has not translated into effective American leadership abroad on either security or economic agendas. Economic woes at home clearly cramp the US's ability to lead abroad; weakness at home translates into weakness on the global stage.

Trade policy has deteriorated in the US since the Obama administration took over. The Bush administration, for all its faults, did not do a bad job on this front, with its major achievement being to contain protectionism at home, especially against China. On the other hand, while not a clear-cut protectionist, President Obama has ambivalent views on the subject and is not an instinctive free trader. He has powerful protectionist forces inside his tent – among Congressional Democrats, the unions and in his cabinet. Packing the office of the United States Trade Representative are staffers with close links to trade unions and congressional lawmakers with protectionist voting records. This makes the Obama administration different from previous administrations, including the Clinton administration.

President Obama's record to date shows a balancing act: one moment giving way to domestic protectionist forces, the next cushioning their impact and maintaining open markets. The 'Buy American' provisions in the fiscal stimulus package passed by Congress were modified to make them compatible with the WTO's Government Procurement Agreement. The president agreed to impose anti-dumping duties on Chinese tyre imports, but announced six weeks later that the US would negotiate to enter the Transpacific Partnership, a free trade agreement with six other Asia–Pacific countries. He has also not given into congressional pressure to label China a currency manipulator.

The administration's overall approach is defensive, and trade policy is very low down its list of priorities, crowded out by domestic priorities. Above all, the administration is not leading with open market initiatives. It has done nothing to finish the Doha Round and only belatedly (after the Republican victory in the congressional mid-term elections) has it renegotiated the free trade agreement (FTA) with South Korea and tried to get Congress to ratify the already negotiated FTAs with Panama and Peru. The Obama administration's main emphasis is on better enforcement of trade laws to ensure foreign access for US exports, with the announced goal of doubling US exports in five years. Overall, the president seems extremely disinclined to face down his union supporters and protectionists in the Congress, which is no surprise. It is not a left-liberal administration given to domestic intervention left, right and centre that will take the fight to protectionists at home and lead international co-operation to open markets worldwide. Finally, open market constituencies in American business have been muted; and relations between the administration and leading business associations (especially the US Chamber of Commerce) soured during 2009 and 2010.

This is bad news as, for all President Obama's sweet-sounding multilateralist rhetoric, he has no substantive trade policy. The US is abrogating its traditional leadership role in world trade, which leaves the field open to creeping protectionism in the US, a deterioration of key bilateral trade relationships (especially with China) and the continued weakening of the WTO. The result is a global vacuum, for no substitute leader exists to forge international co-operation in order to contain protectionism, open markets and strengthen multilateral rules – not the EU, not China, not anyone else. Although diminished in the wake of the crisis and in the face of rising powers, notably China, the US is still the fulcrum of international relations. No rising power is in a position to exercise the kind of global leadership the US has exercised since 1945.

European Union

The picture in the EU is similar to that in the US: internal weakness and external defensiveness.[27] True, some European economies show signs of healthy recovery, but that is not the overall picture. Symptoms of malaise abound: sovereign debt crises, still malfunctioning banking systems, industrial strife, sclerotic labour markets, bloated welfare states, intergovernmental squabbling and weak EU institutions.

In terms of headline protectionist measures, the EU has behaved better than most countries and, unlike the Americans and Chinese, has not increased tariffs or resorted to discriminatory public procurement measures. Although anti-dumping actions and other trade remedies have not increased significantly, worrying signs persist in the crisis-related regulatory measures that could easily spill over into protectionism. The relaxation of EU state aid rules during the crisis opened the door to discriminatory subsidisation, especially to the financial and automotive sectors. The EU already has the most stringent food safety and technical standards in the world, which could become more restrictive, especially those related to environmental and climate change regulations. Indeed, green protectionism, mainly through discriminatory subsidies and standards, is more of a threat in the EU than anywhere else in the world.

EU defensiveness is the main danger. Generally, when the single market is opening up and integrating, EU trade policy is more outward-looking and proactive, as was the case in the 1990s. However, when the single market is under stress from internal protectionism, EU trade policy turns to navel-gazing and gives way to protectionism against outsiders. This is what happened in the 1970s and 1980s and is roughly the situation today.

Perhaps the biggest casualty of the crisis was the abandonment of the Lisbon Agenda of market reforms to boost EU competitiveness. Now the EU has a 2020 strategy, which is unambitious and vague in parts, with hints of soft industrial policy activism (e.g. centralised targets for research and development spending) and contains no hard market liberalisation and concrete structural reforms. Externally, trade policy is defensive. Trade negotiations are not advancing or are stuck, which is the case with the WTO's Doha Round, Economic Partnership Agreements with African, Caribbean and Pacific countries and bilateral negotiations with several countries in Asia, the Middle East and Latin America. Trade relations with China are also adrift and replete with tensions. The exceptions to this rule are the freshly ratified FTA with South Korea and ongoing negotiations with Canada, Singapore and India. Moreover, outside its immediate neighbourhood, the EU's vaunted soft power is hardly taken seriously – when not dismissed as a joke. The European Commission's new trade strategy, announced in November 2010, does nothing to change these facts on the ground, being an update and slight modification of established policy.[28]

Finally, the EU suffers from a paradox. With enlargement and greater market size, the EU is weightier in the global economy. Yet at the same time its decision-making has become more fragmented, making it more difficult to co-ordinate national positions and speak with one voice, thus decreasing its ability to wield collective power abroad. In the one arena where the EU is a global heavyweight – trade policy – competence has been divided on several issues, notably services and investment. An enlarged EU made it extra difficult to have credible positions in international negotiations on services and investment. The Lisbon Treaty is supposed to overcome these problems by streamlining decision-making and by unifying competences on services, investment and intellectual property rights. However, this is counterbalanced with co-decision for the European Parliament, which confers greater power on the European Parliament in EU trade policy. Market sceptical forces and single issue fetishists in the European Parliament are bound to complicate decision-making and could tilt policy outcomes in a more protectionist direction.

China

China has powered through the crisis with a turbo-charged fiscal and monetary stimulus equivalent to almost 45% of GDP in 2009. It is the leading contributor to post-crisis global growth. Other countries around the world export raw materials and capital goods to power China's continuing industrial revolution, as do other East Asian economies, who also export parts and components to China for assembly and export elsewhere. Increasingly, other countries are also gearing up to export finished goods to a booming Chinese consumer market. More than ever, the rest of Asia revolves around China.[29] China is gradually asserting itself in international organisations, and its footprint is evermore visible elsewhere in the non-Western world, in its East Asian backyard, South Asia, Africa and South America.

China is now one of the big three in the global economy. Until recently, the country imported global order, absorbing policies, rules and institutions that materialised from decisions made elsewhere. China still imports global order, but, due to its market size, now exports global order as well, like the US and the EU. Decisions made in China reverberate around the world, to a far greater extent than those made in the other BRIC countries. China plays in its own league among emerging markets, accounting for about 60% of BRIC outputs, two-thirds of its foreign exchange reserves and exports and one-third of its inward investment. The other BRIC partners play in an inferior league and are still larger net importers of global order.[30]

However, this is still a far cry from Chinese leadership, let alone any notion of 'China ruling the world'.[31] To assert the contrary is hype. China may have just overtaken Japan to become Asia's largest economy, but it is still far behind the US (at market exchange rates). Its living standards are less than a fifth of the US average (at purchasing power parity) and its military spending, while growing at double-digit rates, is still only a tenth of US military spending.

On trade policy, paltry unilateral liberalisation going beyond China's WTO commitments has occurred, largely confined to marginal liberalisation of the securities market and baby steps to internationalise trading of the renminbi. Indeed, liberalisation has stalled since about 2006, corresponding with more industrial policy measures to promote selected domestic sectors.[32] The already complex export regime, comprising tariffs, bans, tax rebates, licensing and quotas, has become considerably more restrictive. Tax incentives, subsidies, price controls, as well as administrative guidance on investment decisions, are used to favour domestic sectors over imports, especially in capital intensive sectors where SOEs and assorted national champions operate. Unique national technical standards, such as for 3G mobile phones, have been promoted. Legislation and guiding opinions have enlarged the basket of goods and services sectors in which foreign investment is banned or restricted. The Anti-Monopoly Law, effective from August 2008, contains vague language on the public interest, national economic security and unreasonable prices, and no definition of market dominance. It has sweeping exemptions for SOEs, but can be used as a tool for greater control of multinational enterprises (MNEs). Internet censorship has increased, affecting foreign technology companies such as Google, while recently MNEs have been most worried about China's indigenous innovation policies that aim to promote domestic technology companies. Regulatory measures potentially include discriminatory public procurement and intellectual property restrictions (such as compulsory technology transfer in return for market access).

Such trade and industrial policy measures deepen China's entrenched domestic weaknesses. Growth continues to rely on high rates of domestic saving and investment, but at the expense of repressed domestic consumption. Factor markets (for land, capital, water and energy) remain tightly controlled. Dirigiste policies favour polluting, capital intensive industrial SOEs, state banks in a backward financial system and capital markets and monopolistic services providers in other sectors. Externally, surplus savings and an undervalued exchange rate contribute to global economic imbalances and generate extra trade tensions.

Rebalancing growth, or making growth more consumption driven and less investment driven, requires deep competition enhancing reforms. These range from public sector and financial sector reforms, to secure private property rights, deregulation of internal trade, market pricing for resource inputs and better provision of health, education, pensions and social security. Market liberals would also like to see WTO-plus trade and FDI liberalisation: reversal of export restrictions and import tariff reductions; limits to industrial policy activism through discriminatory standards, subsidies, internet and foreign investment controls; less regulatory discretion and more transparency in trade procedures; better enforcement of intellectual property rights; accelerated services liberalisation; and liberalised markets in government procurement and energy.

These reforms cannot be done quickly – and certainly not in a top-down style global agreement like the Plaza Accord in the 1980s used to depreciate the US dollar. Needed reforms revolve around factor markets and go to the heart of the Communist Party-government-public sector nexus and its grip on power. Politically, this is much harder than liberalising product markets, which has been the thrust of Chinese liberalisation to date. Major structural reforms to liberate factor markets are unlikely to happen soon. Indeed, China's crisis response, which is essentially an investment binge, bolsters the public sector and state power at the expense of the private sector. It succeeded in arresting the growth slowdown in 2009, but has exacerbated China's structural fault-line of over-investment and under-consumption. Its command and control mechanisms take market reforms backwards, and the risk remains that surplus manufacturing capacity floods into shrinking export markets in Europe and North America, thereby inviting protectionist retaliation against China.

Commendably, a pragmatic Beijing leadership has not rocked the boat during the crisis by resorting to aggressive mercantilism. Direct protectionist responses to the crisis have been quite restrained. Recent trade conflicts with the US and EU over internet censorship, export restrictions, indigenous innovation policies and the exchange rate should not be exaggerated, as they do not amount to a trade war. Protectionism has been heavily constrained by China's already deep integration into the global economy, particularly through manufacturing supply chains and by its strong WTO commitments. However, stalled trade and FDI liberalisation, the absence of domestic structural reforms and creeping protectionism threaten future trade tensions.

Overall, China's domestic weaknesses will cramp its ability and desire to lead externally. Its leaders will remain too preoccupied with China's myriad economic, political and social problems to switch to external leadership mode. This context also diminishes China's ability to look outward and exercise leadership in the world economy. Besides, China has no tradition of regional or global leadership.

China alarmists would have us believe that China will be taken over by state capitalism, will decouple from the West and switch to domestic consumption, will be militarily aggressive and dominate Asia and will exercise global leadership.[33] None of the above is likely to happen anytime soon. China remains a complex hybrid, presenting a very mixed political and economic picture.

Japan

In absolute market size, Japan is still about as large as China and Asia's richest economy (in terms of per capita income). But it is stuck in a political and economic quagmire that has lasted two decades. The Japanese political system is blocked and seems hopelessly incapable of delivering clear policy choices, including economic reforms. The economy has sputtered along a low-growth track, now with astronomically high public debt. The crisis seems to have made Japan even more averse to reform. Exceptionally in Asia, Japan has had a Western-style crisis: Keynesian macroeconomic policies alongside escalating public debt, and growth contraction followed by modest recovery. Conditions would be much worse if not for roaring growth in its neighbourhood, especially in China.

These factors play into Japan's passive and reactive trade policy. It has stayed on the sidelines of the Doha Round, preferring to focus on bilateral FTAs and regional integration initiatives in East Asia. But its FTAs are mostly trade-light and its regional integration initiatives half-baked.

Overall, Japan seems condemned to be a dwarf on the global stage, and historical baggage prevents it from becoming a regional leader. Now that China's political and economic ascent casts an ever longer shadow over Japan, at best Japan can be a second-rank or upper-middle power in Asia, perhaps alongside India.

India[34]

India has weathered the crisis well, buoyed by exuberant domestic consumption. Previous market reforms, especially since 1991, liberated domestic producers and consumers and opened India to the world. Trade and FDI liberalisation has been critical to India's recent global economic integration. Internal and external market reforms have transformed the business landscape and spawned an aspiring, vibrant, urban middle class, but relatively high levels of protection remain: agricultural tariffs and NTBs, peak industrial tariffs and big ticket services sectors (such as professional services, banking, insurance, retail and distribution, and aviation).

India's trade and FDI liberalisation has come about almost totally through unilateral measures, but has not translated into much greater flexibility in the WTO. India's GATT and General Agreement on Trade in Services (GATS) commitments are weak and, although a lead player in the Doha Round, it remains defensive, especially about agriculture and industrial goods. India has become very active with FTAs, but these are mostly about foreign policy and very trade light. It also has very high and largely unreformed domestic regulatory barriers, including: draconian employment laws; reserved sectors for small-scale industries, although this list has been reduced; high and differing barriers in the states

(India has a federal system); extremely interventionist agricultural policies, including subsidies, price controls and other internal trade barriers; domestic restrictions on services sectors; huge subsidies and price controls on energy; a lack of rural property rights; and a very inefficient, corrupt public administration. Public sector reform has hardly begun.

India's response to the global economic crisis was to introduce fiscal stimulus packages amounting to about $60 billion, which was (unlike China) in the context of deteriorating public finances, with the consolidated fiscal deficit climbing to above 10% in 2009. Protectionist measures have increased, but not majorly. Higher import tariffs, licensing requirements, provisional anti-dumping duties, safeguards and tighter standards restrictions were applied in selected sectors, much of it targeting Chinese imports, but did not affect a big chunk of India's trade.

The May 2009 election delivered an unexpectedly strong mandate to the Congress-led government, which gave India its most stable government in over 20 years. However, this has not led to a new wave of market reforms. Reforms have stalled since Congress came to power in 2004, and no signs of big change are in sight. Dr Singh and his 'dream team' have proved bogus, not genuine, reformers in the past six years, and anti-market sentiment and vested interests remain strong in the Congress Party.[35] The opposition Bharatiya Janata Party has lost the reform impulse it had in government and is in disarray. Trade policy remains a combination of stalled unilateral liberalisation, defensiveness in the Doha Round and trade-light FTAs.

Nevertheless, a combination of stable government and roaring growth gives rise to exuberant optimism. India supporters claim that growth will soon exceed 8–10% per annum; its catalysts will be high-value services and manufacturing niches, which can happen without a new wave of policy reforms. At the same time, they argue, India is rising to be a regional and global power.

This is India hype that is even more ridiculous than China hype. That India can boost growth above an annual 10% without further structural reforms defies belief. In terms of market reforms, India lags behind China and other parts of East Asia, with higher protection against imports and inward investment. Its public finances, infrastructure and lower education system are much weaker. It has more damaging restrictions, which stymie domestic markets in agriculture, manufacturing and services, especially draconian employment laws that prevent firms from employing unskilled workers in large numbers. Government subsidies are more wasteful. Worst of all, India's unreformed, dysfunctional state – the Union Government in Delhi, the state governments and other levels of government – is the biggest obstacle to faster growth. Growth has come from capital- and skill-intensive sectors in manufacturing and services, which has primarily benefited the urban well-to-do and middle classes, but has not flowed down as much as it has in East Asia to the poor in the rural areas – the bulk of India's population.

Without further market reforms, India will not have what is desperately needed: East Asian-style, labour-intensive agricultural, services and industrial growth. In particular, India's industrial revolution, which will enable the impoverished in the countryside to move (initially) to low-wage work in mass manufacturing,[36] has yet to happen. It demands regulatory reforms – not least in labour markets and the public sector – that remain politically very hard nuts to crack. Moreover, the combination of a barely reforming government in Delhi and worse global economic conditions after the crisis might make current levels of growth difficult to maintain.

No one can deny that India is a bigger player on the global stage. However, economically and militarily, it is still too small to be a pan-Asian, let alone a global, leader. It pales in comparison with China. Even within South Asia, India's leadership is diminished by testy relations with most of its neighbours and disastrous relations with its biggest neighbour, Pakistan.

Brazil[37]

Brazil's big opening up, after half a century of high protectionism, started in the late 1980s. Liberalisation through the 1990s has resulted in a relatively open market for FDI and services, noticeably more open than Russia, India and China. The country now has a diversified export basket, ranging from crude oil and processed minerals (such as petroleum products, coke and ethanol), to metals, chemicals, rubber, plastic, agricultural commodities, food and beverage products and manufacturing. Nevertheless, relatively high tariffs on imported intermediate products still remain, which keep local production costs high, as do equity limits and other restrictions on FDI, notably in banking, oil, mining and air transport.

Brazil has been a prominent player in the Doha Round, especially through its leadership of the G20 in agriculture, and has been active in dispute settlement, winning landmark cases against the US on cotton and the EU on sugar. Brazil is also the South American hub for bilateral and regional trade agreements. At the heart of this network is Mercado Común del Sur (MERCOSUR), which is a relatively weak customs union with several exceptions to its common external tariff and very little progress on NTBs, services and investment. MERCOSUR has several FTAs with third countries, and Brazil has stepped up FTA activity with developing countries outside the Americas. These are mostly very trade light, amounting to fixed preferences on a limited range of tariff lines.

Overall, Brazil relied on unilateral trade and FDI liberalisation to open the economy. Since 1994 trade negotiations – bilateral, regional and multilateral – have almost totally replaced unilateral liberalisation, but have delivered virtually zero liberalisation. Many business voices complain that Brazil's WTO and FTA activity is geopolitics driven and lacks commercial sense. Its accommodation of India in the G20 has compromised its agricultural exporting interests; and defensiveness in Non-Agricultural Market Access negotiations does not reflect Brazil's export strength in industrial goods. Also, its new FTAs are with countries such as South Africa and India with which it does relatively little (though fast increasing) trade, while it has deprioritised existing FTA negotiations with two of its three most important trading partners: the US and EU.[38]

Brazil's domestic regulatory barriers are very high, at roughly the same level as those of India, Indonesia and Russia, and opening and closing businesses, labour markets, pensions, public administration and the tax regime are particularly burdensome. The Lula administration pursued centrist economic policies and did not intervene heavily in the economy, but did have a penchant for occasional industrial policy interventions to promote selected sectors. At the same time, the administration has eschewed further external liberalisation and domestic structural reforms. However, the accent on industrial policy could become stronger when Brazil exploits its new oilfields.

Brazil has weathered the crisis well and hardly raised protectionist barriers. More generally, external liberalisation has made the Brazilian economy more efficient and allowed it to profit from favourable global economic conditions, especially the China-driven resources boom. Although not at Chinese and Indian growth rates, Brazil's growth is expected to increase to 6–7% per annum, a big jump from 2.2% annual growth in the 1990s. This is delivering higher living standards for the broad mass of Brazilians as well as an expanding middle class.

Brazil, like China and India, is in a confident mood. Its political stability, economic rise and global integration make it a new force in the world. Having displaced Mexico as the leading power in Latin America, Brazil is clearly an emerging global power, but remains (like India) a second-tier emerging power, well behind China.

Russia[39]

Russia is exceptional among the BRIC partners. Since 2003–2004, previous market opening reforms not only stalled, but were also reversed, and policy went in a strongly deliberalising direction. Politics have become increasingly authoritarian and have been used by the state to nationalise energy assets, promote monopolistic practices by favoured national champions, and generally apply laws and regulations in a highly selective, arbitrary manner. The order of the day is state capitalism, which manifests externally as hard mercantilism. Russia's foreign policy is aggressive towards its neighbours, or near abroad. Arbitrary trade measures, such as cutting off gas supplies to other countries and unlawful treatment of foreign investors, have become more frequent. Trade mercantilism extends to playing off EU member states against each other in order to entrench EU energy dependency on Russia.[40]

Russia's WTO accession negotiations, which started in 1993, have ebbed and flowed. They slipped down the priority list from 2004, corresponding with more statist policies at home. Prime Minister Putin dropped a bombshell in June 2009 when he announced that Russia would withdraw its solo application to join the WTO and negotiate entry as part of a customs union with Kazakhstan and Belarus. But only a few weeks later, President Medvedev indicated that Russia's solo WTO application had not been withdrawn. Since then, Russia's relations with the EU and US have thawed, and both have concluded bilateral negotiations with Russia as part of its WTO accession process. It now looks like Russia will enter the WTO in 2011.

WTO membership matters less for Russia than for most other emerging markets. Energy (mainly oil and gas) and other commodities that account for 85% of Russia's exports do not mostly suffer from protectionism abroad. They are only weakly covered by WTO disciplines, which impose few constraints on Russian government intervention in energy trade, putting Russia in the same category as Nigeria and Saudi Arabia. All the other BRIC partners have much wider swathes of economic activity covered by WTO disciplines. Besides, Russia views WTO membership in foreign policy rather than in commercial or economic terms. Membership is more about being part of an important international club in which Russia can exert its influence as a big power, and less about using the WTO as a strategic lever for market reforms at home and integration into the global economy.

Russia has hardly any cross-regional FTAs and, on this front, is much less active than the other BRIC partners, which is largely because of not being a WTO member yet. WTO membership would probably trigger many new FTA negotiations. However, since the 1990s Russia has negotiated over 20 000 preferential arrangements with newly independent neighbours within the ex-Soviet Union. These arrangements are contradictory, not applied or weakly enforced, while a customs union with Kazakhstan and Belarus was supposed to come into force in 2010.

Russia had the severest crisis of all the BRIC partners and has had a relatively modest rebound. It was the worst emerging market offender in resorting to new protectionist measures, using them to strengthen state control of the commanding heights of the economy. Tariff hikes were imposed on a range of imports, especially on cars, trucks, buses, steel and agricultural goods, export tariffs were slapped on timber and Russia recently introduced a ban on wheat exports to combat rising prices. In 2008, foreign investment caps in 40 strategic sectors were imposed. However, with the depth of the crisis-induced recession, the market liberalising camp in the Kremlin, led by President Medvedev, has been more vocal in the past year. There are modest signs of a course correction, which has led to better relations with Russia's trading partners. However, so far, this does not amount to a decisive shift of policy in a liberalising direction.

Overall, Russia remains a second-tier emerging market power. Its influence is primarily in its immediate neighbourhood, but much less evident elsewhere. A largely malign influence, Russia revels in being the regional spoiler.

South Africa[41]

Compared to the BRIC partners, South Africa has a far smaller population and much lower levels of trade and FDI. The country's opening up to the world economy took place alongside its transition to multi-racial democracy in 1994. As a consequence of trade opening, South Africa better exploits its comparative advantage in capital intensive primary and manufactured commodities. Trade growth accelerated in 2003–2008, driven by the global commodities boom. However, South Africa's export growth compares badly with developing countries generally, and inward investment is low compared with the BRIC partners and other emerging markets.

South Africa still has a rather complicated tariff structure, with big pockets of manufacturing protection remaining, notably in garments and automobiles. South Africa is also the biggest developing country user of anti-dumping measures after India, but is generally more open to FDI than China, India and Russia. Its highest levels of protection are in electricity and telecoms. State ownership and restricted competition prevail in transport, telecoms and energy.

South Africa was initially quite pragmatic and flexible in the Doha Round, but became more defensive after the Cancun Ministerial Conference in 2003, especially about industrial goods liberalisation. The country is the mainstay of the Southern Africa Customs Union (SACU) and a member of the wider Southern African Development Community (SADC), which has (rather far-fetched) plans for broadening the customs union by 2011. SACU is not viable given SADC's disparate members and their overlapping FTAs with third countries. For example, South Africa has a separate FTA with the EU, while other SACU members (not including South Africa) have signed an interim EPA on goods trade with the EU. South Africa now prioritises South–South FTAs with other developing countries, notably India and Brazil. These are trade-light agreements: some are partial-scope, limited to tariff preferences on a narrow range of products, while others may be more ambitious on tariff elimination, but do not reduce non-border regulatory barriers in goods, services, investment and public procurement.

Since the late 1990s, external liberalisation has stalled, liberalisation scepticism has set in and trade and related structural reforms have fallen way down the list of government priorities. Mercantilism prevails, as unilateral liberalisation is off the agenda, and trade negotiations are driven more by geopolitical than commercial considerations. Defensiveness in the WTO and trade-light South–South FTAs with countries with which South Africa does relatively little trade are not congruent with South Africa's export interests. The latter are not only in agriculture, but also in intermediate manufactures and services, especially to other African countries. Meanwhile, government attention has shifted to sector-based industrial policy intervention.[42]

These trends have become more pronounced under the Zuma administration. There is more pressure from the Congress of South African Trade Unions, the South African Communist Party and the left-wing of the African National Congress to step up industrial policy intervention and even trade protection. Tariffs on garments were increased in late 2009, but generally the government has refrained from major protectionist measures in response to the global economic crisis.

South Africa's core economic problems are very high unemployment, anaemic employment growth, low productivity, low standards of education and skills and lack of diversification, especially into employment generating services sectors. Trade liberalisation is often, and mistakenly, blamed for exacerbating some of these problems. On the contrary, remaining protection keeps business costs high and firms uncompetitive, in addition to taxing (especially poor) consumers. However, more damage is done by domestic (though still trade-related) regulatory barriers, for example in transport, telecoms and energy. Employment policies are the most damaging set of regulatory barriers and have become more restrictive, acting as a powerful deterrent to domestic as well as foreign investment. They are also intimately bound up with affirmative action policies (termed BEE – Black Economic Empowerment) in the name of the black majority.

South Africa has been accepted into the BRIC partnership as an emerging market powerhouse. This is hype. South Africa may have leadership credentials in Southern and sub-Saharan Africa, but is too small to be in the same league as India and Brazil, let alone China. It does not have the dynamism, the education and work ethics found especially in Asia. Rather it is plagued by European-like vices: overweening trades unions, restrictive work practices and a redistributive, not growth oriented, ideology. Its inevitably complicated racial politics also hold back a growth take-off. At best, South Africa can be a third-tier emerging market power.

EMERGING MARKETS IN REGIONAL AND GLOBAL TRADE GOVERNANCE

The Doha Round remains stuck, although an attempt to conclude it is being made in 2011. None of the major players gives it more than lip service, as the crisis has diverted their attentions to domestic fire-fighting. Besides, the Doha Round, even if concluded, would do little to contain emerging protectionism beyond binding developing country tariffs at lower levels. A serious, post-Doha agenda for the WTO lies on the distant horizon, and, as a result, the WTO suffers from a slow-burning credibility crisis.

The US, EU and major emerging markets, especially China, Brazil and India, should prioritise two objectives and invest political capital accordingly. The first objective must be to finish the Doha Round as soon as possible, and the other to move onto a post-Doha agenda that addresses 21st century trade realities. They should aim for a modest Doha package – Doha-lite as it were – that can be concluded expeditiously, as high ambition is politically undeliverable. The main thing is to despatch the Doha Round so that it does not continue to block WTO business and to undermine further its rules. Then the WTO could move onto a post-Doha agenda that would fill gaps in multilateral trade rules, not least to contain the creeping regulatory protectionism that may have accelerated in the wake of the crisis.

However, breaking the WTO's logjam requires filling a leadership vacuum. The US has largely forsaken its traditional leadership role in the GATT/WTO. The EU is not attempting to substitute for the US, nor could it do so on its own. The big three emerging market WTO members, China, Brazil and India, are clearly much more important, but remain reactive players in the WTO, happy to leave logjam breaking initiatives to the US and the EU. They have not made the transition to co-leadership. Without co-operation and co-leadership among this group of five, WTO negotiations are unlikely to move. Finally, middle powers like South Africa and Indonesia, which should play constructive supporting roles, have been conspicuously defensive and obstructive in the Doha Round.

The G20 makes more sense than the G8, as it is more representative of national weight and clout in the global economy, but it is much hyped. Predictably, there were grand aspirations for the G20 as a new and powerful instrument of global governance. Initially, and on the surface, G20 members agreed collectively to loosen macroeconomic policies to combat the crisis, but have subsequently gone their separate ways on macroeconomic policies, and attempts at G20 co-ordination of exchange rates and global imbalances in a 'Plaza II Accord' have conspicuously failed. It remains to be seen how strong collective commitments on financial regulation will be in practice, as in the end collective pledges to refrain from new protectionist measures were never taken seriously.

G20 splits are unsurprising, as the organisation is too large and unwieldy to be a cohesive forum for international policy co-ordination. For it to work requires outward-looking leadership by its major players, led by the US and China, which are (as argued above) both in defensive mode, as is the EU. Worse, the EU does not speak with one voice in the G20, but discordantly through its represented member states, especially the UK, Germany and France, which is symptomatic of the EU's over-hyped soft power in international relations.

Overall, the G20 may be a welcome chat forum, but is distinctly limited as a heavyweight forum for global governance, least of all on trade policy. Deep-seated differences among G20 members on underlying economic policies have prevented and will prevent hard co-ordination of anything – trade, macroeconomic policy, financial regulation, structural reform, or anything else for that matter. In this sense, the G20 is no different from the G8, as soft co-operation is the best that can be achieved, and hardco-ordination is a will-o-the-wisp.

One key factor that prevents emerging powers from rising faster is highly mal-integrated regional markets.[43] This is true of Latin America, Africa, the ex-Soviet Union, South Asia and East Asia.

In the developing world, regional trade integration is most advanced in East Asia. Cross-border economic integration has increased, with intra-regional trade representing about 55% of total trade, roughly halfway between comparable numbers for the EU and the North American Free Trade Agreement. However, this is mostly due to intra-regional trade in parts and components, mainly in information and communications technology products, with final assembly in China and exports of finished goods to Europe and North America. In other words, greater regional trade integration is a product of increasing dependence on the West, which is quite different to regional trade integration in Europe and North America, where most regional production is destined for regional consumption. In East Asia, national policy barriers and a lack of infrastructure prevent regional integration in agriculture, services and other parts of manufacturing.

South Asia is the least integrated region in the world economy, with intra-regional trade representing barely above 10% of total trade, just 5% of regional GDP. India's trade with its neighbours is only 3% of its total trade. South Asia is also not yet plugged into East Asian and global supply chains, accounting for only 5% of Asia's trade and 1.4% of world trade. The pattern in Latin America and the Caribbean, sub-Saharan Africa, North Africa and the Middle East, is closer to the South Asia's pattern than to that of East Asia.

Regional integration boosters argue that region wide FTAs, monetary and financial co-operation, cross-border infrastructure and growing domestic consumption will knit together regional markets, create regional supply chains for regional consumption and lessen dependence on the West. These arguments are either wrong or highly premature.

First, developing country FTAs are generally trade-light and barely liberalise trade or improve upon WTO rules. At best they eliminate most tariffs, but they hardly tackle non-tariff and regulatory barriers that are the bigger obstacles to intra-regional commerce. This is the East Asian picture, centred on the Association of South-East Asian Nations (ASEAN) FTA and ASEAN FTAs with third countries, notably China, Japan, India and Australia/New Zealand. Many other FTAs are even weaker, limited to less-than-comprehensive tariff elimination or reduction. China, India, Brazil, South Africa and Indonesia have a mix of these FTAs, while Russia's preferential trade agreements are even weaker.

Second, several regional integration initiatives are on the table in the developing world. In Asia, these are centred on regional institutions such as Asia–Pacific Economic Co-operation, ASEAN and South Asian Free Trade Area. At the top of the list are ideas for East Asian and pan-Asian FTAs. Parallel initiatives are found in Latin America, Africa and the ex-Soviet Union. However, for the foreseeable future, these institutions are likely to remain quite weak. Regional integration initiatives are unlikely to go beyond soft co-operation and, at best, can be chat forums to gradually build confidence and trust, exchange information and ideas, improve transparency, and promote trade facilitation and other best practice measures. However, this is unlikely to be transformed into hard co-operation with binding, enforceable rules. Intra-regional divisions – countries at widely different stages of development, competing producer interests, significant intra-regional trade barriers, rivalry among regional powers (such as China, India and Japan in Asia), and, not least, a history of bitter nationalist rivalries and lack of cross-border co-operation – will continue to stymie regional integration for a long time to come.

Yet other factors inhibit emerging powers from exercising leadership in regional and global economic governance. To pick out three:

Domestic political and economic systems

Most emerging market political systems, ranging from democracy to authoritarianism, may be able to react to changing global conditions, but lack the capacity and flexibility to be proactive in their regions and around the world. Economic institutions, public administration, enforcement of property rights and diverse regulatory authorities remain relatively weak and keep business costs high, repressing entrepreneurship, innovation and consumption.

Geopolitical obstacles

None of Asia's big three powers, for example, is in a position to exercise outright regional leadership. This is not simply a matter of domestic constraints or the lack of a tradition of external leadership. Most countries in Asia do not want Chinese hegemony, just as they are wary of a resurgent Japan. Instead they prefer a multi-polar regional balance of power, with a vital role for the US as the region's balancing power. While it is also true that stronger economic links among emerging markets help to contain their political tensions and conflicts, security flashpoints remain and will present enduring threats, not least over competition for natural resources.

Limits to emerging powers' role in global economic governance

China, Brazil and India have greater power in international institutions such as the WTO, World Bank, IMF, and now the G20 and are stronger in bilateral relations with other powers, notably the US. Japan should be in the same category, but is constrained by its post-war geopolitical settlement and internal sclerosis. Middle powers such as South Korea, Indonesia, Australia and South Africa have important niches to fill, but are not willing to exercise onerous global (or even regional) responsibilities. Not one of the BRIC partners – not even China – is remotely close to assuming the kind of responsibilities the US has undertaken around the globe since the Second World War.

CONCLUSION

The global economic crisis has sparked the short-term divergence of economic performance between the West and emerging markets, thereby accelerating their convergence in the long-run, and is particularly evident in globalising Asia. This shift to the East is even more evident in international trade and FDI than in other channels of globalisation. It creates very different economic and geopolitical conditions to those that prevailed under US leadership and a transatlantic-centred world economy in the second half of the last century. Western and emerging market elites are only just beginning to recognise this shift, but they still have little clue about how to deal with it.

However, emerging markets' political and economic institutions and intra-regional divisions continue to hold back their rise, which means the shift to the East will not translate into leadership by China or other emerging markets for a long time to come – if ever. The US is still the fulcrum of international relations, and the world is far from being post-American. However, the US is diminished, and less capable and willing to exercise global leadership – clearly evident under the Obama administration. Europe is also no substitute for US leadership, as the extent of the EU's global power is that it is the world's biggest unified market. The EU's hybrid nature, internal divisions and absence of hard power (a unified military capacity) will always prevent it from having a serious, coherent foreign policy. Its soft power, outside the greater European neighbourhood, is mostly postmodern hot air.

Thus the economic shift to emerging markets, accelerated by the crisis, does not translate into a paradigmatic shift in global political-economic order. However, it does insert more multi-polarity and uncertainty into the order and leaves more of a leadership vacuum.

These are very general global political-economic observations, which also capture the present global trade policy context. As for trade policy, governments' responses to the biggest deglobalisation since the Great Depression did not precipitate a descent into 1930s-style protectionism. Domestic crisis interventions – a combination of bank bailouts and expansive macroeconomic policies – took priority. Traditional protectionism hardly increased, and borders remained open. However, crisis interventions and the return to 'big government' leave the West with crippled public finances and more restrictions on competitive markets, which threaten to spill over into creeping protectionism of the subtle, non-tariff, regulatory variety. The new patterns of protectionism are similar to developments in the 1970s and 1980s rather than the 1930s. Barely contained by WTO rules, the danger is that they will slow down recovery and reglobalisation in the next decade.

The short-term challenge is to arrest the slide to 'big government' at home and creeping protectionism abroad. The medium-term challenge is to get back on track with trade and FDI liberalisation combined with domestic structural reforms – substantial unfinished business from before the crisis struck. BRIC and many other emerging markets still have big pockets of up-front trade and FDI protection and have even higher domestic (though still trade-related) barriers embedded in services regulation, intellectual property rules, public procurement, customs administration, food safety and assorted product standards and competition rules. They do badly on business climate indicators compiled by the World Bank and other organisations. However, second-generation reforms to tackle these barriers are much more complex and politically sensitive than the first-generation reforms of the Washington Consensus heyday. Compared with border barriers to trade and FDI, domestic regulatory barriers are defended by more powerful, entrenched interest groups, uniting insider elites in government, business and unions, usually with the public sector and the organs of the state at their core.

Notwithstanding such obstacles, these reforms are primarily a matter for unilateral action by governments and competitive emulation among them. They can be reinforced by international policy co-operation in the WTO, G20 and other forums, but not too much can be expected of cumbersome global governance, let alone regional governance, mechanisms.

On a final contextual note, the global economic crisis has brought Keynesian macroeconomics back into fashion and, with it, Pigovian welfare economics and microeconomic interventions to fix alleged market failures. In the ascendant is a social-engineering mentality – the belief that superior technocratic minds can solve complex social and economic problems with targeted interventions. Welcome to the worldview of Bentham, Keynes, Stiglitz and Krugman. Less popular has become that of Hume, Smith and Hayek – the belief that markets are complex organisms; governments, however expertly staffed, cannot possibly have enough knowledge to fine-tune macro and microeconomic outcomes with detailed, prescriptive regulations; governments also fail through human fallibility, political pressure and corruption; and, consequently, regulation should err on the side of caution and stick to general rules to allow markets to operate effectively.[44]

I happen to side with the classical liberal sages on both domestic and international economic policy. Overall, limits to government intervention and a well-functioning market economy are of a piece with open markets, economic globalisation and international political stability.

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South African Institute of International Affairs
Jan Smuts House, East Campus, University of the Witwatersrand
PO Box 31596, Braamfontein 2017, Johannesburg, South Africa
Tel +27 (0)11 339-2021 · Fax +27 (0)11 339-2154
www.saiia.org.za · info@saiia.org.za

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