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GLOBAL TRADING SYSTEM IN CRISIS

INTERIM REPORT

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INTRODUCTION

In November 2022, the Commission held its sixth evidentiary session focusing on the current crises of the global trading system. The panel—comprising speakers **Dr Dani Rodrik**, Ford Foundation Professor of International Political Economy at Harvard's John F. Kennedy School of Government, **Dr Michael Pettis**, professor of finance at Peking University's Guanghua School of Management, **Mr Ignacio Garcia Bercero,** Director in charge of Multilateral Affairs, Strategy and Economic Analysis at DG Trade in the European Commission, and chaired by **Dr Christine Côté**, Associate Professorial Lecturer in the Department of Management at the London School of Economics—examined the causes and consequences of the current crisis and explored potential solutions to make the global trading system more stable and inclusive.

The growth of the contemporary global economy in recent decades has typically been linked to the expansion of trade and investment alongside the integration of emerging markets into the system. While such an approach has enabled various actors to derive significant economic benefits, the global trading system is currently facing serious challenges. A combination of persistent macroeconomic imbalances from downward pressures on wage shares, destabilizing capital flows associated with these imbalances, the subordinate roles of low- and middle- income countries, and the deteriorating relationship between China and the US have presented severe tests. This is exacerbated by the economic shockwaves resulting from Russia's invasion of Ukraine, which has inspired a move away from the existing economic system towards a more neo-mercantilist approach divided on the basis of political blocs. As the benefits of the existing hyperglobalist system begin to wane, there is mounting pressure to either abandon or rethink how globalisation is operationalised within the economic system.

HYPERGLOBALISATION AND ITS DISCONTENTS

To begin, Mr Bercero observed that the current global economy remains highly integrated with a high degree of economic interdependence, although the extent of integration has reduced from its peak in 2008. Furthermore, the presence of different systems, namely state-led as opposed to liberal economic models, and declining support for globalisation among developed economies has created negative feedback loops which encourage greater fragmentation. Nonetheless, Dr Rodrik argued that there is no universal definition of globalisation and cautioned that fatalistic perspectives regarding globalisation may be premature. Specifically, while the current globalised economic system may be facing significant challenges, it is ultimately merely a singular manifestation of globalisation—hyperglobalisation. Thus, rather than the death of globalisation, we are witnessing the twilight of this specific model of hyperglobalisation. Similarly, Dr Pettis suggested that it is a specific form of globalisation which has created a series of imbalances that creates greater pressure to scale back globalisation. As such, the focus should not be on trying to reverse the process of deglobalisation; rather, effort should be directed towards envisioning a more beneficial form of globalisation where economic competitiveness is not achieved by suppressing wages and household incomes.

According to Dr Rodrik, at the heart of the problems facing the existing hyperglobalist model are several tensions within the global economic system. The first exists in domestic economic development policy between a model favouring diversification on one hand, and an approach following the dictates of competitive economic advantages on the other. Put differently, countries face the twin pressures of trying to reap maximal benefits from global trade and enacting a national development strategy. The best instance of successful management of these pressures is China's pursuit of diversification through a state led economy while leveraging the trade-seeking behaviour of advanced economies.

The second tension is that between gains from trade and distributive effects. Specifically, gains from trade come in tandem with a significant redistribution of income which has lasting socio-political effects. The third tension lies between the need for harmonisation of domestic regulatory systems with global, or regional, systems and the pressure to remain domestically accountable through the maintenance of diverse regulation. This is crucial to ensure that national capital flows would drive down tax rates on capital. In other words, the tension manifests as a contradiction between what countries themselves want to do and what the global economic system requires them to do. Finally, there exists a tension between the positive-sum logic of trade and the zero-sum logic of politics; in recent times, it is zero-sum political objectives that are taking priority.

Beyond this, Dr Pettis also posited that the impact of trade on balance of payments is overemphasised, highlighting the significant role of capital on balance of payments over that of trade. Most trade in the world occurs within four country nodes: the US, UK, Australia, and Canada. These countries share the common trait of possessing open, well-governed and flexible capital markets which allows them to become the destination for excess global capital. As a result of the influx of capital, these economies are thus forced to run a current account deficit, even if they are not trading with a country possessing current account surpluses. While such a situation is rightly identified as problematic for the domestic economies of these countries, the offered solutions often reveal a misunderstanding of the relationship between trade and balance of payments. For instance, the Trump Administration's efforts to manage the US's trade deficit by placing tariffs on trade with countries with which it had the largest deficits (i.e., China) had minimal effect. Specifically, China's trade surplus emerged because of its huge savings imbalance: the US's tariffs were unlikely to have any significant impact on China's current account surplus nor its own current account deficit for as long as China continued to export most of its savings into US financial markets. Crucially, one cannot simply look at the direction of trade to understand trade imbalances; instead, one needs to examine the direction of capital flows. Further, if one wishes to address trade imbalances one must address capital imbalances.

Additionally, Dr Pettis emphasised that countries cannot necessarily control their savings rates. While it is widely perceived that the US has a deficit because it has low savings, the causal direction of the relationship is inverse. That is, the US has a low savings rate because of its trade deficit. This trade deficit, rather than being an effect of savings, exists because the US is the preferred destination for excess savings for the rest of the world. As such, changing the savings rates of the US, or any country, to reduce the trade deficit is the wrong approach.

A NEW MODEL OF GLOBALISATION?

All three panellists agreed that globalisation is not the root issue of the current global economic system: it is the specific iteration of globalisation characterised by porous capital flows and deep economic integration. Likewise, all the panellists also called for a reimagined model of globalisation.

Dr Rodrik advocated a model of globalisation in the form of a peaceful economic coexistence. For such a system to develop, major countries would need to understand and acknowledge that they have significant economic differences between their respective institutions and policies. This is necessary for the emergence of new institutions that support a system of globalisation accepting of diversity. At first glance, such a heterogenous system seems contradictory to globalisation; however, the experience of the former Bretton Woods system suggests a need to allow countries to pursue and achieve their domestic objectives. This is crucial to restoring faith in the global economic system: not only engendering greater legitimacy but, in light of the benefits, citizens would be more open to trading and investment.

Mr Bercero similarly called on policymakers to think of a more sustainable model of globalisation. However, he emphasised that such a system would still require functional multinational trade institutions of a quasi-universal nature such as the WTO. These institutions remain important to the economic system, as they form a bulwark against potential economic fragmentation while also reducing the economic costs and risks of conflict resulting from great-power competition. Further, these organisations can also help stabilise the economic system as it makes further progress on the climate agenda. Global climate negotiations are highly combative and require forums provided by multilateral institutions to reduce potential conflicts and trade impacts. Finally, less developed countries also rely upon these institutions to further their integration into the global economy and protect their interests.

Additionally, Mr Bercero argued that we need to rethink the role of global institutions as merely agents of economic liberalisation; in some instances they have also provided policy space for countries to address potential national security issues: trading regimes such as the WTO or GATT have provisions that allow for the use of temporary rules to address unfair practices. The policy space afforded by international institutions can thus be explored in pursuit of a new model of globalisation.

Dr Rodrik was ultimately pessimistic that a re-envisioned system of peaceful economic coexistence will emerge. On the one hand, powerful actors within the contemporary economic system – big banks and multinational corporations – hold significant sway over the writing of global economic rules. On the other hand, the increasing emphasis on national security issues has meant that the zero-sum nature of political objectives trumps economic goals. Even so, subordinating economic outcomes to national security may potentially backfire as it blunts economic gains while also worsening security concerns via the downward cyclical effects of a security dilemma. Mr Bercero concluded that the defects of the existing global economic system do not justify completely discarding it. Rather, adjustments should be made via dialogue and discussions—judgements on the contemporary economic system should not be made based solely on situations of significant pressure or crisis. ■

PARTICIPANTS

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LSE Global Economic Governance Commission

The LSE Global Economic Governance Commission is a forum for debating and redesigning global economic governance.

COVID-19 has presented the world with a new Bretton Woods moment. It has exposed the fragilities of the global monetary order and the dislocations in the global trading system. With economic damages rising and tax revenues falling, it has presented a new crisis for global development and demonstrated the overdue need for global tax coordination. As states have struggled to band together to overcome their shared challenges, it has made clear the difficult road ahead for the global climate agenda.

To steer the much-needed transformation of the rules, practices, and institutions of the global economy, The London School of Economics and Political Science and LSE IDEAS have convened the LSE Global Economic Governance Commission. The Commission brings together leading academics and policymakers around five core domains of global economic governance: monetary policy, trade policy, development policy, tax policy, and climate policy. The Commission hosts public and closed-door panels, lectures, and workshops on all matters relating to global economic governance. Event details are announced online by LSE and LSE IDEAS.

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