



IF THE GLOBAL FINANCIAL CRISIS BECOMES A GLOBAL TRADE CRISIS

... The consequences will be disastrous

By Professor Jean-Pierre Lehmann - December 2008

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At this perilous hour there has to be a very loud bugle warning that the world economy could be facing disaster. This is not Cassandra. This is a cold hard look at reality and matching it with rhetoric.

There is little disagreement that this is the worst global financial crisis (GFC) since 1929. It took a little while to own up to that reality, but it is not any more seriously challenged. However the “conventional wisdom” remains that while a repeat of 1929 may be occurring, there is little chance of a repeat of 1930, referring to the passage of the Smoot-Hawley Tariff in June of that year that precipitated the world into protectionism, trade wars and the catastrophic social, economic and political repercussions that ensued. In other words, the GFC will not degenerate into a GTC (global trade crisis).

Trade is the absolute lifeblood of the global economy, it is a principal generator of wealth, and directly and indirectly it is responsible for hundreds of millions of jobs. Beyond the economics of trade, it is a crucial force in relations between states. As the early 19th century French economist Frédéric Bastiat commented: “if goods don’t cross borders, armies will”. The creation of the European Common Market after World War Two was the most important factor in bringing endemic European internal warfare to an end. East Asia is a more recent example where the regional battlefield that prevailed for several decades was transformed into a marketplace, resulting in immense benefits of both peace and prosperity for its populations. If other regions of the world, notably South and Central Asia, the Middle East and Africa – the global community’s “arc of instability” – could follow the example of East Asia, they too would be enjoying much more peace and prosperity.

So trade is absolutely vital. But the current conventional wisdom that there will be no trade crisis could be wrong. It rests on two arguments. One is that we have learned from history and the same mistake will not be repeated. The second is that unlike in the 1930s when there were no rules and institutions governing international trade, today there is a rules-based global multilateral trading regime. The first argument can be dismissed as wishful thinking. As to the second, ultimately institutions are as strong – or as weak – as the political support they enjoy. And that is why there is reason to fear.

From the moment the GFC struck, there was apprehension about the risks of protectionism. The risks are all the greater in that the last two decades have seen the rapid emergence of huge new trade actors, China in particular, and considerable trade imbalances. The declaration made at the G20 summit in Washington DC on November 15 was therefore met with relief. The trade relevant section contained in paragraph 13 reads as follows:

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"We underscore the critical importance of rejecting protectionism and not turning inward in times of financial uncertainty. In this regard, within the next 12 months, we will refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing World Trade Organization (WTO) inconsistent measures to stimulate exports. Further, we shall strive to reach agreement this year on modalities that lead to a successful conclusion to the WTO's Doha Development Agenda with an ambitious and balanced outcome. We instruct our Trade Ministers to achieve this objective and stand ready to assist directly, as necessary. We also agree that our countries have the largest stake in the global trading system and therefore each must make the positive contributions necessary to achieve such an outcome."

Tragically, however, the G20 has failed the first test of matching rhetoric with reality. On December 12, when the ink from the G20 declaration was hardly dry, the WTO Director General, Pascal Lamy declared that in spite of very intensive efforts he had to renounce the plan to convene a meeting of G20 trade ministers this month in order to achieve what their political bosses had committed to last month! The reason: lack of political will! If the commitment on reaching an agreement by the end of the year cannot be met, why should any credence be given to the commitment that no new protectionist measures will be resorted to?

In the meantime prospects for trade – and hence for the global market economy – are bleak and the social consequences all the more so. For the first time in decades, trade will decline next year by a significant amount. This is in part due to the collapse of demand resulting from the financial crisis and from the consequent crisis in consumer confidence. Furthermore, trade finance has disappeared. The shipping industry has been brought to a standstill. While goods pile up in ports and warehouses, dole queues lengthen. In China, laid off workers in the tens of thousands are seen queuing at train stations as they head back for their villages with empty wallets and heavy hearts.

Whether the recent social uprisings in Thailand and the current riots in Greece are linked to the crisis or to each other in any way will remain to be seen. But it is certain that there will be many more such scenes throughout the world as the global recession continues to bite. The temptations for populist responses to avert social turmoil and garner support will become very strong. Protectionism is one of the populist's favourite weapons. Things could get very, very nasty.

Implications for the business community

The business community needs to match its own rhetoric with reality. First, it must recognize that it bears considerable responsibility for the mess the world economy is in. The market has failed – quite disastrously – because the main agents of the market, business, have failed or, at best, have been insufficiently vigilant. Second, the business community must recognize that we are at the brink of disaster, the consequences of which will be felt by everyone. Third, business must accept that during this last decade of immense growth and apparent boundless opportunities, business leadership and commitment in respect to the global trade regime and specifically the WTO Doha Round have been very weak. Fourth, business, therefore, must undertake every possible measure to ensure that the rhetoric of political commitment to preventing protectionism and to preventing a repeat of the 1930s is translated into reality. This is not for reasons of altruism, but for reasons of enlightened self-interest, indeed of self-preservation!

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Mary Robinson, former President of Ireland and former United Nations High Commissioner for Human Rights, Victor Fung, Chairman of Li & Fung and Chairman of the International Chamber of Commerce, and Peter Bakker, CEO of TNT, will be among the guest speakers joining a team of IMD Faculty for a Responsible Leadership Summit, February 1-3, 2009 on the IMD campus in Lausanne, Switzerland.

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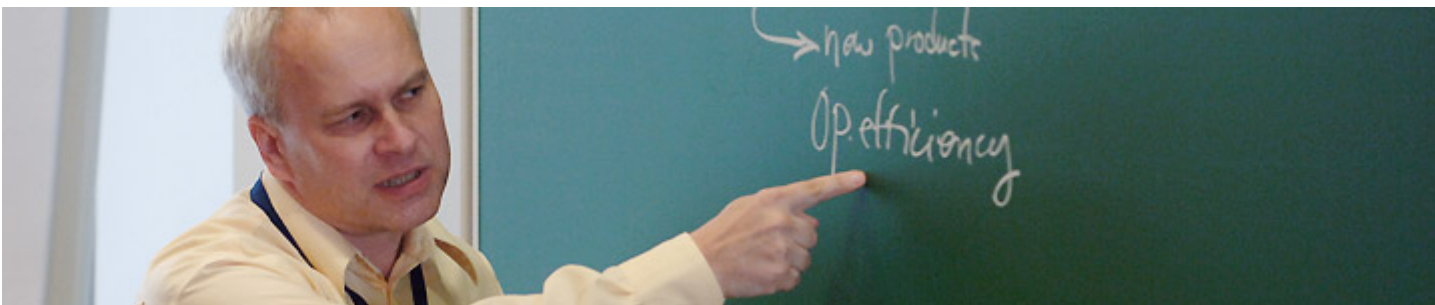


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