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Global Future Council on International Trade and Investment

Strategic Brief for Trade Ministers on Creating an Inclusive Trade Agenda

In July 2017, acknowledging the ongoing backlash surrounding the legitimacy of globalization, the Global Future Council on International Trade and Investment outlined for G20 leaders why open markets for trade and investment still matter. What follows is a summary of its key messages.

Trade has been central to global growth and efforts to end extreme poverty. Increased trade integration was a driver for growth in advanced and developing countries in the latter part of the 20th century. World merchandise trade as a share of global GDP stood at around 17.5% in 1960 and at 50% in 2016. The impact of trade on poverty depends on country-specific circumstances, but overall empirical evidence of its beneficial effect is strong. In the period of rapid economic globalization from 1988 to 2008, average incomes grew by 24%, while incomes for the poorest 30% of the world's population increased by close to 50%. The global poverty headcount ratio (the percentage of the population living on less than $1.90 a day) declined from 35% to 10.7% between the late 1980s and 2013. These numbers are not just about economics; they are about people. Less poverty means greater security, hope and a better future for all.

The Council noted that the benefits of trade operate mostly through two channels. Trade integration increases productivity because it enhances the efficient allocation of resources, leads to increased competition, promotes technology upgrade and innovation, and fosters institutional reform. Greater trade is typically linked to improved domestic institutions because it is difficult to be competitive without a sound enabling environment. For instance, trade opening can reduce rent-seeking behaviour, leading to lower corruption.[12] Trade lowers prices for consumers and firms, which additionally has important ramifications for the poorest. The authors of a study published in March 2016 estimated that in a hypothetical situation of a trade "shut-down", the resulting surge in prices would reduce real incomes of the poorest 10% by 46% in Japan, 57% in Brazil and 60% in the US.[3]

Moreover, trade has helped build a more inclusive global economy, despite headline criticism suggesting otherwise. In recent decades it has moved developing countries from marginal to central participants in world trade. These nations now account for approximately one-half of global trade – up from approximately one-third in 2000 – and absorb close to one-half of total foreign direct investment. The same link between trade and inclusion is evident in global income inequality trends (the gap between the world's richest and poorest). Contrary to assumption, global income inequality has declined since 1990, after a long rise from the 1820s. The causes for this are complex, but economic openness and the global spread of technology has played a role. However, the convergence process is far from complete.

The Council also acknowledges that the benefits of open markets have not yet reached all. The World Trade Organization (WTO)'s *2017 World Trade Report* finds that although more open trade tends to increase wages and the rate of employment, not all workers benefit. How gains are shared depends largely on regional and individual differences between workers. In-country inequality in most advanced economies rose between the 1990s and the mid-2000s and remains very high in some developing economies. All too frequently, and across the world, existing labour force adjustment measures generally appear inadequate. Rapid economic shifts brought about by technological change combined with sudden increases in import competition in some sectors and economies, has resulted in vocal anger and resistance against economic globalization by pockets of communities overlooked and ill-equipped to cope. The result is increased protectionism and political uncertainty in some advanced countries, with challenges brewing elsewhere.

Critically, the Council noted that the benefits of open markets, while significant, do not come automatically. The extent to which trade and investment can drive growth, and reduce poverty and exclusion, is dependent on the breadth of its base and complementary policies and institutions that allow the potential created by access to global markets to be converted into opportunities for people and business.

Trade as one piece of an inclusive growth strategy

As clearly stated in the Organisation for Economic Co-operation and Development (OECD) report, *Making Trade Work for All*, published in May 2017, trade has not created many of the problems over which the public becomes angry, and trade alone cannot solve them. Trade is an easy scapegoat, but blaming it will not address the challenges societies face. Domestic policies are the necessary and indispensable companions to economic globalization.

Trade and investment are not ends in themselves but do offer a means to promote prosperity for all. As such, relevant policies need to be embedded in broader national strategies. These strategies should include efforts to foster a conducive environment for growth, equip people with the tools and skills necessary to reap the benefits of open markets, and mitigate the short- and long-term costs of economic adjustment derived from technology, trade or other shocks, with the ultimate objective of broad-based and sustained progress in living standards. These strategies will also need to be increasingly agile and responsive to the pace of technological innovations and the changing nature of jobs.

Stable macroeconomic conditions are critical, as are well-functioning markets for basic inputs (land, capital and labour) in any economy, but more is needed. In *The Case for Trade and Competitiveness*, the Council argued that trade success is fundamental for a country's economic competitiveness, and competitiveness in turn boosts the success of firms and economies in global trade, in particular to integrate into global value chains. In a rapidly changing world, fuelled by disruptive technologies and globalization, enhanced competitiveness and innovation that fosters productivity increases is crucial. Tapping into the benefits of trade also requires strengthened capabilities with better skills and education, greater connectedness through physical and digital investments and other accompanying policies. Institutions and good governance complement the policy package.

What about more inclusive trade?

Some global conversations have focused on the demise of trade, but others now look for ways to expand its benefits more broadly as part of national strategies to raise living standards. A more inclusive trade agenda needs to provide opportunities for small businesses, individuals facing economic hurdles, those working in the informal sector, and workers in fragile and conflict-affected states.

The continued commitment to connect more women to global markets is especially important. Trade has already brought real benefits for women in terms of jobs and empowerment. Across developing countries exporting firms generally employ a higher share of women than non-exporting firms. There are many specific positive examples, such as in Cambodia, where 85% of total garment industry workers are women. However, significant and persistent opportunity inequalities faced by women – both within and outside the household, and in some regions more than others – can make it difficult to gain from trade. A World Bank survey in 2016 found that 90% of 173 countries surveyed had at least one law discriminating against women. Limitation to certain occupations in some countries can also be a challenge. An International Trade Centre (ITC) survey across 20 countries in 2015 found that only one in five exporting businesses was owned by women.

Regulatory and legal barriers are one of the main reasons behind the lower integration of female-owned businesses into global markets. Arguably, trade policy can help level the playing field. This is the aim, for example, of innovative trade and gender chapters included in the Chile-Canada and Chile-Uruguay free trade agreements. Trade-related capacity building programmes can also make a difference. The multi-donor Enhanced Integrated Framework, for example, runs programmes supporting women's economic empowerment in a number of least developed countries (LDCs). The ITC's Women and Trade Programme works to increase women entrepreneurs' participation in global value chains, making a specific effort to connect one million women entrepreneurs to international markets by 2020.

Box 1: Facilitating worker mobility to opportunities

A recent report, *Making Trade an Engine of Growth for All*, published jointly by the International Monetary Fund, the World Bank and the WTO in April 2017, places a particular emphasis on reducing friction within nations. Benefitting from trade requires the reallocation of resources from shrinking firms and sectors to expanding ones. People need to be able to move, with relative ease, to where the opportunities are. Labour mobility costs (such as those associated with switching occupations or shifting to a different location), and capital mobility friction (including large upfront fixed costs), make it more difficult for the adjustment to take place and essentially affects who benefits from trade, how much and where.

Policies aimed at improving the mobility of workers to new sectors and new places need to take centre stage, along with credit, housing and regional initiatives. Active labour market policies, such as job search and retraining assistance, can sometimes play a role, although evidence on effectiveness is mixed. Fiscal transfers from more to less fortunate regions, and social safety nets for the most vulnerable, can cushion short-term costs, but need effective targeting and may not always be politically viable. Measures that support competitiveness and productivity growth can further ensure that displaced workers find opportunities in the sectors and firms that benefit from trade reform. In the longer term, education systems need to prepare workers for the shifting demands of the modern labour market, and become much more reactive to the pace of change.

Inclusive trade also means ensuring that small businesses can succeed in the global economy. Micro, small and medium-sized enterprises (MSMEs) are essential contributors to job creation and output, but their participation in international trade is generally limited, as detailed in the ITC's *SME Competitiveness Outlook*. Although data is difficult to obtain, the WTO estimates that direct exports represent just 7.6% of total MSME sales in the manufacturing sector, compared to 14.1% for larger enterprises. Approximately one-half of trade finance requests by MSMEs globally are rejected, against 7% for multinational companies.

Global value chains and the digital economy are, however, valuable potential channels for MSMEs to seize the gains from global trade. Policy-makers should explore how best to support small businesses through these. E-commerce, which already drives 13% of the global goods trade, can make it easier for small businesses to be visible in global markets, but this is not yet a reality for all. Targeted policies needed to ensure more MSMEs buy and sell globally could include reducing trade costs, increasing regulatory transparency and providing better access to trade finance, alongside strengthening the conditions for firms' growth and ability to upgrade productivity nationally.

An inclusive trade agenda needs to offer opportunities for the world's poorest countries. Bringing many emerging and lower-income economies into global trade has been an important source of growth and dynamism in recent decades. For example, in Asia, it has helped to significantly reduce poverty while simultaneously creating new markets for goods and services from both advanced and emerging economies. LDC's share of global exports, however, dropped below 1% for the first time in a decade in 2016. International trade cooperation and an enhanced Aid for Trade agenda should specifically aim at strengthening LDC's participation in international trade.

A significant effort to reduce trade costs is necessary to integrate firms into the global economy, in both developing and developed countries. The reasons for high trade costs range from poor road networks to weak logistics, antiquated customs procedures, corruption at border crossings and outdated regulatory structures. Tackling the sources of these trade costs helps smaller and younger firms, which have lower margins and capacity to absorb. Increased investments – including through crowding in private financing – are needed to close the infrastructure deficit in many countries, while reforms to open markets and streamline trade are indispensable.

How to cope with technological change?

To build future-proof inclusive economies, policy-makers and business must navigate accelerating technological innovations, which have already brought major changes to the global economy. The increasing adoption of industrial automation, advanced robotics, smart factories, the internet of things and 3D printing are transforming manufacturing process and changing the landscape of global production. These developments have the potential to introduce radical labour-saving processes, disrupt traditional scale-economies and affect skill demand. The possibility of production reshoring to high-income economies raises questions about opportunities for low-income economies as part of global value chains.

A World Bank Report, *Trouble in the Making? The Future of Manufacturing-led Development*, recommends refocusing and reconceptualizing an agenda of strengthened competitiveness, capabilities and connectedness. Rapid innovations mean policy-makers will need to ensure: governance frameworks support new business models as well as lower costs; strengthen workers' skills and firms' abilities to absorb new technologies; remain connected to the global economy; and explore increasing trade in services embedded as features in goods.

Policy-makers can also establish linkages throughout the economy, as indicated with the mobility question in Box 1, as well as identify and develop transferable skills to take advantage of future growth drivers. Isolated interventions by trade or other policy communities in silos are likely to be ineffective. Cooperation with the private sector and experts can help shape interventions, while innovative partnerships may support skills, training and capacity building.

Global cooperation to reinvigorate trade reform

A tepid uptick in global trade is contributing to a period of strengthened global economic growth. However, trade is not the dynamic engine it once was, and the overall current trade outlook is challenging. Furthermore, major innovations that combine physical, digital and biological spheres are likely to upend the way in which economies and societies interact.

Prospects for trade liberalization at the global level have weakened significantly, and see-saw regionally. The lack of momentum in trade negotiations since early 2016 is particularly acute and comes on top of the longer-term trend of diminished trade liberalization since the early 2000s. The stagnation hampers the potential increased benefits of trade and investment in new growth areas such as services or e-commerce as well as progress in long-standing areas like agriculture.

The Council has previously outlined the best and worst-case scenarios for the future of trade, cautioning against the risks of abandoning current structures. Stronger rule-based trade integration is key to staying up-to-date with global growth drivers. It also complements a sound domestic policy environment focused on creating a virtuous circle between growth as the top-line measure of national economic performance, and broad-based progress in medium standards as the bottom line.

Increased trade integration through regional agreements can make an important contribution. Research shows that comprehensive agreements lead to more trade creation and less trade diversion than their more limited counterparts; moreover, some provisions in these agreements have a global public good aspect and also increase trade with non-members.[4] The result may be partly due to the shifting nature of international economic cooperation. With average tariffs lowered over the years, some countries have concentrated on behind-the-border rules and regulations, as well as explicitly aligning trade policy to support other public objectives such as climate change, ocean health, gender or small businesses. So-called "soft commitments", involving best endeavour language, as well as provisions, cooperation mechanisms etc. can signpost the way for countries interested in shaping a supportive enabling environment, which uses the full potential of trade. Regional trade agreements can, however, only complement the multilateral trading system. The two need to move in tandem.

Recent advances have demonstrated avenues for advancing multilateral trade cooperation. The last two WTO Ministerial Conferences delivered the Trade Facilitation Agreement (TFA) – countries will collaborate to cut the costs of moving goods across borders – expanded an Information Technology Agreement to include tariff cuts on newer tech products, and pledged to eliminate agricultural export subsidies, which disproportionately affect the world's poorest farmers. The TFA showed that an approach aligning assumption of trade obligations with support for the capacity to do so is an effective approach to global rule-making, which can be applied in other areas, such as liberalization of trade in environmental goods or in services. Effectively integrating capacity building into multilateral and regional commitments will be vital to ensure that the benefits of economic globalization are also shared between countries, especially for poorer economies. Along these lines, some regional and bilateral agreements now include provisions for capacity building, development and SME development.

The quasi-universality of the WTO makes this institution central to maintaining a rules-based system to drive global growth and make it more inclusive. These objectives are not served by steps that undermine its current functioning. Instead, all stakeholders should engage collectively, at the Eleventh Ministerial Conference and beyond, to set in motion an agenda centred on the strengthening, updating and modernization of the international trade and investment architecture for widespread benefit.

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Endnotes

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