

# Trading places

## Has globalisation reached its limit?

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### INTRODUCTION

For much of the period since the end of the Second World War, it has been close to axiomatic that trade liberalisation should be a core norm for international economic governance. While there are protest groups, such as [ATTAC](#), opposed to the resulting form of globalisation and some politicians occasionally succumb to the temptations of advocating [mercantilist policies](#), favouring only their own exports, the robustness of support for the free trade agenda has been striking.

Recently, this has changed, and not just because of the aggressive stance adopted by the Trump administration. In several European countries, populist parties – some of which are in government – have sought to capitalise on, and fan, the resentment of those who perceive themselves to have been the losers from globalisation. More broadly, the multilateral, rules-based approach to trade governance is under challenge, despite new evidence from [Douglas Irwin](#), updating the seminal study by [Rodriguez and Rodrik](#), on the positive correlation between trade liberalisation and economic growth.

This policy brief considers the ramifications of the changing trade policy context for the EU and how it adapts to an evolving globalisation. In addition to the need to find an enduring solution to the future economic relationship between the UK and the EU, difficult trade policy choices the EU has to confront include:

- Whether, and if so how, to try to revive a multilateral approach;
- What stance to adopt towards both China and the US, in light of the tensions between the two and the apparent willingness of the US, especially, to ‘weaponise’ tariffs in the pursuit of other policy goals;
- How to reform the governance of trade policy and its main institution, the World Trade Organization (WTO).

### THE TRADE LIBERALISATION AGENDA – FACING EXHAUSTION?

Since 1945, liberalisation has come about mainly through successive multilateral rounds of reductions in tariffs and other barriers to free trade, and the establishment of the WTO in 1995 to ensure the effective functioning of the rules-based system. Before the WTO, trade agreements were between ‘contracting parties’ under the General Agreement on Tariffs and Trade (GATT), but under the new institution, countries became ‘members’, with rights and obligations. Though hard-fought, these deals were widely supported.

### KEY INSIGHTS

MULTILATERALISM, AS A CORE PRINCIPLE OF TRADE POLICY, IS INCREASINGLY BEING QUESTIONED

THE EU FACES A CHOICE BETWEEN DEFENDING MULTILATERALISM, MORE BILATERAL DEALS OR ‘PLURILATERALISM’ IN TRADE RELATIONS

MORE ATTENTION SHOULD BE PAID TO THE CONNECTIONS BETWEEN TRADE, INDUSTRIAL AND SOCIAL POLICIES

THE EU SHOULD LAUNCH A PROCESS, WITH LIKE-MINDED COUNTRIES, TO REFORM THE GOVERNANCE OF TRADE POLICY

Significant milestones included: the ‘Kennedy Round’, concluded in 1968, which was the culmination of a series of tariff reduction rounds; the Tokyo Round (1979) which started a process of cutting non-tariff barriers to trade; and the Uruguay Round (1993, with India only signing in 1994) which broadened the trade liberalisation agenda to include services and protection of intellectual property rights, and paved the way for the WTO. A key feature of the WTO was provision for settling disputes.

European integration is, arguably, also a form of trade liberalisation culminating in the achievement of the single, integrated European market. Yet for some critics, it has created divisions between winners and losers. Others see the EU as a means of protecting its citizens from the worst excesses of globalisation and worry about the encroachment of other competitors.

In response to persistent criticism that the system benefitted developed countries more than developing countries, a further round – the Doha Development Agenda – was launched, with the dual aim of further trade liberalisation and fostering the economic development of poorer countries. However, despite some successes since it began in 1996, it has stalled. Nearly fifteen years on from its planned completion date of 2005, many now regard it as dead in the water.

International trade has changed in character over the last thirty years, with a number of implications for policymakers. In particular, a growing proportion of trade is as part of what are known as global value chains (GVCs). This is reflected in greater flows of international investment, complementing trade flows. Large multinational corporations play a pivotal role in determining the sorts of economic activities undertaken in different jurisdictions, because of how they organise production on ‘just-in-time’ principles. They demand, and expect, policymakers to ensure frictionless trade, and this requires closer regulatory cooperation on, for example, standards and administrative procedures at borders.

Who produces what in these GVCs is shaped by national attributes differing qualitatively from those of the past: instead of specialising in final goods, such as cars or classes of machinery, a country will now tend to specialise in certain stages of production. Some will be relatively better at design or assembly of the finished product, others at specialised components, marketing or digital content. What now matters for a country is the added value retained from exporting, as opposed to the headline figure for final exports.

A second major shift has been a preference, latterly, for regional and bilateral trade accords, rather than the wide-ranging global deals struck in the Kennedy, Tokyo and Uruguay rounds. In part, this is because the grand bargains have become harder to settle, witness the problems of the Doha round, with more partners to assuage and greater diversity of interests among them. It is also because much has already been achieved, certainly in trade in goods. Further liberalisation would encroach on more sensitive areas of national life: national public procurement and health care are just two areas where governments are prone to resist foreign competition. In parallel, attempts to extend the trade policy agenda to investment, on the one hand, and adherence to standards (for example, regarding workers’ rights), on the other, have proved much harder to take forward.

Third, what is traded has been evolving in a number of ways. Tankers of oil and shiploads of other raw materials from countries rich in primary goods still criss-cross the globe, but much of the trade in industrial products is no longer finished products, but inputs into the finished products for final consumers. For the more developed countries, a growing share of exports is services, often embedded in goods, blurring the boundaries between merchandise, creative or digital content, and services: how, for example, should a smartphone be classified?

Plainly, another big change over the last three decades has been the reconnection of China – now the world’s largest exporter of merchandise, having overtaken both the EU and the US – to the global economy. China’s transformation is likely to be emulated in the years to come by India, while other emerging market economies, from Brazil to Vietnam, can also be expected to power ahead.

**A MAJOR CHANGE OVER THE LAST THREE DECADES HAS BEEN CHINA’S RE-CONNECTION TO THE GLOBAL ECONOMY**

### TENSIONS IN THE GOVERNANCE OF GLOBALISATION

When Lester Thurow published *Head to Head* in 1992, he warned of the looming competition facing the US from the rise of Japan and the completion of the EU internal market. His timing was awry, as Japan fell into two decades of stagnation from which it has still not fully emerged. Nor, considering recent economic developments, has Europe proved to be the threat Thurow foresaw, while the US lead in digital industries has been a source of economic resilience.

However, if his analysis is transcribed to China, it becomes more compelling. Since 1995, China's share of world merchandise trade has quadrupled to reach some 13 per cent. China's success has been accompanied by a persistent trade surplus, prompting claims of unfair practices. These claims long pre-date the Trump administration – threats to penalise China for being a currency manipulator have surfaced regularly in Congress – but the recent resort to punitive tariffs is an evident escalation. As recent contributions on [VOXEU](#) show, the tensions in the global system are worsening, with potentially damaging ramifications for global prosperity.

In a number of respects, the governance of the global order has become less effective, amid growing concern about some of its key institutions. For example, the WTO is accused by some of being too orientated to richer countries, while others bemoan its inability to respond to current developments.

Formal provision for dispute settlement is a crucial function of the WTO and was one of the major innovations adopted as a consequence of the Uruguay Round. However, it is facing collapse because of a hiatus in the appointment of members of the Appellate Body, the entity charged with making binding rulings on trade disputes once resort to initial conciliation procedures has been exhausted. As explained in a [Linklaters](#) blog, the US has (starting in the Obama years) been blocking the appointments of new members or renewal of current members.

The US has employed this tactic partly because of specific concerns about the way the Body has operated, but also because of political objections to how judicial processes should work and wider demands for WTO reform. The usual complement of members is seven, with three required to hear a case. Because of the block on appointments, the number of members fell to three at the end of 2018, meaning no scope for rotation of those involved in hearings and an unreasonable workload, and is set to fall to just one in December 2019. It would then be unable to function. The [EU and Canada](#) have just agreed a bilateral means of solving disputes, but with so many current disputes involving the US, it is only a partial answer.

In his valedictory speech on 28<sup>th</sup> May 2019, [Peter van den Bossche](#), a two-term Belgian member of the Appellate Body, is trenchant on the damage being done by the US stance. While he concedes there are concerns about the Appellate Body's functioning, he argues change can be achieved 'without undermining

the essential features of the current system'. Noting the plethora of proposals from various members – a good example is one co-authored by the [EU, China and India](#) – he asserts:

'very few, if any, of these members consider that there is something so fundamentally amiss with the Appellate Body and its functioning that blocking the appointment of Appellate Body members – and thus endangering the very existence of the Appellate Body – is an appropriate and proportionate action'.

Meanwhile, the roles of other bodies, such as the G20, have become more marginal, often limited to issuing worthy communiqués, rather than acting decisively. [Carlo Monticelli](#) argues that the dominance of richer countries is being challenged, but there is as yet no clear direction for change. Faced with what he calls the 'widespread and multifaceted backlash against globalization', there are demands for a more even distribution of the benefits. Yet, in parallel, there has been a debilitating trend towards fragmentation in governance, inhibiting capacities to act.

## WHAT NEXT FOR THE EU?

Together with the diminishing commitment of the US to multilateralism (evident well before the increasingly belligerent Trump administration), these changes have already led the EU to review its approach to trade policy. Nevertheless, the EU continues to regard itself as the leading defender of the rules-based order (see a [recent overview by Steve Woolcock](#)), even though it has put most of its effort of late into bilateral deals.

While still keen to portray itself as a defender of the rules-based, multilateral system, the EU faces awkward choices about its international trade policy. These can be summed up as follows.

- With the emphasis in recent years having been on bilateral trade deals, and with more in the pipeline, the EU's commitment to multilateral trade liberalisation appears to be wavering. In response to aggressive US trade policies and the threats to the WTO, a key question for the EU is how ready it is to escalate matters.
- Trade sanctions have become an instrument of first resort for the US in seeking to impose its will on countries with which it is in dispute, including on matters unrelated to trade (for example, Mexico's control of migrant flows). Other countries then face secondary actions aimed at companies seeking to trade with the country

subject to the sanctions. The result can be to force the EU to follow the US line, like it or not.

- In a world of GVCs, the connections between trade and industrial policy have to be examined. Jobs, output and the scope for raising tax revenue are all dependent on the share of the value-added of a finished good or service retained within a country. Moreover, there is a potential clash between internal market imperatives and strategic measures to facilitate the emergence of globally competitive European champions – see [CAE](#).
- China is a conundrum for the EU. It is a powerful competitor, posing a threat to many European businesses and jobs. It has ambitions to be a major player in many technology-driven sectors the EU counts on for its future prosperity. China's trade surplus has been a source of global imbalances. Yet, China's rapidly growing market offers rich pickings for EU exporters, and its citizens are a growing source of tourism revenues. Faced with the US onslaught on established trade norms and institutions, the EU has reason to cultivate China as an ally in global governance, building on the collaboration already underway through a [joint working group on reform of the WTO](#).
- The social dimension of trade is looming larger in response to populist politics. Many insurgent parties have identified 'losers' from globalisation as a disaffected constituency to cultivate. Although proponents of trade liberalisation can point to the overall gains, it is undeniable that voters in areas hit by structural change have seen jobs in traditional industries being destroyed and their communities being ripped apart, rendering them receptive to promises of more protectionist policies. Politicians as different as Marine Le Pen, Donald Trump and Viktor Orban offer a convincing alternative narrative, even if some of their 'back to the future' promises are misleading. Nevertheless, EU political leaders need to find ways of either slowing the advances of globalisation or mitigating its adverse effects on 'losers'.

## CONCLUSIONS AND RECOMMENDATIONS FOR THE EU

Faced with the various threats to the integrity of the rules-based international trading system, the [Leaders' declaration at the June 2019 G20](#) meeting in Osaka reaffirmed support for an open global system and

emphasised the need for reform of the WTO.

However, the warm words in the declaration, including about action on the dispute settlement system, are not enough. The international community has to make some hard choices, yet shies away from being decisive.

The EU, while far from blameless for some of the current tensions, is well-placed to take the lead in the making of these choices. At the same time, the EU should re-consider its approach to managing globalisation, both externally and internally. Does it see bilateral deals as the main way forward or should it attempt to revive a multilateral approach? Could a plurilateral approach in which subsets of WTO members agree to advance liberalisation, without having to obtain unanimity, offer an appealing intermediate solution? As [Robert Basedow](#) explains, with the changing character of trade (and, by extension, globalisation), plurilateralism may lead to better 'mutually agreeable legitimate and welfare-maximizing agreements than multilateralism'.

The following policy recommendations are intended to stimulate debate on directions for EU trade policy.

1. To capitalise on the goals articulated in the Osaka G20 declaration, the EU should convene a conference on the future of the international trading system. It should have an open agenda, encompassing the range of options, including plurilateralism, and the rethinking of key elements, especially dispute settlement.
2. Europe should redouble its efforts to complete bilateral trade deals already in the pipeline, and accelerate the process of drawing in other strategically important partners, including China.
3. Despite concerns about maintaining the level playing-field of the single market, EU trade policy should be more integrated with strategic industrial policy. The aim should be to foster the emergence of European champions in the technology-driven industries of the future, including by avoiding overly zealous competition policy.
4. To mitigate the negative consequences of trade deals and respond to the populist movements that feed on them, the EU should review its budgetary and regulatory instruments for cushioning the localised effects of trade liberalisation. There is a need to learn from the shortcomings of the existing [Globalisation Adjustment Fund](#).

## FURTHER READING

Basedow, R. (2018) 'The WTO and the rise of plurilateralism—what lessons can we learn from the European Union's experience with differentiated integration?' *Journal of International Economic Law*, 21.2, pp 411-31 <https://academic.oup.com/jiel/article/21/2/411/5039902>

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