Recent Research in the Area of Trade and Trade Policy

Dmitriy Rozhkov
International Monetary Fund
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Outline

1. Motivation
2. Effect of Export Diversification
3. Role of Monetary and Exchange Rate Policies
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5. Conclusions

1. Motivation

- TPCC is a forum for
  - Knowledge sharing
  - Capacity building
- Recent experience of the global crisis provides useful lessons, including for trade policy
- Global trade contracted during the crisis
  - What lessons have we learned?
  - What factors determine the impact of crisis on trade?

2. Effect of Export Diversification

- Importance of diversification was suggested by several theoretical models (Krugman, Grossman and Helpman)
- A recent IMF study looked at the impact of crisis on trade in Latin America
- Used gravity trade model
- Key question: Does diversification help to soften the impact of crisis?

Different Dimensions of Diversification

- Geographic diversification (exports going to many or few trading partners)
- Industry/sectoral diversification (exports scattered across many or few industries or sectors)
- Product diversification (exports of many or few products within each industry or sector)

Findings: Does Diversification Help?

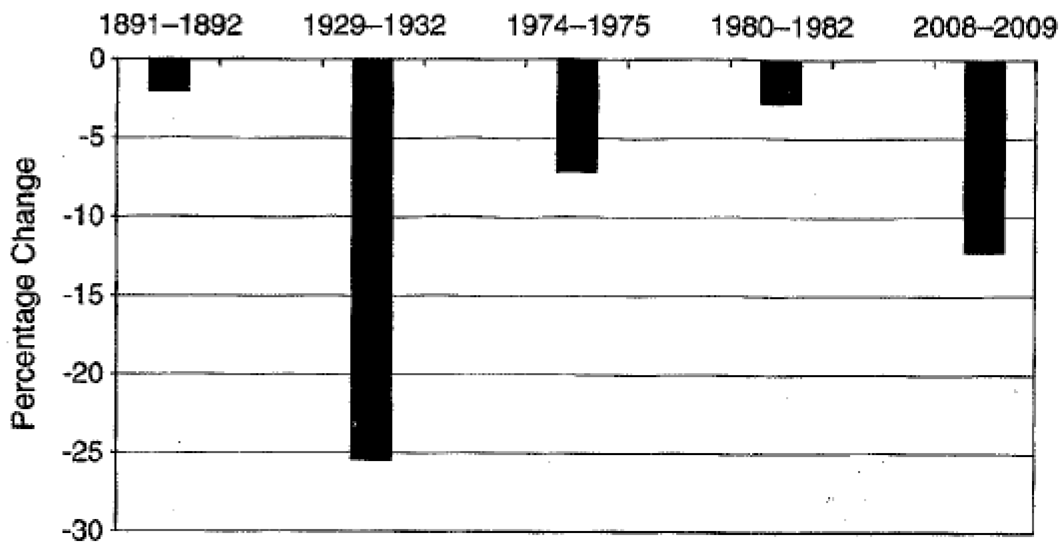
- Increasing diversity of export sectors and export products significantly reduces the decline in exports
- Diversifying exports across many trading partners does not significantly affect outcomes
- Relevance for CAREC countries: Focus on diversification of exports, reducing dependence on a few commodities

3. Role of Monetary and Exchange Rate Policies

- 1929-32: Global trade falls by over 25 percent; half of the fall is attributed to protectionist measures
- 2008-09: Global trade falls by about 12 percent; only about 2 percent of the fall is attributed to protectionism
- What explains the difference? What lessons can we learn from history?

The Fall in Trade in 2008-09 was the deepest since the Great Depression

World trade volume



Source: Douglas A. Irwin, *Lessons From the 1930s*. Original data: Lewis (1981), League of Nations (1939c), and World Trade Organization (2010).

What was different in 1929-32?

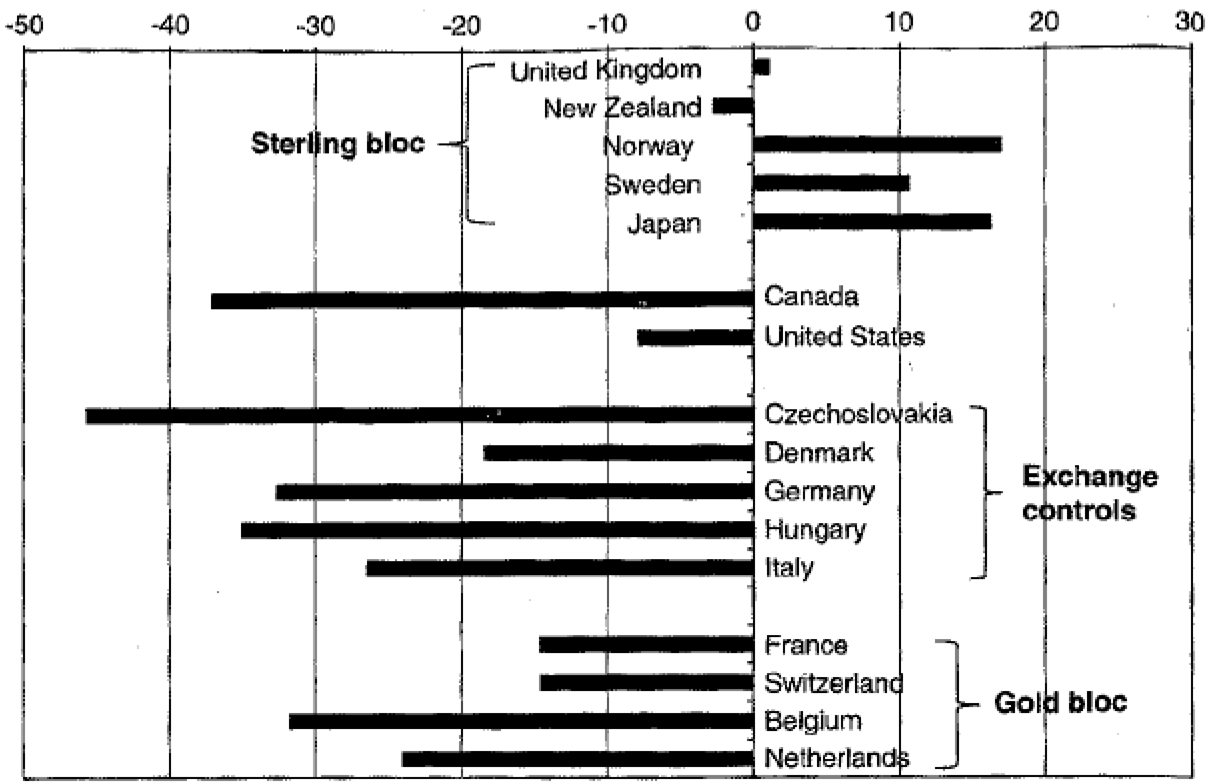
- Monetary and exchange rate policies built around the interwar gold standard
- With open trade, Governments could not preserve fixed exchange rates and stable domestic prices simultaneously
- Many chose to limit imports to prevent capital outflows and preserve foreign exchange
- Eventually, were forced to abandon the gold standard and devalue exchange rates

Evidence of the Role of Exchange Rate Policy

- Compare countries that devalued early (UK, Scandinavia) with those that remained on gold standard (France, Belgium, Netherlands, Switzerland) or introduced exchange controls (Germany, Hungary, Austria, Czech Republic)
- Gold standard countries imposed higher tariffs and used import quotas more than countries with depreciated currencies
- Exchange control countries restricted imports the most
- Trade controls relaxed after devaluation

Countries That Devalued Did Not Have To Restrict Their Trade...

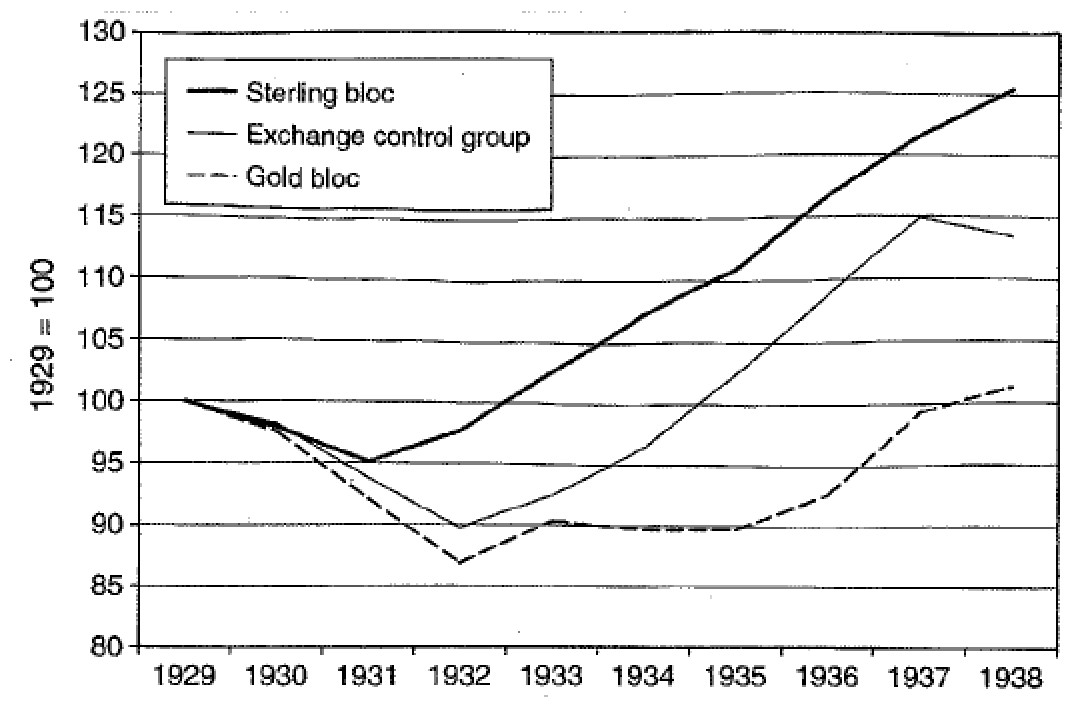
Change in volume of imports, 1929-35



Source: Douglas A. Irwin, *Lessons From the 1930s.* Original: League of Nations (1939a).

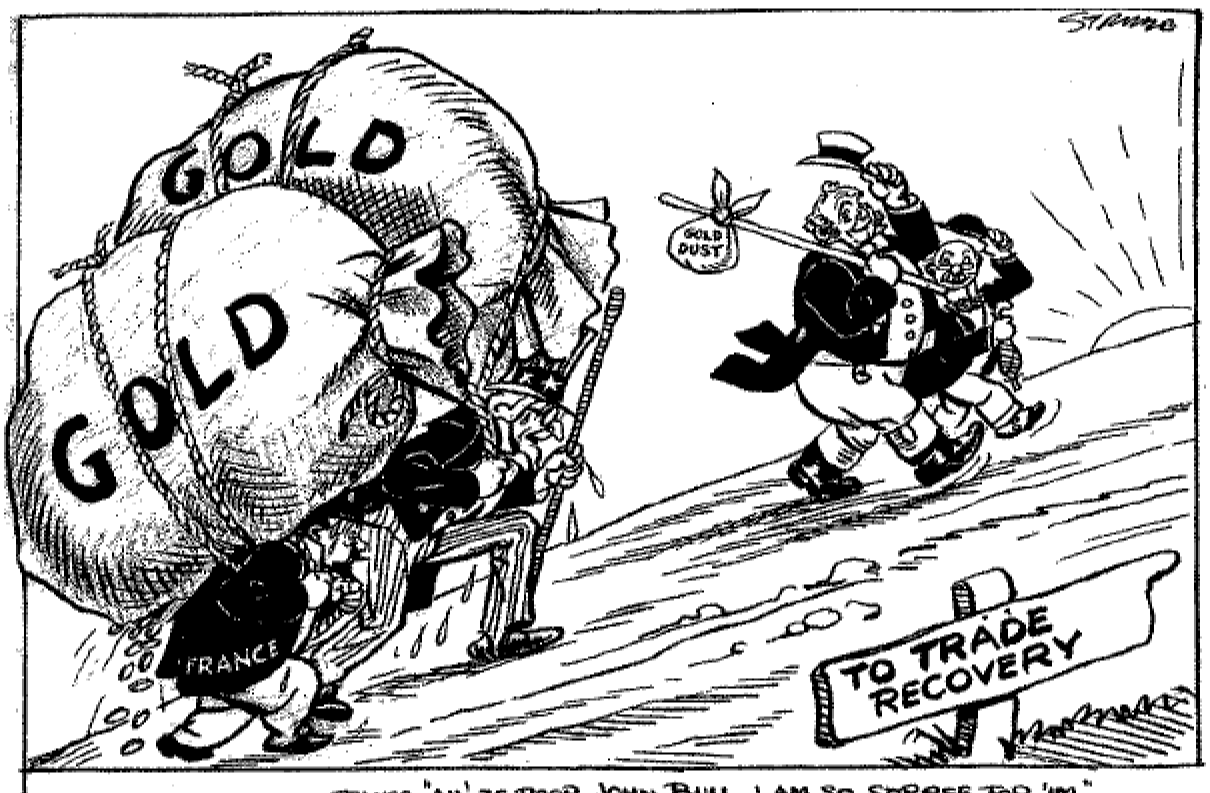
…And Ended Up With Higher Growth…

Real GDP by country group, 1929-38 1/



Source: Douglas A. Irwin, *Lessons From the 1930s*. Original: Maddison (2010).
The sterling block includes the United Kingdom, Sweden, Norway, Finland, Portugal, Ireland, and Japan. The exchange control group includes Germany, Austria, Bulgaria, Czechoslovakia, Romania, Denmark, Italy, and Yugoslavia. The gold bloc includes France, Belgium, the Netherlands, Switzerland, and Poland.

…And Feeling Generally Better



FRANCE. "AH! ZE POOR JOHN BULL, I AM SO SORREE FOR 'IM."
SAM: "WAAL, I'M NOT SO SURE THAT HE'S THE ONE WHO NEEDS THE SYMPATHY, BIG BOY!"

Source: Douglas A. Irwin, *Lessons From the 1930s.* Original: British Cartoon Archive, University of Kent re-printed with the permission of Express Syndication.

Why Less Protectionism Today?

- Monetary and fiscal policy response
- Flexible exchange rates (although not everywhere)
- Supply chains and economic interests
- WTO rules and danger of retaliation
- Lessons learned – protectionism does not solve the country’s financial problems

4. Bilateralism, Multilateralism and Trade Rules

- Global trade rebounded after the global crisis
- The rebound reflected in part the increasing importance of bilateral and regional trade agreements
- At the same time, multilateral pacts proved to be more elusive. WTO’s Doha round is “at an impasse” (Report by WTO Director General)
- Is this a problem?

What’s Wrong With Bilateral Agreements?

- Any bilateral agreement results in trade creation (with favored trading partners) and trade diversion (from other countries). The net effect on trade is often ambiguous and difficult to estimate.
- Multiplicity of trade regimes and rules increases complexity and can increase costs of trade and distort production decisions.
  - Rules of origin are hard to monitor and enforce

Global Trade Agreement

- Remains a goal that is worth pursuing
- Offers unique opportunities over and above what is available via more limited agreements
- Are bilateral agreements stumbling blocks or building blocks on the path to a global pact?
  - Arguments can be made both ways

5. Conclusions

- Industry and product diversification of exports helps to soften the impact of crisis on trade
  – Priority in many CAREC countries
- Flexible exchange rate is an important shock absorber
  – Room for improvement in many CAREC countries
- Bilateral trade agreements work best as steps toward multilateral trade liberalization
  – CAREC countries' focus on WTO accession remains appropriate