

## It's time to update our thinking on trade

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Our institutions for governing world trade and our thinking about world trade date back to a simpler era. Without a radical rethink, we risk the gradual decay of our most valuable international institutions, loss of extraordinary opportunities to improve global living standards and possibly the sidelining of the West in developing modern institutions.



The GATT and the WTO were devised for a simpler era, when it was possible to think about world trade in the way Ricardo taught — namely that a good is produced in one country and consumed also in a single country. If Portugal was adept at making wine and England at cloth, it would benefit both to reduce barriers and enhance trade. That two-country model worked relatively well until about 1978, when China started opening its economy by establishing special economic zones across the border from Hong Kong.

By the last decade of the twentieth century, production had become a complex global process. The logic of increasing efficiency by reducing trade barriers remained completely valid, but [policy adaptation of that logic](#) <sup>[1]</sup> to a new era has faltered.

A laptop or a smart phone now is typically made in 15 to 20 countries. When old-style trade thinking is applied to this situation, confusion causes bad policy and gratuitous conflicts. A laptop made in 17 countries might be assembled in China for \$2 worth of local wages then exported to the United States, but old two-country thinking leads members of Congress to react as if China had exported \$1500 of value to the US. This bolsters protectionism, reduces support for multilateral trade liberalisation and contributes to the fragmentation of the global trade regime.

Because it is difficult to continue the process of trade liberalisation, countries feeling a need for deeper integration form their own regional blocs, inducing [further fragmentation](#) <sup>[2]</sup>.

Regional and bilateral trade negotiations today are focused on 'country of origin', by definition a single country or preferential grouping, with the result that it is considered normal to have 500 pages of country of origin rules in a single trade agreement. Since each country has many trade agreements, companies may find the rules so complex that they simply pay high tariffs rather than trying to manage the complex paperwork to prove countries of origin. The complexity of the system discriminates against small, open economies like Singapore, and it discriminates against smaller companies without huge accounting departments. Because it cannot adapt to the globalisation of production, the system is beginning to defeat itself.

Moreover, the addition of over one billion new workers to the globalised workforce entailed very low wages in Eastern countries such as China, flat wages in the West and huge trade imbalances between East and West. This discouraged Western countries from vigorously pursuing the kinds of global agreements that would have eliminated those dozens of separate, conflicting 500-page rule books about countries of origin.

Feeling overwhelmed by Chinese manufactured exports, Western countries have also [moved to exclude China](#) <sup>[3]</sup> from the most important efforts to modernise the global trading system. The proposed Trans-Pacific Partnership (TPP) and Transatlantic Trade and Investment Partnership agreements (TTIP) both seek to exclude the world's second-largest economy from potential membership, an arrangement that is both economically untenable and a potential geopolitical disaster.

The geopolitical consequences were magnified by the inclusion of Japan in the TPP agreements, even though Japan's economy is much less open than China's and historically has been much less willing to reform in the face of domestic interest group pressure than China has. Given Sino-Japanese tensions, this has come across in Asia as part of a strategy to isolate China.

Magnifying Sino-American differences could make a more inclusive, truly multilateral future trade system much harder to negotiate.

While we still flounder over attempts to come to terms with globalised *production*, we are heading into globalised *consumption*. Instead of an era with one billion new globalised workers, we are heading into a world that will contain two billion or more new middle class consumers, mainly in Asia and heavily in China. Chinese wages are rising 13 to 20 per cent a year and total compensation is rising even more. This phenomenon should gradually resolve the most serious trade imbalances and begin to allow Western wages to rise.

But Western media, interest groups and politicians remain obsessed with the problems of yesterday. This could lead the West to squander one of the greatest economic opportunities in world history, namely the extraordinary consumer boom in China, India and other emerging markets. It could also disastrously delay responses to the jobs challenge of the new era: a technology-driven transformation of the workplace driven by robots, other automation, the

internet of things and 3D printing that will eventually force billions of workers out of old jobs.

We must begin addressing the world as it is and will be, not the world of generations past. Ironically, in the process the WTO remains crucial to a vibrant world economy. Without the WTO's dispute settlement mechanism, trade wars will ignite everywhere. By allowing the WTO system to decay, and by blaming globalised trade for problems that are unique to the past generation, we risk going back to pre-World War II trade wars. We need a modern, multilateral structure that updates the WTO, not a degeneration of the global trade and investment system based on a failure to recognise the shape of the new world we are entering.

We are now at one of those great historical turning points. Disillusionment, often misplaced, with existing institutions and obsession with obsolescent problems have allowed the process of trade negotiations to decay so far that TPP and TTIP negotiations could fail or, if they succeed, the exclusion of China could make them Pyrrhic victories. Continued Western failure to address the real issues of our emerging world of globalised production and consumption, and the reality of China's central role, could lead to trade regimes with the most dynamic markets governed by structures like the Regional Comprehensive Economic Partnership promoted by Asian emerging economies.

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