

Mohamed El-Erian: The dialectic of global trade policy

It is often said that with risk comes opportunity. What initially was viewed as an unfortunate US shift to protectionism may in fact have opened a window to improve the functioning of the global economy and world trade, **writes Mohamed El-Erian**



Source: Wikipedia Commons

There is a subtle yet important change occurring in how political leaders think about international trade, including how to remedy long-standing problems. It results from a key distinction between the “what” of trade (where there is relatively broad-based agreement among countries) and the “how” (where differences have tended to undermine important relationships, whether transatlantic or between China and the world’s advanced countries). As a result, there is some room for greater optimism than is suggested by talk of damaging trade wars, stifling investment restrictions, technological conflicts, and multiplying great-power tensions.

The relatively wide agreement in the international trade area tends to focus on four main hypotheses that are supported by a body of research and evidence:

Four hypotheses

First, free and fair trade is in the interest of most people in most countries, but it is not sufficient for inclusive prosperity. Specific segments of society can be displaced, marginalized, and alienated. As such, trade is not just an economic issue. It also entails important institutional, political, and social dimensions.

Second, trade is inherently underpinned by a mutually beneficial set of voluntary interactions that are best conducted, to use the language of game theory, as a cooperative game.

Third, an accumulation of legitimate grievances undermines both the ideal and reality of free and fair trade. These grievances relate mostly to what economists call non-tariff barriers, including issues such as intellectual property theft, the weaponization of economic and development tools, forced technology transfer, insufficiently effective and credible multilateral institutions, and a less-than-stable global economic and financial order.

Lastly, fixing these problems has proven frustratingly slow.

A beneficial disruption?

That is where the major areas of disagreement begin. How should the accumulating set of problems that undermine free and fair trade be addressed?

Over the years, conventional wisdom has stressed that the best option is to maintain an approach focused on cooperative resolution. This implies negotiations that are best conducted free of actual or threatened punishment such as tariff imposition, and it favors reliance on the rules-based framework established by existing multilateral institutions.

The other approach is that adopted by the US President Donald Trump's administration. Noting that past efforts to reverse the growth of non-tariff barriers have not worked and will not work, this strategy is more open to the use of tariff penalties to influence behavior modification, and the threat of escalation in response to any and all retaliation by trading partners.

First widely dismissed as an unfortunate policy pivot, more people now are beginning to wonder whether the new US approach – provided it's not used repeatedly – could in fact serve as a beneficial disruption that helps reset international trade relationships and place them on a firmer footing. It's a view that is underpinned by evidence (the shift from retaliation to resolution by such countries as Canada, South Korea, and Mexico) and the prospect that, due to its limited options, China will have no choice but to do the same by addressing some of its non-tariff barriers.

Structural changes

The task for the international community is to take advantage of the emerging window to move more comprehensively on implementing measures to counter slowing growth, reduce the risk of financial instability, and ensure more inclusive prosperity. Such measures are less a problem of engineering (in the sense that most economists agree on what's needed) than of politics (the need for decisive leadership and sustainability).

For starters, domestic pro-growth policies must be re-energized, both as an urgent standalone priority and to take pressure off trade. This is particularly important for China and countries in Europe, including six of the EU's largest economies. The focus must be on productivity

enhancement, structural changes to respond better to the realities of the global economy of today and tomorrow, more effective safety nets for the most vulnerable and displaced segments of society, and addressing market and government failures that frustrate growth and investment.

Moreover, existing trade arrangements need to be modernized, not only to fix existing problems, but also as part of a broader effort to enhance these arrangements' agility in the face of rapid technological change. Particular attention needs to be devoted to improving the approach to big data, technology transfer, digital infrastructure, artificial intelligence, networks, and mobility.

It will be no less crucial to continue reforming the multilateral institutions in order to enhance their effectiveness and credibility.

Critical time

Finally, the international community must guard against regional arrangements, such as China's Belt and Road Initiative, which are intended to promote development but can end up undermining partner countries. This requires steps to enhance transparency on the terms and conditions of projects and debt undertaken through such initiatives, encourage greater reliance on local labor, and ensure that recipient countries are not encumbered with excessive liabilities. Excessively one-sided debt-for-physical-assets swaps, which can also raise genuine national security concerns, must also be resisted.

It is often said that with risk comes opportunity. What initially was viewed as an unfortunate US shift to protectionism may in fact have opened a window to improve the functioning of the global economy and world trade. The next few months will be critical.

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Author

Alissa Lefebvre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Sector Economist, TMT & Healthcare

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials
Marina.Le.Blanc@ing.com

Samuel Abettan
Junior Economist
samuel.abettan@ing.com

Franziska Biehl
Senior Economist, Germany
Franziska.Marie.Biehl@ing.de

Rebecca Byrne
Senior Editor and Supervisory Analyst
rebecca.byrne@ing.com

Mirjam Bani
Sector Economist, Commercial Real Estate & Public Sector (Netherlands)
mirjam.bani@ing.com

Timothy Rahill
Credit Strategist
timothy.rahill@ing.com

Leszek Kasek
Senior Economist, Poland
leszek.kasek@ing.pl

Oleksiy Soroka, CFA
Senior High Yield Credit Strategist
oleksiy.soroka@ing.com

Antoine Bouvet
Head of European Rates Strategy
antoine.bouvet@ing.com

Jeroen van den Broek
Global Head of Sector Research
jeroen.van.den.broek@ing.com

Edse Dantuma
Senior Sector Economist, Industry and Healthcare
edse.dantuma@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics
Rico.Luman@ing.com

Jurjen Witteveen
Sector Economist
jurjen.witteveen@ing.com

Dmitry Dolgin
Chief Economist, CIS
dmitry.dolgin@ing.de

Nicholas Mapa
Senior Economist, Philippines
nicholas.antonio.mapa@asia.ing.com

Egor Fedorov
Senior Credit Analyst
egor.fedorov@ing.com

Sebastian Franke
Consumer Economist
sebastian.franke@ing.de

Gerben Hieminga
Senior Sector Economist, Energy
gerben.hieminga@ing.com

Nadège Tillier
Head of Corporates Sector Strategy
nadege.tillier@ing.com

Charlotte de Montpellier
Senior Economist, France and Switzerland
charlotte.de.montpellier@ing.com

Laura Straeter
Behavioural Scientist
+31(0)611172684
laura.Straeter@ing.com

Valentin Tataru
Chief Economist, Romania
valentin.tataru@ing.com

James Smith
Developed Markets Economist, UK
james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Piotr Poplawski

Senior Economist, Poland

piotr.poplawski@ing.pl

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios

maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy

Maureen.Schuller@ing.com

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@asia.ing.com

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Inga Fechner

Senior Economist, Germany, Global Trade

inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands

Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania

+40 31 406 8990

ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com