How the World can benefit from the Network Effects of the Commonwealth

Shanker Singham

Director of the International Trade and Competition Unit, IEA

16th April 2018

Summary:

On April 16th, Commonwealth Heads of State will meet in London at the start of the UK's chairmanship of the CHOGM process (which ends in 2020). While it is coincidental that this timing directly overlaps with the UK's exit from the European Union, many in the UK have turned their focus back onto the Commonwealth, after years of neglect. The Commonwealth is an alignment of nations, a potentially powerful network that has lain dormant in recent history. It is also unique in that it counts as members some of the most developed countries in the world as well as the smallest microstates. The Commonwealth has shared values and commitment to the rule of law, English common law and open trade, competition and property rights protection. We believe that this network can be usefully deployed to help solve some of the difficulties that the world faces, particularly in terms of the lack of wealth creation and global growth.

While we do not advocate a Commonwealth trade zone or bloc, we do believe that the Commonwealth countries could do better at reducing the trade barriers that they impose on each other, and could also play an important role in ensuring that global meetings achieve better outcomes, leading to wealth creation and global growth. Financial inclusion is also on the list of issues to be addressed by Heads of State. Poorer Commonwealth nations are also adversely affected by lack of access to financial services. Correspondent banking relationships have declined in the Caribbean and parts of Africa for example as regulatory compliance burdens impact financial institutions.

Key Points:

- We advocate that the Commonwealth countries' relevant ministers meet more regularly prior to important global meetings. If they do this, the networks' ability to ensure that the shared commitment to trade liberalisation, competition and property rights protection can more effectively be channelled to improve the outcomes of those global meetings.

- We advocate a Commonwealth trade barrier mechanism so that individual Commonwealth countries better understand the barriers they impose on each other's trade.

- We advocate a Commonwealth Protein Summit so that beef, dairy, lamb, poultry and other protein producers can integrate supply chains and be more effective players in global trade as the world's demand for protein increases.

- We advocate a project to evaluate the reasons for the lack of financial inclusion and whether commonwealth countries can better advocate in Global Standard Setting Organisations so that their interests are not damaged by financial services regulations.

The Commonwealth spreads across many dimensions of our economic, legal and constitutional lives. For the purposes of this briefing paper we will focus on the trade and regulatory dimensions of its activity, and highlight the significant opportunity that Commonwealth Heads of Government (CHOGM 2018) represents.

Heads of State of the fifty three Commonwealth countries will be meeting in London the week of April 16th. The UK will then be in the chair of the CHOGM process until 2020. Most of the more developed countries in the Commonwealth have not really exploited the potential of the Commonwealth as a group of nations in the recent past. For example, the UK turned its attention to Europe, and felt that the EU was where its future lay. But now the UK, as it prepares to leave the EU has begun to renew its focus on the Commonwealth and is actively exploring what these opportunities might be. Hosting the Commonwealth leaders here in the UK is an unprecedented opportunity for the Commonwealth group of countries to develop and propagate a theory of what the Commonwealth's role in the world should be. In order to better understand what that role might be, we first ask where the Commonwealth might be able to help solve a pressing global problem. We then ask how the Commonwealth might be uniquely placed to do so.

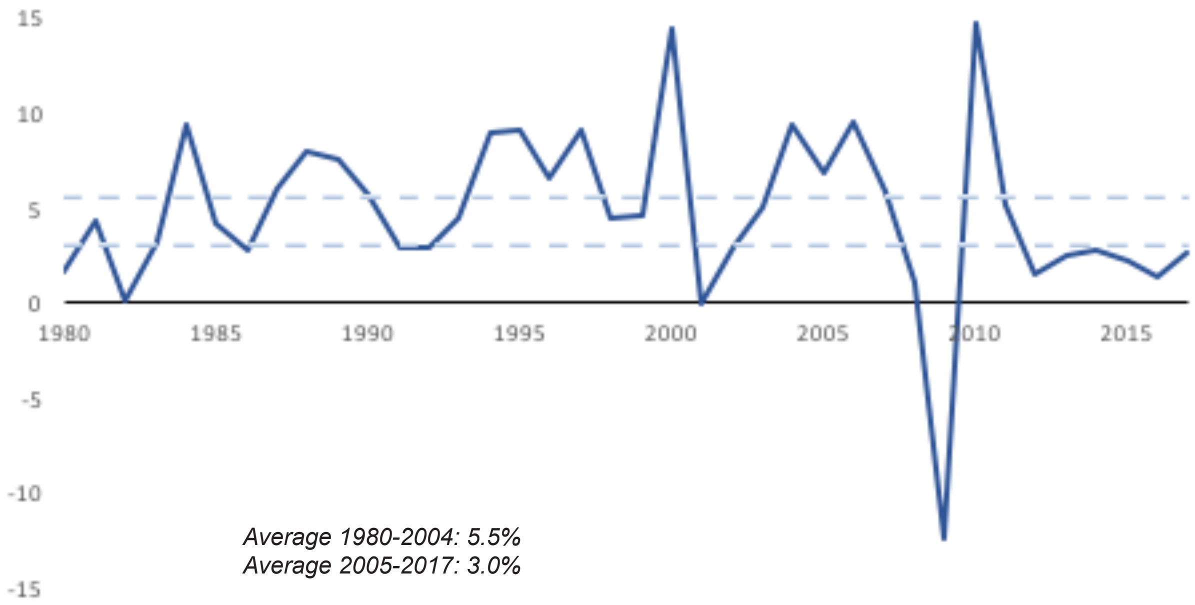
What is the global problem we are trying to solve?

The global economic architecture is in crisis. The problem began with the decline in the global trading system. We have seen very little progress in the multilateral agenda in the WTO, almost no progress in the services agenda since 1997, and this has led to increased structural impediments in both developing and developed countries. As a result of this we have seen a slow down in measures of economic output such as industrial output, and global export volumes. Trade measures have also seen similar declines.

It is this that the world needs to solve if we are to avoid the "new normal" of limited economic growth and little innovation going forward. We can solve this problem by kickstarting the stalled global trade framework, and spurring its resultant effects on global economic activity.

Figure 1 illustrates the change in global export volumes over an almost forty year period, and particularly how growth rates have not returned to pre-GFC levels.

Figure 1: Global export volume, annual percentage growth, 1980–2017[1]

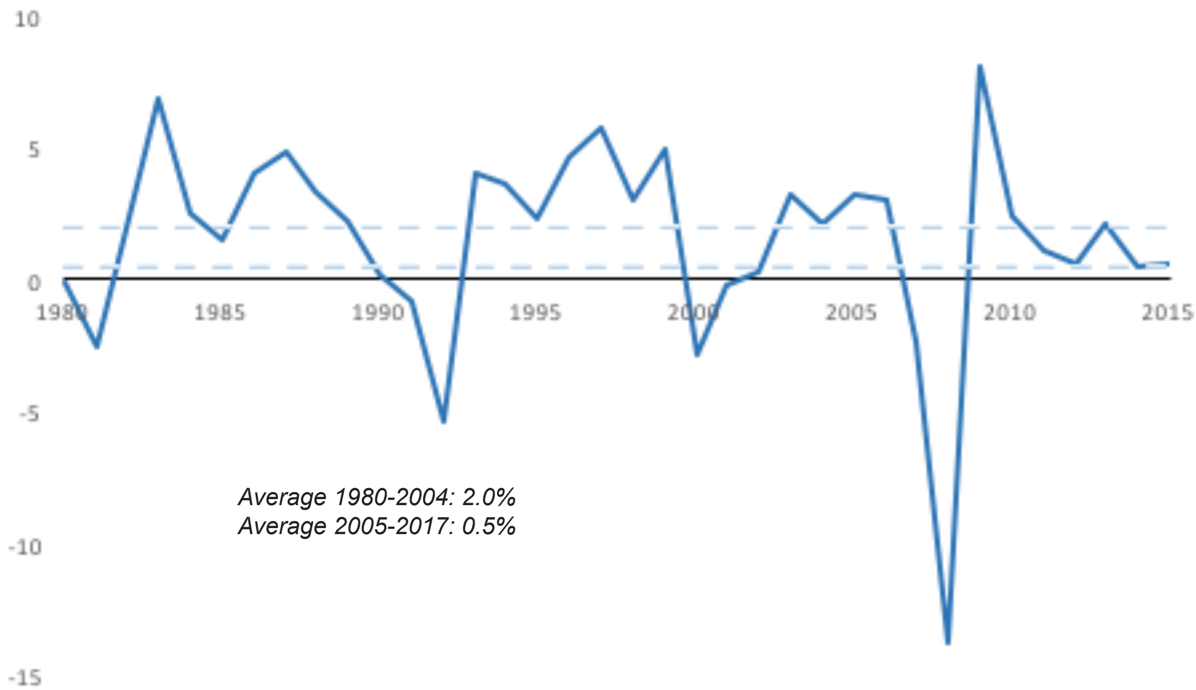


Source: World Bank (1980-2000) and CPB World Trade Monitor (2001-2017). The figure for 2017 is based on the first 10 months of global export volume.

1 Acknowledgment to Timbro for Figure One, and the following charts: https://timbro.se/app/uploads/2018/03/den-ökande-protektionismen-efter-finanskrisen.pdf

There is a marked slow down in the average growth after the crisis in 2008. The GFC alone cannot explain this as the world has rebounded much more quickly from previous recessions and depressions as the above graph demonstrates. Indeed the data suggest that some bounce back from the GFC did occur, but there is now a systemic pattern of low growth which is beginning to emerge. The data also shows that the slow down began before the GFC. This is illustrated even more clearly in Figure 2 which shows Global Industrial Output over time.

Figure 2: Global Industrial Output Growth

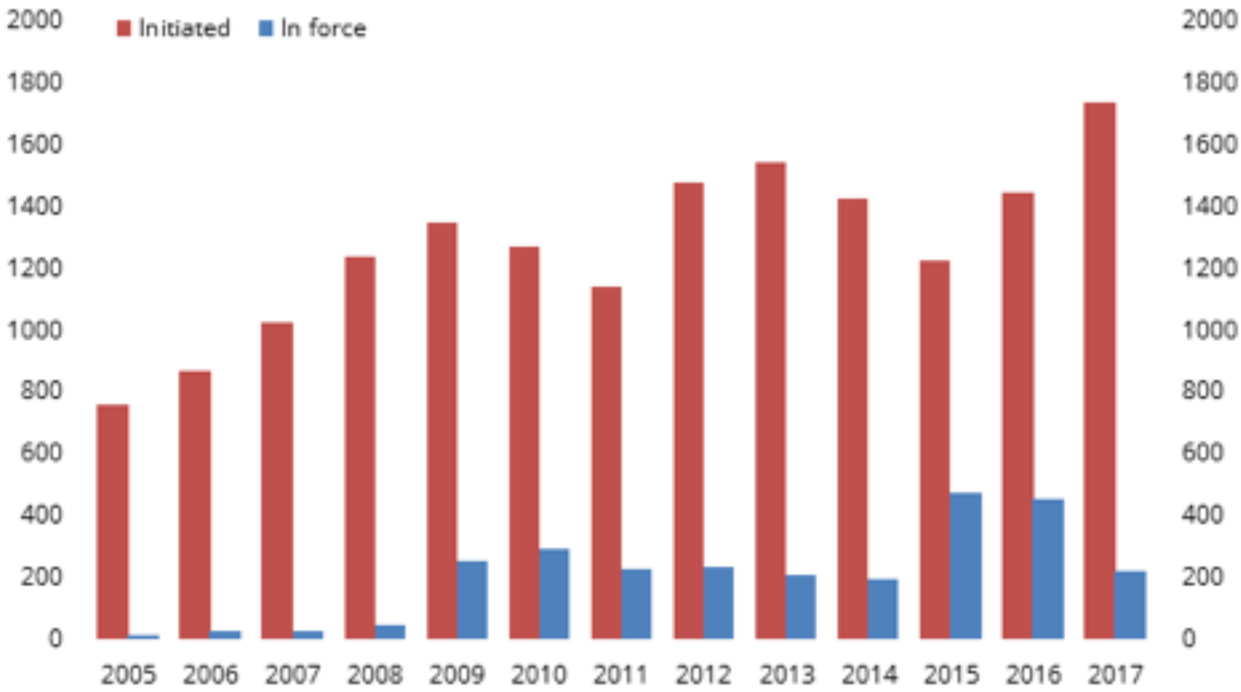


Source: IMF, insufficient data for all nations over time period, so data is mostly from advanced nations.

There has been a dramatic increase in technical barriers to trade since 2005, (importantly before the financial crisis). These have increased largely as we have made little progress through negotiations in WTO rounds. What is particularly disturbing in this data is that even before the GFC, the number of restrictive measures being initiated was much higher than the stock of measures in place, and was on an upward, not a downward trend.

Figure 3: Technical trade barriers, 2005–2017

Number of initiated and introduced measures

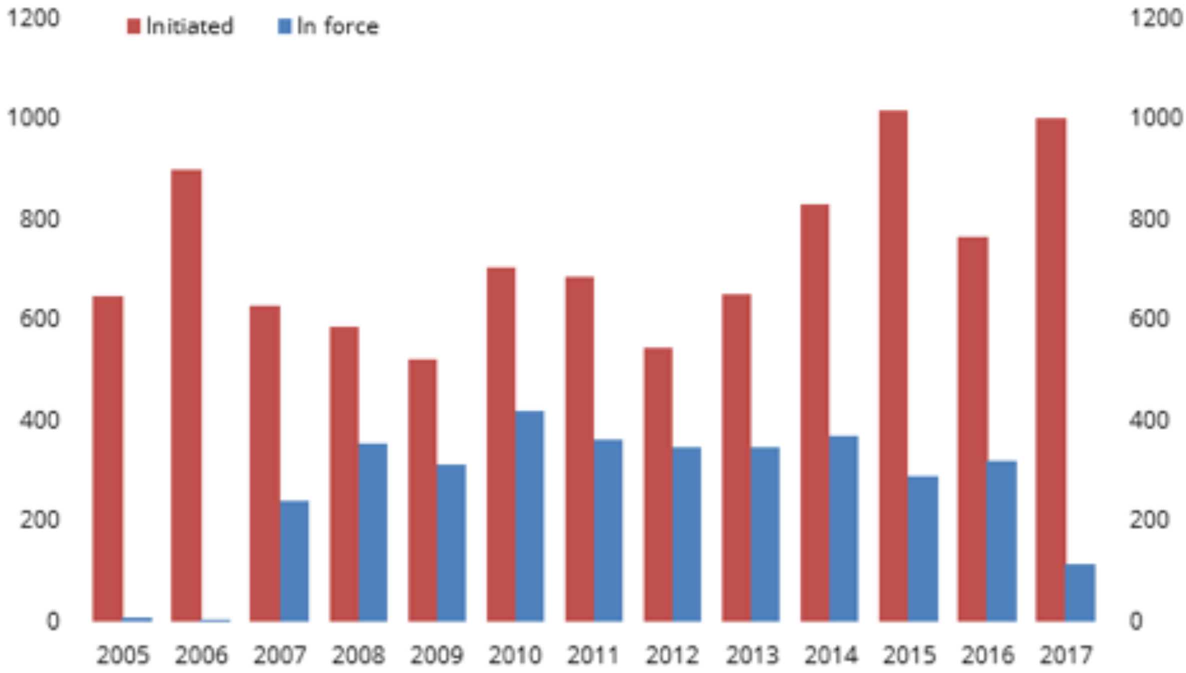


Source: I-TIP (WTO)

There is also a marked increase in Sanitary and Phytosanitary (SPS) barriers being initiated over the period studied. This is again evidence that efforts to reduce this kind of protectionism have not succeeded. This is not surprising as countries seek to use regulatory protection and Anti-Competitive Market Distortions (ACMDs) to damage foreign trade and protect local firms as the usual form of such protection (tariffs) has come down.

Figure 4: International health and safety requirements, 2005–2017

Number of initiated and introduced measures

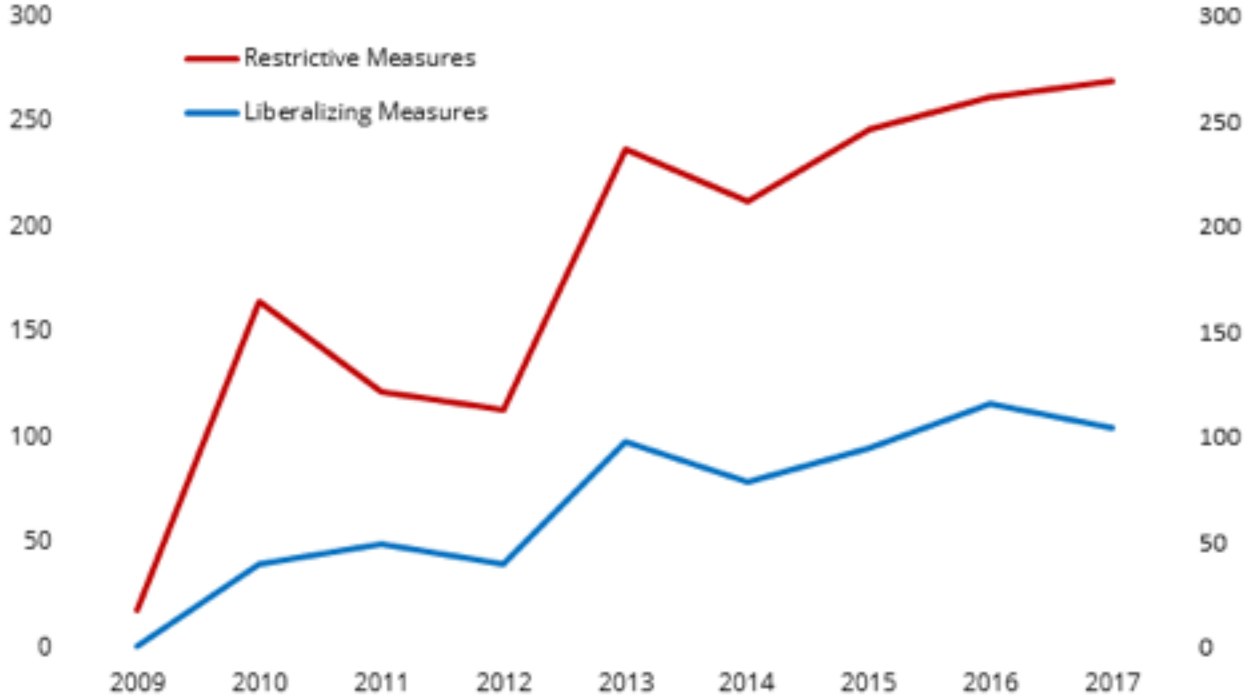


Source: I-TIP (WTO)

The Global Trade Alert[2] has also looked at the rise in behind the border barriers to trade and finds these to be on the increase:

2 Global Trade Alert (Simon Evenett, University of St Gallen): https://siaw.unisg.ch/de/lehrstuehle/evenett/gta

Figure 5: Behind border trade measures



Source: Global Trade Alert

Here we see an increase in the number of restrictive measures being passed since the financial crisis, and liberalizing measures lagging considerably behind restrictive measures (Note that the GTA's measurements start in 2009).

All of this taken together suggests that, unless some change is made, the direction of travel is very disturbing for the future of the planet. This is why thought leaders such as Christine Lagarde at the IMF, and Robert Gordon at Stanford University have suggested that we have entered a new normal of limited economic growth, and the end of innovation. Such a prospect, bad for advanced economies is a catastrophe for developing countries, many of which are Commonwealth countries.

How are countries responding to the challenge?

Countries and regions have responded to this emerging reality in a number of different ways. New Zealand and Singapore, two Commonwealth countries, recognizing the slowdown in economic growth and the danger of a trading system that was adrift, came together to agree a high standards agreement that could be spread to other countries over ten years ago. That arrangement ultimately became the P4, and then the P4+1 (including Chile, Brunei and Australia). They were able to do this in part because of their shared commitment to open trade and competitive markets. Meanwhile, an idea to create a Prosperity Zone of like-minded countries committed to open trade and competitive markets which began as a policy concept in Governor Mitt Romney's 2008 campaign ultimately joined with the P4+1 to forge the Trans Pacific Partnership. It is important to note that this was initiated by Commonwealth countries but now includes many non-Commonwealth countries, such as the US, Mexico, Chile and Japan. This was an example of the shared tradition of the Commonwealth leading to a positive global result.

In the European Union, in default of negotiations at a multilateral level, in many areas which affect the WTO's agreements on technical barriers to trade and sanitary and phytosanitary measures (the WTO TBT and SPS agreements) for example, and in the context of data, the EU is adopting a particular standard or approach and then seeking to impose this on the rest of the world. We see this particularly playing out in the EU approach to finding a balance between data protection and privacy, which is at variance with the way the rest of the world thinks of these issues. According to Australian former GATT Council Chair, Alan Oxley, the EU has "wrecked" the Codex Alimentarius (Telegraph, 2018) and is applying its own food standards, often in defiance of sound science (including the EU's own scientists). The global norm has been to agree in global standard setting bodies like Codex based on a scientific consensus of what is appropriate. The EU is moving away from this global norm in many areas.

Meanwhile, China has been adopting global standards and adding Chinese characteristics, and seeking to impose these on the rest of the world. In both of these cases, the EU and China seek to use the size of their markets to propagate their standard. In the case of China, aggressive propagation of its regulatory approach and standard is accompanied by intellectual property violations.

Unless there is a change in global approach, it is likely that firms will simply cave in to the increased compliance costs, and adopt the most restrictive approach as the global norm. There is a developing pattern of large business organisations complaining about a particular European regulation (Regulation, Authorisation and Restriction of Chemicals (REACH), or the General Data Protection Regulation (GDPR)) on the basis of the massively increased compliance costs associated with it, only to cave in when it is in place, and then to assume that this will be the global norm and plan accordingly.

While the largest firms, and incumbents might be able to manage these costs, smaller firms will likely exit the market and this anti-competitive harm increases inefficiency and cost for consumers. This will also create an environment which is not conducive to new innovative business formation.

Direction of Travel of the Global Regulatory System

The overall direction of travel of global regulation is not positive. The more anti-competitive market distortions (ACMDs) damage the competitive landscape and lead to wealth destruction, the more damage is done to consumers and the overall business environment, the less innovation is likely and the more likely the "new normal" scenario becomes.

Meanwhile in the WTO, we have moved from agreeing to disagree in the Nairobi ministerial declaration in 2015 to no ministerial declaration at all at the Buenos Aires ministerial in 2017.

One of the topics that will be discussed at CHOGM is access to financial services particularly for small less developed countries and businesses located therein. The direction of travel of the global regulatory system has had profound effects here. The increased compliance costs associated with regulatory requirements emanating from global institutions (for example the Basel 3, and International Organization of Securities Commissions (IOSCO)), as well as the raft of anti-money laundering regulations mean that the number of correspondent banking relationships in developing countries such as Africa and the Caribbean has declined dramatically, as banks seek to avoid risk. The figure below which shows the decline in value of correspondent banking relationships in the Caribbean highlights the scale of the problem.

Figure 6

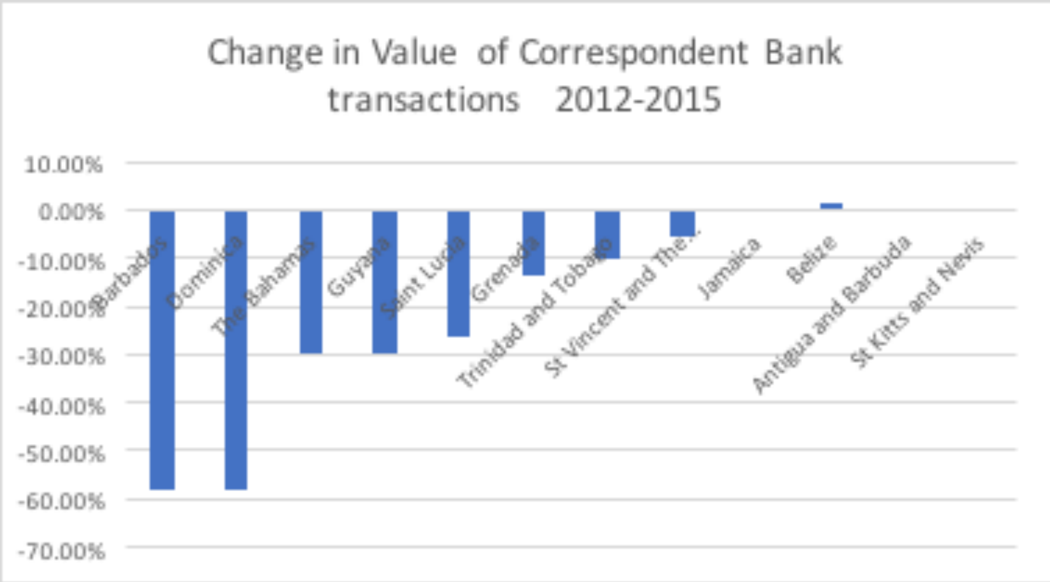
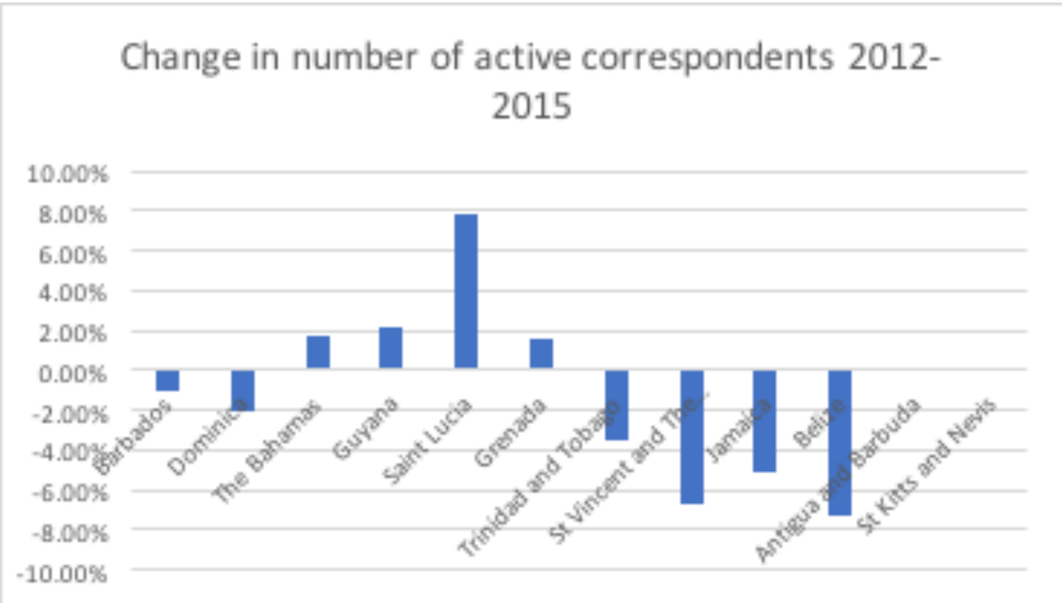


Figure 7



If the Commonwealth is to make any progress in access to financial services, then it needs to address the reasons for the decline in correspondent banking relationships. This is in part because of the step change in compliance rules post crisis, that make banks much more risk averse than previously, and this has a particular impact on their operations in developing countries. Indeed many have withdrawn from developing countries leading to less accessibility to financial capital.

What role can the Commonwealth play?

Into this history of trading system failure comes CHOGM 2018 which the UK hosts. The question is what role can the Commonwealth play, if any to help reverse this dangerous trend?

The Commonwealth is an alignment of nations around concepts such as rule of law, and in particular the English common law. It is an unusual network in that it contains some of the most developed countries in the world, as well as the smallest micro-states. Far from being a weakness, as it is often perceived to be, this diversity is the source of its strength. One of the most important things the Commonwealth can bring to the debate is to help facilitate an unblocking of the global economic architecture by enabling its members to discuss issues prior to interacting with their various affinity groups in international organisations. By surfacing and discussing international issues, Commonwealth countries, while not necessarily agreeing as a bloc to a particular approach, may nevertheless subscribe to similar philosophies and broad positions. Ministers from these countries, if they meet in advance of global meetings will, in effect get two bites at the apple when it comes to forging coalitions in support of a more liberalizing approach. In the case of trade, many of the Commonwealth countries belong to affinity groups with others who have historically been opposed to efforts to liberalise trade. A Commonwealth trade pre-meeting could be used to broker solutions in the WTO ministerial meeting which follows it. It could also be used to discuss how non-Commonwealth members might react to proposals that members might be making. In the trade context we have seen countries emerge to salvage aspects of trade ministerials, such as when Australia's trade minister, Steven Ciobo led an effort to develop a plurilateral agreement on e-commerce, when the multilateral work appeared to be foundering. Often in WTO ministerial meetings, trade ministers do not have much time to break through logjams (typically 48 – 72 hours maximum), and so unless there is a degree of alignment prior to the meeting, it is extremely unlikely that big differences can be papered over sufficiently to allow for a Ministerial Declaration that all can live with. We are entering into a particularly dangerous time now, as the US withdraws from playing the brokering role it has historically played.

Many of the countries the UK would be seeking to negotiate free trade agreements with as it executes its independent trade policy, such as Australia, New Zealand, Canada and so on are Commonwealth countries. These countries are like-minded in terms of a shared commitment to trade liberalisation and competitive markets, and have worked together in other contexts to deepen liberalisation such as the Trans Pacific Partnership (TPP). They are discussing the kinds of concepts which should ultimately be multilateralised and could play a significant role in pushing them pro-actively in WTO councils.

Commonwealth Network Effects

The Commonwealth has significant network effects which could be exploited. It is important that these are used to ensure pro-competitive and liberalised trade, so that the overall levels of market distortions around the world are lowered, and consequently wealth is created in the global economy. The Commonwealth could also play a role in helping its members engage in the structural reform that is so necessary to improve their own economies. Such structural reform would also make their members better trading partners as they would then be able to negotiate both tariff reductions and regulatory improvements.

Another potential use of the Commonwealth network is to bring together businesses that can integrate into global supply chains which feature Commonwealth countries. There are a number of Commonwealth groups, including the Commonwealth Enterprise and Investment Council (CWEIC) that can play a role in bringing Commonwealth businesses together.

Finally, the Commonwealth can be used as a vehicle for members to identify trade barriers faced by their members which are imposed by other members. This could be a Commonwealth Trade Barrier Mechanism (CTBM), and could be used to identify trade and regulatory barriers in all Commonwealth countries.

Commonwealth Trade Barrier Mechanism ("CTBM")

Many countries such as the US and the EU maintain an index of foreign country trade barriers and regulatory distortions. In the US, the National Trade Estimate ("NTE") a yearly inventory of foreign country trade barriers. The EU, through its Trade Barrier Regulation maintains its list of foreign country trade barriers.

We suggest that Commonwealth, individually and as a group identify the barriers to trade and economic growth they face in other Commonwealth countries. While some of the larger more developed markets already have mechanisms to analyse and compile market access barriers, many of the less developed countries do not and are adversely affected by these kinds of barriers and distortions. This is not a precursor to a Commonwealth trade agreement as such, but it is a way that the Commonwealth can at least reduce trade barriers to other Commonwealth countries.

This work will lead to the identification of barriers that Commonwealth exporters face and how they will be able to overcome them. Many of the behind the border barriers affect all trade globally, and if Commonwealth countries reduce these barriers they will improve all global trade.

Commonwealth Protein Summit

Some of the more advanced members of the Commonwealth have major exporters of protein, especially beef, pork, poultry, lamb and dairy products. At the same time, the demand for protein has risen considerably as people have been lifted out of poverty. Ensuring that all farmers in the Commonwealth are integrated into global supply chains would be a significant step forward in ensuring that this increased demand for protein can be properly met. This would be a positive step for all Commonwealth farmers.

Improving Access to Financial Services

The Commonwealth countries could agree what constitutes good practice in the area of financial services, prioritizing the needs of consumers and businesses over solely prudential concerns. The goal of this exercise would be to identify potential regulatory pathways to creating environments that stimulate trade and competition.

This could be a research project of the Commonwealth countries to ensure that poorer people in the Commonwealth as a whole have access to capital. This does not just mean poorer people in less developed nations, but poorer people in developing and developed nations alike.

Conclusion

The Commonwealth can play a role in unlocking the pressing problem of today which is lack of wealth creation leading to stalled global growth and the consequent loss of opportunity and hope for people all over the world. If the Commonwealth, operating in the way that we have described can actually play a role in improving the environment so that the barriers to growth are overcome, then the competitive markets created will spur economic activity, lifting billions out of poverty.

iTCU UNIT International Trade & Competition

iea Institute of Economic Affairs