

THE G8 MULTILATERAL RULE- BASED TRADE AND EXCHANGE RATE REGIMES

Chiara Oldani, ISAE

Paolo Savona, Luiss G Carli
University

Outline

- o Aim of the paper
- o The stall of Doha
- o Rule-based vs. Principle-based regulation
- o Income and exchange rate elasticity
- o The Asian Union
- o Policy conclusions

Aim of the paper

Which is the best scheme for the implementation of international trade?

- Liberalisation and globalisation, in the presence of free competition, introduces certain distortions.
- Main negative effects lie on the shoulders of poor, unskilled and untrained working class, and the environment.

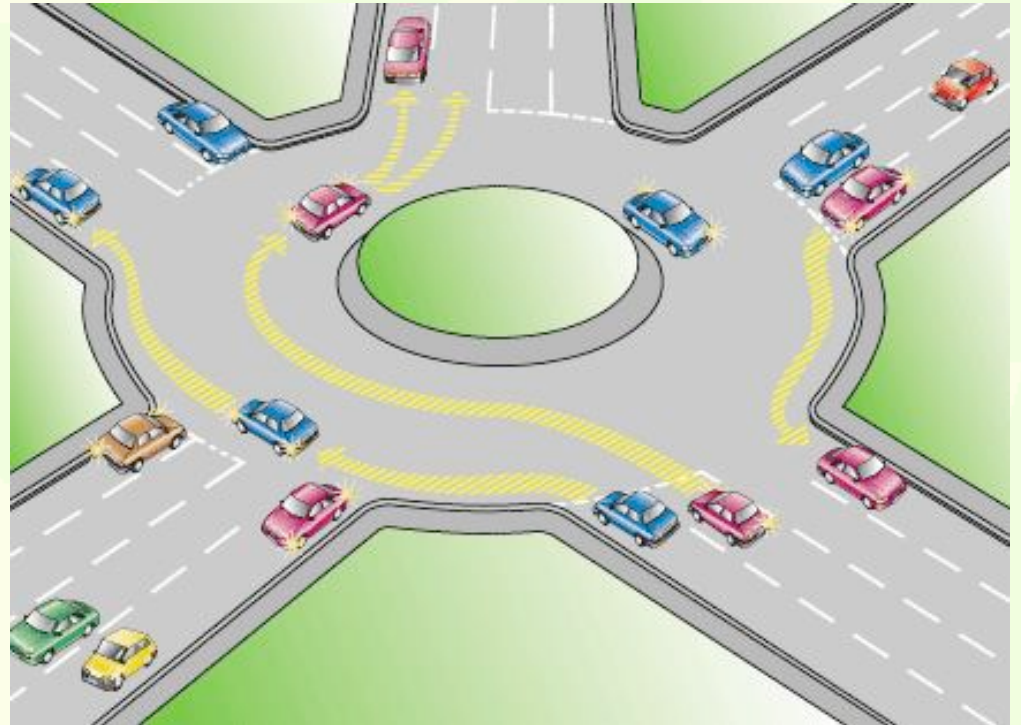
The stall of Doha

- WTO focuses on children protection and trademarks, leaving out the elderly, the environment and the service sector;
- Social dumping is the result of international free trade in the presence of asymmetries in the production conditions among countries;
- The WTO rules should implement fair competition.

The stall of Doha

- The Doha Development Agenda is focused on diminishing the negative effects of trade unions (EU, USA) for emerging countries, i.e. tariffs;
- Big emerging countries (China, India, Brazil) are colluding in order to increase their world trade shares, basing on the social dumping;
- This approach is not going to work.

Traffic Light or Roundabout?



Rule-based vs. Principle-based regulation

WTO is based on rules, treaties and agreements; rule-based regulation can be implemented in the presence of small countries, and clear international incentives.

Big emerging countries have an incentive to circumvent regulation, conquer market shares, and crowd out developed countries.

Rule-based vs. Principle-based regulation

- Principle-based regulation allows firms and countries to decide how best to achieve required outcomes (e.g. fair competition) and allows for an alignment of regulation with good business practice;
- It is the approach used in finance and banking (Basel II and Financial Derivatives);
- Is not easy to be implemented, but more coherent with evolving markets and economies.

Rule-based vs. Principle-based regulation

- Violation of rule-based: fine.
- Violations of principle-based: expulsion from the market; loss of all profits. No fine would be so high.
- Is a challenge for supervisors and policy makers.

Income and exchange rate elasticity

- Today international trade is based on bilateral rules, floating and fixed exchange rates regimes.
- Over 2002-2007 the US\$ devaluated w.r.t other main currencies; the Yuan has a \$-peg which boosted the current account surplus (export-led growth model).
- Main imbalances are in the US (neg.), and China (pos.). This system is not able to adjust via exchange rates variations.

Income and exchange rate elasticity

$$\ln(\text{Exp}_t) = a_{\text{exp}} + b_1 \ln(\text{ER}_{t,\text{real}}) + b_2 \ln(Y_{t,\text{world}})$$

$$\ln(\text{Imp}_t) = a_{\text{imp}} + b_3 \ln(\text{ER}_{t,\text{real}}) + b_4 \ln(Y_{t,\text{Country}})$$

Table 1 Elasticity Estimates

| | China | | USA | | EU | |
|---------------------|-------------|-------|-------------|-------|-------------|-------|
| | Coefficient | Prob. | Coefficient | Prob. | Coefficient | Prob. |
| a_{exp} | -35.58 | 0.00 | -1.91 | 0.16 | -1.26 | 0.32 |
| b_1 | 1.24 | 0.00 | 0.79 | 0.00 | -2.07 | 0.00 |
| b_2 | 3.63 | 0.00 | 1.13 | 0.00 | 1.71 | 0.00 |
| a_{imp} | 3.18 | 0.19 | -13.18 | 0.00 | -51.00 | 0.00 |
| b_3 | -1.24 | 0.03 | 1.39 | 0.00 | -0.19 | 0.28 |
| b_4 | 1.44 | 0.00 | 1.75 | 0.00 | 3.73 | 0.00 |
| R^2_C | | | | | | |
| $\text{exp } R^2_C$ | 0.99 | | 0.93 | | 0.98 | |
| $\text{imp } R^2_C$ | 0.96 | | 0.98 | | 0.99 | |

Income and exchange rate elasticity

- If the €-\$ goes to 1.60 the increase in trade would not diminish the US deficit (today is 6.1% of GDP). Chinese surplus would not diminish as well!
- The negative effects would be on European exports.
- The devaluation of the Yuan-\$ would decrease the speed of accumulation of surplus, but not reverse it (elasticity).

The Asian Union

- In order to increase domestic stability, mitigate the currency risk, increase internal trade and manage (huge) foreign exchange reserves Asian countries are working on the proposal of a Union, similar to the EU and the US.
- The world scenario is that of trade and currency unions with a limited number of (strong) currencies.

Policy implications

- Asian trade surplus reflects in huge foreign reserve accumulation; US trade deficit aliments the accumulation;
 - Exchange rates manoeuvres are not a solution for global imbalances;
 - Free trade needs to become fair for globalisation to be sustainable;
- Principle-based regulation

THANK YOU

Chiara Oldani

c.oldani@isae.it

coldani@luiss.it