The Impact of the Financial Crisis on Global Trade: The Threat of Protectionism

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Abstract

Ongoing international financial crisis has caused significant harm to lots of economies and businesses and led to a large number of bankruptcies. Although it originated in the USA it has spread to other nations, generating far-reaching effects on the world economy and trade. Indeed, further companies and banks worldwide are on the verge of collapse and global trade is forecast to decline 10 % this year. To face such alarming trends, governments all over the world are injecting more funds into their economies and are struggling hard to promote trade as a crucial driver of economic growth. Moreover, many analysts are urging world leaders to avoid taking financial and trade protectionist measures to cushion the economies against the effects of the financial and economic crisis. Still, as the latter deepens anti-trade tide is feared to further undermine the recession and jeopardize the growth of the world economy.

KEYWORDS: **Crisis - Economy - Growth - Trade - Protectionism**.

Résumé

La crise financière internationale en cours avait endommagé beaucoup d'économies et d'affaires et avait causé un nombre important de faillites. Bien que la crise ait commencé aux Etats-Unis, elle s'est étendue à d'autres pays en engendrant des effets considérables sur l'économie mondiale et le commerce international. En effet, d'autres sociétés et banques au niveau mondial sont au seuil d'effondrement et le commerce international est prévu de baisser 10% cette année. Pour faire face à ses tendances alarmantes, les gouvernements du monde sont en train d'injecter des fonds énormes dans leurs économies et ils luttent difficilement pour promouvoir le commerce comme conducteur crucial de croissance économique. En outre, un grand nombre d'analystes ont recommandé aux dirigeants du monde d'éviter la prise de mesures protectionnistes financières et commerciales afin d'amortir les effets de la crise financière et économique. Cependant, comme la crise s'approfondie, la vague du protectionnisme, est craint de miner d'avantage la récession et ainsi mettre en péril l'économie mondiale.

MOTS CLES : Crise - Economie - Croissance - Commerce - Protectionnisme.

INTRODUCTION

The international financial crisis of September 2008 has caused significant harm to lots of economies and businesses. Although it originated in the USA it has generated far-reaching effects on the world economy and trade. Indeed, a large number of banks and companies worldwide, such as Lehman Brothers and General Motors, have gone bankrupt and others are on the verge of collapse. More importantly, world trade is to decline by 10 % this year and there are little signs for the world economy to bounce back in the near future. This has caused considerable panic among world leaders, particularly for those countries relying heavily on foreign trade for their economic growth.

Since the end of September 2008 world governments have been holding official meetings in search of tools and ways to curb the effects of ongoing financial and economic crisis and to ultimately achieve recovery. The Group of Seven (G7) industrialized countries summit held in Rome, the Group of Twenty (G20) advanced and emerging countries summits held in Washington (November 2008) and later in London (April 2009) and the summits held within the European Union (EU) and Asian regional meetings have all resulted in economic stimulus packages, injecting more funds into domestic economies in an attempt to keep world demand high. Moreover, governments pledged to maintain free trade to avoid exacerbating the critical downturn of the global economy.

Undoubtedly, these meetings reflected the need for a united global action to solve the crisis. But more importantly, they showed the world's awareness of the dangers of declining global demand and prices that could lead to the collapse of world trade. Indeed, recent official comments highlighted deep worries that the economic slowdown could lead to additional trade barriers that could further hit world exports, undermining the prospects for global economic recovery. Apparently, official declarations have been political more than anything else and the Doha round of trade talks has so far failed to reach a global trade agreement, something which seem to be hindering the World Trade

Organization (WTO) from doing its job to ensure 'fair' trade. Government Leaders currently warning about the dangers of protectionism seem to be themselves behind the recent anti-trade tide. Besides, as time goes by, the various financial and fiscal stimulus packages may prove to be insufficient to pull the world out of the crisis if not followed by genuine financial and banking reforms.

This paper attempts to scrutinize the effects of the world financial crisis on global trade. It seeks to examine the causes behind the fall in world exports and imports. The main object is to see whether this decline is related to demand or to protectionism? Is it due to the lack of financial grease in the wheels of trade? Focus will be on the dangers of protectionism to global economic growth and the prospects of what can be done to boost global trade and growth under the pressures of the current economic and financial crisis.

I- The damaging effects of the financial crisis

Until August 2008, growth worldwide was viewed a priority and was maintained so. It was stimulated particularly through low global interest rates. Indeed, over the period 2004-2007 cheap money enabled the world economy to expand at its fastest rate in 30 years. This unleashed growth led to the commodities price boom. Price increases started in food and energy and then spread to the rest of commodities, resulting in a global food and energy crisis. For instance, oil prices rocketed to $147 a barrel in July 2008 and the prices of soybeans and other food items became three to five times higher in 2008 than a year ago.

More significantly, the new money generated easier credit conditions, extending cash to new borrowers in the US who in the past few years had been unable to buy houses, cars and durable goods. Indeed, over the past three decades Americans were importing more than what they were exporting, spending more than what they were earning and borrowing more than they could bear. These practices affected badly the US economy and in the end brought about a credit crisis in September 2008, causing hard lending to households and companies and later to the financial sector. It has to be said, though, that the credit crisis was mainly due to the great expansion of mortgage loans in the US coupled with significant increases in housing prices.

It should be noted, however, that the US economic slowdown generated a decrease in mortgage prices later while interest rates and unemployment went up. As a result, borrowers became unable to repay their debts and mortgage banks found themselves unable to sell the houses to get their money back. More importantly, the value of mortgages became far lower than the value of the credits. Consequently, mortgage credits became unsafe, pushing mortgage banks to collapse. This led the US government to nationalize the two biggest mortgage banks, Freddie Mac and Fanny May. This mortgage crisis later moved to the financial markets, resulting in a collapse of confidence and a severe financial and economic crisis. And because of economic and financial globalization, the crisis quickly spread to other economies in Europe and Asia and subsequently to other parts of the world.

In an attempt to contain the crisis and its effects, central banks in the developed countries offered emergency liquidity support for financial institutions, changed policy rates and eased monetary and fiscal policy. Moreover, governments all over the world adopted stimulus packages and major world governments pledged to aid the financial institutions facing credit problems, through buying bad credits in particular, to boast confidence in the financial markets. Other countries led by China and Russia called for a reform of the international financial system and a new reserve currency because of fears of a loss of confidence in the US dollar and ultimately a collapse of the world monetary system. The object is to save the world economy and to secure global stability.

In the G20[**1**] London summit held in April 2009, leaders decided to raise the IMF financial assets by US$500bn. In addition, they dedicated US$250bn to support IMF Special Drawing Rights (SDRs) and another US$250bn to boost world trade. Furthermore, the G20 countries planned to spend about US$5 trillion by 2010 with the purpose of stimulating the world economy.[**2**] These coordinated measures were intended to raise world production and demand. Nevertheless, the measures taken so far have managed to slow down the financial and economic crisis but seem to have failed to stop it from spreading to other rich and poor countries. The economic downturn is reported to continue throughout 2009 and recovery is forecast to start for major economies in the first half of 2010. Indeed, the world is witnessing the worst economic crisis since World War II, with far-reaching effects on natinal economies and global trade. The major effects of the crisis can be summarized as follows:

1. Collapse of confidence in financial markets and shortage of liquidity. Because of bad credits and the scandal of mortgage-guaranteed securities, risks became higher, driving banks to halt funding investment operations in domestic and foreign financial and business markets.

2- Bank and business bankruptcies. A significant number of banks and firms have gone bust, particularly in the US, the UK, Germany and Japan. A large number of banks have gone bankrupt in the US and others are on the verge of collapse.

3- Slowdown in economic growth. The IMF has recently announced that the world economy will shrink by 1.3 per cent this year before recovering to a limited growth rate of 1.9 per cent in 2010.[**3**] Moreover, the World Bank warned that the world industrial output will decline by 15 per cent in the first half of 2009 as compared to that of 2008.[**4**] The figures which have recently been released seem to assert these forecasts. The US GDP contracted by 6.3 per cent in the fourth quarter of 2008, the biggest slowdown since 1982.[**5**] In July 2009 the US economy showed a slight improvement as the economic slowdown dropped to 1 per cent in the second quarter of 2009, indicating that the US economic stimulus package may have started to bring positive effects. However, according to some economic analysts, the US economy needs 3 - 4 years to recover from the current recession.[**6**]

Similarly, the Euro zone economies shrank by about 2.5 per cent in the first quarter of 2009 as compared to 1.3 per cent a year ago. The EU economic downturn is forecast to continue in

2010 with a contraction rate of 0.1 per cent.[7] However, Germany is the most hit, recording a decrease in GDP of 3.8 per cent in the first quarter of 2009 as compared to a Frensh contraction rate of 1.2 per cent over the same period. This German decline in GDP is reported to be due to a sharp drop in exports and investments.[8]

Asian countries have also been undergoing similar economic declines. Japanese GDP shrank by 4 per cent in the first quarter of 2009, the worst since 1955. [9] In April 2009, direct investments in China fell by 22.5 per cent as compared to a year ago. However, China appears to be relatively less affected by the economic crisis. Despite a dorp of foreign demand on Chinese goods, the Chinese economy still achieved a growth rate of 6.1 per cent in the first quarter and 7.9 per cent in the second quarter of this year. This compares to a growth rate of 6.8 per cent in the last quarter of 2008 and 9 per cent in 2007. Moreover, in June 2009 china recorded a further increase in foreign currency reserves, amounting to US $2131.6bn.[10]

5- Sharp increases in unemployment. Since the breakout of the crisis there have been lots of job losses. The number of the world unemployed increased at the end of 2008 to 200 mn people as compared to 179 mn in 2007.[11] The US lost 4 mn jobs in just one quarter and now unemployment is nearing 10 per cent of the working population. [12] In the EU, the rate of unemployment rose to 9.4 per cent in June 2009 as compared to 7.5 per cent in 2007 and is expected to further reach 10 per cent in 2010. [13] In France, unemployment rose to more than 2 mn people in November 2008 and is forecast to reach 8.1 per cent of the working population by the end of this year.[14] In Spain, however, unemployment amounted to a much higher rate of 18 per cent in June 2009. In Japan this rate remains around 5.4 per cent, whereas in China about 20 mn people lost their jobs, mainly rural migrants.[15] The World Labor Organization has recently estimated that the world needs to create 90 mn jobs over the period 2009-2010 to provide employment for newcomers on the work market.

6- Increasing World poverty. According to UN figures, the crisis is anticipated to raise the number of poor people in the world by more than 100 mn people. This is anticipated to affect world political and social stability, particularly in lower income nations.

7- Declining world trade. According to Pascal Lamy, general-director of the World Trade Organization (WTO), global trade has decreased in the second half of 2008 and will drop by 10 per cent this year. Countries relying most on exports, such as Germany, Japan and developing nations, are expected to be severely hit by the crisis. Moreover, Robert Zoellick, the World Bank president, has recently warned that as the year goes on "*national leaders will come under more and more pressure to shift problems to others*".[**16**] This suggests that as the economic and financial crisis deepens the world will plunge into economic patriotism, something which could drive the world into a Great Depression, just as America's Smoot-Hawley Act did 79 years ago.[**17**]

II- The surge of a protectionist tide

Throughout history international trade has been viewed as a major driving force for world economic growth. However, all countries have sought to protect either the whole economy or some of its sectors from foreign competition with tariff and non-tariff barriers, particularly at times of crises. Economic and political dislocation led to rising custom barriers in Europe in the 1920s, and the Great Depression (1929-1933) produced a spate of protectionist measures; world trade shrank drastically as a result. By contrast, the world enjoyed its greatest economic growth during the relatively free trade period of 1945-1970.

Protectionism refers to policies or doctrines which "protect" businesses and workers within a country by restricting or regulating trade with foreign nations. The aim is to bring the prices of imported goods up to or even above the prices of domestically-produced goods. The support given to agriculture in the European Union is a case in point. This protectionist policy raised the competitiveness of EU farmers and enabled them to become large-scale exporters of food to the rest of the world. However, protectionism has frequently proved to be a temporary solution to the flood of foreign-made goods on the market, and, in the long run, will raise the cost of living for consumers while simultaneously protecting inefficient domestic companies.

Protectionist policies are closely aligned with anti-globalization and contrasts with free trade. In economic theory mercantilism and import substitution are associated with protectionism. Mercantilists believed that trade is a source of wealth and advised governments to maintain a positive trade balance; obviously this can be done only at the expense of other nations.[**18**] Import substitution equally urged governments to produce domestically what they imported, ignoring the cost factor and what this might entail. However, classic theorists such as **Adam Smith**, **David Ricardo** and **John Stuart Mill** warned against protectionism and preached the benefits of free trade, arguing that 'interested sophistry' of industry seeks "to gain advantage at the cost of the consumers".[**19**] Today nearly all economists maintain that the costs of protectionist actions outweigh the benefits and they can seriously impede economic growth.[**20**] In this respect, trade theorist **Paul Krugman** noted: "If there were an Economist's Creed, it would surely contain the affirmations 'I understand the Principle of Comparative Advantage' and 'I advocate Free Trade'."[**21**]

Protectionism always entails some loss of efficiency, as compared to free trade, because the lowest price obtainable through competition is replaced by a higher subsidized price. The result is over-production in the home market by suppliers who are less efficient than they would be if exposed to world-wide competition. Furthermore, protectionism flares retaliation throughout the world. It should be noted, however, that protectionism is not just the imposition of tariffs and import or export quotas. Today, protectionism includes a wide range of trade barriers:

- Administrative restrictions, such as rules regarding food safety and environmental standards.

- Anti-dumping laws to fight 'unfair' trade to protect local firms against deliberate lower prices of foreign goods.

- Export and direct subsidies to enable local producers to compete on overseas markets and to promote exports.

- Exchange rate manipulation to make the cost of imports higher and that of exports lower or the other way round.

There are also other governmental actions which are seen by many as protectionist. For instance, trade economist **Jagdish Bhagwati** sees in imposing local labor as protectionism.[**22**] The imposition of restrictive certification procedures on imports are also viewed in this light. Others point out that even free trade agreements often have protectionist clauses such as intellectual property, copyright, and patent restrictions that benefit large companies.

In spite of evidence of damaging effects caused by trade restrictions, pressure for more protectionist laws persists. Using the pretext of promoting quality goods and improving competition, governments all over the world continue to take various protectionist measures. They frequently adopted new national quality standards to boost the sale of home-produced goods on local markets. French president, Nicolas Sarkozy, recently urged Frensh carmakers to repatriate their production from east European assembly plants to France.[**23**] Similarly, Gordon Brown, UK prime minister, further remarked that "British jobs for British workers".[**24**] The US $787bn economic stimulus package further included "Buy American" provisions for some US public works and building projects. In a recent speech, President Obama said he would seek to end tax breaks that benefited companies that outsourced jobs overseas.[**25**] These statements clearly show the link between the financial crisis and anti-trade tide and they are likely to instigate other nations to impose further trade restrictions to protect their markets.

In fact, G20 countries seem to remain uncommitted to their pledge to refrain from raising new barriers to investment and trade. The WTO has recently warned of the "danger of an incremental build-up of restrictions that could slowly strangle international trade and undercut the effectiveness of policies to boost aggregate demand and restore sustained growth globally".[**26**] Another World Bank report pointed out that 17 of G20 nations had implemented "47 measures whose effect is to restrict trade at the expense of other countries".[**27**] So, it is blatantly clear that protectionist measures have started to reach an alarming level and now it is estimated that there are more than 57 restrictive measures.[**28**]

Indeed, ongoing financial and economic crisis seems to have not only revived old forms of trade protection but also contributed to the emergence of new ones. Today, restrictions are quantitative and non-quantitative. In other words, they are not merely import and export barriers; they are now financial, restricting capital movements outside national borders. Some analysts warned of some potential attempts on banks, such as efforts to restrict the securitization of assets and force banks instead to return to a more conservative “buy and hold” lending mode.[**29**] Moreover, recent government economic stimulus packages tend to impede financial institutions from investing abroad or providing credits to borrowers from other countries. Thus, governments are trying to keep the money inside their countries and are seeking to disperse stimulus money at national levels only. According to some estimates, private capital outflows to emerging markets will regress by 65 per cent this year as compared to those registered last year, that is a drop of about US $300bn.[**30**] Quite clearly, this is a devastating blow to the world economy and trade, considering the important role free capital movements have played in the creation of wealth over the years.

Moreover, new individual and collective practices emerged; since the beginning of the crisis investors have been withdrawing their assets from foreign financial markets, causing breakdowns of national and international shares and resulting in huge capital losses estimated to be trillions US dollars. For instance, in October 2008, about US$30bn of foreign capital fled the Russian stock market in a week.[**31**] Similarly, some foreign investors draw their deposits from banks located in some EU member eastern European countries, adding extra challenges to the

EU. Therefore, Protectionism has gone beyond the practice of "Buy American". These practices are financial and are expected to jeopardize 'globalization' and put curbs on world growth.

Old-fashioned ways of protectionism have also been common practice since the breakout of the crisis. The US has been making allocations to the maximum level allowed under the Uruguay Round Agreement on Agriculture and these allocations have been increased recently, especially for subsidized exports of dairy products.[**32**] Furthermore, the US imposed tariffs amounting to 30 per cent on French cheese. To justify its move, the US government announced that these actions were taken in response to the increased use of export subsidies by the European Union. Similarly, Russia decided to raise automobile tariffs to protect its car industry undergoing sharp declines in demand. India further increased tariffs on imports of steel products and, for alleged health reasons, banned imports of Chinese toys which represented about 60 per cent of toys sold on the Indian market. The UE also put restrictions on beef imports and many countries, including the EU, took anti-dumping measures against imports of Chinese goods.[**33**]

However, it is not just developed countries which are practicing old and new forms of protectionism. Developing countries are also imposing trade restrictions. In developed countries, 'globalization' helped create what came to be known as "vertical specialization" or " global supply chain", where many producers from different countries tend to cooperate to produce inputs and finished goods. This makes it uneasy for a developed country to put restrictions on trade with another developed country. By contrast, for developing countries with less 'globalised' economies, imposing tariffs seems to be the most prominent way to adjust trade imbalances when they occur. In this respect, Ecuador raised tariffs on about 600 imported goods and Indonesia limited the number of ports to 5 for some imports such as textiles, shoes and toys. Likewise, Argentina imposed new requirements for the delivery of favored import authorizations of goods among which are spare parts, cars, clothes, TV sets, and leather products. China equally banned imports of some European food products like Irish pork, Italian brandy and Spanish dairy products.[34] Mexico further decided to impose import duties on about 90 items of US exports as a retaliatory measure against an earlier US protectionist action against Mexican trucks travelling on US highways in a move to protect US transport companies. This US action was viewed by the Mexican government in contradiction with the free trade agreement (NAFTA) signed between the two countries in 1994. These anti-trade measures are expected to cost both economies about US$2.4bn of goods.[35]

The protectionist measures which have been taken so far by governments of both developed and developing countries are allegedly destined to protect national industries, save jobs, improve incomes and expenditures and raise prosperity. In fact, some of them are retaliatory and have nothing to do with internal and external balances. They are the sign of trade wars that could break out any time like they did 79 years ago when the US enacted the Smoot-Hawley tariff in 1930. Thus, history may be repeating itself.

III- The impact of the crisis and protectionism on global trade

Over the period 1990-2006 global trade was growing at an annualized rate of 6 per cent, overtaking the growth rate of the world economy estimated at 3 per cent over the same period.[36] However, the extreme slowdown in the world economy and the rise of economic patriotism is shrinking international trade. The IMF has recently announced that world trade will decline by 10 per cent this year.[37] Countries relying substantially on trade for economic growth, such as Japan, Germany and most developing countries, are expected to be severely slapped. In the long run, however, poor countries will pay a higher price because they often rely on a limited number of exports. Trade accounts for 40-50 per cent of GDP in developing countries as compared to an average of 15 per cent in advanced countries.[38] That is why the less developed countries are more worried about the recent protectionist tide than the developed countries.

Recent figures have revealed severe regressions in world exports, with varying rates from one region to another, affecting badly industrial outputs in both advanced and developing economies. Exports all over the world are forecast to continue falling worldwide throughout 2009**.** Prior to the financial crisis, the US economy played a pivotal role in the world economy. Its imports accounted for 15 per cent of world trade and helped maintaining the world expansion, particularly in Asia and oil-exporting countries**.**[**39**] However, US imports have been declining since 2007 because of global economic slowdown. In May 2009, despite slight improvements, the US trade deficit was still around US$26bn. Exports rose by 1.6 per cent to US$123.3bn, while imports fell by 0.6 per cent to US$149.3bn, the lowest since August 2004, reflecting a weakening US role in world trade**.**[**40**]

Apparently, Asian countries have been among the most affected by the crisis because of their heavy dependence on exports. For instance, in January 2009 South Korean exports, especially computer chips, mobile phones and ships, fell by 32.7 per cent from a year ago and registered a further drop of 17.1 per cent in February 2009. Likewise, Japanese exports, mainly cars, heavy machinery and electronics, dropped by 19,6 per cent in December 2008[**41**] and by 45.7 per cent in January 2009, widening the country's trade deficit to about US$9.9bn and a balance of payments deficit of US$1.8bn, the first in 13 years.[**42**] Japanese exports to the US fell by 52.9 per cent and those to China were down by 45.1 per cent**.**[**43**] Falling demand has forced manufacturers such as Toyota and Sony to cut outputs and jobs. China is equally undergoing serious hardship despite relatively higher economic growth rates. Its exports fell by 11 per cent in the first quarter of 2009, even though a trade surplus of US$96.4bn was achieved, that is a decrease of 1.3 per cent as compared to last year.[**44**]

In Latin America, economies have also been suffering from the decline of overseas demand. According to World Bank estimates, from October 2008 to April 2009 Latin American exports declined by 20 per cent, whereas those of eastern Asia and eastern and central Europe fell by

35 per cent.[**45**] Compared to 2007 figures, Brazilian and Argentine exports decreased 26.3 per cent and 24 per cent respectively in December 2008.[**46**]

Likewise, the exports of European countries have been contracting. Russian exports dropped by 16.7 per cent and those of Germany by 11.8 per cent in November 2008. However, in March 2009 German exports recorded a slight increase of 0.7 per cent, reaching US$88.46bn, and imports rose to 0.8 per cent, totaling US$76.73bn, enabling Germany to achieve a trade surplus of about US $11.73bn.[**47**] This might be a sign of an economic upturn for Germany and the world because of its economic weight, ranking third in terms of GDP (more than US$4.3 trillion).

The impact of the crisis on Arab economies and trade does not seem to differ much from the rest of the world. Despite significant improvements in their GDPs and foreign reserves last year because of exorbitant oil prices, oil-exporting Arab countries have started to feel the pinch of the crisis. Algeria and Saudi Arabia are a case in point. After recording all time high levels of oil exports and foreign currency reserves in 2008 (about US$70-80bn and US$138.5bn respectively), Algeria's oil and gas revenues fell by 46.5 per cent in the first half of this year to US$20.7bn and they are forecast to reach US$40bn by the end of the year, that is roughly half last year's earnings. Algeria's recent ban on consumer credits looks like an emergency protectionist measure to cut imports, particularly automobiles which totaled 350 thousand cars last year. Apparently the ultimate aim of this move is to preserve Algeria's external balances and to shift bank loans to the housing sector to boost domestic demand. Similarly, Saudi Arabian non-oil exports fell to US$1.7bn in April 2009 compared to US$2.85bn a year ago, that is a drop of 27 per cent. As to imports they contracted by 21 per cent in April 2009 as compared to those of last year, going down to US $7.3bn.[**48**]

It should be noted, however, that the decline in world trade is also the outcome of shrinking funds destined to financing and guaranteeing trade. According to some analysts, about 80-90 per cent of world trade relies on some form of trade finance.[**49**] Since the first half of 2008, there has been evidence of tightening market conditions for trade finance. This situation worsened in the second half of the year and further in the first quarter of 2009. It appears that rescue packages have not been enough to bridge the gap between supply and demand of trade finance worldwide. According to some statistics, funds which used to finance about 90 per cent of world trade exchanges has so far fallen short by about US$100bn. Besides, trade finance experts estimated in February 2009 that there was a shortfall of US$100-300bn a year and the situation is not expected to improve in the near future. In some countries, like Ecuador, Indonesia, The Philippines, South Africa, funds for trade dropped by about 30 per cent.[**50**] This situation is likely to contribute to deepening the global economic downturn, making it difficult for many countries to recover from the effects of the crisis any time soon.

More analyses are sending serious warnings of devastating financial effects on the world economy and trade. In a recent World Bank report it was announced that the developing countries will undergo a global deficit of $700 bn this year.[**51**] This indicates that competition among countries will become tense for scarce foreign bank credits, driving poor countries to rely more on foreign aid. Thus, the developing countries will have to work harder to maintain growth and to avoid social and political unrest.

More significantly, financial shortfalls and global trade declines are expected to further undermine the problem of foreign debt in many countries, including east European countries. Their exports are falling and their currencies are depreciating fast and many governments in the developed countries have encouraged banks to repatriate funds. As days goes by, their foreign-denominated debt burdens will become heavier, making repayments even harder. According to some estimates, east European countries need about US$200bn this year to service external debt, and up to US$150bn more to recapitalize anticipated bank losses.[**52**] Therefore, east European economies will remain underfunded for years to come and economic recovery seems to be out of reach for the time being.

Thus, ongoing regression of global trade is not only the aftermath of declining world demand; it is also due to increasing old-fashioned protectionist forms and the spreading of new restrictions accompanied with considerable financial shortfalls. And although the WTO seems to have limited the scale of trade restrictions it has so far failed to stop the protectionist tide and the Doha trade negotiations do not seem to be heading for an agreement very soon. In this respect, Pascal Lamy, secretary-general of the World Trade Organization announced that "a successful completion of the Doha round based on what is currently on the table [would result in] $150bn in global tax cuts on imports, a global stimulus that could help jump-start our economies".[**53**]

IV- What should be done to restore growth and boost world trade?

Despite signs of world's pulling out of recession, governments still need a lot to do to restore economic growth and boost international trade. Recent increases in oil prices, improvements in financial markets and rising industrial production in Japan and growth rates in some emerging economies could prove to be temporary if not sustained by improvements in other economies and followed by genuine financial and economic reforms.

In fact, the most important indicator for recovery is the performance of the US economy because of its paramount influence on the world economy and trade. The US economy has so far been sending contradictory data. In spite of a reported slowdown in the US economic decline, unemployment is still on the increase and companies' stocks are still high coupled with low domestic demand. Furthermore, the mortgage crisis is still there and borrowing remains hard and limited despite slight increases in housing prices, about 1.2 per cent at the end of June.[**54**]

Likewise, economies all over the world are facing serious challenges, particularly financial deficits, unemployment and poverty. More importantly, trade and financial restrictions are rising and the future for world financial markets looks gloomy because of lacking consensus among governments on financial and banking reforms. This will undoubtedly add to world instability and economic uncertainty.

Moreover, world governments have not been able yet to conclude an agreement on free trade under the auspices of the WTO. The Doha round negotiations which started in November 2001, with the aim of lowering trade barriers and increasing trade globally, do not seem to be resulting in any progress because of considerable disagreements over many trade issues, particularly agricultural subsidies. The lack of a global trade agreement will further make it harder for the world to pull out of recession.

To reverse the trend of the world economy, governments should cooperate to coordinate economic and financial policies, including exchange rates. It is in every country's interest to restore financial stability and economic growth. To prevent further crises, the world is virtually required to protect wages and the purchasing power of workers; the gap between productivity and wages must be narrowed. Besides, the world desperately needs bold and urgent reforms of the international financial and banking system, as well as new clear-cut regulations for financial markets, otherwise the economic stimulus will only alleviate the effects of the recession.

Moreover, the world must stand firm against protectionism and refrain from introducing new trade barriers. The world community is urgently required to adopt new trade policies and regulations. The recent anti-trade tide is not merely the outcome of ongoing economic and financial crisis; it is also due to lacking coordination and the failure of the Doha trade talks. Government commitments must not remain political; there must be binding legal commitments to avoid protectionism. If the Doha round fails again to reach an agreement in its next summit due in September 2009, commodity prices will continue to rise and consequently the world economic recession and the food crisis will both be undermined. Developing countries, in this case, will continue to be the most affected.

Economic recovery in developing and poor countries hinges very much upon recovery of the US economy and other advanced economies. This is because their economic growth is considerably tied to exports and many of them rely on foreign 'aid'. Therefore, to save the world economy the world financial institutions, especially the World Bank and the IMF, need to make more funds available to these countries. However, financial 'aid' is not enough; 'aid' must be through trade as well. Developed nations need to loosen their trade and investment restrictions with developing countries. 'Globalization' must not be at the expense of the latter and the burden of the economic crisis must not be shifted to them either.

In a shaky world, developing countries are required to arm themselves with a new long-run vision to reduce their dependence on trade for economic growth. Restructuring their economies to emphasize domestic demand and confront the economic crisis is extremely vital. They should equally coordinate their efforts to promote regional economic integration and single markets. This will help boost their trade and raise economic growth. The creation of regional emergency funds must also be one of their priorities to enhance their capacity to face probable economic and financial crises in the future.

CONCLUSION

From the preceding pages we come to conclude that the present financial crisis which originated in the USA has culminated in cumbersome financial and economic losses. A significant number of businesses have collapsed and many economies are now undergoing severe recession. Growth rates worldwide are decreasing and unemployment and poverty are rising at staggering rates and prospects for recovery seem to be poor this year. This fearful situation contributed to a sharp contraction of world demand, leading to huge declines in global trade.

Still, the above analyses lead us to believe that shrinking world trade is not only the result of decreasing world demand. It is also due to protectionism and financial shortfalls. Recent world governments' restrictions on trade, trade finance and capital movements have been strangling trade exchanges worldwide and therefore deepening the world crisis. The absence of a binding world agreement regulating trade relations between nations has contributed and is contributing to the surge of trade barriers. Under such circumstances, the world does not seem to be heading for economic recovery very soon. On the contrary, disagreements between nations over trade are still significant and they are threatening to bring the world economy to a standstill.

Now what remains to be seen is whether world governments manage to sustain the economic stimulus packages to reverse the downturn of the world economy and to avoid other economic and financial hardships. However, further actions seem to be necessary to help solve ongoing economic and financial crisis. Reforms of the world financial and banking system and the completion of the Doha round negotiations are vital for the world to achieve political stability and economic prosperity.

FOOTNOTES

1. G20 countries are: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turky, The UK, The USA, and the EU. G20 countries represent about 85 per cent of world GDP, 80 per cent of world trade and a third of world population.
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