Trade Policy 3.0:

Three Scenarios for Tomorrowland

Full Transcript

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Oscar Guinea: Hello, and welcome to ECIPE's Global Economy Podcast. My name is Oscar Guinea, and I'm Director at ECIPE.

Our guest today is Lucian Cernat*. Lucian is Head of Unit at DG TRADE in the European Commission and the author of several studies and papers.

And today he joins us to talk about his latest paper, Trade Policy 3.0: Three Scenarios for Tomorrowland. You can download and read the paper at the ECIPE website.

Lucian, welcome to our podcast.

Lucian Cernat: Thank you, Oscar. And hello, everyone, whoever is listening to us.

Oscar Guinea: Good, let's start with the questions. In your paper, you describe three generations of trade policy. 1.0, 2.0 and 3.0. What defines each phase, and what has really changed from one to the next?

Lucian Cernat: Yes, indeed. I think that's the fundamental question behind the paper. And I would like to try to explain why I think this is a very good framework of analysis to separate the long history of international trading into three distinct periods.

In a nutshell, each of them is shaped by a different set of economic realities. In trade policy 1.0, we have the traditional post-war model that was centred on macroeconomic objectives. I think macroeconomics was the key defining logic behind.

And trade policymakers and academics alike were perhaps most interested in the impact of tariff liberalisation, classical market access, and ways in which we could advance the multilateral rulemaking. Essentially, the core assumption was that reducing border barriers would maximise welfare gains. And frankly, for several decades, for many decades, that logic held.

Then we enter trade policy 2.0, essentially at the same time as the rise of global supply chains. Once firms engage in international trade, they start to fragment and slice production across borders, involving many other suppliers and subcontractors. Then this economic reality, combined also with a fairly important fundamental change in the economic thinking, underpinning trade policy analysis, the importance of individual firms, led to what I called in 2014, a new trade policy 2.0 period. In this period, we moved away, I think, in our key questions from classical trade questions. We started to look at regulatory frictions, standards, investment, all the kinds of things that individual companies worry about in the behind the border, the type of measures, technical barriers to trade. I think if I were to summarise trade policy 2.0 in some simple terms, the first is the change from macroeconomics to microeconomics, to firm-level realities. My preferred motto of the trade policy 2.0 period is, countries don't trade, firms

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do. I recently authored a paper where I applied this idea to the EU-Canada FTA, the CETA agreement, looking with co-authors at one of the critical elements in trade policy 2.0, which is supply chain, as I said, but also SMEs, small and medium firms, participation in global supply chains. That in itself changed in many ways the way in which we did trade policy making during these recent decades.

Now, what the paper is arguing is that we're entering into a new era, which I call trade policy 3.0. In this new era, at least to me, the current environment is shaped by systemic shocks and geopolitical tensions, among many other things. Again, one very distinct difference between trade policy 3.0 and previous eras is that efficiency is no longer the sole organising principle. We now have key objectives and key parameters revolving around issues like resilience, strategic autonomy, and economic security. These are now core policy objectives in trade policy.

So, in other words, what we had as an evolution for decades since World War II and trade policy 1.0, which evolved then in trade policy 2.0 with a certain continuity, now we are faced with a significant disruptive set of issues that would, if they succeed in the tendencies we see now, that will lead to a very, very different trade policy 3.0.

Oscar Guinea: When I was reading your paper, a thought I had was this trade policy 1.0, 2.0, and 3.0. It kind of tells the story of different generations, right? So, in a way, trade policy 1.0 is the baby boomers, Generation X type of trade policy. Trade policy 2.0 is more like, well, it could be a mix of people having born in Generation X or millennials like myself. And the kind of trade policy that those who are coming to terms now with Generation Z will be trade policy 3.0. So, my question to you is, how does the time when you started to work on international trade really shape the way you think about trade policy?

Lucian Cernat: I think that's an excellent question and a very useful analogy, Oscar. I actually haven't thought about it when I created this conceptual framework to analyse trade policy, but it's very fitting indeed. So, if we go with that analogy, I think I can clearly say that I belong to Gen X and I entered trade policy during the, I would say, the last phase of trade policy 1.0. I joined trade policy when I was a young diplomat in the Romanian Ministry of Foreign Affairs, doing some bilateral negotiations at the time. And then I moved to Geneva, where I was part of the UN in charge of trade and development. So, yes, I was shaped in a way by this golden age of trade policy 1.0, where principles matter, this idea that we trust in trade liberalisation to deliver its benefits to countries around the world. And in my capacity at the time, also to maximise the development dividends of openness, I was the dominant and the defining logic that shaped my thinking.

Then it allowed me also to very quickly move into trade policy 2.0, which, as I said, was a natural evolution without changing too much in terms of principles. I was rather enthusiastically jumping into trade policy 2.0, looking at firm levels, competitiveness, and global supply chain issues, and I think that was really important.

Now, the same for those other generations. If you are a millennial, you probably joined trade policy in the 2.0 period, and then you were probably immediately dragged into how to make sure that we are efficiently working together. It's about standards, logistics, and investments. Digital flows already was a big thing. And I think the question wasn't anymore, shouldn't we integrate? In trade policy 2.0, the question was, how do we make sure that we integrate in the most efficient manner?

Now, if you are a Gen Z, I think you would then enter now in trade policy, the end of trade policy 2.0, the beginning of trade policy 3.0, and your thinking would be shaped by a different landscape. It's, as I said, geopolitical shocks, avoiding overdependencies. There's a revival of industrial policy going on right now. There is a very important blend now between securitisation and economics.

There are no longer just the core economic principles. There's a lot of geopolitics involved. So, you will develop instincts to interrogate yourselves about how to avoid vulnerability, how to avoid the risk of overconcentration of supply chains, and how do we build resilience.

So, I think you're right. In a way, the period when you start working in trade policy may, in fact, have lasting consequences on your way of thinking.

Oscar Guinea: Absolutely. It's like when people say that the music that you listen to when you are in adolescence really marks your taste for music forever, right? It really stays with you.

I remember when I started to work in trade policy, I mean, it was with you at the Chief Economist. I was an intern. That was my first job in international trade.

And at this time, I remember we were moving. It was in 2010. So, I think it placed me in trade policy 2.0. And we were moving from multilateral trade policy to the Doha Round, to doing bilateral SFTAs. And the trade agenda started to get opened as a response to the Seattle Ministerial Conference. So, there were more topics about human rights, the environment. But there was a clear expectation that there was only one way that tariffs would go. And that was down.

So, the feeling of trade as a force for good and the importance of integrating countries within global value chains for development was very, very present.

Lucian Cernat: Yeah, you're right. I'm going to be a bit provocative now. But for those colleagues who dealt with tariffs in that period for many years, I personally thought that in trade policy 2.0, when we had so many other important questions on the table, frankly, those days, if you were dealing with tariffs, I personally thought that was such a dull topic. Like, this is boring tariffs. I mean, this is so behind us, which is no longer the case nowadays. So, indeed, at the time, at the peak of trade policy 2.0, if you wanted to be advancing the policy agenda or the policy research agenda, you would be looking at, as I said, from level data, "trade ands", lots of "trade ands", all sorts of things. And you would probably try to collect detailed statistics. We've been looking at the participation of small and medium enterprises, how they become unicorns and competitive, even being born global. All these things were probably the exciting part of trade policy 2.0. But now, in a way, we're back to tariffs.

Oscar Guinea: Yeah, and remind us, what is your current title in the European Commission? You have ridden the waves of trade policy 1.0, 2 and 3, and now you are dealing with tariffs in DG TRADE, correct?

Lucian Cernat: I am in charge of tariffs. But as I said, now is not a dull moment. I think dealing with tariffs now is extremely important, and we have many challenges ahead.

But speaking of our own DG, the name of the DG has changed, so we are DG Trade and Economic Security. So that's also a sign of the times we live in.

Oscar Guinea: Indeed, the clue is in the name. So, something that really separates trade policy 3.0 from the earlier phases is the role of international organisations. You described that in your paper.

So, from your point of view, how important is the WTO, the World Trade Organisation, in the era of trade policy 3.0?

Lucian Cernat: Yes, this is a difficult question, in a sense. I don't think I have a definitive answer in my paper to it. But here I can probably try to speculate a bit more.

In reality, if you think about it, in trade policy 3.0, the role of the WTO becomes a bit paradoxical. On the one hand, it's more essential than ever. If you look at the challenges we face, we need the WTO now more than ever before.

That's one part of the paradox. The other part of the paradox is that when you look at the WTO and its current positioning on all these strategically important topics, we realise that somehow it seems structurally less capable of delivering what policymakers expect in this new environment.

So, why is that so?

I think, in my personal opinion, the core mandate of the WTO, transparency, predictability, rules-based disciplines, that's exactly what we need now in an era defined by uncertainty, geopolitical friction. So, when some countries try to weaponise interdependence, if you have a strong set of multilateral rules and you have a very strong institution, that's not a luxury. This is a very powerful stabilising factor if we could reach that stage.

So, in that sense, the WTO could be a foundational element in a new trade policy 3.0. It could reinvent itself. But here's the other side of the paradox. Because trade policy 3.0 is driven by issues that the WTO was not originally designed to handle, it faces difficulties entering these new topics. Economic security, data governance, technology controls, outbound or inbound investment screenings, critical raw materials, and the list could go on and on. These are topics that would probably fall into grey zones in any WTO agreement. We have plenty of WTO agreements.

They are supposed to be coherent with each other, but if you were to place all these topics squarely in one or the other WTO committees, it would be very difficult. So, I think the challenge of the WTO's traditional legal boundaries and the consensus-based decision-making will make its new role in these very polarising types of topics much more difficult. So, now we end up with an institution that remains normatively very important, but at least for the time being, increasingly mismatched with the core policy agendas.

I think the upcoming WTO ministerial next year would offer a very good opportunity in this regard to see whether the WTO reform could bring a new impetus in this domain. So, we just need to be patient and let's see what happens.

Oscar Guinea: Very good. So, let's see what happened. So, let's continue unwrapping this concept of trade policies 3.0. So, you point out that COVID-19 was a major driver, and I remember during that period you co-authored a great paper, a DG Trade paper, showing the benefits of imports and open supply chains.

It's a paper that I have read several times and recommend to everyone listening to read it. So, my question to you is, why do you think the lessons many governments drew were to make trade harder, not easier, when you showed exactly the opposite?

Lucian Cernat: That's, I think, a question that will... I mean, we can go on and on with these elements because there are so many things to unpack, but I could start with some very simple answers and then I will expand.

So, the first thing is that during a crisis, I think time gets compressed. People need to react very fast. So, we have this famous book by a Nobel Prize winner about thinking slow and thinking fast. So, in a crisis, you don't have the luxury to think slow and think slow is the rational, you know, you have time to reflect,

you have time to look at all the consequences. In a crisis, you have to think fast. Sometimes when you think fast, you have to respond to instincts and things that you prioritise.

And there is also the fear factor. And in a crisis, fear travels faster than the data. So, even though we had all this data and the two of us wrote a nice blog for each side, I remember still the title with references to ants and dinosaurs and the resilience, and what's the best way to survive through a trade apocalypse. All these elements had only a limited impact on policymakers because, at the same time, policymakers, they probably saw empty shelves in some critical goods for a while.

They saw that some countries introduced export bans, or they had some knee-jerk reaction to some other measures. So, in the end, what prevailed was the narrative of we need to avoid over-dependence, we need to fight vulnerability. And these were powerful narratives, emotionally intuitive and politically mobilising.

So, in the end, data had only a limited impact on shaping that debate. So, we saw that the reaction was suboptimal, maybe a bit too late. And in parallel, COVID also coincided with, I think, a broader geopolitical shift.

It was a pandemic, but there were many other things that made a few trading partners look at each other as strategic rivals. So, when you put all these things together, you realise that people pay a lot of attention to those elements that I mentioned in the paper, resilience, and strategic autonomy.

Therefore, I think the data pointed one way, but the politics pointed another way.

And the bottom line is very simple. Now, we can say very clearly, and everyone would agree, that COVID-19 didn't prove that globalisation failed. Now, it's clear.

Now, we have the time to think slowly. We have all the data, and we're no longer in crisis. So, we can see the evidence.

But at the same time, we have new forces that will, in my view, shape trade policy 3.0 in a way that will take these new priorities into account in an important way.

So, this security, the politics, and the resilience will have an important element in the future.

Oscar Guinea: This takes us very nicely to the next question because in your paper, you don't only talk about the past, but you venture into the future, and you outline three possible futures.

Immunity, sclerosis, and contagion. Can you unpack this for us?

Lucian Cernat: Well, first, I probably need a caveat. If a Nobel Prize in physics had to put a caveat saying that prediction is very, very difficult, especially when it's about the future, I should probably say the same. I think economics is far more uncertain than physics.

So, that caveat applies even more to economics or trade policy. So, yes, prediction about possible futures is extremely fraught with uncertainty. So, I'm not sure I have any better educated guess than any of our listeners here.

But I thought that, logically speaking, we see the potential for three distinct scenarios to unfold. So, one I call the immunity, the other one I call sclerosis, and the last one, the worst-case scenario in a way, it's contagion.

Immunity is the easy one. It's the optimistic scenario. It means that all the things we like about the standard trade policy 1.0 or 2.0, they will remain dominant as an organising principle, as the logic of international trade. But in this framework, new elements will be adapted, and they will fit nicely together. So, it's like imagine that the, in a way, trade policy 2.0 gets a vaccine, gets some antibodies, and that it is immune to trade policy 3.0, but at the same time, it adjusts a bit to these new realities.

Sclerosis is the middle scenario where the system doesn't collapse, but it doesn't reform either. And everyone knows that something needs to be done, but nobody gets to agree on what and how exactly we should do things. So, we will continue to trade. We will probably have more sluggish trade, less predictable, but we will not have a real crisis. That's why it's more like stagnation. So, the system will be a bit harder, you know, harder to navigate, but it's more of the same, I would say, what we currently see at the moment.

Now, contagion is the pessimistic scenario where things can go a lot worse than today. When we have a lot of, even more politicised trade relations, the trust will break down across multiple supply chains, there will be systemic fragmentation, and then we'll even have competing blocks trying to, you know, preserve all these new priorities of resilience, strategic autonomy, etc.

So, the global economy will no longer be, in fact, paradoxically resilient. By trying to become resilient, if we have too much fragmentation, we lose resilience. So, I hope contagion doesn't go that far.

So, this is it. In three simple terms, immunity would be like adaptation, sclerosis is stagnation, and contagion is fragmentation.

Oscar Guinea: So, my last question before we end the podcast. If I give you 100 euros to bet on which scenario will define the next decade, how will you split that bet across the three scenarios?

Lucian Cernat: 100 euros, that's very generous of you. Let's see what we can make out of 100 euros. Let's maximise our returns on this together, right?

Now, if you trust me with 100 euros, Oscar, one thing I promise you is that I would not spend it all in one place. So, I would definitely spread it on all three scenarios because I think the world is far too complicated for a single trajectory. Frankly, I don't know which one is going to happen.

They're all perfectly plausible in my view. And if the idea was to put the 100 euros in a way that we maximise our returns, I think we also need to take into account what others are thinking. So, I ran a little poll on LinkedIn, and I think most places, most people place their bets on sclerosis and contagion.

So, if you want to have high returns, we should also put a little bit of our 100 euros on immunity because if that scenario turns out to be true, we get all the money. Everyone else is betting on sclerosis or contagion. If we're the only ones betting on immunity, then that means we win big.

But that scenario probably means it's not as likely as the others. So, here's my proposal. Let's spread it evenly across all three scenarios and see what happens in a couple of years from now.

Oscar Guinea: I bet the diplomats spread evenly and the economists spread in the bet. Very good. Lucian, thank you so much for this conversation and for helping us navigate what's next in global trade.

And for everyone listening, you can find Lucian's excellent paper and many of his other papers, which I also recommend, on the ECIPE website. Have a nice day.

Lucian Cernat: Thank you, Oscar.