Economia Viva 2019 – Nova SBE

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Introduction

Thank you to the Nova Economics Club for inviting me to be part of this edition of "Economia Viva".

This cycle of conferences represents a great forum for students to engage with representatives of national and international institutions, policymakers, managers and academics from around the globe.

This format provides the floor for open discussions on issues with relevance from a domestic, European and global level.

I will focus on the impact of trade agreements on competition.

This reflection calls first for an illustration of how global our economies have become.

Global supply chains

Let's talk first about global supply chains.

Milton Friedman's pencil[1], you've probably seen this example, whose wood comes from the state of Washington; graphite from South America and rubber from Malaysia, is a paradigmatic example of how complex and global supply chains can be, besides being an example that preaches the free market for the benefit of all consumers. This example dates back to 1958[2].

Today, this is even more so. Apple, for example, in 2017, had hundreds[3] of direct suppliers from 43 countries[4]. If we consider just four raw materials used in the components of Apple products – gold, tungsten, tin and tantalum – we can count over 300 suppliers from 41 countries upstream of Apple[5].

Seemingly all industries and society, in general, are experiencing a great transformation with the increasing digitalization of the economy. Increasing digitalization fosters innovation, reduces economic distances and deepens economic integration.

Trade agreements

Now, moving to the importance of trade agreements.

Such a deep economic integration cannot arise if the different interacting parties do not share a common and stable legal framework. In the case of trade between countries, the rules of the game and the roles each party *may* or *must* play are defined by trade agreements.

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[1] https://www.youtube.com/watch?v=R5Gppi-O3a8
[2] https://en.wikipedia.org/wiki/I,_Pencil
[3] https://www.apple.com/supplier-responsibility/pdf/Apple-Supplier-List.pdf
[4] https://www.cnbc.com/2018/12/13/inside-apple-iphone-where-parts-and-materials-come-from.html
[5] https://www.apple.com/supplier-responsibility/pdf/Apple-Conflict-Minerals-Report.pdf

Trade agreements are increasingly more complex, but the goal remains (or should remain) to reduce transaction costs between firms and consumers globally. Therefore, legal harmonization resulting from trade agreements delivers more integrated markets.

Countries have looked beyond the narrow vision of tariffs as the main barrier to trade; and have increasingly focused on non-tariff measures. Trade negotiations and trade agreements grew in scope to include rules on health and safety, cross-border investment, banking and finance, intellectual property, competition policy, labor, environmental issues, among others. It is true, though, that while protecting legitimate public interests such as the ones mentioned just now, other unjustified non-tariff measures may be added. This is also, by the way, called protectionism. And these may result in less competitors, less innovation and higher prices to the consumer.

This is why we must maintain domestic and global conditions that provide firms and consumers with wider opportunities and greater welfare.

Benefits of trade agreements

Let's see in closer detail which are the benefits of trade agreements.

Reducing barriers to entry and expansion to foreign firms fosters competition and allows for efficiency-enhancing specialization. This, in turn, delivers benefits to consumers in the vector of prices, quantity, quality, choice and innovation.

The pro-competitive effects of trade agreements may also boost productivity growth, employment and investment along the entire global supply chain and through the economy more widely.

Countries and regions are better-off when they dismantle barriers that inhibit trade, prevent investment or reduce fair competition.

The European Union provides a great example of the value of market integration. Although the common market is yet to be fully implemented in the European Union, steps in this direction are taken on a daily basis. And we have achieved quite a lot in the past decades.

Just last December, for example, a new regulation came into force tackling unjustified geo-blocking practices, which limited trade between Member States.

This is a step forward in defending consumers' right to competition – the motto we chose for the 15th anniversary that the Autoridade da Concorrência celebrated in 2018.

In fact, according to the European Commission, over half of European consumers made an online purchase in 2017. Yet, many consumers were not able to buy goods and digital content online across national borders. They were either refused or redirected to a website in their country, with less favorable terms.

Geo-blocking thus prevents consumers from reaping the benefits of technological developments. Acting against this is key to deliver consumers their right to better and borderless deals.

Trade agreements also allow countries to commit themselves relative to others and to themselves. In addition to multilateral trade rules, they ensure predictability and trust among trading partners.

We are well aware that governments may face short-term political pressure from import-competing interest groups. Failing to resist to such pressures may harm the economy and consumers, especially in the long-run. Hence the importance of trade agreements. Their purpose of trade thus shares similar goals with those of the independent mission of competition authorities, central banks and other regulators.

Risks of trade agreements

Let's move now to the risks of trade agreements.

As mentioned, trade agreements may seek to pursue legitimate public policy goals. Nonetheless their terms may also end up serving as a tool for protectionism and curtail competition.

Opacity as to the true aims of a given non-tariff measure introduces the risk that special interest groups push for legislation that goes beyond what is needed to achieve the underlying policy aim. Let us be clear on this: barriers do not just keep out threats; they also make you miss opportunities. So instead of isolating ourselves, we should be looking for openness.

Horizontal industrial policy

Now, let's look at very concrete examples of how industrial policy should be carried out in the view of a competition enforcer.

In a well-functioning economy, economic policy ought to be as neutral and non-distortionary of competition as possible.

Just last week[6], the European Commission opposed the merger between Siemens and Alstom, which would have significantly reduced competition in the markets of signaling systems and very-high speed trains.

This decision came amid pressure from the French and German governments for the Commission not to oppose it. This pressure followed a desire to create a "European champion"[7].

Following the Commission's opposition to the merger, the French finance minister stated that the Commission's decision was a mistake as it would strengthen the Chinese industry and weaken the European industry[8].

The call for "European champions" echoes an old debate on "national champions", where governments prop up specific firms or sectors so they are more able to compete internationally.

This type of industrial policy is highly distortionary of competition and may bring harm to the functioning of markets in the vectors of price, quantity, quality, choice and innovation. Hence, it may come at the expense of consumers or the competitiveness of other firms supplied by the "national" or "European champion".

This does not mean that the relevance of industrial policy should be disregarded.

It rather means that industrial policy must remain horizontal and, as such, economies must be attractive because of their stable macroeconomic environment, their competitive and stable fiscal policy, the availability, quality and competitiveness of their infrastructure, of utilities provision and of their workforce, because of their effective framework of economic regulation and their effective judicial system. All of this is what makes a country attractive.

It is on these grounds that each economy may spawn firms capable of competing on equal terms in international markets while bringing significant benefits to consumers. Those are the real champions. We should want real champions, not artificially-bloated champions that we know will not prevail in the long-run.

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[6] 6 February 2019

[7] https://www.bmwi.de/Redaktion/DE/Publikationen/Industrie/nationale-industriestrategie-2030.html
https://www.europe1.fr/politique/fusion-alstom-siemens-mise-a-mal-bruno-le-maire-critique-durement-la-commission-europeenne-3833348

[8] https://www.youtube.com/watch?v=7_MDD5cELk0

We know that a level-playing field on subsidies is important. The EU works with WTO in order to achieve similar rules with China. And we have had, in the EU, state aid rules for over 60 years.

This point becomes especially relevant as the recent trade war between the US and China has been disrupting global supply chains.

Firms have become weary of trade policy risks and are looking to diversify their sourcing to other countries[9]. As global trade slows down[10], attracting these firms may ease the sail through troubled waters.

The effects of trade wars

That trade war has reignited the debate on the impact of trade wars on the global economy.

Last week[11], the United Nations Conference on Trade and Development (UNCTAD) issued a study on the repercussions of the bilateral tariff hikes between the US and China, as well as the effects of the increase scheduled for the 1st of March[12].

Three concerns were identified by UNCTAD in that scope:

1. the unavoidable impact that trade disputes will have on the global economy and, in particular, on currencies, commodity prices and financial markets;
2. the potential escalation of protectionist policies to a global level, with more countries joining the trade war; and
3. the domino effect which is likely to take place, given that tariff increases penalize not only the assembler of a product, but also suppliers along the chain.

Conclusion

To sum up, trade agreements are an important instrument to create value for the countries involved and for the global economy. Nonetheless, attention should be paid to the risks that both tariff and non-tariff barriers carry for competition. One thing is clear: History has shown us that, in the end, nobody wins with trade wars.

We must seek an open and competitive economy that works well for consumers globally, rather than for the few that may benefit from unnecessary barriers - and even those, only in the short term.

We must also remain committed to the rule of law and multilateral framework, ensuring good results for consumers.

Thank you and I look forward to your questions following the presentations.

[9] https://www.ft.com/content/03e4f016-aa9a-11e8-94bd-cba20d67390c
[10] https://www.bloomberg.com/opinion/articles/2018-09-07/the-global-trade-slowdown-is-happening-now
[11] February 4, 2019
[12] https://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=1989