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TRADE, GLOBALISATION AND EMERGING PROTECTIONISM SINCE THE CRISIS

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ABSTRACT

THE GLOBAL ECONOMIC crisis, and governments' responses to the crisis, did not precipitate a descent into 1930s-style protectionism. That is a relief. But it provides no refuge from policy measures that will slow down globalisation and growth in the next decade. "Creeping protectionism" is increasing, and the crisis has reinforced trends visible before the start of the crisis. New patterns of protectionism are similar to developments in the 1970s and 1980s rather than the 1930s. Domestic "crisis interventions", especially in capital and product markets, and the return of Big Government, will spill over to external policy, with more defensive trade policies as a consequence.



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1. INTRODUCTION*

TWO THOUSAND AND nine was a crisis year for international trade, which suffered its steepest decline since the 1930s. Protectionism returned, reversing an almost three-decade trend of trade liberalisation. But, contrary to expectations, it has *not* returned with a vengeance, rather creeping to the surface in subtle ways.

Time, therefore, to take stock of trade policy after the crisis, and consider its outlook at the beginning of this century's second decade. How serious is the new protectionism? Can it be contained? How are the major players -- the United States, the European Union, China and the WTO -- responding? And what are the implications for economic globalisation?

We start by contrasting the benign political and economic context for international trade up to 2007/8 with the dramatically different context ushered in by the crisis. Then we summarise crisis-induced "deglobalisation". The next section surveys the global trade-policy climate following macro- and microeconomic interventions to combat the crisis, and the seeming return to "big government". Section 3 goes on to assess crisis-related protectionism. And Section 4 "reviews the troops", i.e. the major players in global trade policy, notably the United States, the EU and China.

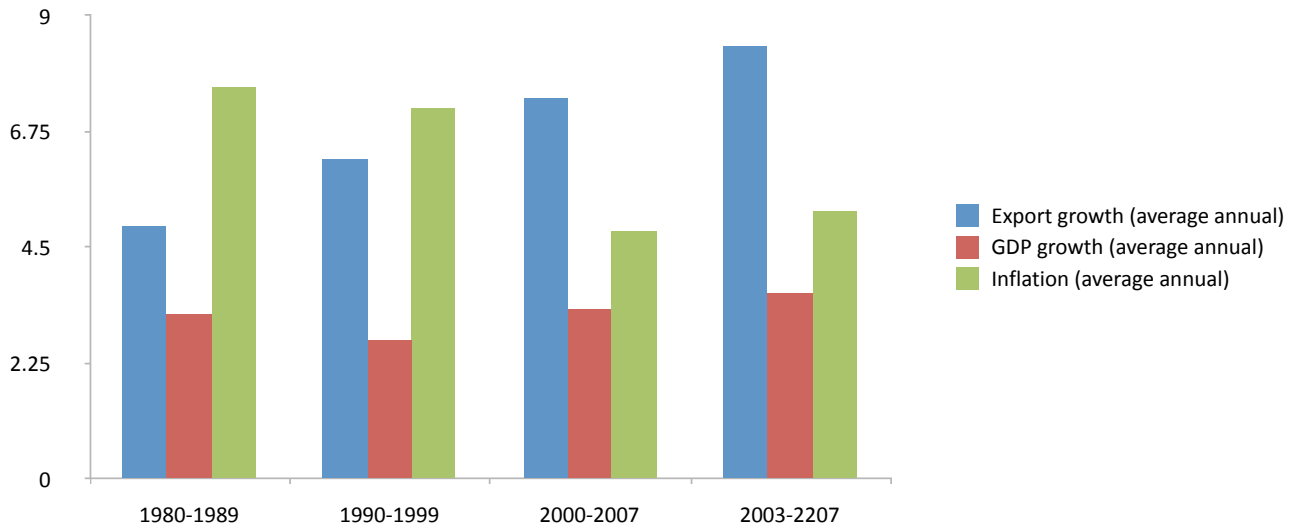
2. THE GOLDILOCKS GLOBAL ECONOMY BEFORE THE CRISIS

THE PRE-CRISIS GLOBAL economy enjoyed golden conditions. The quarter-century up to the crisis saw the fastest increase in economic growth, globalisation and prosperity in history. International trade increased sevenfold between 1980 and 2007, outpacing the increase in world GDP in the same period. World foreign direct investment (FDI) far outpaced both. The global stock of outward FDI increased from USD 579 billion in 1980 to USD 16 206 billion in 2008. The number of transnational companies in 2008 was estimated at 82 000, with 810 000 affiliates representing sales of USD 30 trillion.¹

The global economy had its "Goldilocks" moment in the half-decade from 2002. Growth, trade and FDI soared to ever-greater heights. Financial globalisation soared even higher. Comparative advantage worked in textbook fashion. Labour-abundant Asia rose, powered by the opening and global integration of China and, to a lesser extent, India. China became deeply enmeshed in east-Asian manufacturing supply chains linked to final markets in the West. Resource-abundant Latin America, Africa and the Middle East did well in a China-led commodity supercycle. And the capital- and technology-abundant West also prospered.

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FIGURE 1: TRADE, GROWTH AND INFLATION (AVERAGE ANNUAL INCREASE)

Source: World Bank, World Development Indicators

Rapid globalisation had two driving forces: technology and policy liberalisation. The West had its Reagan, Thatcher and European Single-Market revolutions in the 1980s and early 1990s. Developing countries liberalised massively and integrated into the global economy in the 1980s and '90s, with ex-Soviet economies following from the early 1990s. Average tariffs in developing countries fell from about 30 per cent in 1985 to just above 10 per cent in 2005. There were corresponding reductions in non-tariff trade barriers, FDI restrictions and restrictions on trade in services. The Washington Consensus reigned, reaching its apogee in the late 1990s. According to Jeffrey Sachs and Andrew Warner, around a quarter of the world's population lived in open economies in 1980. By 1993, a majority of humanity lived in (more or less) open economies.² Today, adding China and India, that figure is closer to 90 per cent.

Finally, there was a conducive geopolitical environment. America became the sole superpower in the 1990s, replacing Cold War bipolarity. And global economic institutions, especially the IMF, World Bank and WTO, were at the height of their powers.

3. THE GLOBAL ECONOMIC CRISIS AND DEGLOBALISATION

THE FINANCIAL CRISIS that exploded in September 2008, preceded by the credit crunch that started a year earlier, transformed a benign global political and economic context into something more malign. A sharp contraction in global growth ensued. This was reinforced by even sharper contractions in trade, FDI and other channels of globalisation. The world suffered its worst "deglobalisation" since the Second World War. Contrary to some predictions, Asia did not "decouple" from the West; it too was dragged down.

Contractions in growth, industrial output and trade bottomed out towards mid-2009, followed by a halting recovery. By year-end the latter remained anaemic and uncertain in the West, but the picture looked very different in Asia. Unlike the West, Asia did not suffer a financial crisis; its banks and balance sheets (household, corporate, government and external) were reasonably solid. Rather it suffered a trade or deglobalisation crisis as the financial crisis, originating in the West, spread to the rest of the global economy. But Asia rebounded quickly – much more so than the

West. China led the Asian bounceback, helping to lift other east-Asian countries out of the crisis, and India recovered fast as well.

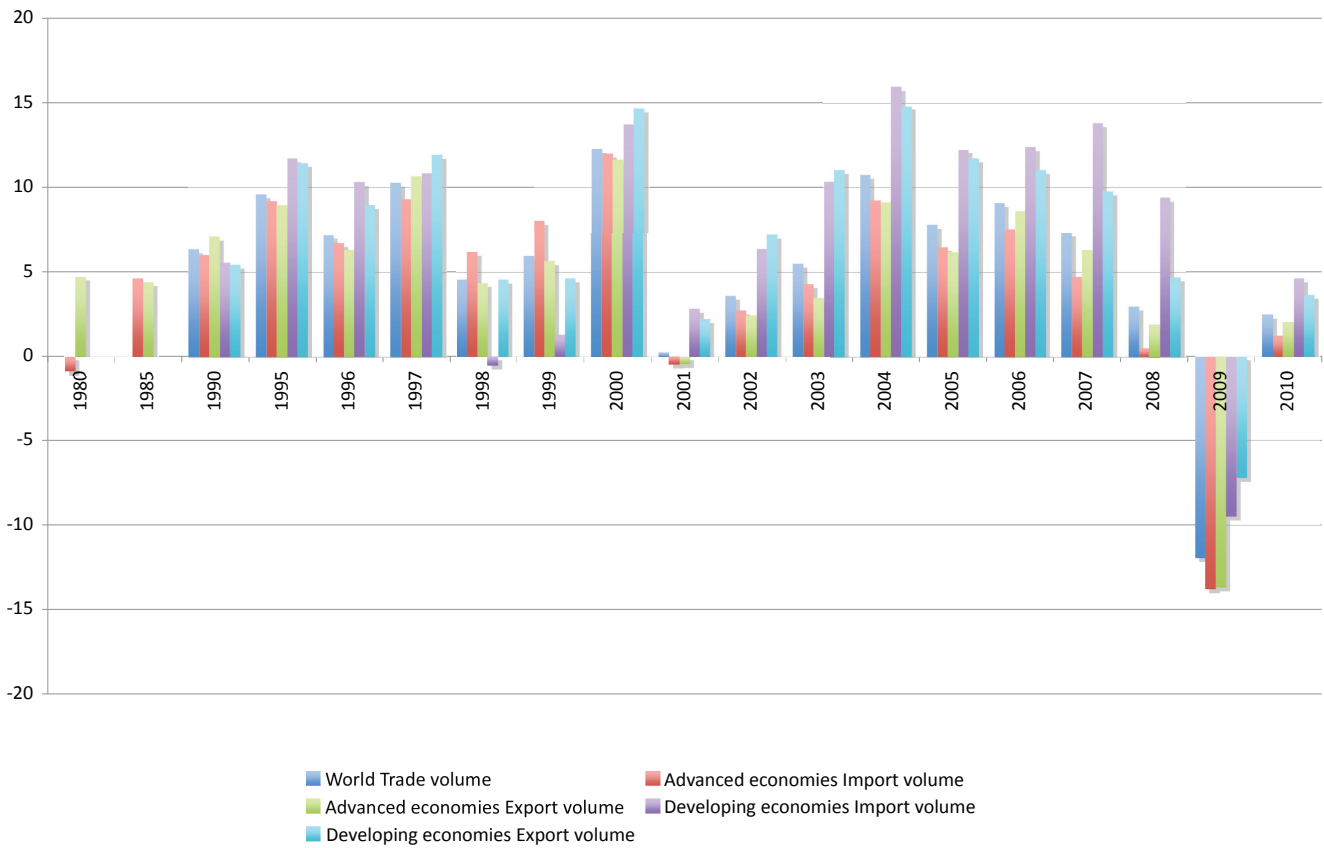
Thus the crisis seems to have accelerated the shift of economic gravity to the East. It has given rise to sunny Asian optimism, which contrasts sharply with Western gloom. There is widespread sentiment that Asia has recovered from the crisis in striking “V-shaped” fashion, just like its recovery from the Asian crisis a decade ago. There is even revived talk of “Asian decoupling”. But that is dangerous Panglossianism. The global economic outlook remains uncertain, probably with turbulent times ahead. That Asia cannot escape. Moreover, Western *and* Asian – notably Chinese – policy responses to the crisis are storing up a lot of trouble (of which more later).

To put flesh on the bones of crisis-induced deglobalisation: The IMF estimates a decline of 0.8 per cent in world GDP in 2009, split between a decline of 3.2 per cent in developed economies and an increase of 2.1 per cent in emerging and other developing economies. It estimates growth of 6.4 per cent in developing Asia in 2009, going up to a Tigerish 8.5 per cent in 2010. China is expected to post growth of more than 8 per cent, and India more than 5 per cent, in 2009.³

Deglobalisation has been most dramatic in finance. International capital flows shrunk by 82 per cent in 2008, and the loss of value of financial assets may have reached USD 50 trillion at the height of the contraction in 2009. Cross-border bank lending fell by USD 5 trillion (a 13 per-cent contraction) between March and December 2008.⁴

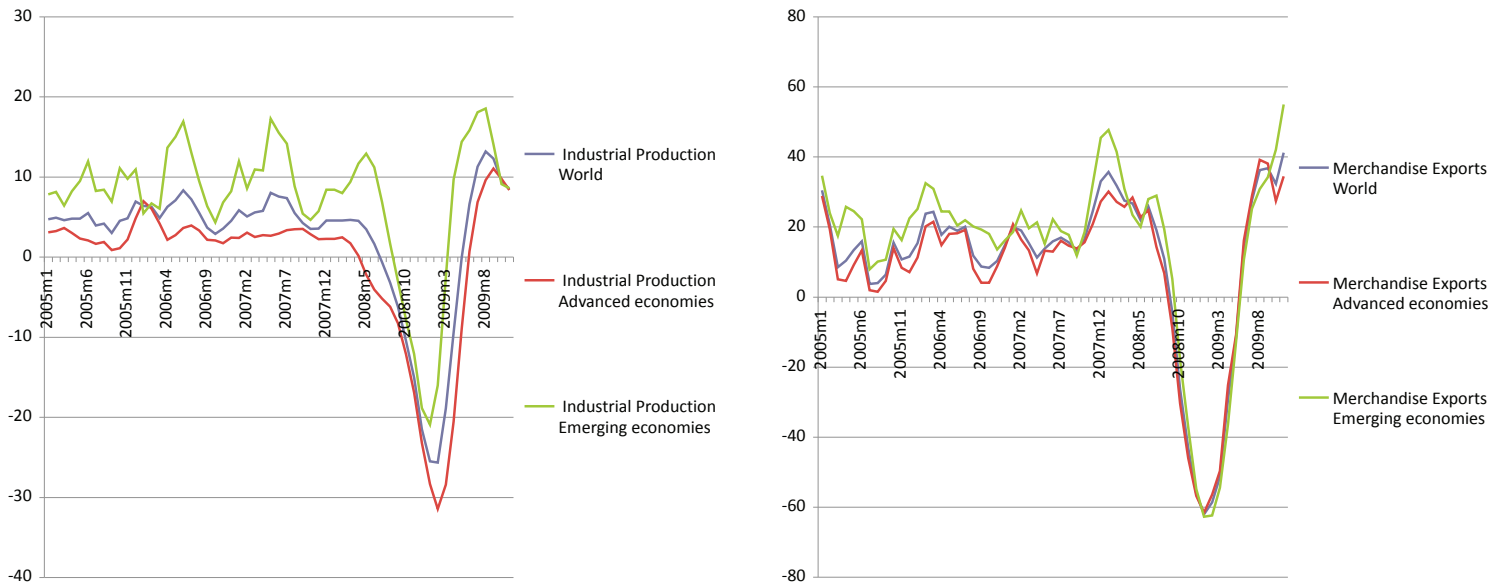
The IMF estimates that the volume of international trade in goods and services contracted by 11.9 per cent in 2009, split between a contraction of 14 per cent in developed economies and 7 per cent in developing economies (Figure 2). This is concentrated in trade in merchandise goods, linked tightly to the collapse of global industrial output in the last quarter of 2008 and the first quarter of 2009 (Figure 3). East-Asian countries at the heart of manufacturing supply chains were hit hardest as global demand for durable consumer and investment goods crashed. Parts of trade in services suffered equivalently, especially transport (related to goods trade), financial services and tourism. But other services, mainly business and professional services, were much more resilient, even registering modest growth. European services trade shrunk by 7 per cent between April 2008 and April 2009, compared with the 24 percent decline in overall trade.⁵ In the United States, services trade slightly increased in the year up to April 2009. According to UNCTAD, global FDI decreased by 15 per cent in 2008 and is estimated to have decreased by an extra one-third (to USD 1.2 trillion) in 2009 (Figures 4 and 5). UNCTAD expects migrants’ remittances to have fallen by 5-8 per cent in 2009. The World Tourism Organisation projects international tourist arrivals to have fallen by 2-3 per cent in 2009.⁶

FIGURE 2: GROWTH IN WORLD TRADE VOLUME OF GOODS AND SERVICES



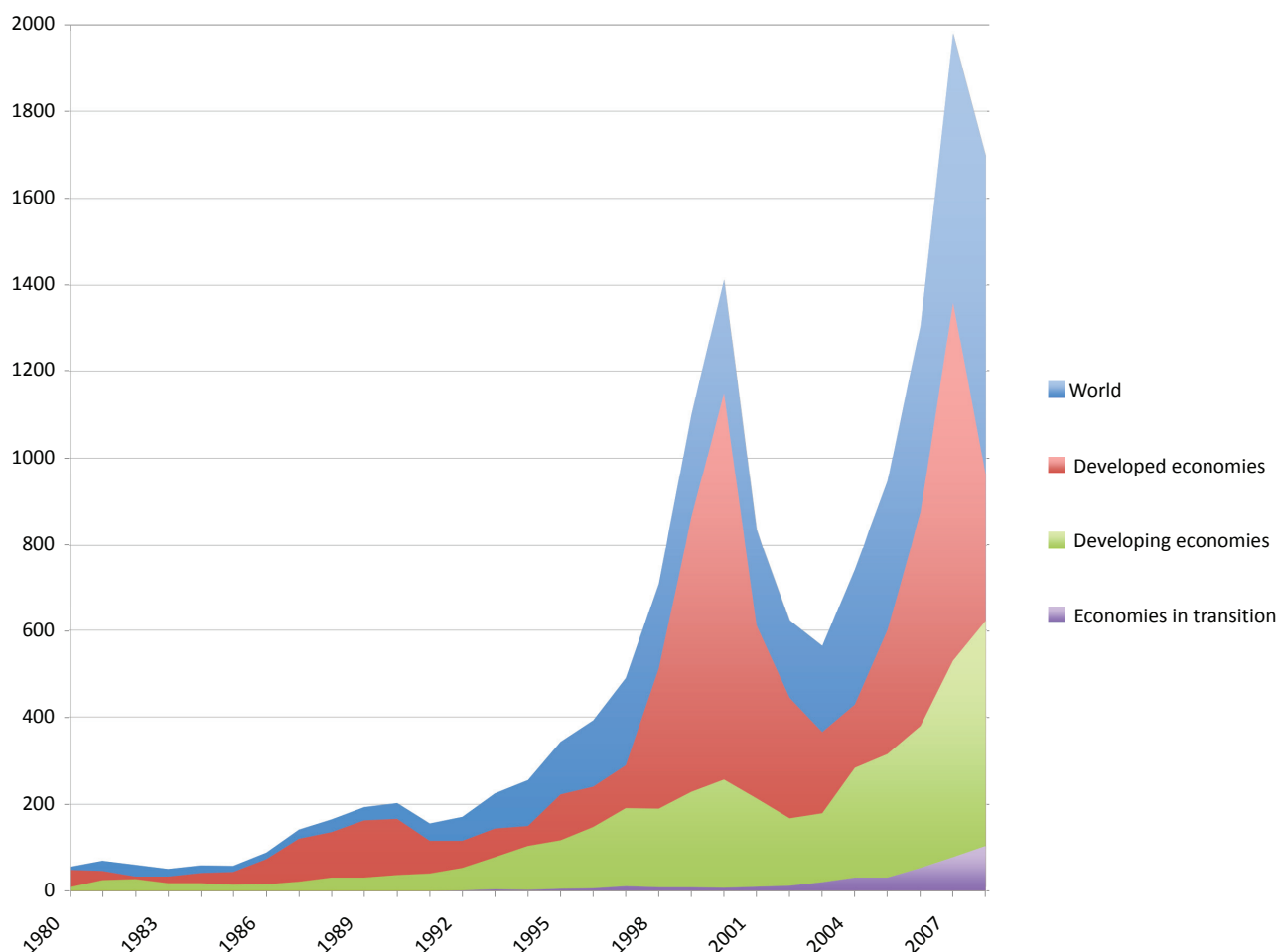
Source: IMF, *World Economic Outlook*, October 2009.

FIGURE 3: GROWTH IN INDUSTRIAL PRODUCTION AND MERCHANDISE EXPORTS (2005-2009)



Source: IMF, *World Economic Outlook*, January 2010

**FIGURE 4: FDI INFLOWS, GLOBAL AND BY GROUPS OF ECONOMIES, 1980-2008
(BILLIONS OF DOLLARS)**



Source: UNCTAD, World Investment Report 2009 and UNCTAD Statistical Handbook 2008.

4. THE ECONOMIC AND TRADE-POLICY OUTLOOK

THE GLOBAL ECONOMIC crisis has triggered a big shift in ideas and policies against free markets and in favour of government interventionism. Pro-market reforms had slowed down around the world before the crisis broke, and there was rising scepticism of the liberalisation-and-globalisation policies associated with the Washington Consensus. But the crisis marked the close of a thirty-year chapter of freer markets and more limits on government intervention. A new chapter of bigger government has opened.

So far, government interventions have been more evident in domestic economic policy than in trade policy. Domestic “crisis interventions” are bunched in two key areas: huge bailouts and associated subsidies, especially but not confined to financial services; and fiscal stimulus packages, usually combined with loose and unorthodox monetary policies. The former is concentrated in the West; the latter spread across the OECD and developing countries.

Headline fiscal-stimulus measures include the Economic Recovery Act in the United States, releasing initially USD 787 billion of extra public spending,⁷ and China’s USD 585 billion package. Fiscal-stimulus packages, i.e. discretionary fiscal spending, amount to about 3.5 per cent of

GDP in the OECD.⁸ Taking account of automatic stabilisers (the extra demand created by bigger public spending on welfare and other payments in a downturn), fiscal crisis measures amounted to approximately 10 per cent of OECD GDP in 2009. They have been supported by near-zero interest rates, central-bank purchases of government debt and other emergency monetary-policy measures. But financial bailouts have dwarfed macroeconomic interventions. It is estimated that total economic stimulus and financial-sector support amounts to about USD 12 trillion in the United States and USD 18 trillion in the EU. Financial bailouts in high-income countries cost 28 per cent of GDP in 2008 – and close to 75 percent in the United Kingdom – akin to public financing of a large-scale war.

In China, state-directed bank lending dwarfs direct government stimulus spending. Overwhelmingly, it is channelled through state-owned banks to state-owned industrial firms. It cost about 10 trillion Yuan (USD 1.5 trillion) in 2009, equivalent to about one-third of GDP. However, given solid public finances, this takes the fiscal deficit to a modest 3 per cent of GDP, and public debt to about 20 per cent of GDP, in 2009. Most high-income countries are not as fortunate. In the OECD, the average fiscal deficit is estimated to have risen to 9 per cent of GDP in 2009 (even higher in the United States and the UK). US and EU public debt is projected to rise to about 70 per cent and 120 per cent of GDP respectively over the next decade.⁹

The new conventional wisdom holds that massive bank bailouts were necessary to avert financial Armageddon, and so was shock-and-awe fiscal stimulus to boost aggregate demand and stave off another Great Depression. Bank bailouts were unavoidable in the extreme conditions of late 2008. So were extra loose monetary policies to inject a superdose of liquidity, avoiding a repetition of the fatal contraction of money supply in the early 1930s. But it is highly debatable whether massive fiscal pump-priming – Keynesianism on steroids – was necessary. Sceptics doubt the effectiveness of discretionary spending. First, fiscal packages appear to have little effect on GDP; measures often kick in too late or are spent in a way that adds little economic activity. Even with a talented team of economists in charge, as in the Obama administration, it is almost impossible to get policies right. Second, the fiscal multiplier is far from as big as thought by governments, especially in complex open economies (in which some of the extra demand leaks abroad through imports). The multiplier effect of non-defence spending is likely to be far smaller than 1, the level at which GDP expands more than government spending itself.¹⁰ Third, the wreckage of public finances by fiscal stimulus packages is not only a worrying prospect – it is already reality. Recent packages also reinforce unsustainable deficit trends (overall and especially in social-security systems). In the OECD, public debt is projected to reach absurdly high levels in a few years. Oceans of public debt will mean higher taxes and real interest rates, in addition to inflationary threats (given governments' temptation to inflate their way out of debt repayments). Collateral damage will include crowding out of capital for emerging markets, as well as making it more expensive.

The *microeconomics* and *politics* of financial bailouts and profligate macroeconomic policies are at least as vexing. *Bien pensant* policy-makers and commentators -- social engineers in Washington, Whitehall, Brussels and other European capitals, *bona fide* engineers in the Chinese Politburo, "saltwater economists" in US academia, recent Nobel laureates, columnists and editorial writers in the *New York Times* and the *Financial Times* – think that well-designed government interventions can "fix" market failures in finance and the macroeconomy. That is the *raison d'être* for the return to Big Government since the crisis. But it is stupefyingly naïve to expect intrusive financial regulation and bigger public expenditure to be well-targeted and effective, while avoiding arbitrary interventions, wasteful pork-barrel spending and long-term entitlements. These are all inevitable. They portend more discretionary power for politicians and bureaucrats, indiscriminate subsidies, rent-seeking and corruption. This will stifle private-sector incentives to save, invest and innovate.

It will restrict competition and raise costs for businesses and consumers. It will cramp individual property rights and, ultimately, economic freedom. These are likely to be the medium-term consequences of short-term crisis interventions.

This process is already underway. In the United States, in the first year of the Obama administration, it is visible in a battery of microeconomic interventions under cover of the fiscal-stimulus package and other major pieces of legislation and regulatory initiatives, notably on health care, financial markets, industrial relations, antitrust and climate change. In China, fiscal stimulus and state-directed bank lending fortify already subsidised and protected state-owned enterprises (SOEs). They increase SOEs' market and political power at the expense of the unsubsidised (and much more productive) domestic private sector. As the Chinese saying goes, "The state advances while the private sector retreats". This is tantamount to a halt to, indeed a creeping reversal of, market reforms.

One aspect of the new conventional wisdom – dear to the hearts of Keynesian and other social engineers – is the belief in "Keynes at home and Smith abroad" (otherwise known as "embedded liberalism" in International Relations jargon). Greater government macro- and microeconomic interventions at home are needed to stimulate recovery and preserve social stability – and thereby prevent a slide into protectionism. But this should proceed in tandem with open markets abroad, which require robust international policy coordination (sometimes labelled "global governance").

This idea is based on a contradiction. First, Big Government at home, with its discretionary power and panoply of competition-restricting regulations, will inevitably spill over into protectionism. It is childishly innocent to believe otherwise. Keynes at home is Keynes abroad. After all, Keynes turned to protectionism in the 1930s, not least to make activist fiscal policy work in a "closed-economy" setting. Second, the benefits of recent decades of globalisation are as much a story about increasing competition in home markets – the result of microeconomic deregulation of capital, labour and product markets -- as it is a story of increasing trade volumes.

Adam Smith saw this link in the eighteenth century. To him, protectionism is the overspill of government pandering to rent-seeking activity by "merchants and manufacturers". Thus the "clamorous importunity of partial interests" makes governments lose sight of "an extensive view of the general good." Hence legislatures should be "particularly careful neither to establish any new monopolies of this kind, nor to extend further those which are already established. Every such regulation introduces some degree of real disorder into the constitution of the state, which it will be difficult afterwards to cure without occasioning another disorder."¹¹

To Jan Tumlir, the GATT's long-time in-house philosopher, the source of the problem is overactive governments in cahoots with domestic organised interests. Cumulative interventions distort prices, rigidify economies, and make public and private actors more resistant to adjust to external change. The predictable corollary is a "fear of trade" and the resort to import protection. Thus "protectionism is the inherent logic of the redistributive state working itself out externally." This is how Tumlir accounted for twentieth-century protectionism, in the 1920s, 1930s, 1970s and 1980s.¹²

We agree with Smith and Tumlir. We are more worried about the medium-term competition-restricting consequences of Big Government, including protectionism, than we are about a short-term contraction of aggregate trade and demand in the wake of the crisis.

Here historical parallels are in order. It is fashionable to make comparisons between the recent crisis and that of the 1930s. This is appropriate in one sense. Then, a financial crash metastasised

into the Great Depression. It also sparked massive government intervention, starting with intrusive and protectionist financial regulations. That caused global finance to fragment into national enclaves. The recent crisis, given its financial origins, has led to a bigger fall in output than in other post-1945 recessions. Recovery will probably take longer. And there is the danger that over-regulation of financial markets will cause global finance to fragment once again.¹³

But in one other important respect the comparison with the 1930s is highly misleading. Then, tit-for-tat trade protection rapidly followed the Wall Street Crash, and the world splintered into warring trade blocs. This has *not* happened today, and it is unlikely to happen anytime soon. As we will discuss in the next section, crisis-related protectionism today is remarkably restrained. Multilateral trade rules, international policy cooperation and market-led globalisation provide defences against a headlong descent into 1930s-style protectionism.

Rather the appropriate comparison is with the 1970s. Then, a series of shocks (notably the collapse of the Bretton Woods system and oil-price hikes) ended a long boom and triggered more government intervention. New labour-market and capital-market regulations were introduced. Subsidies were sprayed at vulnerable sectors. There were fiscal-stimulus packages. Governments slapped on price-and-wage controls to combat inflation. These measures exacerbated initial crises and prolonged stagnation. But they also spawned protectionism. Industry after industry, coddled by government support at home, demanded protection from foreign competition. The result was the “new protectionism” and “managed trade” of the 1970s and 1980s.

Voluntary Export Restraints (VERs), Orderly Market Arrangements (OMAs) and other mostly nontariff barriers followed bailouts for sectors at home. In the 1980s, American car manufacturers were protected by VERs that restricted the number of Japanese cars exported to the United States. The EC negotiated a similar agreement with Japan in 1983. To further restrict Japanese exports, some European governments imposed “local-content requirements” on the cars produced in Europe by companies such as Nissan and Toyota.¹⁴ Many other sectors, e.g. semiconductors and videocassette recorders, were also protected by VERs or similar measures (see Tables 1 and 2).¹⁵ The European steel sector was awash in subsidies. British Steel, owned by the British government, received subsidies through the 1970s and early 1980s that averaged 40 per cent of the export price. The United States defended its steel producers with higher tariffs against steel from emerging Asia and Brazil.¹⁶ The French government even demanded that Japanese VCR imports enter France via Poitiers, a town hundreds of miles from the nearest port.¹⁷ The use of antidumping measures in the United States and the EU also accelerated sharply in the wake of the 1970s’ crises (see Figure 5). All these measures had a contracting effect on global trade in the 1980s. The 1980s became the “lost decade” for trade in many Western countries (see Figure 6). The trade-to-GDP ratio shrunk in major Western economies and contributed to overall slow GDP growth in that decade.

TABLE 1: VOLUNTARY EXPORT RESTRAINTS 1986-7 BY PRODUCT GROUP*

MAJOR KNOWN VERS	NUMBER OF AGREEMENTS	PERCENTAGE OF NUMBER OF CASES
Iron and Steel Products	44	32
Textiles and Clothing	25	18
Machine Tools	6	4
Automobiles and Transport Equipment	15	11
Electronic Products	10	7
Footwear	8	6
Agricultural Products	24	18
Other*	5	4
Total	137	100

*Excluding the Multifibre Agreement

Source: Michel Kostecki, 1987, 'Export-restraint agreements and trade liberalization'. *The World Economy*, vol. 10, no 4:1987

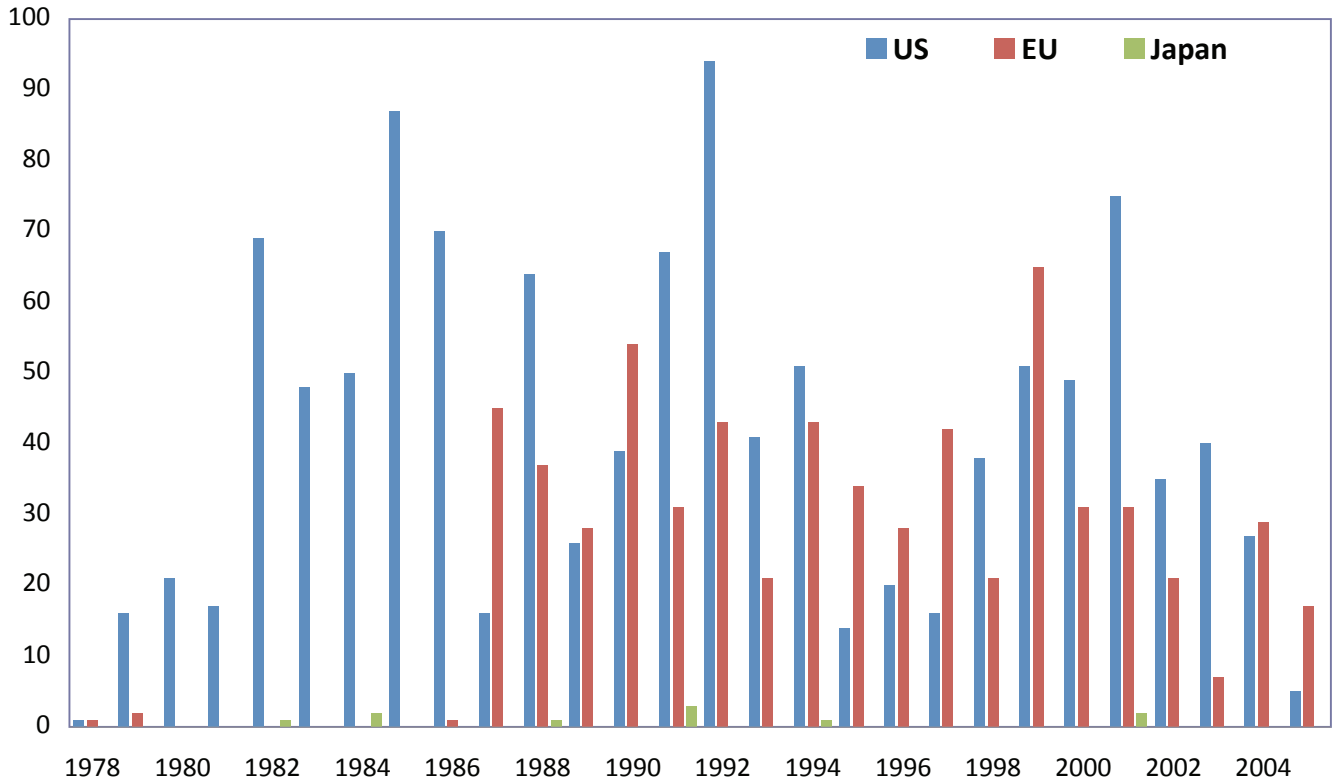
TABLE 2: VOLUNTARY EXPORT RESTRAINTS 1986-7 BY PROTECTING IMPORTING COUNTRY*

PROTECTINGIMPORTING COUNTRY	NUMBER OF AGREEMENTS	PERCENTAGE OF NUMBER OF CASES
Australia	1	0.7
Austria	1	0.7
Canada	10	7.3
EC	52	38.0
Finland	2	1.5
France	2	1.5
Italy	3	2.2
Japan	4	2.9
Norway	5	3.6
Portugal	1	0.7
Spain	2	1.5
UK	8	5.8
US	45	32.8
West-Germany	1	0.7
Total	137	100

*Excluding the Multifibre Agreement

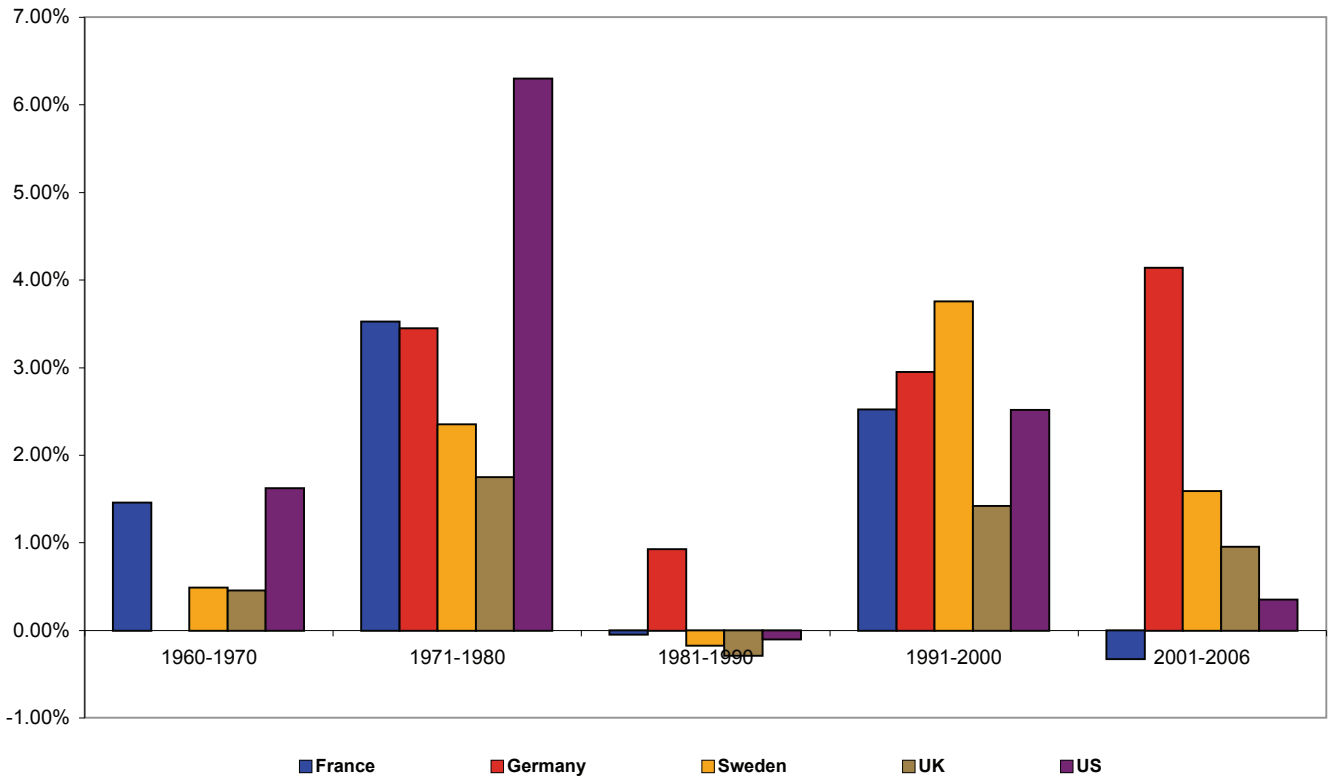
Source: Michel Kostecki, 1987, 'Export-restraint agreements and trade liberalization'. *The World Economy*, vol. 10, no 4:1987

FIGURE 5: ANTIDUMPING MEASURES BY DATE OF INITIATION



Source: Chad Bown, The Global Antidumping Database, http://people.brandeis.edu/~cbown/global_ad/

FIGURE 6: ANNUAL AVERAGE GROWTH OF TRADE AS PART OF GDP



Source: World Trade Organisation, International Trade Statistics, database

New Protectionism was *creeping* protectionism. Unlike 1930s-style protectionism, it was not an up-front declaration of a trade war with tariff hikes, blanket quotas and draconian foreign-exchange controls. Rather it was more subtle, deploying non-tariff regulatory barriers such as subsidies, public-procurement restrictions and onerous standards requirements. It did not spiral out of control; rather it unfolded slowly and insidiously, and lasted over a decade-and-a-half. It created overcapacity in several industrial sectors (cars, steel and airlines, for example), and delayed global recovery and globalisation. That, not a melodramatic 1930s scenario, is the danger facing us today.

5. EMERGING PROTECTIONISM

PERHAPS THE BIGGEST surprise is that the world has not hurtled into tit-for-tat protectionism. That spectre was real enough in late 2008, given the scale of growth contraction and deglobalisation.

The good news is documented in WTO updates on new trade measures in 2009. New protectionist measures have appeared – what the WTO refers to as “policy slippage” – but they are remarkably mild. They affect a maximum of 1 per cent of world trade in goods, and protectionism in trade in services has not increased noticeably. New protectionism is concentrated in sectors that have long been protected: textiles, clothing, footwear, iron, steel, consumer electronics and agriculture. Trade remedies have increased, as they do in economic downturns. New anti-dumping (AD) investigations increased by 15 per cent from mid 2008 to mid 2009, and there has been a marked pickup in new investigations for safeguards and countervailing duties. Signs are that trade-defence filings and investigations are mounting quarter-by-quarter, which points to a sharp increase in imposed duties in 2010 and 2011. Nevertheless, new investigations affect a tiny share of world trade. For example, new AD investigations affect 0.4 per cent of the value of US and EU imports. Finally, up to one-third of new trade measures have been *liberalising*. These include tariff reductions, removal of export restrictions and FDI liberalisation in several developing countries.¹⁸

One caveat: The WTO focuses on established and commonly understood trade instruments covered by WTO disciplines, especially import and export tariffs, quotas and licenses, and trade remedies. It notes a range of non-border measures such as government-procurement restrictions, technical standards and potentially trade-distorting subsidies. But it does not take a stand on financial bailouts, saying that their discriminatory impact on international trade is still unclear.

Global Trade Alert (GTA) paints a more alarming picture. It counts at least 297 trade-discriminatory measures from November 2008 to November 2009. The G20 accounts for 184 of these measures. Trade-discriminatory measures outnumber trade-liberalising measures six to one. And protectionism in the pipeline is trending upwards quarter-by-quarter. Unlike the WTO, GTA includes financial bailouts. It estimates that one-third of new protectionist measures are bailouts to financial services, automobiles and other sectors. Trade remedies account for one-fifth and tariffs 14 per cent of new protectionist measures. China is the biggest target, followed by the EU and the United States. Russia is probably the worst offender, with a significant increase in protection since the crisis started. The EU, though, tops the list in terms of the number of new protectionist measures imposed. Russia, China, India, Indonesia, Argentina and the EU figure in the top-ten list of offenders (see Table 3).¹⁹

TABLE 3: CRISIS MEASURES – WHICH COUNTRIES HAVE INFLICTED MOST HARM?

RANK	RANKED BY NUMBER OF MEASURES	RANKED BY THE NUMBER OF TARIFF LINES AFFECTED BY MEASURES	RANKED BY THE NUMBER OF SECTORS AFFECTED BY MEASURES	RANKED BY THE NUMBER OF TRADING PARTNERS AFFECTED BY MEASURES
1	EU27	Russia	Algeria	China
2	Russia	Ukraine	EU27	EU27
3	Argentina	China	Ecuador	India
4	Germany	Ecuador	Indonesia	Russia
5	UK	Indonesia	Russia	Indonesia
6	China India Indonesia Italy Spain	India	Ukraine	UK
7		EU27	China	USA
8		Japan	Belarus	France
9		UK	Mexico	Germany
10		USA	Germany	Argentina

Source: Evenett, Simon (ed.), *The Unrelenting Pressure of Protectionism: The 3rd GTA Report*. London: CEPR/Global Trade Alert, 2009. Accessed at http://globaltradealert.org/sites/default/files/GTA_report_3.pdf

Summing up, the good news on remarkably mild “traditional” protectionism (mainly border barriers) is balanced by worrying signs of non-traditional, non-border protectionism.

“Financial mercantilism” is at the top of the latter list. One aspect of it is home-government pressure, whether formal or through nods and winks, on bailed-out and other banks to “lend local”, i.e. to lend at home at the expense of foreign lending (e.g. through foreign subsidiaries). Cross-border lending has shrunk during the crisis, e.g. by west European banks in eastern Europe, but the extent to which this is the result of home-government pressure is unclear. A second, related aspect of financial mercantilism is pressure from home governments and regulators to concentrate more financial trading activities at home, with accompanying restrictions on cross-border trade. One example is a proposed EU directive that requires non-EU-based private-equity and hedge funds to establish physical presence in the EU in order to trade. Finally, regulatory proposals in the United States, EU and elsewhere may end up with a *cordon sanitaire* around mammoth banks deemed “too big to fail”, with alarming implications for global competition as well as moral hazard.

Financial mercantilism is clearly a “work in progress”; it is too early to judge its protectionist impact. But it has potential to escalate and cause great harm. It threatens the renationalisation and fragmentation of global finance, which would damage market globalisation generally, and with it the welfare of rich and poor countries.

There are several other non-traditional protectionist instruments deployed in the wake of the crisis: industrial subsidies, restrictions on migrant workers, FDI restrictions, and standards.

First, industrial subsidies. These have gone overwhelmingly to the automobile industry in the United States and the EU. In China, they have been sprayed more liberally at SOEs in several capital-intensive sectors. In the OECD, subsidies to auto firms have been in the form of direct support and “scrappage” schemes (subsidising the trading in of old cars for new ones). In the OECD and China, direct support has gone to domestic firms and could well fall afoul of WTO disciplines on trade-distorting subsidies.

Second, public-procurement or “buy-national” restrictions. The headline examples are the “Buy American” provisions in the US fiscal-stimulus package and the seemingly retaliatory “Buy Chinese” provisions in China’s fiscal-stimulus package, which spread to many Chinese provinces.

Third, restrictions on migrant labour in both developed and developing countries. The United States, for example, has restrictions on H1B visas for foreign nationals working in bailed-out banks. There is no equivalent measure in the EU, but labour migration to the EU has fallen significantly, and some governments have resorted to “local-jobs-for-local-workers” rhetoric (as was the case in the UK).

Fourth, FDI restrictions or “investment nationalism”. This has not been a major global problem so far. New FDI restrictions are bunched in energy-related sectors. There are North American, European and Australian anxieties about emerging-market sovereign-wealth funds and the overseas expansion of SOEs, particularly from China. Chinese FDI restrictions have clearly increased in the last few years. But UNCTAD notes that 85 per cent of new FDI measures were liberalising in 2008, not far off the trend between 1992 and 2004 (when 92.5 per cent of investment measures were “more favourable” to FDI).²⁰

Fifth, standards protectionism. Anecdotal reporting points to more restrictive application of technical and food-safety standards on imports since the crisis started. China banned several European agricultural products. India imposed tighter standards on imports of iron, steel, yarn, soyabean oil and aluminium, in addition to import bans on Chinese toys, cellphones and poultry. Indonesia imposed pre-shipment inspection requirements on over 500 goods, which could only enter through 6 seaports and all international airports.²¹ The WTO also notes a marked increase in TBT (technical barriers to trade) notifications in 2008/9.²² These are all areas in which officials have considerable discretionary powers. It is predictable that they would use this leeway to tighten the screws on imports in a severe economic downturn.

The climate-change agenda is set to be the Trojan Horse of new standards protectionism. The EU already has an emissions-trading scheme, and legislation on an equivalent scheme is working its way through the US Congress. Because such cap-and-trade schemes will impose substantial compliance costs on energy-intensive sectors at home, there will be more pressure to impose similar costs on cheaper, carbon-intensive production elsewhere not subject to carbon-reduction policies. Hence the spectre of trade sanctions on “free riders” – China in particular. Retaliatory threats will no doubt become shriller after the Copenhagen summit. They revolve around “border tax adjustments”, i.e. tariffs on carbon-intensive imports. But climate-change protectionism could include “green subsidies” that discriminate in favour of domestic renewable-energy providers, and all sorts of discriminatory standards. The EU, for example, has a technical regulation in its Renewable Energy Directive that insists on a 35 per-cent saving on greenhouse-gas emissions from biofuels entering the EU market. Effectively, this discriminates in favour of French and Spanish producers of rapeseed oil at the expense of cheaper east-Asian competition.²³

Predictably, the WTO and G20 have been quick to claim credit for restraining traditional protectionism. That is an empty claim. G20 pledges not to increase protectionism have been violated “every other day” by its members.²⁴ WTO disciplines may, at the margin, have restrained border protectionism by OECD members and newly-acceded members like China and Vietnam, given strong GATT disciplines in particular. But they have certainly not restrained most developing countries’ protectionism, even on tariffs. Most developing countries have high bound tariffs in the WTO, and they could quite legally raise applied tariffs much higher than they have done.

There is something else at work. The credit for restraining traditional protectionism should go to *markets* and *globalisation*, not to multilateral trade rules, international policy coordination and assorted summitry and palaver in the G20, WTO and other international fora. Global market integration has imposed *spontaneous* disciplines on governments and businesses. They realise that up-front protectionism raises business costs, invites retaliation, excludes them from the benefits

of globalisation, and damages wealth and welfare at home. That applies particularly to global supply chains. Take manufacturing supply chains with production centred in east Asia. They suffered disproportionately from trade contraction in the first six months of the crisis. But protectionism did not increase in these sectors. And supply chains remained intact, ready for the upturn that followed.

More worrisome is the non-traditional regulatory protectionism in the pipeline, especially on subsidies and standards, on which WTO disciplines are weak-to-non-existent. These measures are not covered by the Doha agenda. Given the parlous state of WTO negotiations, it will be a long time before the WTO strengthens rules on subsidies, FDI, government procurement, cross-border movement of labour and standards – if it ever happens, that is. These measures are more opaque than border-based protection. Governments and organised interests may well resort to them more frequently, not least to evade existing WTO disciplines. The danger is that, if not contained, they will spread gradually to cover bigger swathes of international trade. That is the 1970s scenario we worry about.

6. A REVIEW OF THE TROOPS

NOW WE TURN to the major players in trade policy and see how they have responded to the crisis. We start with the United States.

Trade policy has deteriorated in the United States since the Obama administration took over. The Bush administration, for all its faults, did not do a bad job on this front. Its major achievement was to contain protectionism at home, especially against China. President Obama, on the other hand, while no clear-cut protectionist, has ambivalent views on the subject and is not an instinctive free-trader. He has powerful protectionist forces inside his tent – among Congressional Democrats, the AFL-CIO, and at his Cabinet table (notably the Labour Secretary, Hilda Solis). The Office of the United States Trade Representative is packed with staffers with close links to trades unions as well Congressional lawmakers with protectionist voting records. This makes the Obama administration different from previous administrations, including the Clinton administration.

President Obama's record to date shows a balancing act, giving way to domestic protectionist forces at one moment, but cushioning their impact and maintaining open markets the next moment. The Buy American provisions in the fiscal stimulus package passed by Congress were somewhat modified to make them less confrontational and more compatible with the WTO's Government Procurement Agreement. The President agreed to impose anti-dumping duties on Chinese tyre imports. But six weeks later he announced that the United States would negotiate to enter the Transpacific Partnership, a free trade agreement with six other Asia-Pacific countries.

Nevertheless, this administration's overall approach is defensive; and trade policy is very low down its list of priorities, indeed crowded out by domestic priorities. Above all, the administration is *not* leading with open-market initiatives. It has done nothing to finish the Doha Round, nor has it tried to get already negotiated FTAs with South Korea, Columbia, Panama and Peru ratified by Congress. Its main emphasis seems to be on better enforcement of trade laws to ensure foreign access for US exports. Overall, the President seems extremely disinclined to face down his union supporters and protectionists in the Congress. That is no surprise: a left-liberal administration given to domestic intervention left, right and centre is not the sort of administration to take the fight to protectionists at home and lead international cooperation to open markets worldwide. Finally, open-market constituencies in American business have gone quiet; and relations between the administration and leading business associations (especially the US Chamber of Commerce) have soured.

This is bad news. For all President Obama's sweet-sounding multilateralist rhetoric, he has no substantive trade policy. The United States is abrogating its traditional leadership role in world trade. That leaves the field open to creeping protectionism in the United States, a deterioration of key bilateral trade relationships (especially with China), and continued weakening of the WTO. It also leaves a global vacuum, for there is no substitute leader to forge international cooperation to contain protectionism, open markets and strengthen multilateral rules – not the EU, not China, not anyone else. The United States may be diminished in the wake of the crisis and in the face of rising powers, notably China. But it is still the fulcrum of international relations. No rising power is in a position to exercise the kind of global leadership the United States has exercised since 1945.

The EU is also in defensive mode. Generally, when the Single Market is opening up and integrating, EU trade policy is more outward-looking and proactive. That was the case in the 1990s. When the Single Market is under stress from internal protectionism, EU trade policy turns to navel-gazing and gives way to protectionism against outsiders. That happened in the 1970s and '80s. And that is roughly the situation today.

National crisis responses within the EU included the effective suspension of rules on state aid, which restricted competition from other member-states. The Lisbon Agenda of market reforms to boost EU competitiveness was forgotten – one of the big casualties of the crisis. Externally, trade policy is defensive. With the exception of the (yet to be ratified) FTA with South Korea, trade negotiations are stuck. That is the case with the WTO's Doha Round, Economic Partnership Agreements with African, Caribbean and Pacific countries, and bilateral negotiations with countries in Asia, the Middle East and Latin America. Trade relations with China are also adrift and replete with tensions. True, the EU has not markedly increased traditional protectionism (e.g. tariffs and simple non-tariff barriers), but there are signs of regulatory protectionism, especially on product standards (some of it to do with the EU's climate-change agenda).

Finally, the EU suffers from a paradox. With enlargement and greater market size it is weightier in the global economy. But at the same time its decision-making has become more fragmented, making it more difficult to coordinate national positions and speak with one voice. That decreases its ability to wield collective power abroad. In the one arena where the EU is a global heavyweight -- trade policy -- competence has been divided on several issues, notably services and investment. An enlarged EU makes it extra-difficult to have credible positions in international negotiations on services and investment. The Lisbon Treaty is supposed to overcome these problems by streamlining decision-making and unifying competence on services, investment and intellectual property rights. But that may not be the result, especially with "co-decision" for the European Parliament. That confers the EP greater power in EU trade policy. Market-sceptical forces and single-issue fetishists in the EP may complicate decision-making and tilt policy outcomes in a more protectionist direction.

What about China? Liberalisation has stalled since about 2006, corresponding with more industrial-policy measures to promote selected sectors and "national champions", mainly SOEs.²⁵ Export restrictions, discriminatory national standards, FDI restrictions, and internet controls that discriminate against foreign technology companies, have all increased. Growth continues to rely on high rates of domestic saving and investment, but at the expense of repressed domestic consumption. *Dirigiste* policies favour polluting, capital-intensive industrial SOEs, state banks in a backward financial system and capital markets, and monopolistic services providers in other sectors. Externally, surplus savings contribute mightily to global economic imbalances and generate extra trade tensions.

“Rebalancing growth” – making it more consumption- and less investment-driven – requires deep competition-enhancing reforms. It cannot be done quickly – and certainly not in a top-down style global agreement like the Plaza Accord in the 1980s to depreciate the US dollar. Needed reforms go to the heart of the Communist Party-government-public sector nexus and its grip on power. It is unlikely to happen soon. Indeed, China’s crisis response – essentially an investment binge – bolsters the public sector and state power at the expense of the private sector. It has succeeded in arresting growth slowdown in 2009, but it exacerbates China’s structural fault-line of over-investment and under-consumption. Its command-and-control mechanisms take market reforms backwards. And there is the real risk of surplus manufacturing capacity flooding into shrinking export markets in Europe and North America, thereby inviting protectionist retaliation against China.

Commendably, the Beijing leadership has not rocked the boat during the crisis: it has not resorted to aggressive mercantilism. Recent trade conflicts with the United States and EU over internet censorship, export restrictions, government procurement and the exchange rate should not be exaggerated: they do not amount to a trade war. Protectionist responses have been heavily constrained by China’s already deep integration into the global economy, particularly through manufacturing supply chains, and by its strong WTO commitments. But stalled trade and FDI liberalisation, the absence of domestic structural reforms and creeping protectionism threaten future trade tensions. Finally, this context diminishes China’s ability to look outward and exercise leadership in the world economy.²⁶

What about other big players in trade policy?

Japan’s domestic political and economic quagmire has long made its trade policy passive and defensive, except for (mostly trade-lite) FTAs in east Asia. The crisis has exacerbated structural problems in the Japanese economy; and the new DPJ-led government has far from coherent economic and trade policies.

India has weathered the crisis well. Protectionist measures have increased, but not in a major way. The May 2009 election delivered an unexpectedly strong mandate to the Congress-led government, but it has not led to a new wave of market reforms. Reforms have stalled since Congress came to power in 2004, and there are no signs of big change. Trade policy remains a combination of stalled unilateral liberalisation, defensiveness in the Doha Round and trade-lite FTAs.²⁷

Brazil has also weathered the crisis well and hardly raised protectionist barriers. But there are no signs of a more liberal trade policy. Unilateral liberalisation has been off the agenda for some time. FTAs are geopolitics-driven, prioritising negotiations with relatively minor trading partners in the “South” while putting negotiations with Brazil’s two key trading partners, the United States and EU, on the backburner. In the WTO, Brazil’s accommodation of India in the G20 has compromised its agricultural exporting interests; and defensiveness in the NAMA negotiations does not reflect Brazil’s export strength in industrial goods.²⁸

Russia is exceptional among the BRICS. Policy has gone in a strongly *deliberalising* direction since 2003/4. Authoritarian politics has been used to nationalise energy assets, promote monopolistic practices by favoured national champions, and generally apply laws and regulations in a highly selective, arbitrary manner. “State capitalism” and “hard mercantilism” are the order of the day. Russia has suffered severely from the crisis, with growth contracting by over 8 per cent in 2009. Protection has increased significantly, and extra uncertainty clouds Russia’s WTO accession negotiations.²⁹

Finally, what about the WTO? And the new kid on the block, the G20?

The Doha Round remains stuck, with no serious prospects for conclusion in 2010. None of the major players gives it more than lip-service; and their attentions have been diverted to domestic fire-fighting by the crisis. Besides, the Doha Round, even if concluded, would do little to contain emerging protectionism beyond binding developing-country tariffs at lower levels. And a serious post-Doha agenda for the WTO lies on the distant horizon.

The G20 makes more sense than the G8: it is more representative of national weight and clout in the global economy. But it is much-hyped. It is too large and unwieldy to be a cohesive forum for international policy coordination. To work, it requires outward-looking leadership by its major players, led by the United States and China. But, as argued above, they are both in defensive mode. So is the EU. Worse, the EU does not speak with one voice in the G20, rather speaking discordantly through its represented member-states, especially the UK, Germany and France. That is symptomatic of the EU's over-hyped "soft power" in international relations. Overall, the G20 may be a welcome chat forum, but it has distinct limits as a heavyweight forum for "global governance", least of all on trade policy.

7. CONCLUSION

THE GLOBAL ECONOMIC crisis has ushered in a new age of Big Government. Keynesian macroeconomics is back in fashion, as is Pigovian welfare economics – microeconomic interventions to fix alleged market failures. A social-engineering mentality – the belief that superior technocratic minds can solve complex social and economic problems with targeted interventions – is in the ascendant. Welcome to the world-view of Mr. Bentham. That of Mr. Hume, Mr. Smith and Mr. Hayek – the belief that markets are complex organisms; that governments, however expertly staffed, cannot possibly have enough knowledge to "fine-tune" macro- and microeconomic outcomes with detailed, prescriptive regulations; that governments also "fail" through human fallibility, political pressure and corruption; and, consequently, that regulation should err on the side of caution and stick to general rules to allow markets to operate effectively – is much less popular at the moment.³⁰

We think Mr. Bentham's world-view will cause damage, not only to domestic economies but also to the world trading system. This will not be a replay of the 1930s, but a replay of the 1970s is a serious prospect. The world is in danger of undoing the market reforms of the 1980s and '90s that brought unprecedented prosperity, especially to emerging markets outside the West. Like the 1970s, policy backsliding could prolong a severe downturn and compromise eventual recovery.

The short-term challenge is to arrest the slide to Big Government at home and creeping protectionism abroad. The medium-term challenge is to get back on track with trade and FDI liberalisation combined with domestic structural reforms – substantial "unfinished business" left before the crisis struck. More, not less, markets and globalisation are what the world needs. That is primarily a matter for *unilateral* action by governments and *competitive emulation* among them. It can be reinforced by international policy cooperation in the WTO, G20 and other fora, but not too much can be expected of cumbersome global-governance mechanisms. Overall, *limits* to government intervention and a well-functioning market economy are of a piece with open markets, economic globalisation and international political stability.

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