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Containing Creeping Protectionism: A Realist Agenda for the G20

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INTRODUCTION

Expectations run high for the G20 summit in London in early April. Governments will report on their advancement of the plan set out at the last summit in Washington. This plan is primarily concerned with transparency and regulations in the financial sector, and governments are expected to commit to further work on the items of the agenda. But it is the off-agenda items that have aroused most expectation. European governments agreed at a "local" G20 summit in Berlin earlier this year to use the London summit as a vehicle for two "old" wishes – to increase the regulation of hedge funds and to turn the heat up on tax havens. The United States, on the other hand, has called for a considerable increase in fiscal stimulus by G20 countries, especially the European members. The global trade agenda is expected to be boosted by renewed calls from the G20 to finish the Doha Round of trade negotiations. Reforms of the International Monetary Fund, mainly involving an increase in the role of big emerging powers, are expected to be co-ordinated. Calls for a grand re-engineering of global balances are likely to be echoed. Stronger pledges on the need to fight climate change and terrorism will be proposed.

All this is underpinned by hopes of fostering a new architecture of global economic governance – a new Bretton Woods system. This summit, it has been said, is the "moment of truth" for world leaders to re-write the constitution of the global economy and, in the words of President Sarkozy, to civilize the raw nature of capitalism.

SUMMARY

The G20 summit in London offers an opportunity for world leaders to prevent a continued slide towards protectionism. Yet the summit is already at risk of ending in failure as expectations run too high. The agenda is already far too wide and cover areas characterized by sharp differences of opinion rather than an emerging consensus. Individual members have also thrown in additional wishes for what the summit should achieve. Furthermore, G20 rhetoric is ingrained in global governance romanticism, but the naïve hopes of building a new Bretton Woods system will meet the hard realities of global economic co-operation.

This Policy Brief is concerned with what should be the relevant trade agenda for the G20. At the summit in Washington, D.C. last autumn, the G20 agreed that no country should impose new barriers to trade. G20 leaders also instructed their trade ministers to agree on a headline deal for Doha Round before the end of 2008. However, nothing has happened in the Doha Round since the last G20 summit, and it took only a few days until a G20 country had imposed new trade barriers. Since November last year, 17 of the G20 members have imposed protectionist measures.

Governments have not responded to the economic crisis with massive protectionist measures. It is rather creeping protectionism that has characterized recent trade policies. However, as the crisis deepens countries are likely to increase protectionism. The chief task now is to prevent such a development, in particular the risk of escalating tit-for-tat protectionism. This Policy Brief sets out a six-point agenda to contain protectionist threats.

One can understand the high level of ambitions. The global economy has contracted, and even if the decline is soon levelled out, annualized, trade figures for 2009 will be in the red. The World Trade Organisation (WTO) has predicted that global trade will fall by 9% in 2009. In countries such as China, Germany and Japan the decline in trade will be even bigger. Naturally, such figures invite references to the Great Depression in the 1930s and trigger fears over a similar development today.

Yet the G20 will fail to live up to the high expectations. And it will fail even if the ambitions with a strong flavour of political romanticism are neglected. We are not, as has been suggested, at a "1944 moment" in the history of the world economy – a moment for building up new institutions to regulate and supervise the world economy. References to the Bretton Woods summit in 1944, and the twin organisations founded at the summit (the IMF and the World Bank) are misplaced. Institutional engineering then concerned an economy which looked very different from today's world economy. It took the Second World War and a serious turn to economic nationalism to foster the spirit necessary to forge an international agreement, effectively between a fairly small number of countries. Furthermore, global economic co-operation in 1944 started almost from scratch – in the debris of the collapsed League of Nations. Today the world has plenty of institutions, multilateral and regional, for economic co-operation. New forms of co-operation will have to start from the existing institutional structure and not from a blank slate. G20 leaders may or may not have a strong desire to engage in serious re-engineering of global economic institutions, but the brutal fact is that there are stark differences between countries that cannot easily be papered over. It is even more difficult today as there is no global hegemony to lead and finance new initiatives.

This Policy Brief aims at setting out a realistic agenda for the G20 summit. Its prime focus is world trade and G20 ambitions in trade policy. But the trade agenda is closely linked to other key developments in economic policy (fiscal policy and monetary policy chiefly) and the paper will thus cover aspects other than trade policy.

TIT-FOR-TAT TARIFF PROTECTIONISM AS IN THE 1930s?

The global economic crisis has spawned fears of rising protectionism. Fears centre particularly on a repeat of tit-for-tat protectionism as in the 1930s. On June 17, 1930, the U.S. enacted its Smoot-Hawley Tariff Act which sharply increased tariffs on several hundred goods. Other countries retaliated, and this spiralling protectionism helped to turn a financial crisis into a decade-long depression. Between 1929 and 1932 world trade fell by 30% and it took another four years until trade had recovered back to the aggregate volume of 1929. Furthermore, as the prices of many traded goods fell sharply the value of trade consequently took a sharp hit. International prices on food and raw materials fell by 60-70% between 1929 and 1932.[1] While some hoped protectionism in the interwar years to be temporary, barriers did not disappear quickly. Governments had to spend a few decades negotiating in the GATT and other international organizations to get rid of the protectionism imposed during the interwar period.

Alarm bells should ring when countries are getting closer to the trade and monetary policies pursued in the early 1930s. However, fears over a repeat today of tit-for-tat tariff protectionism have not yet materialized. According to recent surveys by the World Trade Organisation and the World Bank, there is not much evidence of a sharp rush to increased tariffs.[2] Only about a handful of countries have increased tariffs since the crisis started last autumn (Argentina, Brazil, Ecuador, India, Indonesia, Russia, and Turkey)[3], and the increases have covered only a limited number of goods.[4] These new tariff are vexing and destroy trade, but they do not pose systemic threats to the world economy or to the integrity of the world trading system.

Nor are there reasons to believe a destructive scenario of spiralling tariff protectionism to be an imminent threat. Certainly, some other countries will increase tariffs, believing it will ease conditions for local companies suffering from contracting demand. But such tariff hikes are not likely to trigger a retaliatory spiral à la the 1930s, or to cover goods that are significantly traded. There are two restraining factors.

First, countries have bound their tariffs in WTO agreements and understand they will be taken to dispute settlement if they raise tariffs above these limits. A number of emerging countries with significant tariff water – the difference between the bound levels and the applied levels – can raise tariffs without violating WTO commitments. Some emerging markets have already made use of the room for WTO compliant tariff hikes; others will likely do so as the effects of the crisis on output and employment grow worse. Table 1 indicates the countries in which that may happen. A handful of countries could double and triple their tariffs without violating their WTO commitments. In the agricultural sector, increases could be even larger.

TABLE 1. TARIFF WATER IN EMERGING MARKETS

	Tariffs on manufactured imports		
	Average bound tariff (%)	Average applied tariff (%)	Tariff Water Ratio
China	9.14	8.96	1.02
India	34.94	16.44	2.13
Mexico	34.91	13.33	2.62
Brazil	30.79	12.63	2.44
Turkey	17.03	4.69	3.63
Indonesia	35.55	6.75	5.27
Saudi Arabia	10.50	4.81	2.18
South Africa	15.72	7.85	2.00
Thailand	25.55	8.17	3.13
Argentina	31.84	12.57	2.53

Source: WTO Country Profiles

Second, countries with a significant participation in world trade cannot raise tariffs on a grander scale without damaging the competitiveness of their home firms. A significant portion of all trade today is trade in parts and components, or input goods, and companies have fragmented their supply-chains to such an extent that it is difficult to trace the origin or nationality of a particular good. Advanced economies and emerging markets are densely integrated through such production networks. Import is needed in order to export, and new tariffs on input goods will adversely affect profitability and output higher up in the value-added chain. The supply-chain factor in global trade works in two ways: when demand falls there will be, as today, a considerable decline in total trade as the volume of trade per unit of consumption has increased. But a mercantilist, producer-oriented interest keeps governments from serious increases of tariffs; such measures would hurt domestic firms competing on the world market.

However, these two constraining factors do not prevent all forms of protectionism. WTO agreements are more powerful against tariff hikes than other forms of protectionism, e.g. non-tariff barriers and state aid to companies. Patterns of supply-chain fragmentation limit the temporary mercantilist value of a tariff increase, but they do not have the same effect on trade-distorting subsidies to domestic firms. Non-tariff protectionism is often more damaging than tariffs. Tariffs are quantified and companies can calculate their margins and the profitability of trade. Non-tariff measures, on the other hand, are often opaque and foreign firms have difficulties in assessing the cost such measures impose on existing or potential trade. As such, the uncertainties are bigger.

It is this form of protectionism – creeping rather than spiralling protectionism – that governments are now succumbing to amidst the economic crisis.

CREEPING PROTECTIONISM

Current protectionist trends are similar to protectionism in the 1970s and 1980s. In the 1970s, oil-price hikes and other shocks triggered inward-looking, mercantilist policies, not least in Europe and the United States. Immediate policy responses were not massively protectionist: there was no equivalent of the Smoot-Hawley tariff. Nonetheless, escalating domestic interventions exacerbated economic stress and prolonged stagnation, not least the spawning of protectionist pressures. Industry after industry, coddled by government subsidies at home, sought protection from foreign competition. The result was the "new protectionism" of the 1970s and 1980s.[5]

Then, as now, manufacturers of gas-guzzling cars in America faced bankruptcy. The U.S. Congress bailed out Chrysler in 1979. By then, the British government had already bailed out Rolls Royce and British Leyland, and Renault was saved by French taxpayers shortly after President Carter signed the Chrysler bailout. Several other sectors (wood and timber, energy and minerals, railways, airlines, shipbuilding) received government subsidies in the 1970s. Many companies were nationalized.

Policies like "voluntary export restraints," "orderly marketing arrangements" and other mostly nontariff barriers were deployed to "manage trade." The sectors that received subsidies at home also got protected from foreign competition. Through the 1980s, American car manufacturers were protected by VERs that restricted the number of Japanese cars exported to the U.S. Europe 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 like Nissan and Toyota. Many other sectors, like semiconductors and videocassette recorders, were also protected by VERs or similar measures. The French government even demanded that Japanese VCR imports enter France via Poitiers, a town hundreds of miles from the nearest port.

Many more references could be made to trade-distorting subsidies, increased non-tariff barriers, and other creeping protectionism in the 1970s crises. Similarly, in a few years time we could produce an equally extensive list of measures that governments undertook in 2008-2010. The process has already begun.

What has happened? Governments around the world have bailed out domestic banks and automotive industries. The World Bank estimates total auto industry support to amount to 48 billion U.S. dollars.[6] More is likely to come as the crisis deepens. New support packages to the Detroit car makers are under preparation and the German government is considering new measures for Volkswagen. Other countries are likely to increase their support (e.g. France, Portugal, South Korea and the United Kingdom) to car producers or component suppliers as support to one producer distorts competition and easily triggers calls from other producers to receive similar favours.

Subsidies are also likely to spread to other sectors. State-aid rules in the EU have been relaxed and certainly enabled suspicious state aid to go through the Commission's examination of the lawfulness of state aid. So far, the European Commission has not had a very strong increase in notifications of subsidies, but an increasing part of the notifications clearly concern support to industries suffering from contracting demand.

The air is thick with governments' nods-and-winks to banks to lend at home, not abroad, and to car companies to ensure that their subsidies are spent on production and employment at home, not abroad. U.K. banks receiving subsidies have been requested to deleverage abroad. The French support of its automotive sector appears to have pulled companies to move production from foreign countries to France. One hidden part of the U.S. bailout of its banks is a restriction on firms to apply for H-1B visas. Other countries have not gone as far as to impose new restrictions on labour migration, but political leaders have echoed calls for "British-jobs-for-British-workers"-style views.

"Buy America" provisions in government procurement have been attached to the U.S. fiscal stimulus package. Other governments, as in Spain and Sweden, have encouraged people to buy nationally produced goods. Government procurement has also been a favoured measure to support domestic manufacturers in Asian countries that are not members of the Government Procurement Agreement in the WTO. Chinese provinces and Indonesia, for example, have singled out domestic steel mills as favoured subjects. Several Chinese provinces have gone much further; in Hunan the local government introduced in January directions to government offices to buy passenger vehicles and raw materials, including medicines, made or sourced in the province. Non-tariff barriers (NTBs) have also increased in some sectors – from Belgian chocolate and Dutch eggs (China) to toys (India) and to auto parts and TVs (Argentina). Apart from new sectoral NTBs, Indonesia has also limited the number of import entries.

CREEPING PROTECTIONISM IS A BIG WORRY

Creeping protectionism is less confrontational than crude tariff protectionism but it is not correct to say such measures are less damaging to world trade than tariff hikes. The effect depends on the scale of measures and which sectors they cover. There are four reasons to be worried about current trends of creeping protectionism.

First, current protectionist measures can escalate and trigger tit-for-tat protectionism. Measures are strongly linked to fiscal stimulus packages, bailouts and to government behaviour. As the crisis deepens, and as there is a clear risk that current stimulus policies will not have the intended bite, governments can move further in the protectionist direction to increase the effect of the new stimulus. Increased subsidies are likely to trigger other countries to subsidise the same sector. This was the experience from the first round of subsidies to automotive companies. The U.S. subsidy to its producers triggered similar policies in Canada and Europe.

Second, WTO agreements do not discipline creeping protectionism as much as they limit the discretionary power of countries to increase tariffs. Many measures adopted today (e.g. non-tariff barriers or visa restrictions) are not covered, legally or effectively, by a WTO agreement. There is a WTO agreement on subsidies that certainly is actionable on some of the subsidies given to auto manufacturers, but the agreement itself has weaknesses, which explains why some countries have pushed for a stronger subsidy agreement in the current Doha Round.[7] There is also a problem of transparency and with substantiating a complaint to the WTO; the effect a subsidy has on a company or on trade can be unclear. Finally, the disciplining effect from the WTO weakens if almost all countries participating in sectoral trade adopt measures that in one way or the other have the intention and the effect of subsidising local firms at the expense of foreign producers. The risk is that no country takes another country to the WTO to avoid a Boeing-Airbus situation when both parties accuse each other of unlawful subsidization.

Third, subsidies, buy-local policies and non-tariff measures are often a more direct form of support than protection under tariffs. Such measures are often more difficult to get rid of once they are there. Political sensitivities tend to be higher.

Fourth, current creeping protectionism exacerbates protectionist trends that were underway before the crisis started. This should be the big worry for global leaders as they consider measures to prevent escalating protectionism.

Creeping protectionism was surfacing before the crisis began and involved other policies than those mentioned above. Antidumping actions have been on the march again for some time. Global antidumping took a big jump in the first half of 2008, and estimates show the increase continued in the second half.[8] The increase is driven both by developing and developed economies.[9]

"Standards protectionism" has proliferated – in agriculture and manufacturing – and increasing talk of carbon-based tariffs have magnified protectionist threats. The EU has introduced a cap-and-trade scheme which will increase the cost for European producers vis-à-vis other countries. To avoid deteriorating competitiveness, and so called carbon leakage, it has been proposed that the EU should impose a border tax on imports from other countries. So far, such demands have been postponed until after the Copenhagen meeting this autumn. The bill in the U.S. Congress on cap-and-trade makes provisions for similar arrangements against countries that do not reduce their emission of carbon.

"China-bashing" is getting worse, with accusations of "unfair trade" linked to "currency manipulation" and bilateral trade deficits. Calls for corrective measures against China are likely to increase as the new US administration has officially labelled China a currency manipulator. The crisis itself, and its alleged roots in global imbalances, have increased the risk for trade measures to correct the imbalances. China is already the most frequent target in anti-dumping measures, and this trend is likely to increase.

Investment restrictions have increased, and the number of laws unfavourable to cross-border investment has increased in recent years. Countries as diverse as China and France have singled out strategic sectors and national champions to be protected from the embrace of globalization. Protectionist tendencies can be seen everywhere in the energy sector.

AN AGENDA FOR THE G20

What can the G20 do to block current protectionist trends?

1. Avoid sweeping, shallow and non-committal pledges to fight protectionism. At the G20 summit in Washington DC in November last year, members agreed to avoid protectionist measures for a year and to instruct their trade ministers to agree on Doha-round modalities before the end of 2008. It took only a few days before tariffs had been increased by a G20 member, and at least 25 percent of the membership has increased tariffs since November. At least 17 of the G20 countries have imposed measures that are clearly protectionist, even if they are not forbidden by any WTO agreement. Making pledges you are likely to dishonour is a good way of undermining the entire legitimacy of the G20.

2. Acknowledge the real protectionist threats. Governments today are fighting the wrong enemy. They argue for a battle against a 1930s-style scenario of spiralling tariffs while such a development is highly unlikely. This Maginot line of anti-protectionism is morally admirable, but it prevents governments from fighting actual protectionism or real protectionist threats.

3. G20 governments should acknowledge that current expansion of fiscal spending – regardless of its merits as counter-cyclical policy – is a source of protectionism and potentially a source of es-

calating tit-for-tat protectionism. There is a clear risk of falling for the "Keynesian fallacy" – governments turning protectionist to increase the effect of government interventions. Increased fiscal spending, especially in the U.S., has been justified by economic theories and evidence that has exaggerated the potential economic effect of deficit-financed spending. If stimulus packages do not have the intended economic effect, there is a risk that "fiscal stimulus protectionism" will increase.

4. Take a realistic view of the likelihood of finishing the Doha Round. The current economic crisis has demonstrated the benefits of the WTO and the defence it offers against protectionism. However, the crisis has not given new impetus to the stalled negotiations in the Doha Round. The effects and the sources of the crisis are distant from the key areas of dispute in the negotiations. This year will probably be a lost year for the Doha Round; India goes to elections this spring, the European Commission will change in the autumn, and the new U.S. administration will have to lay down a new trade agenda and ask the U.S. Congress for a Trade Promotion Authority to support it. Until this has happened, the Doha Round will not be revived.

5. Ideally the G20 summit would commit to new initiatives to open up for increased trade and cross-border integration. Such policies, however, are unlikely in the current political climate. The agenda now should be to protect current openness. To that end G20 governments should establish a "ceasefire agreement" on key protectionist measures. Such an agreement cannot cover all measures but should focus on the type of measures that could escalate and trigger tit-for-tat races for protectionism. So far the crisis has not triggered massive protectionism, but the next six months are likely to become more problematic than the past six months as unemployment will increase and several more sectors find themselves under "existential threat". What measures should be covered by a ceasefire agreement? Tariff increases (regardless of WTO commitments), state aid not using the non-objectionable part of the subsidy agreement, and buy-local policies (regardless of whether a country is signatory to the GPA or not) should be the core elements. Together they cover measures adopted by a variety of countries. Other protectionist measures are problematic as well, but they are difficult to address. It is impossible, for example, to prevent the use of anti-dumping measures. The important task now is to sort out the really bad apples – those who can trigger tit-for-tat developments – and not to address all problematic parts of trade policy.

6. Give a smaller group of countries – China, the EU, Japan and the United States – the task of proposing guidelines at the next G20 summit on how to prevent protectionist threats from materializing and how to progress multilateral agreements that strengthen disciplines on the favoured tools of protectionism. Cooperation is needed, but the G20, let alone the WTO, is too unwieldy to allow for clear proposals and leadership from the big countries to emerge from summits or unprepared plenary sessions. The G20 itself cannot be a forum for trade negotiation nor can it direct the WTO to act; the WTO is a member-driven organisation operating under the principle of consensus. The G20, however, could give legitimacy to a selected group of countries that assumes a greater leadership role for the Doha Round and for other needed trade-policy developments outside the remit of the Round.

FOOTNOTES

1. James (2001).
2. WTO (2009) and Gamberoni & Newfarmer (2009).
3. Trade remedies like antidumping are not accounted for as such measures are targeted against specific countries/ exporters.
4. Ecuador, however, has imposed tariffs on more than 600 items.
5. Erixon & Sally (2009).
6. Gamberoni & Newfarmer (2009).
7. The U.S. in particular has made strong calls for greater disciplines on coverage of operating losses, forgiveness of government-held debt, and lending to and investments in uncreditworthy companies.
8. See Elisa Gamberoni &Richard Newfarmer (2009)
9. Davis (2009).

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