Of Great Depression and Protectionism

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While there are no widespread protectionist measures on trade and investment, nonetheless, there is some slippage in policy in G20 countries following the global crisis. Given that protectionism had been a factor in the deepening of the Great Depression in the 1930s, countries should learn the lessons well and avoid a similar reaction.

While there has been no indication of a descent into high-intensity protectionism as a reaction to the global financial and economic crisis, there has been some policy slippage in the area of trade, with some G20 members raising tariffs and introducing new non-tariff measures, and most of them continuing to use trade defence mechanisms.

This is the main finding of a joint report by the Organization for Economic Cooperation and Development (OECD), the World Trade Organization (WTO) and the UN Conference on Trade and Development (UNCTAD) on trade and investment measures imposed by the governments of the G20.

The report, released on 14 September, was prepared in response to the request of the G20 leaders at their summit in London on 2 April 2009, that the WTO together with other relevant international organizations monitor and report publicly on G20 adherence to undertakings on resisting protectionism and promoting global trade and investment.

In a preface to the joint report, the heads of the three organizations, Angel Gurria of the OECD, Pascal Lamy of the WTO and Supachai Panitchpakdi of UNCTAD said that during the period under review, "we have not observed widespread resort to trade or investment restrictions as a reaction to the global financial and economic crisis."

"Nevertheless, there has been policy slippage since the global crisis began. In some cases, G20 members have raised tariffs and introduced new non-tariff measures, and most of them have continued to use trade defence mechanisms," they added.

"These measures, along with reports of additional administrative obstacles being applied to imports, are creating 'sands in the gears' of international trade that may retard the global recovery.

"The fiscal and financial packages introduced to tackle the crisis clearly favour the restoration of trade growth globally, but some of them contain elements that favour domestic goods and services at the expenses of imports. It is urgent that governments start planning a coordinated exit strategy that will eliminate these elements as soon as possible," they said.

"It is the responsibility of all world leaders, in particular of those of the G20 members, to take the appropriate policy actions so that trade and international investment can help economies recover from the global crisis on a sustained basis. In this regard, G20 Leaders should undertake a stronger commitment to open markets and make concrete their call to conclude the Doha Round in 2010," they stressed.

The joint report for the G20 leaders' summit in Pittsburgh later this month covers developments in the period since the G20 London Summit, from April to August 2009. It supplements earlier reports by the WTO on the Financial and Economic Crisis and Trade Related Developments, and by the OECD and UNCTAD on investment measures.

According to the joint report, there is no indication of a descent into high-intensity protectionism as a reaction to the crisis, involving widespread resort to trade or investment restriction or retaliation. "This suggests that G20 members and other governments have so far succeeded in managing the political process of keeping domestic protectionist pressures under control."

Overall, says the report, the incidence of new trade and investment measures taken in response to the current crisis is not out of line so far with what happened during previous downturns in economic activity. WTO rules and its dispute settlement mechanism continue to provide a strong defence against protectionism as do OECD rules and peer monitoring and UNCTAD's monitoring of national and international policies for foreign investment.

However, the report cautions, trade and investment policy risks remain and are likely to continue until economic recovery is well-rooted and job and business opportunities have started to grow again.

The main risk is that G20 members will continue to cede ground to protectionist pressures, even if only gradually, particularly as unemployment continues to rise. The danger is of an incremental build-up of "sand in the gears" of international trade that could aggravate the contraction of world trade and investment and undermine confidence in an early and sustained recovery of global economic activity.

G20 members should reflect on the contradiction of using any measures that restrict or distort trade or investment, and therefore that tax production and incomes, at the same time as the main thrust of their policies to overcome the crisis is geared to expanding aggregate demand.

"Best practice" in current circumstances, to accompany financial and fiscal stimulus, is to reduce trade and investment restrictions so as to cut costs and prices worldwide. Where subsidies can be afforded, their full value as a stimulus for economic activity will come from targeting them at consumption, not production level, with consumers free to choose internationally the goods and services that they buy, says the report.

The second risk is that measures taken temporarily to try to protect jobs and business profits now from the effects of the crisis will create a legacy of uncompetitive industries and sectoral over-capacity that will continue to generate protectionist pressures even after economic activity picks up again.

The failure of trade restrictions and subsidies to provide effective industrial support in the 1970s and 1980s, and the long-term costs imposed on world trade until they were unwound during the Uruguay Round, need to be recalled. "The same mistakes must not be made again," says the report.

"A collective decision by G20 members to bring the Doha Round to a rapid conclusion would be well-received by other WTO Members and send an unambiguous signal that protectionist measures are not the solution to this crisis and that measures taken to combat the crisis will be quickly unwound," the report adds.

"Concluding the Round will substantially narrow the scope for introducing new trade restrictions or raising existing ones; where WTO disciplines are currently weak, or their coverage is limited, governments face greater difficulties to resist protectionist pressures. It would also generate a new stimulus package for the world economy that would not depend on public finances and that would benefit directly developing countries, who as a group have been by far the worst affected by the crisis."

Pending the conclusion of the Doha Round, the report says, the "do no harm" principle points to the value of a strong commitment by G20 members not to introduce new trade restrictions and trade-distorting subsidies, including those that are regarded as being consistent with WTO rules.

While only a small number of G20 countries applied trade restrictions in reaction to the A(H1N1) influenza pandemic (most of which were removed), however, there have been reports from traders of generally stricter application of SPS (Sanitary and Phytosanitary Measures) and TBT (Technical Barriers to Trade) regulations in some G20 markets, and of slower procedures and additional procedural requirements in the administration of existing trade measures in others. This kind of "sand in the gears" is not easy to substantiate empirically, but it can be significant in raising the cost of trade transactions, says the report.

The report notes that in May, the United States followed the lead of the European Union earlier in the year by re-introducing agricultural export subsidies for dairy products.

Some G20 members have increased tariffs and non-tariff barriers across a relatively wide range of imports, but most seem to have limited their policy actions narrowly to a small number of products. Agricultural products, iron and steel, motor vehicles and parts, chemical and plastic products, and textiles and clothing have been the products most affected overall by these measures.

In 2009, the number of initiations of anti-dumping investigations by G20 members is running at about the same level as in the same period of 2008, although the distribution of investigations among individual G20 members has changed substantially in a few cases. The number of initiations of safeguard investigations has increased considerably during the first half of 2009 compared to the same period in 2008.

The report notes that there has been some evidence of improvement in the trade policy environment, with several G20 members introducing trade-liberalizing and facilitating measures. For example, Brazil, China, India, Indonesia, Mexico, the Russian Federation and Saudi Arabia announced cuts in import duties, fees and surcharges and the removal of non-tariff barriers on various products, and China removed some restrictions on trade in certain services sectors.

Monitoring the impact on trade of fiscal stimulus programmes and industrial and financial support programmes presents a particular challenge because of the paucity of data available, in particular on the specifics of how these programmes are being implemented, says the report.

Concerns have continued to be raised by governments and business about "buy/invest/lend/hire local" requirements that have officially or unofficially been attached to some of these programmes. Because of their evident nationalistic appeal in current circumstances, there is a particular danger that these programmes could become targets for retaliation and proliferate. Several new cases of "buy local" campaigns, usually at local government levels, have been reported in the press in the past five months.

Concerns have also continued to be raised about the competition-distorting effects of the subsidy components of these programmes, says the report, adding that the longer the subsidies remain in place, the more they "will distort market-based production and investment decisions globally, the greater will become the threat of chronic trade distortions developing, and the more difficult it will become to correct those distortions.

An important consideration, for G20 countries in particular, is to design and announce as soon as possible an exit strategy from this component of their crisis measures that will allow world markets to return to normal again, the report recommends.

During the reporting period, says the report, 17 of the G20 members took some sort of policy action in the investment area (investment measures, investment measures related to national security, emergency and related measures) or concluded international investment agreements.

Also during the reporting period, 11 G20 countries changed policies governing inward and/or outward investment. Most of these changes aimed (according to announcements or notifications by governments) at increasing openness and clarity for investors.

In response to the crisis, 11 of the G20 countries (Australia, Canada, France, Germany, India, Italy, Japan, the Republic of Korea, the Russian Federation, the United Kingdom and the United States), as well as the European Union, took emergency measures that have the potential to restrict or distort worldwide capital movements. These include firm-specific, sector-specific and cross sectoral measures.

Public expenditure commitments related to the measures covered in this report amount to approximately US$3 trillion.

The sheer size of these measures and their potential effects on competitive conditions (e. g. on firm entry and exit) in globalized sectors such as finance and automobiles create a strong presumption that they influence worldwide capital flows. "Moreover, akin to subsidies, emergency measures may effectively create advantages for domestic sectors and put foreign players at a disadvantage."

Continued international monitoring can help ensure that policies are effective in their intended purpose and are not a disguised form of protectionism and that investment distortions arising out of domestic policies taken in response to the crisis are kept to a minimum, the report concludes. □□□

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