The fateful allure of protectionism: Taking stock for the G8

Edited by: Simon J. Evenett, Bernard M. Hoekman and Olivier Cattaneo

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The front cover of this book features images of Reed Smoot and Willis Hawley, and the Jarrow Marchers. The Smoot-Hawley Tariff Act (1930) raised US tariffs on over 20,000 imported goods to record levels, prompting a retaliation in kind from many countries, and is widely thought to have been a contributing factor to the severity of the Great Depression. The Jarrow March (or Jarrow Crusade) was an October 1936 protest march against unemployment and extreme poverty suffered in the north-east of England. The 200 marchers travelled from the town of Jarrow to the Palace of Westminster in London, accompanied by their MP, Ellen Wilkinson, to lobby parliament.

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Foreword

The world is facing the most severe global economic crisis since the Great Depression of the 1930s. For the first time since World War II, world GDP is expected to decline, and growth in developing countries is expected to fall to 1.2% from 5.9% in 2008. Trade has declined as well: global trade volumes are expected to fall by some 10% in 2009; the worst decline in trade since the 1930s. Governments have responded to the crisis with policies to support economic activity and employment. Efforts have been made to coordinate these policy responses, in particular to maintain an open trade regime. The systemic risks of a resort to protectionist policies are generally recognized by world leaders: at their April Summit in London, they committed to refrain from raising new barriers and to minimize any negative impact on trade and investment of domestic policy responses to the crisis.

CEPR and the World Bank believe that at present the greatest threat to the world trading system is that – through accident or design – a major trading nation decides to turn inward and reject global economic engagement. For this reason Simon Evenett, Co-Director of the CEPR trade programme, and Bernard Hoekman, Director of the World Bank's International Trade Department, brought together researchers and trade policy practitioners to assess the cross-border impact of policy responses to the crisis. Their verdict? "So far so good": to date we have not observed large scale increases in the level of discrimination against foreign suppliers of goods and services by major trading states.

There are, however, reasons for continued concern. Even the most optimistic forecasts for economic recovery imply substantial increases in unemployment in the major trading powers in 2010 and, in some cases, in 2011. The protectionist temptation will almost surely intensify before it abates, and a significant use of trade-distorting policy by a major jurisdiction could set off unwelcome domino effects.

Continued vigilance is necessary. A key aspect of this vigilance is Global Trade Alert (*www.globaltradealert.org*), supported by the World Bank (and other donors), and coordinated by CEPR. Global Trade Alert provides real-time information on state measures taken during the current global downturn that are likely to affect foreign commerce. It goes beyond other monitoring initiatives, by identifying the trading partners likely to be harmed by these measures and by encouraging third parties to submit measures for scrutiny.

We are delighted to have sponsored the Brussels conference and grateful to Simon, Bernard and Olivier Cattaneo for their hard work in organizing it, and to the DFID-supported Global Trade and Financial Architecture project for co-financing. More meetings like it will be needed in the future. These meetings – along with Global

Trade Alert – will provide the information needed to ensure that policy responses to the crisis do not beggar us all.

This volume contains summaries of the papers that were presented and discussed at the conference. The full-length papers will be edited in a volume to be published in the World Bank Trade and Development Series in September 2009.

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Introduction: Principal Findings and Policy Recommendations

Simon Evenett, Bernard Hoekman and Olivier Cattaneo
University of St. Gallen and CEPR; World Bank and CEPR; World Bank

1. The context

The world is facing the most severe global economic crisis since the Great Depression of the 1930s. For the first time since World War II, in its projections for annual economic growth published last week the World Bank expects world GDP will decline (-2.9% in 2009) and developing countries growth will fall to 1.2% from 5.9% in 2008.[1] Excluding China and India, other developing nations' economies will shrink on average by 1.6%. Net private capital flows to developing countries will likely turn negative in 2009 – a more than $800 billion drop from the 2007 peak. The decline in global foreign direct investment (FDI) flows that started in 2008 will deepen and spread to the developing world – with overall inflows projected to fall some 30% compared to 2008, the first time FDI has fallen more than 10% in a year since 1986. The value of remittances, perhaps the most stable source of external financing for developing countries, is expected to drop by 5% this year.

Trade is no exception. Global trade volumes are expected to decline by some 10% in 2009; the worst decline in trade since the 1930s. While all regions in the world are severely affected, the impact of the decline is stronger in countries that are highly dependent on trade with developed countries where demand has contracted most. For example, in Cambodia, which relies heavily on tourism and exports of garments to the US, growth fell from 10.2% in 2007 to 6.7% in 2008 and the economy is expected to decline by 1% in 2009.

Governments have responded to the crisis with large fiscal stimulus packages and central banks around the globe have engaged in far-reaching monetary easing. The objective has been to support demand and thus economic activity and employment. Efforts have been made to coordinate policy responses, through the G20 and other fora, including in the area of international commerce. Maintaining an open trade regime is an important part of the path for getting out of the crisis. At the April 2, 2009 London Summit, the G20 countries committed to refrain from raising new barriers and to minimize any negative impact on trade and investment of domestic policy responses to the crisis (Box 1). This recognizes the importance of not taking meas-

1 All data reported are from World Bank, *Global Development Finance*, 2009.

ures that discriminate against and between foreign providers of goods and services, so disrupting further the commercial playing field. The systemic risks of a significant resort to protectionist policies are generally recognized by world leaders. The 1930s, as well as the more recent extensive resort to protectionism ('voluntary' export restraints for cars, quotas on textiles and steel) during the early 1980s recession, illustrate that if some major countries put in place measures to close domestic markets, the risk of others following is high. At present the greatest threat to the world trading system is that – through accident or design – a major trading nation decides to turn inward and reject global economic engagement.

Box 1: Paragraph 22 of London Summit Communiqué, 2 April 2009

World trade growth has underpinned rising prosperity for half a century. But it is now falling for the first time in 25 years. Falling demand is exacerbated by growing protectionist pressures and a withdrawal of trade credit. Reinvigorating world trade and investment is essential for restoring global growth. We will not repeat the historic mistakes of protectionism of previous eras. To this end:

- we reaffirm the commitment made in Washington: to refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing World Trade Organisation (WTO) inconsistent measures to stimulate exports. In addition we will rectify promptly any such measures. We extend this pledge to the end of 2010;
- we will minimise any negative impact on trade and investment of our domestic policy actions including fiscal policy and action in support of the financial sector. We will not retreat into financial protectionism, particularly measures that constrain worldwide capital flows, especially to developing countries;
- we will notify promptly the WTO of any such measures and we call on the WTO, together with other international bodies, within their respective mandates, to monitor and report publicly on our adherence to these undertakings on a quarterly basis;
- we will take, at the same time, whatever steps we can to promote and facilitate trade and investment; and
- we will ensure availability of at least $250 billion over the next two years to support trade finance through our export credit and investment agencies and through the MDBs. We also ask our regulators to make use of available flexibility in capital requirements for trade finance.

2. What we have observed so far

This volume summarizes the findings of a set of papers presented at a joint World Bank-CEPR conference in May 2009 that assessed the prevalence and cross-border effects of the different policy responses put in place by governments to the crisis.[2] The

2 The conference was financed in part by the Global Trade and Financial Architecture project, an initiative that is supported by the UK's Department for International Development (*www.worldbank.org/trade/gtfa*).

conclusion that is suggested is 'so far so good,' or to paraphrase Josling and Tangermann in their contribution on agricultural trade policy, so far the protectionist 'dog did not bark.' Although there is much heterogeneity in terms of policy responses, and a growing number of countries have put in place some protectionist measures, to date we have not observed large scale increases in the level of discrimination against foreign suppliers of goods and services by major trading states. Indeed some countries, including Mexico, have responded by reducing tariffs and other barriers to trade.

A stylized fact that is suggested by the evidence to date and the analyses in the papers included in this volume is that where multilateral disciplines exist, recourse to protectionism has been limited. Some countries have utilized the 'policy space' they have to raise tariffs, but projections – based on past behavior – are that any such increases are likely to remain limited: Olarreaga and others predict increases in 2009 of perhaps 8 percent. In the area of agriculture, Josling and Tangermann stress that reactions to the crisis have been relatively muted, and good news (tariff reductions, removal of import bans and export taxes) coincides with bad news (tariff increases, reactivation of export subsidies). In a sector that in the 1970s and 1980s became a bastion of protectionism, textiles and apparel, Frederick and Gereffi argue that policy remains very open. Another illustration of this stylized fact is that countries that are not WTO members are among those that have made the most intensive use of measures to restrict trade and investment – e.g., Algeria and Russia.

Insofar as protectionist actions are being pursued, many are taking the form of measures permitted by the WTO, especially antidumping and (selective) safeguard actions. While such measures are discriminatory and clearly inconsistent with the letter (and spirit) of the G20 declaration, they are relatively transparent and in principle are constrained by multilateral rules. Indeed, these instruments are often described as 'safety valves' that need to be included in trade agreements in order to give governments the assurance that in times of need – as is the case today – they will be able to re-impose a certain level of protection if this is needed for political purposes. While the use of trade policy is second-best – fiscal and monetary policy is more effective and efficient – using instruments of contingent protection to manage pressures for restricting imports in specific sectors is typically superior to a government having recourse to nontariff barriers (such as VERs in 1980s). In his analysis of the use of these WTO 'trade remedies' Bown notes there has been an 18.5 percent increase in the use of antidumping, safeguards, and countervailing duties, including by almost all the G20 countries. These actions increasingly affect 'South-South' trade, and primarily target exports from China. However, the amount of imports targeted by these measures thus far remains relatively small: less than half of one percent of the total merchandise imports of G20 countries. The number of measures taken is still below what it was only a few years ago, suggesting that with the exception of a small number of countries – such as India – the overall use of these instruments remains limited.

A second, and related stylized fact emerging from the papers is that where no multilateral disciplines exist, or where they are weak and limited in coverage, countries have been less able to resist protectionist pressures. The reintroduction of export subsidies by the United States and the European Communities (EC) are high profile examples of this point; high profile precisely because these subsidies are thought to

have harmed many developing countries' commercial interests in the past. According to Global Trade Alert (*globaltradealert.org)*, 80 jurisdictions export the commodities for which the U.S. has reintroduced export subsidies.[3] The comparable number of affected exporting jurisdictions for the EC's export subsidies was 41.[4]

In his paper, Claessens stresses that the absence of adequate multilateral disciplines and mechanisms for cooperation in the area of finance services gave rise to nationalist solutions, distorted resource allocation decisions and undermined conditions of competition. Similarly, the lack of multilateral disciplines on the movement of natural persons providing services implies that countries are free to unilaterally redefine the rules of the game and (re-)introduce barriers to the local employment of foreign professionals. Malaysia, the United States, and the United Kingdom have done just that in the past 6 months.[5] The absence of any disciplines in the WTO on measures that affect the export of services implies that source countries are free to take actions that have the effect of raising the costs and/or reducing the flow of financial services.

In his paper on stimulus packages and public procurement, Evenett notes that WTO disciplines in this area have limited coverage and that local (sub-national, municipal) governments may be free to require that funds be spent on domestic firms' raw materials, parts and components. A number of examples of explicit discrimination can be found in the implementing regulations of the American Recovery and Reinvestment Act at the state and local level. Similar provisions have been adopted in Australia by New South Wales and most recently it is said by China – neither of which is bound by the relevant WTO disciplines on procurement because they have not signed the Agreement on Government Procurement.[6]

The policies in these areas are potential examples of so-called 'murky' protectionism (Baldwin and Evenett, 2009), where damage to foreign commercial interests is the consequence of the non-transparent application of discretion given to regulators and line ministries. This type of protectionism is at first cut difficult to identify, and harder to quantify. For example, it could be the strings attached to bailouts received by automobile producers in Europe. All too often, the devil is in the details of implementation rather than the umbrella legislation. This suggests that there is an urgent need to monitor closely what all government bodies do, not just those central entities that are subject to international trade disciplines. In his contribution to this volume, Jenny argues for a systematic assessment of the impact on competition of all the policy responses to the crisis. This is particularly needed for those state policies which are promoted as serving some unobjectionable objective but where the implementation details suggest that competition and market forces are unduly distorted.

3 See *http://www.globaltradealert.org/measure/united-states-america-dairy-export-incentive-program*.

4 See *http://www.globaltradealert.org/measure/ec-reintroduction-export-refunds-milk-butter-and-butteroil*

5 See the reports on these measures on *globaltradealert.org,* the CEPR-led portal for online monitoring of trade-related measures taken during the current global economic downturn.

6 This Agreement is one of two agreements in the WTO where participation is voluntary. Almost all developing countries and some OECD countries have not signed the procurement agreement. The reason a separate agreement is needed in the first place is that the WTO does not cover public procurement-i.e., the basic nondiscrimination rules (MFN and national treatment) do not apply to government purchases of goods and services.

Beyond this, given that countries appear to be abiding by WTO commitments where these apply, the problem is that there are no multilateral disciplines in these areas (financial sector; fiscal stimuli) or countries have not committed themselves to abide by them (procurement, services trade). Ultimately this suggests a priority for governments is to (re-)engage in negotiations to establish such disciplines. Indeed, the resort to discriminatory state policies during this sharp global economic downturn could-and should-help define the commercial policy priorities for governments in the early twenty-first century.

3. Factors explaining the limited use of trade policy to date

Although many countries have imposed protectionist measures, there has not been much in the way of tit-for-tat retaliation. A number of factors explain why, so far, protectionism seems to have been contained. As Irwin stresses in his contribution, the foremost reason that countries have been able to avoid repeating the experience of the 1930s is because of their willingness to rely on expansionary monetary and fiscal policy. In the 1930s these instruments could not be used to the same extent due to the gold standard and balanced-budget orthodoxy.

Another important factor is the extent of globalization of production that has occurred in the last 20 years or so. For many companies (and thus governments) this has changed the incentives to seek protectionist policies. Maintaining an open trade regime is in the interest of firms that are part of global supply chains, as closure would substantially raise costs and undermine competitiveness. This helps to explain why many of the countries that have taken overt protectionist action tend to be less integrated in global supply chains (e.g., Algeria, Argentina, Ecuador, India, Russia). It may also explain why firms have sought bail-outs and subsidies rather than tariff increases from their governments. (Plus, tariff increases are not much use to a firm that sells little to the market in which it is operating or where a sharp economic downturn has cut into the customer base substantially. Much better to obtain a direct fiscal transfer – a subsidy – if it is available, rather than wait for a tariff to reshuffle what customers remain from foreign goods to goods produced domestically.)

A third factor is the WTO, as well as deep regional integration agreements such as the EU and the web of bilateral investment treaties. There are now binding international disciplines that go some way to deter countries from violating the national treatment principle. As mentioned above there is a negative correlation between the use of restrictive trade policy and WTO disciplines in the relevant areas. Should the number of WTO and investment disputes increase substantially as the crisis unfolds, then this finding may need to be nuanced. Still, it would demonstrate that governments are resorting to official dispute settlement procedures and not taking matters immediately into their own hands.

There is also a willingness to build on and use the multilateral trading system as a tool to fight the crisis. The ability to pledge over $250 billion over the next two years to boost trade finance is an example. Another is the engagement by the WTO to actively and publically monitor the use of policies by its members, increasing transparency and stimulating peer pressure with regard to the design and implementation of potentially harmful policy responses to the crisis.

4. Worrisome trends call for increased vigilance, now and in the future

The monitoring work of the WTO and other organizations, including the World Bank, has revealed some worrisome trends that could strengthen if the crisis lasts and deepens. The crisis has put governments under severe pressure to assist domestic industries and support employment. It is too early to know whether the worst of the decline in economic activity is behind us. But even if the crisis is now bottoming out, the prospects are for a slow recovery. This implies that governments will remain under pressure for some time to take actions to support local economic activity.

A number of considerations all call for increased vigilance over the next months.

1. Only a small portion of the stimulus package money has been spent so far, and implementation may produce further discrimination. As trading partners realize the growing level of discrimination, the temptation to 'retaliate' may grow.
2. Even the most optimistic forecasts for economic recovery imply substantial increases in unemployment in the major trading powers in 2010 and, in some cases, in 2011. In fact, the rises in unemployment experienced to date are smaller than those expected in the coming 12 months. Rising unemployment has long been associated with government resort to protectionist measures. The protectionist temptation will almost surely intensify before it abates – a finding that will hold even if the much vaunted ‘green shoots’ do emerge into recovery.
3. Many governments now have little margin for manoeuver in fiscal and monetary policy, and in the event that the recession persists, they could turn to trade and industrial policies as a stop-gap resort.
4. A significant increase in the use of trade-distorting policy by a major jurisdiction could set off unwelcome domino effects, not unlike that witnessed for auto subsidies, diary export subsidies, and procurement nationalism in the last few months.

While there is clear need for continued vigilance in the coming months, the crisis has also revealed significant weaknesses in the WTO transparency and notification mechanisms. Monitoring of policies has shed a new light on the limited extent of information on discriminatory application of policies, whether or not subject to WTO rules. There has been substantial ‘slippage’ in the global trade system towards more discrimination in recent years and some complacency regarding breaches of the non-discrimination principles that are the core of the WTO system. Elements of this slippage include the spread of preferential trade agreements, both reciprocal and unilateral, and selective safeguard actions. The general trend away from MFN – part of the status quo ante – has received considerable attention in the context of the crisis as a result of the fear of repeating the historic mistakes of protectionism. This suggests the crisis may have a silver lining for the trading system – it may revive interest in, and support for, pursuit of multilateral cooperation.

5. Policy implications and recommendations

Resisting the protectionist temptation is not a matter of luck or chance. Beyond declarations of good intent, concrete steps toward reinforcing the global trade system are needed.

The crisis has revealed that rules matter: WTO disciplines appear to have played a positive role in constraining recourse to protectionism. This makes rapid conclusion of the Doha Round important. The responses to the crisis clearly illustrate that a multilateral trade negotiation should not be assessed only on the basis of how much new market access opportunities it generates. This has been the metric used by many lobbies, analysts and the press, as well as some key negotiators. It is misconceived. The primary role of the WTO is to set the rules of the game and to lock-in the policies of members.

As the crisis continues, the opportunity cost of inaction on Doha rises. A common conclusion from the contributors to the World Bank-CEPR workshop is the need to rapidly conclude the Doha round. This would limit the ability of governments to increase tariffs or agricultural subsidies in the future, send a strong signal of the international community's commitment to keep trade and investment flowing and help countries resist pressures for protection when they begin to unwind their current expansionary policies. The value of 'what's on the table' has increased as a result of the crisis.

Concluding Doha is also important as critical policy matters outside the Doha Development Agenda need to be addressed. The lack of agreement on the Doha Round is crowding out the prospects for cooperating on initiatives that address large cross-border knock-on effects. Climate change is the most obvious example where there is an urgent need for governments to consider the implications for the trading system of concerted action to reduce carbon emissions and green house gas emissions. Finishing the Doha Round is a precondition for addressing some of the weaknesses in the global trade and financial architecture that the crisis has revealed.

Government responses to the current global economic downturn have other implications for the multilateral trading system. First, the areas where 'murky' protectionism has emerged suggests that there is a need to expand the scope of multilateral cooperation. Potential areas for negotiating rules of the game include competition policy, public procurement, other non-tariff barriers, service-sector regulation, and subsidies, including investment incentives. 'Murky' protectionism is just one facet of a fundamental mismatch between trade rules that were designed in the early 1990s or earlier and contemporary regulatory priorities as they relate to the global trade and financial system.[7] The absence of international rules in these areas allows discrimination to be pursued with impunity.

Second, 'murky' protectionism may not be just a crisis phenomenon. The monitoring work and related analysis revealed that very little is known about the distribution of local government procurement and what share of purchases is allocated to local firms. The same is true of subsidies and many nontariff policies. In part this is a reflection of the absence of multilateral disciplines, so that there is no need to report

7 It being recalled that the prevailing multilateral trade accords were negotiated on the basis of an agenda set in 1986! Those born in that year are now old enough to drive cars and vote.

or to collect the requisite data. In part it is a reflection of the fact that WTO members are simply not living up to their existing commitments in the area of notifications and transparency.

At a minimum, recent monitoring exercises suggest that the WTO notification and review mechanisms have been both neglected and inefficient. It is important to increase monitoring and public reporting efforts, so that government measures that could negatively affect trade and investment – whether compatible or not with WTO rules – can be identified more systematically and at an earlier stage. Transparency is one of the best defenses against rampant protectionism.[8] Predictability and security of transactions remain the main drivers of global trade and investment.

The papers by Steenblik (on 'green protectionism') and Borchert and Mattoo (on services) illustrate that, whether or not policies are subject to disciplines, it is important that there be regular monitoring of government policies that may have major cross-border spillovers and analysis of their impact and incidence. In some policy areas there is much information – see e.g., Wyplosz and Weber's observations in their paper on exchange rate policies – but in others we are very much in the dark. Beyond ad hoc monitoring mechanisms, it is necessary to strengthen institutional notification and review mechanisms, such as on subsidies, competition, public procurement, non-tariff measures, or services trade policies. This will require dedicated resources, both financial and political, as the data will need to be collected and compiled.

Third, while many government policy responses to the crisis may be temporary, the effects of ‘buy national’ or 'buy local’ could prove enduring if they result in emulation. It is noteworthy for example that some of the countries that are engaging in ‘buy national’ policies are among those that have been most interested in seeing developing countries accede to the Agreement on Government Procurement. The signal that is being sent may have long term negative consequences for the realization of this objective. The same is true of actions by governments to restrict access to local services markets for foreign nationals, especially those countries where the demographics point to a greater need for foreign workers in the future. The longer-term costs of short-term policies may be significant if it results in future suppliers (trading partners) requiring a 'risk premium' to supply services. It was amidst strained circumstances, in 1943-1944, that the architecture of the post-war world economic order was established. There should be no delay on taking action to begin to remove discriminatory and trade-distortive measures that have been adopted to respond to the crisis.

Finally, it would be short-sighted to yield ground to protectionism. The crisis is stimulating innovation by firms and in so doing creating new trade opportunities. Eventually the crisis will end and once the recovery starts the more open economies will be better placed to benefit from the increase in demand. From this perspective, it is particularly important that efforts continue to focus on enhancing the competitiveness of firms and farmers in low-income countries by, inter alia, actions to lower trade and transport costs. In general, sustaining efforts to expand the delivery of ‘aid for trade’ and achieving the commitments that were made in this regard at the 2005 WTO ministerial meeting in Hong Kong should be a priority, as they will help developing countries to benefit more from the recovery.

8 The desire to provide high quality information that could be used to add peer pressure on governments was an important rationale for the CEPR to launch Global Trade Alert, an independent online trade monitoring service at *www.globaltradealert.org*. The World Bank is one of five sponsors of this initiative.

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Section 1
The Protectionist Allure: Then and Now

1. A Historical Perspective

Douglas A. Irwin
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In various gatherings, world leaders have pledged not to repeat the mistakes of the past by adopting protectionist measures. What mistakes of the past have leaders been referring to? Almost unquestionably, the references are to the Great Depression of the 1930s, which was marked by a severe outbreak of protectionism and breakdown of the world trading system. The rise in 'beggar-thy-neighbor' trade barriers during that decade is believed to have intensified the Depression and hindered the economic recovery. Moreover, the trade barriers imposed under the 'emergency' conditions of the day remained in place for a period that stretched into decades, blocking the expansion of world trade even though the original justification for the barriers had long since past.

In order to avoid repeating the calamity of the 1930s, it is necessary to understand precisely what happened to the world trading system during that terrible decade and contrast it with the situation today. In the 1930s, it is important to remember that countries were on the gold standard. This fixed exchange rate system is key to understanding the different trade policy responses to the Great Depression. In addition to balanced budget orthodoxy, which constrained public works and expansionary fiscal policy as a policy response, the gold standard constrained the monetary policy response. As a result, countries turned to restrictive trade policies as one of the few policy tools at their disposal to fight the economic collapse.

As the Depression spread around the world, countries responded in one of three ways. One group centered on Britain devalued their currencies against gold in late 1931. Another group centered on France stayed on the gold standard and continued deflationary policies. A third group centered on Germany maintained its gold parity but imposed strict foreign exchange controls on all trade and capital transactions. By devaluing its currency, Britain and its followers were able to pursue an expansionary monetary policy that promoted economic recovery. These countries did not impose many trade restrictions because they chose to abandon fixed exchange rates instead. (A devaluation is economically equivalent to an import tariff plus an export subsidy, except it is better than a tariff alone because it gives monetary policy the flexibility to boost domestic demand in times of recession.) By staying on the gold standard, France and its followers ruled out a monetary policy response and imposed high tariffs and quotas on imports to reduce gold outflows and bolster the balance of payments situation. By imposing exchange controls, Germany and its followers did not need to implement formal trade barriers, such as tariffs, but it implicitly restricted trade volumes just the same.

Thus, the outbreak of protectionism in the 1930s did not affect all countries, but

mainly those that handicapped themselves by staying on the gold standard, thereby ruling out the discretionary use of monetary policy. Today, the situation is different on several dimensions. First, countries have many more macroeconomic policy tools at their disposal to address the current recession. Second, the WTO is an international compact that prevents arbitrary increases in protection, something that the world of the 1930s did not have, and makes more transparent the retaliation that will take place if countries deviate from the rules. Third, the share of the workforce in sectors directly affected by international trade – mainly agriculture and manufacturing – is much lower today than in the 1930s. Combined with international supply chains and investment, there are fewer interest groups who will benefit from trade barriers now than there were in the 1930s. These differences auger well for the hope that protectionist responses to the world's current economic crisis can be contained.

About the author

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2. Too Early to Cry Wolf

Patrick A. Messerlin
SciencesPo

The WTO used the term 'significant slippage' to qualify changes in protection during Fall 2008 and Winter 2009. Most newspapers translated these terms into 'rise of protectionism.'

Evoking such a rise is premature. It is crucial to address this statement because it offers a huge tactical advantage to protectionist interests. First, it makes it much more difficult for governments to push for more liberalization when everybody else is – allegedly – busy raising protection. Second, since nothing bad will flow from such a 'rise of protection' (since there is none) protectionist lobbies can claim that raising protection does not have the dire effects that economists predict, and they will quickly ask for more protection.

The following observations can be made on the basis of the raw information provided in the March 2009 WTO Report:

a) One third of the measures taken during the last eight months have been market-opening (cuts in tariffs, export taxes, etc.). The most important measure of these last few months is the vast programme of tariff cuts of Mexico (7th largest world economy).

b) Assessing the increase in antidumping initiations in 2008 compared to those in 2007 as a rise in protectionism is far-fetched for several reasons. The year 2007 shows the lowest annual number of cases since 1995. Suggesting a link between the 2008 rise in antidumping cases and the current crisis ignores the duration of antidumping procedures (12 months or more). The products involved have been antidumping addicts for the last two decades at least.

c) Other protectionist measures (increases of non-tariff barriers or tariffs) are limited, except for a couple of (unsurprising) exceptions (Argentina and Indonesia).

d) Half of the stimulus packages have little or no discriminatory impact, but simply aim at boosting economic activity. There are only two key exceptions: (i) China's stimulus package has a systematic sectoral approach, and (ii) the car sector across the OECD (from assemblers to dealers) has been a major beneficiary of stimulus packages.

e) 'Financial nationalism' is unlikely for several reasons. Governments are eager to give banks back to the private sector, and the rapidity of such moves depends crucially on the capacity of these banks to keep foreign clients. Local politicians have begun to realize that jobs in the local subsidiary of a foreign firm are as valuable in terms of votes as jobs in a wholly domestically owned firm. After

almost 20 years of globalization, it is almost impossible to define what is a 'domestic' firm.

This cold-minded assessment suggests three 'counter-offensives': (i) monitoring closely antidumping initiations (especially, a widening of the scope of products in new antidumping complaints), (ii) cutting back car subsidies, and (iii) launching talks to improve market access in services, first between the EC and the US, then extending such talks to fewer than the ten countries that account for more than 80 percent of the world output in services.

About the author

Patrick Messerlin is Professor of Economics at Sciences Po. He has also been the Director of the Paris-based think tank Groupe d'Economie Mondiale at Sciences Po (GEM) since its creation in 1998. Since June 2006, he served as Chairman of the Steering Committee of ECIPE (European Center for International Political Economy) based in Brussels. He specializes in international trade policy and regulatory impact assessment. His current research deals with WTO issues, EC commercial policy, services liberalization in services and the associated "Better regulations" initiatives. In 2001-2002, Messerlin was a special advisor to Mike Moore, WTO Director General. In 2003-2005, he also served as co-chair, with Ernesto Zedillo, of the United Nations Millenium Development Goals Task Force on Trade for Development. Since June 2008, he is serving as co-chair again, with Ernest Zedillo, of the joint World Bank & UK Department for International Development Task Force on Global Finance and Trade Architecture. Messerlin is the author of many books, most recently *Measuring the Costs of Protection in Europe: European Commercial Policy in the 2000s* (Peterson Institute for International Economics 2001), and *Europe after the No Votes* (Institute of Economic Affairs 2006).

3. Business Perceptions of Changing Trade Measures

Mondher Mimouni, Carolin Averbeck, Olga Skorobogatova
International Trade Centre
and Elisa Gamberoni
The World Bank

In response to the current crisis, there is a risk that the governments may revert to protectionist measures, outlines the Report on the Financial and Economic Crisis and Trade-Related Developments, released by the WTO on March 26, 2009. Protectionism can use various channels, such as currency devaluation, subsidies, and an increase in the application of tariff and non-tariff measures.

An analysis of the changes in the tariff rates between 2008 and 2009, recently undertaken by the International Trade Centre (ITC) for a number of countries, has revealed only minor differences, not leading to any significant effect on trade. Compared to tariffs, non-tariff measures (NTMs) is an area which is considerably more difficult to monitor and analyze, as they include a wide range of requirements which vary from country to country. Furthermore, the way the NTMs are applied can also constitute an obstacle to trade. The impact of these measures on the business sector, therefore, can be fully captured only through the polling of companies.

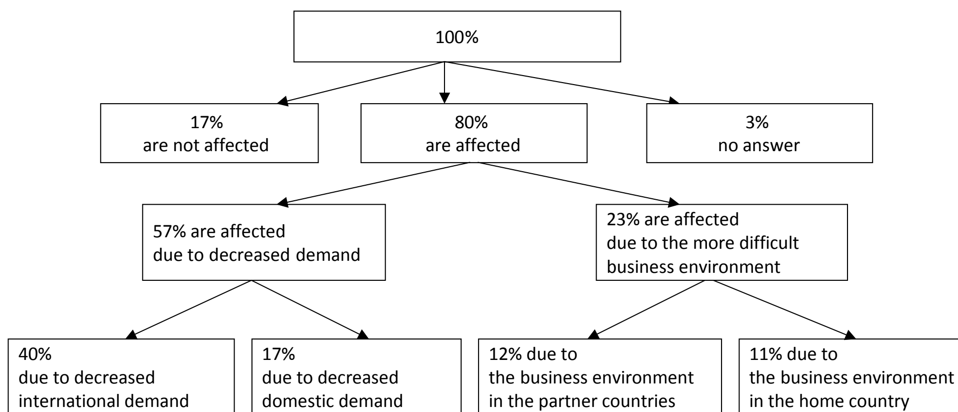
ITC and UNCTAD have conducted company level surveys based on face-to-face interviews in seven developing countries, namely Brazil, Chile, India, the Philippines, Thailand, Tunisia and Uganda. The surveys aimed to increase understanding on non-tariff obstacles to trade by capturing and classifying a full range of problems experienced by exporting and importing companies. They were finalized in the third quarter of 2008 before the full rise of the current financial and economic crisis.

In order to assess the effect of the crisis on the business sector, a second set of complementary surveys was undertaken by ITC and the World Bank in May 2009. It was based on phone interviews, mostly with the same companies that had already participated in the first survey. Nearly a thousand companies from four countries – Chile, the Philippines, Tunisia and Uganda – responded to the questions on new trade restrictions and trade facilitating measures implemented in the past six months, either by their own governments or the governments of their partner countries.

The overall results of the survey suggest that about 80 percent of companies are affected by the current crisis (see Figure 1 below). About a half of all interviewed companies report that the principal cause has been a drop in demand in both foreign and domestic markets (40 and 17 percent respectively); and about a quarter pointed to a more restrictive business environment.

'More difficult business environment' was mentioned in 23 percent of responses. About half of these responses are related to new restrictive measures in the preceding 6 months, while the remaining ones concern existing measures that have been imple-

Figure 1 Responses to the question: "What have been the most serious effects of the current crisis on your company?"



mented more vigorously in reaction to the crisis.

The highest share of the affected companies, according to the 2009 survey, is in the Philippines. More than a third of all companies interviewed in this country have experienced new trade restrictive measures that trading partners have introduced during the past sixth months. About one third of these new measures have been implemented by countries in North America followed by European countries (25 percent) and Asia (23 percent). These measures are mostly related to new certification requirements, testing requirements and pre-shipment inspection. However, the companies do not directly attribute these new restrictions to the crisis, yet comment that their impact has heightened. Furthermore, the distribution of the types of NTMs and partner countries does mirror the situation before the crisis that was captured during the initial survey in 2008.

Contrary to the Philippines, only a small number of Ugandan companies report new trade restrictive measures. However, when asked to provide a general comment on the current situation, Ugandan companies suggested that the current financial crisis is impairing their ability to exports and imports. About a third of all interviewed companies are concerned about the dollar appreciation limiting their ability to produce since imports of raw materials were becoming too expensive. Other prevailing concerns include increased cost of local intermediates, delays in worker remittances, leading to reduced local demand, as well as delays in payments. Regarding the latter point, Ugandan companies suggested that, whilst before the crisis payment arrived with a lapse of 3-4 days, since the financial crisis payments were made after 2-3 weeks.

In Chile, companies report that trading partners have implemented around 36 new measures affecting their exports. Whilst the number is limited, in a period of shrunken demand, restrictive measures could have drastic effects on the ability of companies to survive during the crisis. Indeed, the companies indicate that demand on average has dropped by 30 percent. Furthermore, almost two-thirds of all new measures have been initiated by trading partners in Latin America, a major destination for Chilean exports. Most of them involve NTMs, and in particular certification requirements. Some of these measures can be linked to the official information released by Chile's

trading partners. For example, Annex 1 of the March 2009 WTO report contains a reference to non-automatic licensing requirements temporarily introduced by Argentina and covering textile, steel, metallurgical products and tyres.

The impact of the depressed demand can be offset by trade facilitation and liberalization measures. However, only 12 percent of the surveyed companies in the Philippines and 8 percent each in Chile and in Tunisia reported that they had experienced such measures introduced by their home governments. Nearly half of these measures in Chile and 80 percent in Tunisia referred to trade finance. In the Philippines 8 percent of the responses were related to trade finance, while the majority credited their national government for helping them to 'keep abreast with the latest regulations ahead of actual shipment'. Contrary to other countries, Ugandan companies reported that they had not benefited from any measures introduced to liberalize or facilitate trade. A possible explanation could be that a least-developed country may not have enough means to introduce such measures.

From the perspective of the interviewed business sector, governments have not reverted to protectionist measures. Although several new measures have been reported in the survey, the majority of them cannot be directly attributed to the current crisis. However, the negative impact of existing NTMs on companies is greater than before the crisis, because the cost of compliance is fixed, but the volumes of trade are decreasing due to the shrinking demand. At the national level, trade facilitation measures can bring a strong positive impact, especially those related to trade finance and access to information. At the international level, the commitment not to use NTMs for protectionist aims and transparency of macroeconomic policy and data remains a priority.

About the authors

Carolin Averbeck has been working as a Market Analyst in the Market Analysis and Research section of the International Trade Centre (ITC) since late 2006. Her focus is on market access and non-tariff measures in particular. Prior to joining ITC, she contributed to UNCTAD's research and analysis in the area of information and communication technologies (ICTs) for development. Formerly, she worked in the private sector, including Cap Gemini.

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Mondher Mimouni has worked as Senior Market Analyst in the Market Analysis and Research section of the International Trade Centre since 1999. As part of his work on international trade, he has built the Web-based application Market Access Map and developed the Trade Performance Index for assessing and monitoring the export performance and competitiveness of countries. Mr Mimouni has also contributed to a

variety of joint market access analysis projects of the ITC, UNCTAD, and the WTO, including World Tariff Profile; MDG indicators; and the multi-agency initiative on the collection, classification, and analysis of Non-Tariff Measures.

Olga Skorobogatova is a Market Analyst with the International Trade Centre. Her responsibilities include collection and analysis of trade and market access data, as well as implementation of related web-based applications from the user perspective. Formerly she worked in the United Nations Economic Commission for Europe and in the private sector.

4. Can International Economic Law Constrain Protectionism?

Anne van Aaken and Jürgen Kurtz

University of St. Gallen; University of Melbourne Law School

Economists and political scientists have begun to isolate the causes and implications of the spread of the global financial crisis in late 2008. Critical attention – often accompanied by strident disagreement – has also focused on the efficacy of various domestic plans implemented in response to the crisis. International lawyers have contributed little to these debates. This is a surprising omission given the discrimination against foreign goods, services and actors embodied in many of the emergency responses to the crisis. After all, international economic law – including the General Agreement on Tariffs and Trade as forerunner to the World Trade Organization – has its genesis in post-Second World War attempts to constrain the freedom of states to resort to short-term protectionist measures.

Yet the discrimination at play in state responses to the global financial crisis is far more complex than those practised in the inter-war period, leading to the outbreak of the Great Depression. States have moved beyond classic and visible embodiments of protectionism, such as increases in tariffs and the resort to particular trade remedies (especially anti-dumping measures). The current financial crisis is marked by a resort to nuanced forms of preference, embedded within regulatory responses to the crisis. This covers, for example, governmental provision of liquidity support, purchase of banking assets, inter-bank (wholesale) lending activities and increases in retail deposit guarantees. There is considerable evidence of discrimination directed at foreign investors operating in the finance sector, across a range of these emergency interventions.

Governments are clearly facing a policy dilemma. They face an urgent need often within tight budgetary constraints to take measures to preserve their own financial services industry, yet international investment law prohibits discrimination against foreign investors in that sector. This dilemma becomes particularly acute given the general (soft law) rule under international banking standards that the home country exercises regulatory supervision over foreign bank branches. States are then confronted with a tension between international economic law (which prohibits discrimination and may require a host state to extend its bail-out funds to foreign bank branches) and these banking standards (which offer the host state no authority to regulate these branches). The dilemma is less acute in emergency measures targeting other industry, such as the automotive industry.

The question then is whether international economic law will in fact operate as a constraint on these more nuanced forms of protectionism. International economic law comprises a variety of sources, most notably commitments on trading relations (especially under the World Trade Organization) and the treatment of foreign

investors. We believe that international investment law, comprising International Investment Agreements in the form of Bilateral Investment Treaties (BITs) and even older Treaties of Friendship, Commerce and Navigation (given their particular country pairings), is, in the short-term, more likely than any other area of international economic law to give rise to complaint and initiation of legal action. There are three critical factors that could see international investment litigation under BITs where states have regulated in a discriminatory fashion against foreign investors in the aftermath of the crisis. First, the scope of most investment treaties is typically broader than instruments of trade law (and especially the WTO). This is particularly apparent in the relative absence of exceptions for state conduct under most investment treaties, compared to the detailed and elaborate carve-outs in the WTO. Second, the right to initiate a WTO dispute is vested only in states that are members of the WTO. This has important limiting effects in the context of the current crises as states may rationally refrain from invoking their legal rights against each other given their own (discriminatory) attempts to respond to the crisis and the possibility of attracting retaliatory litigation. Investment treaties displace this default position by conferring standing on a private party, foreign investors of a signatory state. The foreign investor has the right to initiate action against a host (signatory) state in a range of institutional fora, including the World Bank's Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (ICSID). There is thus no political filter at play in this system; a foreign investor will consider *only* the commercial imperatives for initiating action and there is no possibility for the state party to retaliate through cross-claim or invocation of the system. Third and perhaps most crucially, international investment law is characterized by a range of hard, enforceable remedies adding significant incentive to commencement of international litigation. In investment arbitration, the remedy nearly always consists of monetary compensation for loss suffered by the foreign investor. Significant monetary awards have been issued against states under this system, including Argentina who was found to be in breach of investment treaty obligations in the aftermath of its 2001-2 financial crisis.

Even with these institutional differences in mind, there is still the question of whether the surveyed forms of discrimination are likely to constitute breach of particular investment treaty commitments. There are two key treaty obligations that could apply to current state regulation passed in the aftermath of the crisis. First, the obligation of national treatment,` which prohibits both de iure (origin-specific) and de facto (origin-neutral) discrimination directed at foreign investors. Second, there is the broader guarantee that states accord fair and equitable treatment to foreign investors and their investments. Both of these legal obligations have been the subject of varying and sometimes conflicting interpretation by adjudicatory tribunals. For example, there is some uncertainty within the case-law on whether discriminatory intent is a necessary condition of breach of the obligation of national treatment. Even with this in mind, there is a strong case for breach of the obligation to accord national treatment and a possible (but weaker) case on the guarantee of fair and equitable treatment. Perhaps most importantly, there is little possibility that states might escape liability through attempting to rely on prudential carve-outs and security exceptions in operative treaty instruments.

If past trends in international litigation are taken as a guide, it is unlikely that for-

eign investors will commence legal action in the immediate future. It took a number of years after the Argentine crisis before foreign investors elected to initiate international arbitration. Yet when that choice was made, it triggered a flood of litigation. Argentina has the highest number of claims of any state party in the system of investor-state arbitration and arbitral tribunals have awarded hundreds of millions in dollar damages to complainant investors. That episode should act as a warning for state parties engaging in discriminatory responses to the current crisis. States that elect to do so run the very real risk of attracting future litigation and adverse damages awards.

About the authors

Anne van Aaken is the Max-Schmidheiny Tenure Track Professor for Law and Economics, Public, International and European Law at the University of St. Gallen, Switzerland. Before that she was a Senior Research Fellow at the Max Planck Institute for the Research of Collective Goods in Bonn as well as a Senior Research Fellow at the Max Planck Institute for Comparative Public Law and International Law in Heidelberg.. She is admitted to the bar in Germany, was a Visiting Scholar at UC Berkeley and Yale Law School, and has taught at the University of Fribourg, Humboldt-University Berlin and Universities of Osnabrück and Hamburg in Germany, the Heidelberg Center para América Latina in Santiago de Chile, the University of Turin, Italy, the University of Haifa, Israel, IBMEC in Sao Paulo, Brazil, Addis Ababa, Ethiopia and for the IEEM Academy of International Trade. She will be teaching as a Global Law Professor at the NYU Law School in 2010. She is the Vice-President of the European Association of Law and Economics, Member of the Programmatic Steering Board of the Hague Institute for the Internationalisation of Law and Member of the ILA Investment Committee and the ILA Committee on Private Actors.

Jürgen Kurtz is a Senior Lecturer and Director of the International Investment Law Program of the Melbourne Law School's Institute for International Law and the Humanities. He researches and teaches in the various strands of international economic law including the jurisprudence of the World Trade Organization and that of investor-state arbitral tribunals. He has a particular interest in examining the impact of treaty-based disciplines on regulatory autonomy and development strategies of member states. Jürgen's work has been published in a range of leading international law journals and has been cited by international tribunals in adjudication. In 2008, he was appointed the inaugural convenor of the General Course on International Investment Law of the Academy of International Trade and Investment Law based in Macau and organized by the Institute of European Studies. Jürgen has also recently accepted an appointment and will teach in the Master of Laws program at the Universidade Catolica in Portugal in 2010.

Section 2
Policy Responses to the Crisis with Economy-Wide Implications

5. Tariff Changes

Liliana Foletti, Marco Fugazza, Alessandro Nicita
UNCTAD
and Marcelo Olarreaga
University of Geneva

During the Great Depression protectionism spread rapidly. By 1933 world trade was only a third of what it was in 1929. Part of this slump had to do with the decline in economic activity, but several studies estimate the contribution of protectionist forces somewhere between 25 to 50 percent of the total decline in world trade.

Some observers have warned of a similar trend developing as the current crisis deepens. However, an important difference between today and the world in the 1930s is the existence of the WTO that imposes legal limits to the protectionist responses of member countries. How effective the WTO will be in restricting the protectionist response in the current crisis is an open question. A first step towards an answer is to assess the extent to which countries can increase their MFN tariffs without violating their WTO obligations.

The degree of flexibility available in the system can be measured by the difference between WTO tariff bindings and the Most Favored Nation (MFN) applied tariffs. This is called tariff overhang or more commonly tariff water. Tariff water in current bindings is such to potentially allow tariffs to triple without violating WTO rules.

But there are at least two reasons why this measure may overestimate the extent of flexibility available to policy makers. First, some bound tariffs may be above prohibitive levels (i.e., tariffs for which imports are zero). Any tariff increase above this level may be legally possible, but economically meaningless. Second, an important share of world trade is not subject to MFN tariffs, but is regulated by deeper tariff commitments under preferential agreements. Very high tariff water on products that are mainly imported from preferential partners also does not provide economically meaningful policy space. We call all this meaningless policy spaces: 'smoke in the tariff water'. Table 1 shows the average MFN and bound tariffs, as well as the tariff water, the smoke in the tariff water and the economically meaningful policy space for different groups of countries. As can be seen from Table 1 the economically meaningful protectionist response could double existing MFN tariffs.

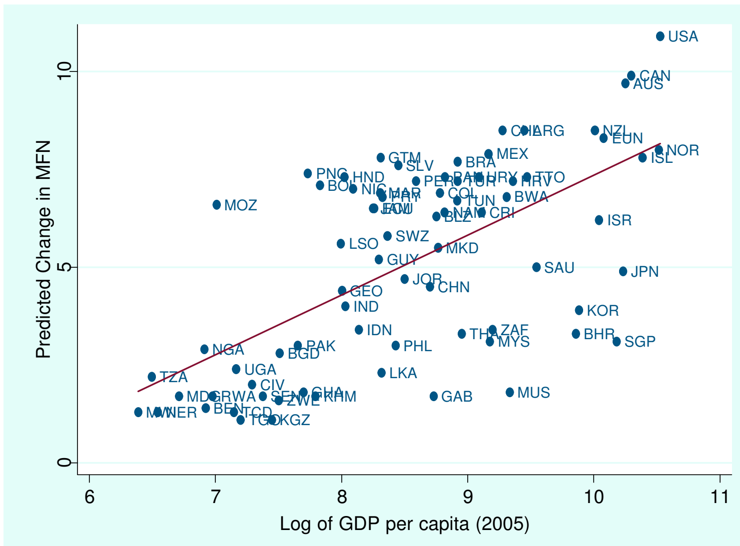
The key question then is whether countries are willing to use this policy space in times of economic crisis. When looking at the post-WTO world (1995-2008), it seems that this large policy space has been rarely used by WTO members. Protectionist responses to shocks or lobbying have tended to be relatively modest with tariff hikes around 2 to 3 percent on average. Large countries tended to increase their tariffs more than small countries when facing a crisis, and tariff increases were large when the economic crisis was shared with neighbouring countries. Increases in final goods' tariffs are larger than increases in intermediate good's tariffs, as one would expect in a world with a growing share of trade in intermediate goods.

Table 1 WTO legal and economically meaningful policy space (or tariff water)

Country	MFN Tariff	Bound Tariff	Tariff Water	Smoke in the Water	Meaningful Water
All Countries	0.05	0.15	0.11	0.04	0.07
High Income	0.04	0.11	0.07	0.02	0.05
Middle Income	0.08	0.24	0.16	0.06	0.10
Low Income	0.09	0.45	0.36	0.11	0.25

Note: Authors calculations from UNCTAD's Trains data.

Figure 1 Predicted change in MFN tariffs



Note: Authors' estimation from UNCTAD's Trains and World Bank's World Development Indicators.

Using the estimates we predict modest tariff increases in 2009 of around 8 percent, with the largest percentage increases in countries with relatively low levels of MFN tariffs in 2008. Figure 1 shows the predicted tariff hike in percentage terms plotted against the log of GDP per capita. Higher tariff increases in percentage terms are predicted among richer countries. Note however that rich countries tend to have lower tariffs, and therefore in absolute terms their tariff increases would tend to be relatively modest.

In the current crisis only a few small developing countries have increased their MFN tariffs (Ecuador and Ukraine). The paucity so far of traditional protectionist responses to recent economic crisis is somewhat surprising. It may be related to the simple recognition that protectionism may not be the right response and that it can exacerbate the problem it is trying to correct, or it may be due to fear of signaling beggar-thy-neighbor behaviour to other countries. However, MFN tariffs are only one of many instruments in the protectionist toolbox. Baldwin and Evenett (2009) have warned of the recent increase in the use of murkier forms of protectionism.

If murkier and less transparent forms of protectionism are being chosen for signal-

ing reasons and fear of retaliation, then an adequate response by the international community would be to bring transparency into the system and publicly monitor it.

About the authors

Liliana Foletti is a graduate student at the University of Geneva working on economic and political determinants of trade agreements and an intern at UNCTAD.

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Alessandro Nicita is an economist at the United Nation Conference for Trade and Development (UNCTAD). Before his present position he worked as an economist in the Development Economics Research Group at the World Bank. His research focuses on issues related to international trade and development. His work has included the measurement of the effects of trade policies, the analysis of policies improving market access for developing countries, as well as the effect of trade policies on poverty and inequality. He has authored several publications in the field of international trade and economic development. He holds a PhD in Economics from the Université de Genève and a MA in Applied Economics from the University of Michigan.

Marcelo Olarreaga is a Professor of Economics at the University of Geneva and a CEPR Research Fellow. Prior to joining the University of Geneva in 2007, he was a Senior Economist in the World Bank's Office of the Chief Economist for Latin America and the Caribbean. Prior to this he worked in the Development Research Group of the World Bank and the Research Division of the World Trade Organization. He is also a CEPR Research Fellow and had visiting positions at INSEAD and the University of Antwerp. He obtained a Ph.D. in economics from the University of Geneva in 1996 and an M.A. in international economics from the University of Sussex in 1991. He has published in the area of international trade and development. He is currently doing research on the political economy of trade policy, barriers to developing countries' exports, and the impact of trade reforms on income inequality and poverty.

6. Antidumping, Safeguards, and other Trade Remedies

Chad P. Bown
Brandeis University

WTO member countries turn to import-restricting 'trade remedy' instruments during both good and bad macroeconomic times. Nevertheless, the historical economic evidence finds a strong link between economic downturns associated with recessions and exchange rate shocks and an increase in use of policies such as antidumping and safeguards. The sudden onset and global nature of the current economic crisis has created concern that countries may dramatically increase their use of such trade remedy instruments beyond the 'normal' underlying current of protectionism associated with the ongoing process of adjustment due to the forces of globalization.

Newly available data tracking the global use of these trade remedy instruments from the *Global Antidumping Database* does indicate a marked increase in WTO members' combined resort to these instruments beginning in 2008 that continued into the first quarter 2009 during the spread of the global economic crisis. As Figure 1 illustrates, the product-level use of trade remedies was 34.0 percent higher in 2008 relative to 2007, and the first quarter 2009 use was 22.3 per cent higher than the same period in 2008. The imposition of new definitive measures in 2009 is projected to be 18.5 per cent higher than the amount imposed in 2008.

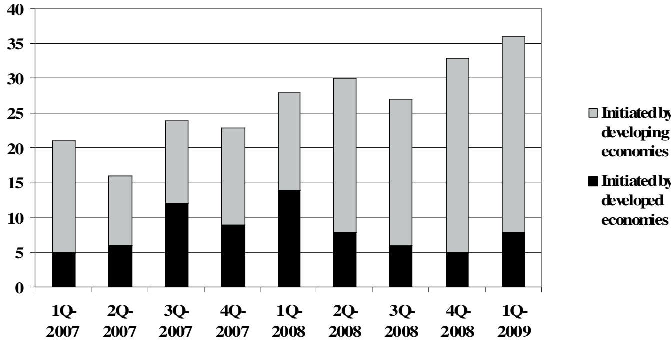
A number of countries have resorted to these instruments, including almost all of the Group of Twenty (G-20) that are members of the WTO. These countries have few alternatives for invoking new forms of potentially WTO-consistent import protection as many are constrained both by the rules of the international system and because their pre-crisis applied tariff rates may have been somewhat close to their tariff bindings legally submitted to the WTO. The use of these import-restricting instruments is increasingly affecting 'South-South' trade, i.e., developing country importers initiating and imposing new protectionist measures primarily affecting developing country exporters. The majority of the product-level actions to limit import competition intensively target exports from China.

Despite the increasing use of these instruments the amount of imports targeted by these measures thus far is relatively small. Collectively, the value of imports in 2007 for these major G-20 economies that has subsequently come under attack by the use of import-restricting trade remedies during the period of 2008 to early 2009 is likely to be less than $29 billion, or less than 0.45 per cent of these economies' total imports. With the exception of the concern raised by India's use (1.8 percent of its total 2007 imports) in particular, country-by-country estimates indicate that the new protectionism thus far covers only 0.2 to 0.8 per cent of these economies' total pre-crisis (2007) level of imports.

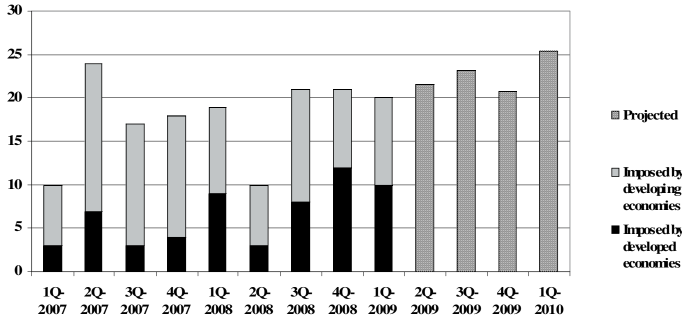
While the level of trade affected thus far may be small for most of these economies,

Figure 1 Combined Use of Import-Restricting Trade Remedies, 1Q 2007 - 1Q 2009

a. New Import-Restricting Trade Remedy Investigations at the Product Level



b. Newly Imposed Import-Restricting Trade Remedies at the Product Level , Including Projected Impositions through 1Q 2010



Source: Compiled by the author from the *Global Antidumping Database*. These are non-redundant AD, CVD, SG, CSG at the product level The Figure 1b projections for 2Q 2009 through 1Q 2010 are based on the 2007 year rate of 79 per cent of initiations subsequently resulting in definitive measures, the 2007 average of a 4 quarter lag between initiation and imposition of final measure, and the rate of initiations between 2Q 2008 and 1Q 2009 documented in Figure 1a.

a first assessment of some of the case-level data identifies many possible ways in which the crisis use of these import-restricting trade remedies may have economically important welfare-distorting effects. These potential losses go beyond the first order concern of the size of lost imports associated with targeted products and the losses to domestic consumers and using industries that suffer due to reduced access to imported varieties and higher prices. An established body of economic research identifies a number of unintended and adverse consequences associated with national resort to these trade remedies. A more detailed investigation of individual cases suggests a number of examples in which firms may be using such remedies during the crisis period to generate anti-competitive effects that end up imposing an additional burden on consumers and using industries. This may especially be the case in concentrated sectors such as chemicals and in steel in which recent M&A activity and legacy of foreign direct investment creates an environment in which multinational firms and their subsidiaries have access to trade remedies *in multiple jurisdictions* and the possibility of abusing them to segment markets.

An examination of the products being targeted by trade remedy use across countries during the crisis also suggests that current protectionism, while limited, could quickly lead to *escalating protectionism* through at least three possible channels. The first of these is simple tit-for-tat retaliation in which one country responds to another country's use of a trade remedy on its exporters with imposition of a retaliatory trade remedy. The second occurs after one country imposes a trade remedy on a product, and a second, third, fourth (etc.) country follow up by using their own import restrictions to target the same product due to the fear of a 'trade deflection' surge of exports of the product into their own markets. Third, a newly imposed upstream trade barrier on imported inputs raises the cost to downstream users, creating competitiveness concerns that can generate additional downstream industry demands for cascading protectionism. There is some evidence of all three channels in the data.

The possibility that the major G-20 economies are currently invoking trade remedies that may *increase* the probability of a spiraling, 1930s-style resort to Great Depression protectionism is therefore still a primary concern during the global crisis. The foremost lesson for policymakers stemming from data on the crisis use of trade remedies and from decades of economic research into the effects of these policies is to *hold the line*. To the greatest extent possible, policymakers should refuse new requests to implement demands for new import protection.

However, if it is not possible to dismiss all the requests for new import barriers, policymakers should shepherd protectionist pressure into the policy instruments that end up imposing new trade barriers in the *least-distorting* means possible. From this second-best perspective, economists typically recommend the use of global safeguards and not antidumping for both short-run (less trade diversion) and long-run (removal of the policy more quickly and with more certainty) reasons that will also impact how quickly economies are able to grow and successfully emerge from the crisis.

About the author

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7. Trade Finance

Jean-Pierre Chauffour and Tom Farole
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Along with the rapid decline in trade during the second half of 2008, the financial crisis may have reduced the supply of trade finance, raising fears that the lack of trade finance may deepen and prolong the recession. Various estimates have put the size of a possible trade finance 'gap' in the range of $25-500 billion. Governments and multilateral institutions have responded with a variety of trade finance programmes, including a pledge by the G20 leaders at their April 2009 London Summit to ensure $250 billion of support for trade finance.

Historically, trade finance has tended to be highly vulnerable in times of crisis, as was the case in East Asia in the late 1990s. Indeed, trade finance differs from other forms of credit, such as investment or working capital, in ways that make it higher risk-during periods of crisis-because of the difficulty of securing and enforcing credible commitments across borders in times of turmoil.

In the current crisis, it is clear that access to affordable trade finance has been constrained. A number of banks, global buyers, and firms surveyed by the World Bank are reporting to be constrained by lack of trade and other forms of finance, such as working capital and pre-export financing. In addition, the costs of trade finance are substantially higher than they were pre-crisis, raising the problem of affordability for exporters. SMEs and exporters in emerging markets appear to be facing the greatest difficulties in accessing affordable credit.

Yet, available information also suggests that trade finance is not down to nearly the same degree as actual trade flows. Data from the IMF indicate that trade volumes declined by about four times faster than trade finance volumes during the period October 2008 through January 2009. In short, while the contribution of trade finance to the massive decline in world trade should not be overestimated, there is evidence that a trade finance shortfall participated in the drop of international trade and risks hindering its eventual recovery.

A critical question is whether the decline in the supply of trade finance is the result of market and/or government failures, and, hence, whether there is a rationale for public intervention to address them. Two broad cases that would create a real trade finance 'gap' would be where there is insufficient supply (i.e., 'missing markets') or where it is being supplied at prices that are temporarily too high to meet demand in the market (i.e., 'overshooting markets').

Missing markets. There are a number of reasons why bank deleveraging and risk-adjustment processes in response to the financial crisis might restrict the supply of trade finance more than other forms of bank credit, despite the fact that trade finance should be a relatively low risk product line in normal times.

First, there may be a temporary inability of the market to properly calculate risk – in other words, not a problem of risk per se but uncertainty, which is particularly acute in opaque and highly internationalized markets like trade finance. Second, information asymmetries in international markets have been exacerbated by a collapse of interbank trust and a hoarding of cash, raising the risk of interbank strategic default. Third, with the liquidity crisis forcing banks to recapitalise as quickly as possible, trade finance – the majority of which have terms less than 180 days – tend to be the first lines of credit banks cut. Finally, there may be strong political economy factors at play. As much of the response to the crisis has taken place at the national level, through central banks and governments providing liquidity and insurance to domestic banks, there is likely to be strong political pressure and moral suasion to use these resources to support domestic lending.

Overshooting markets. The largest piece of the trade finance 'gap' may result not from a lack of demand or supply, but of the two failing to meet – specifically, where the prices at which banks are willing to supply trade finance are temporarily too high to clear market demand. Again, there appear to be specific aspects of trade finance which may make it relatively more prone to this form of market failure, particularly during a financial crisis.

First, systematic recalibration of risk has essentially forced a downward shift in the supply curve for all kinds of credit. However, deflationary pressures in the real economy makes prices for most goods sticky, giving international traders little scope to pass on these costs. Second, changes in regulatory regimes (specifically Basel II) may also have raised the price of trade finance to a level that is out of line with its true risk profile, due to its calculation of counterparty risk through a geographic rather than a performance lens. Third, with markets undergoing a rapid process of risk recalibration, the adjustment process may overshoot the equilibrium temporarily.

A final rationale for intervention in support of trade finance lies in its potential multiplier effects. Strong interaction amongst bank-intermediated trade finance, other forms of bank credit, and inter-firm credit, means that banking sector shocks may trigger chain reactions in the trading sector, which resonates back to the banking sector, amplifying and prolonging the crisis. As no individual seller is likely to fully take into account the cross-supply chain gains of extending credit, there may be an insufficient provision of inter-firm trade credit along a supply chain. Intervention to support liquidity in the banking sector may therefore contribute to realizing these potential multipliers.

These failures – both market and government in nature – may require government interventions in the form of liquidity injection and risk mitigation to address market confidence, information provision, and collective action, as well as to manage the adjustment process. Whilst the current economic crisis is still unfolding, a number of domestic and multilateral interventions have been launched that may or may not lead to the desired results.

Drawing on the lessons from past crises, effective public actions in support for trade finance should be guided by a number of key principles. These include: (1) targeting interventions to address specific failures; (2) ensuring a holistic response that addresses the wider liquidity issues of banks; (3) channelling the response through existing mechanisms and institutions; (4) ensuring collective action in the response across countries and regions; (5) addressing both risk and liquidity issues; (6) recog-

nizing the importance of banks in developed countries for freeing up trade finance for emerging market exporters; (7) promoting greater use of inter-firm credit and products like factoring; (8) maintaining a level playing field in terms of risk weight; (9) improving transparency in the trade finance market; and (10) avoiding moral hazard and crowding out commercial banks by setting clear time limits and exit strategies for intervention programs and sharing rather than fully underwriting risk.

About the authors

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8. Stimulus Packages and Government Procurement

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In terms of macroeconomic policy the response by governments to the current global economic downturn has been more aggressive than that seen in the Great Depression. Monetary and fiscal policies have been substantially relaxed and many governments have borrowed heavily in their attempts to pump aggregate demand into national economies.

The so-called stimulus packages that have been enacted in Australia, Canada, China, France, Germany, Japan, the United Kingdom, and the United States over the past year or so are in addition to the built-in fiscal stabilizers that cushion economies during cyclical downturns. According to one recent report, governments plan on injecting US$5 trillion into national economies over the coming years.

Three factors account for current interest in the commerce-related implications of fiscal stimulus packages. First, the scale of these packages represents a substantial injection of demand into national economies, with the potential to shift a share of national demand towards domestically-produced goods and services. One question that arises is whether the short- and longer-term implications for trade flows are substantial and, in turn, whether this is likely to trigger retaliation by trading partners.

Second, in an era of considerable international outsourcing, the manner in which imported parts and components are treated in any revised national procurement regulations could have considerable effects on all along the supply chain, implicating many nations' commerce. In turn this raises the question as to whether domestic firms that have invested considerably in international supply chains will lobby against discriminatory state purchasing rules and whether their opposition is decisive.

Third, the current disciplines in international trade agreements are, to put it mildly, incomplete in terms of government entities covered, product and services covered, and the instruments of procurement policy. Existing disciplines have tended to ban the more transparent forms of discrimination in procurement policy, so the question arises as to whether murkier means are now being used to favour national firms, however the latter are defined. Matters have taken a turn for the worse in the past two months as several national and sub-national governments are resorting to outright favouritism towards local firms in the implementation of stimulus packages. Some such favouritism has been justified in terms of other nation's favouritism, the beginning of a potential cycle of retaliation and counter-retaliation in an area of spending affecting trillions of dollars.

To highlight what is at stake a detailed analysis of the implementation of the United States' American Recovery and Reinvestment Act that was signed into law on

17 February 2009, was undertaken. While the total value of this package was US $787 billion, a fraction will be spent on public procurement (some have estimated that approximately a third of a trillion U.S. dollars will be spent on goods and services). Readers may recall that the enactment of this stimulus package was very controversial both inside and outside the United States. Many trading partners expressed concerns about the so-called Buy American provisions in the pro-posed legislation, in particular the expansion of the products that must be sourced nationally to include 'manufacturing goods' (a very broad category). The focus of what follows is, however, not on that trading partners' criticism or the U.S. Administration's immediate response, but on the subsequent implementation of the Act.

Even so, readers are cautioned that it is premature to come to any final conclusions concerning the overall impact of recent stimulus packages. The package being implemented in the United States, for example, was enacted around 120 days ago and is expected to influence government spending over at least the next three years. It is too soon to come to make sweeping statements about the overall impact of these stimulus packages. This argument cuts both ways. Those who fear that such stimulus packages will distort international commerce need to recognize that the regulations implementing the U.S. stimulus package could be revised, possibly taking account of trading partners' concerns. Those who believe that this global downturn has not resulted in widespread protectionism should bear in mind both the scale of several nations' stimulus packages and the fact that to date only a small fraction of the monies appropriated have been spent to date.

A key finding is that the assurance offered to the U.S. trading partners at the time of enactment, namely to implement the stimulus package in line with the U.S. international trade commitments, has by and large not found its way into the implementing guidance given by federal agencies to those spending the funds. Indeed, one federal agency has suggested that U.S. cities and states seek assurances from each firm that bids for stimulus package-funded projects that 100 percent of all their parts, components and manufactured goods are U.S. made. Little or no mention is made of the fact that waivers can be sought for supplies from the least developed countries, the countries the U.S. has free trade agreements with, or the members of the World Trade Organization's Agreement on Government Procurement.

A detailed examination of the implementation of the U.S. American Recovery and Reinvestment Act points to several implications for trade policymaking. This examination identified factors that may be relevant when evaluating other nation's stimulus packages, if so the following observations may be of more general interest. The first implication of U.S. experience is that it highlights the incomplete nature of the current set of international trade disciplines on public procurement matters. Arguably recent U.S. experience demonstrates the folly of confining trade obligations to the expenditures of a government body and not to the transfers by that body to another body that is ultimately responsible for buying goods and services. The present arrangements merely encourage those seeking to prevent stimulus package monies being spent on foreign items to transfer funds from the central government to a government level or body less or unconstrained by international trade accords.

Second, given the widespread apparent adoption of Buy American resolutions by sub-federal authorities, there is a strong case for expanding trade disciplines against discrimination to them and making this a negotiating priority for trading partners.

For sure, certain sub-federal authorities in the U.S. and elsewhere may resist such obligations. Still, the matter requires a higher profile in trade negotiations. If a trading partner is unwilling to take on such additional obligations, then recent experience suggests that any commitments concerning the central government of that trading partner may need to be discounted. Considerable thought is needed to examine how the discretion of those agencies responsible for setting procurement rules can be curbed so that any enacted mandates dictating nondiscrimination against foreign bidders, even if qualified, is given the profile intended.

A third implication is that 'buy national' policies tend to spur retaliation by trading partners. Already several Canadian townships and cities are taking action to discourage purchases of U.S. products. Recently, the U.K. Ambassador to the U.S. gave a hard-hitting speech about the expanded Buy American provisions of the stimulus package. A sub-national government in Australia has just introduced a 'Local Jobs First' programme. Perhaps, more significantly, at the beginning of June 2009 the Chinese government is said to have issued new 'buy national' regulations to its cities, provinces, and central government departments, although whether this represents a major change in policy is contested by Beijing.

Fourth, the fact that the implementing regulations for stimulus packages can change over time suggests that eternal vigilance on the part of trading partners is needed. Merely seeking assurances at the time of enactment from trading partners that their stimulus packages will respect international obligations looks naive in retrospect. Fifth, by excluding developing countries (but not the least developed countries) from potential preferential treatment in implementing Buy American provisions in its stimulus package, the United States has strengthened the incentive of developing countries to request the launch of negotiations towards a free trade agreement. Thus one form of discrimination (procurement discrimination) may beget another form of discrimination (tariff preferences).

Sixth, steps should be taken to limit the informational burdens necessary to obtain waivers from Buy American legislation and counterparts in other jurisdictions. Given that outsourcing and international supply chains are pervasive, perhaps a model waiver could be developed. Finally, legislative provisions demanding that all iron, steel, and manufactured goods be produced in the United States effectively discriminates between those firms, both U.S. and foreign, that participate in international supply chains and those that do not. Thus the current implementing regulations for the U.S. stimulus package seeks to discourage one of the modern innovations in international corporate practice, effectively promoting the entire repatriation of associated production to the United States.

The Buy American provisions in the U.S. stimulus package, which themselves have been repackaged in another form in legislation that is currently working its way through the U.S. Congress, could therefore have far-reaching implications for corporate strategy, international investment flows, as well as trade flows. The contrast between this outcome and the apparently innocuous language included in the American Recovery and Reinvestment Act emphasizes the important fact that when it comes to recent procurement discrimination the devil is in details and that a new form of murky protectionism has been spawned.

9. Exchange Rate Policies

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Nearly two years after the onset of the financial crisis, many central banks have brought their policy interest rates down to, or close to, zero. Various governments have seen their budget deficits soar. Both policies have affected exchange rates, partly through market expectations.

With a majority of exchange rates officially floating, exchange rate movements do not necessarily reflect official decisions as was the case in the 1930s. Yet, also in this crisis, authorities have directly intervened in the foreign exchange market, sometimes in order to defend a falling currency but in other instances with the aim of limiting appreciation pressure, akin to competitive devaluations. These direct exchange rate interventions have been rather limited so far and contagion of devaluation has been limited to one regionally contained case.

However, sharp market-driven exchange rate movements have reshaped competitive positions. At a time when traditional policy measures are increasingly constrained (high debt burden and zero lower bound), these developments heighten the incentive for countries whose exchange rates have in effect appreciated to make use of direct exchange rate interventions to 're-establish' competitiveness or generally ease the adjustment burden. The incentive is particularly strong for countries that rely heavily on exports and those which are likely to experience a profound reduction in GDP growth throughout the year.

It appears that the exchange rate movements observed during the crisis, while often deep, have so far not seriously disrupted global trade. This may be because most of these changes have been in response to market pressure or that interventions have been carried out by minor players, with few exceptions. After all, a world crisis is likely to require widespread exchange rate adjustments as different countries are affected in different ways and have different capacities to weather the shocks.

The concern remains that further upheaval could disrupt trade patterns and threaten to reduce overall trade since the effect on import reduction generally dominates. Likewise, capital controls that require exporters to convert foreign currency revenues within a short period into local currency are also likely to disrupt trade.

Because there is simply no way to allocate desirable exchange rate changes across countries, no such effort should be undertaken. Even among the key leading exporters, agreeing on an efficient burden sharing is unlikely to be feasible in theory, not to mention political considerations. On the other hand, our review of incentives to depreciate suggests that the risk is high that some authorities may find it irresistible to resort to beggar-thy-neighbour policies. Even though it has not happened the risk that it does may well rise as governments run out of better options. To reduce the

odds of conflicting use of exchange rates, some form of coordination is needed. We consider three possibilities.

1) First, all countries that operate a flexible exchange rate regime should agree to refrain from non-conventional monetary easing via the foreign exchange market. Similarly, countries with fixed exchange rates – no matter how fixed they are – should not undertake any depreciation without in-depth consultations with the IMF
2) Second, when market pressure threatens a currency, whether the exchange rate floats or is fixed, IMF support should be sought and provided. Lending should come along with the conditions that ensure a behaviour that is consistent with the external balance and repayment capability, but should not be encompassing any other dimension.
3) Third, capital controls need to me monitored closely to avoid measures which interfere with trade and may backfire.

About the authors

Sebastian Weber is a PhD candidate in International Economics at the Graduate Institute in Geneva, Switzerland. His research interests include labour markets, monetary policy and financial integration. His current research agenda focuses on the interaction of domestic institutions and monetary policy in shaping the transmission of external shocks. Recent assignments included positions with the European Central Bank and the Organization for Economic Cooperation and Development.

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10. Labour Movement Restrictions

Biswajit Dhar and Girish Srivastava

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The downturn that the global economy has been experiencing for nearly a year now has brought with it tendencies to restrict temporary movement of natural persons, or Mode 4 services. This development potentially reverses the moves to liberalise Mode 4 service transactions that are afoot in the on-going negotiations under the aegis of the World Trade Organization (WTO). For most developing countries, the Doha mandate for liberalising trade in services brought with it expectations that temporary movement of natural persons, or Mode 4, in which these countries have substantial export interests, would witness meaningful liberalisation. And because trade in services under Mode 4 has historically been the most protected among the four modes of supply of services, the potential suppliers of Mode 4 services had high expectations from the Doha Round.

But while the developing countries have been pushing for increasing services trade under Mode 4, the developed countries have remained reluctant to take additional commitments to allow greater market access under this mode. Given the sensitivities of the developed countries in allowing temporary movement of natural persons from other WTO Members in their territories, it was hardly surprising that the economic downturn would bring with it renewed attempts by the potential importers of Mode 4 services to raise import barriers.

Restrictions on Mode 4 services have been imposed on both sides of the Atlantic particularly since the onset of the current phase of economic downturn, which have adversely affected the temporary movement of persons. The US and the Members of the EU are the two largest importers of Mode 4 services and therefore measures taken by them can have far reaching implications on the global market for this mode of service transactions.

The most pervasive restrictions on temporary movement of persons under Mode 4 have been proposed by the policy makers in the United States. These restrictions have been introduced as a part of the economic stimulus package. More recently, additional measures to restrict entry of temporary workers in the US have been proposed in the H-1B and L-1 Visa Reform Act 2009, a narrowly-tailored bipartisan legislation that is aimed at preventing ‘abuse and fraud’ and to ‘protect American workers’. This proposed legislation includes a stronger enforcement regime in respect of H-1B visas. Complementing the initiatives taken in this proposed legislation are measures that are being taken by the Department of Homeland Security (DHS) to introduce robust employer enforcement as a critical part of the US immigration system. These measures are ostensibly aimed at deterring foreign workers from participation in the US economy.

The impact of the restrictions that have been imposed by the US Administration on the entry of non-immigrant workers is already being felt. Beginning April 1 each year, the US Citizenship and Immigration Services (USCIS) receives H-1B petitions for filling the Congressionally-mandated cap of 65,000 visas, which are issued to non-immigrant workers for joining the workforce the following year. In 2008, the USCIS had received enough applications to meet H-1B quota within a week of accepting the petitions, while in 2007, the number of applications reached 150,000 in the first two days. In the current year, however, the experience has been radically different. On May 18, 2009, USCIS announced that it had received approximately 45,500 H-1B petitions counting toward the Congressionally-mandated 65,000 cap for the year 2010.

The pitch on the issue of restricting the inflows of non-immigrant workers in the US has been queried by the recent move by two Congressmen, Assistant Senate Majority Leader Dick Durbin and Senator Chuck Grassley, to introduce the H-1B and L-1 Visa Reform Act 2009, better known as the 'Durbin-Grassley bill'. Durbin and Grassley have introduced this narrowly-tailored bipartisan legislation that seeks to amend the Immigration and Nationality Act in order to prevent 'abuse and fraud' and to 'protect American workers'.

The Durbin-Grassley bill proposes to give the government more authority to conduct employer investigations and streamline the investigative process. Besides, the bill also seeks to influence the participation of H-1B non-immigrants through an elabourate wage determination system, one that imposes onerous requirements on the potential employers.

The UK has also taken a slew of measures to introduce enhanced restrictions on the entry of foreign workers. In February 2008, the UK Border Agency launched the 'new immigration system ... to ensure that only those with the right skills or the right contribution will be able to come to the United Kingdom to work and study'. As in the case of the US, the UK Administration has initiated steps to introduce regulatory impediments that would put sands in the wheels of temporary movement of persons under Mode 4. Although most of the measures that UK Administration has been proposed may not be implemented immediately, the introduction of these measures would have a large impact on the entry of non-immigrant workers under Mode 4.

The industry in countries like India, that have utilised a large share of the H-1B visas granted in the past, thinks that the US has in fact undermined its own interests by taking measures to restrict non-immigrant workers. The association representing India's interests in IT and ITES, viz. Nasscom, has argued that the H-1B visas have been used to provide technically qualified talent that is in short supply, to open new markets, and to accelerate innovation and increase competitiveness for US companies. Nasscom has therefore surmised that the stricter regulations accompanying the grant of H-1B visas and the H-1B and L-1 Visa Reform Act 2009 proposed by Durbin and Grassley would have a detrimental effect on the US economy by reducing its global competitiveness. This observation by the industry associations in India is supported by the findings of several studies which have point to the fact that the countries imposing restrictions on the temporary movement of natural persons may, in fact, adversely affect their interests.

Restrictions on temporary movement of natural persons under Mode 4 imposed in the midst of the economic downturn that has been deepened by the severe contrac-

tion of demand would clearly impact both on the importers as well as the exporters of Mode 4 services. Ironically, however, the implications of the increasing restrictions on Mode 4 service suppliers have received much less attention in the on-going discussions centreing on the economic downturn. The relative neglect of this issue is more galling given the fact that although the global leaders, particularly those in the G-20, have been cognizant of the contribution that open markets can make towards extricating the economies from the current morass, they have remained silent on the imperatives of keeping the market for Mode 4 services. In view of the growing tendencies to impose restrictions on the market for Mode 4 services it is imperative that the global leaders take cognizance of the role that this mode of services can play in the turnaround of the global economy. The positive impulses that liberalisation of Mode 4 could unleash on the global economy can be substantial given that this mode of service supply accounts for only 1-2 per cent of the total trade in services.

About the authors

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11. Competition Policy

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In order to contain the damage done by the financial and economic crisis and to prevent the occurrence of new crises, governments are under strong pressure to intervene in the financial sector and in the real sector. Government interventions, either to contain the crisis or to prevent the occurrence of a new crisis, are varied, substantial and entail serious risks of having an anti-competitive effect.

Some of the measures aiming to restore confidence in financial markets and ensure their stability can distort incentives and have potential anticompetitive effects both on domestic markets in the country implementing them and internationally. The Irish Government decision to grant a sweeping unlimited guarantee on all bank deposits at its six main banks in order to maintain financial stability provides a good example of the way in which a bank guarantee scheme can be discriminatory and trade distorting as well as competition distorting. The United Kingdom experience with Northern Rock shows that such schemes also have the potential to disrupt competition. Bank mergers may also have the potential to restrict competition, as illustrated by the UK government engineered acquisition of HBOS Plc by Lloyds TSB. Proposals for regulations designed to limit concentration in the banking sector, such as the June 2009 proposal by the vice president of the Swiss Central Bank to force the shrinkage of banking groups such as UBS and Credit Suisse, or to separate commercial banking from investment banking, or to control credit rating agencies, also have the potential to unduly limit competition if they are not carefully crafted.

Stimulus packages, whether general or sectoral, often include discriminatory provisions which restrict trade and competition. The adoption by Chinese authorities in May 2009 of a requirement that only Chinese companies should receive contracts for government stimulus projects was partly a retaliation for what the Chinese government perceived as protectionist measures against Chinese goods.

The imposition of export quotas and tariffs on raw materials (such as bauxite and fluor-spar used to make aluminium products) led to a rash of complaints and antidumping investigations from China's trade partners.

Other protectionist measures, such as increased tariffs, antidumping proceedings and non tariff barriers also seem to be on the rise according to the World Bank and the WTO. Their adoption, like the adoption of subsidies for troubled industries, may lead to retaliation by other countries and more trade and competition distortions. For example, in January 2009, Ecuador raised its custom tariffs on 630 products (from cereals to cell phones and tennis shoes), accounting for 8.7% of its imports for one year in order to restore its balance of payments. Russia imposed temporary increases of import tariffs of up to 30% on a number of products such as cars, trucks, buses, par-

ticular types of flat metals and of ferrous metal pipes. Similarly, in March 2009, Ukraine imposed import duty surcharges up to 13%, except for 'critical imports', for a period of up to six months, with a view to restoring its balance of payments.

Economic evidence and past experience show that far from speeding up recovery, trade distorting and anticompetitive measures may slow economic recovery or even prevent full recovery.

Yet there is no systematic attempt, at the international level, to assess the potentially deleterious effects on competition of policy responses to the crisis or to find alternatives less restrictive of competition. In the EU state aid and bank mergers are allowed only after a careful competition assessment by the Commission. But tariff and non tariff barriers are not subject to the same scrutiny and neither are some regulations at the national level. In most countries outside of the EU, such as the US, the anticompetitive effect of state aids is not even systematically or transparently assessed and neither are protectionist measures such as antidumping.

During the 1990s there was a movement to convince countries to undertake systematic regulatory reform programmes, to adopt regulatory impact assessments for new laws or regulations and to go through peer reviews of the quality of their regulation. While this movement has allowed a number of countries to upgrade unnecessarily restrictive laws and regulations or to improve the quality of their new regulations, it is insufficient in the present circumstances to stem the flow of government interventions for three reasons: regulatory impact assessments are often ex post; they are usually undertaken voluntarily; they concern mostly or uniquely the anti-competitive impact of regulations, whereas policy responses to the crisis encompass a wide variety of interventionist tools.

Besides reinforcing international cooperation on stimulus packages (to discourage the adoption of discriminatory anticompetitive provisions leading to retaliation by trading partners) and advancing negotiations of the Doha Round in the WTO (to limit the use of tariffs or non-trade barriers), governments should commit themselves to make a competition assessment of all policy responses to the economic and financial crisis considered and that such competition assessments be made public at the time of the adoption of the policy responses. Thus, there will be a monitoring of policy responses to the crisis, governments will be better informed about the long-term risks they take in promoting trade distorting or competition restricting measures and they will exercise restraint for fear of retaliations.

As we all know, sunlight is the best detergent.

About the author

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12. Green Protectionism

Ronald Steenblik

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It did not take long after the first hints were given by governments that they were contemplating trillion-dollar economic stimulus packages, in addition to the bail-out packages they had already provided to their financial sectors, that exhortations for a complete re-orientation of spending patterns in support of 'green' priorities took on the characteristics of a mantra. Borrowing from a term last heard during the economic crisis of the 1930s, environmental groups, and even a number of prominent economists, have called for a 'Green New Deal', involving massive increases in spending on the environment, particularly investments in lower-carbon sources of energy, which would be matched in a short time by an international agreement on an ambitious post-2012 climate regime, and corresponding policy changes at the national level.

Judging from the pattern of stimulus spending so far, governments are heeding these calls. According to analysts for the HSBC Bank plc, of the nearly USD 2,800 billion in tax cuts, credits and extra spending announced by the world's economies through the end of January 2009, more than USD 430 billion was targeted at increasing the supply of low-carbon power, improving energy efficiency (particularly of buildings and transport) industries, or upgrading water or wastewater infrastructure. The average 'green' share is estimated to have been around 16%, but approached 40% in China (the world leader in 'green' spending) and over 80% in South Korea.That this unfolding shift in policies has been watched with some unease by trade economists is understandable. There are the cautionary tales of the Great Depression, naturally. But there are also lessons to be learned from more recent crises. In the wake of the oil crises of the 1970s and early 1980s, and their ensuing recessions, governments poured enormous amounts of money into developing all manner of alternative energy supplies – alternative in that era meaning 'not petroleum'. That much of this expenditure was poorly targeted and wasteful was as good as pre-ordained. But there were also long-lasting consequences for trade, and for the environment, consequences that are still being worked out today.

We argue that the global economic downturn risks not so much making policy makers more apt to resort to green protectionism than providing a broader stage for it. Among the three faces of green protectionism – blatant, murky and unintentional – the murky face is only the ugliest because it is the most insidious. Murky green protectionism occurs when governments adopt policies favourable to their own domestic producers under the guise of addressing legitimate environmental goals. Trends in environmental priorities and approaches have pre-dated the current economic crisis, and will continue to influence the shape of environmental and related energy poli-

cies long after the crisis is over.

Reviewing the types of policies and programmes that have been enacted as part of national economic recovery plans, we note that, so far, their protectionism quotient appears to be remarkably low. Nonetheless, there is plenty of reason for continuing vigilance. Since March 2009, for example, several countries have provided investment aids to help their car manufacturers develop 'greener' vehicles. Some of these investment aids are being provided to fund private R&D into truly new propulsion systems, notably advanced batteries for electric cars. But some are merely providing the means by which car companies that previously chose to concentrate on manufacturing large, gas-guzzling vehicles can retool and start producing vehicles more like those that were already being produced by companies that, prior to the crisis, had wisely pursued the market for energy-efficient cars.

The combination of continued anxiety over global energy supplies, plus the strength of the 'renewable energy = domestic jobs' narrative, will continue to be exploited by special interests and policy makers who are less antithetical to protectionist measures than are trade economists.

Succumbing to pressures for green protectionism would not only reduce the gains from trade and blunt the spur to technological innovation provided by international competition, it would also undercut the credibility and trust that nations need to maintain as they enter into multilateral negotiations over new and wide-ranging environmental agreements, most notably a post-2012 climate regime. Among economies that are only now beginning to develop their own markets for environmental goods and services, there is a suspicion that calls by highly developed economies for ever more stringent environmental regulations are influenced by their commercial interest in supplying the goods and services needed to comply with those regulations. However unfounded those suspicions may be, green protectionism sustains them.

One obvious conclusion is that policy makers need to become more attuned to the early signs of green protectionism and understand how to resist it. In order to be able to do that, however, there needs to be much more transparency on existing as well as proposed policies, and more independent analyses of their effects.

About the author

Ronald Steenblik is Senior Trade Policy Analyst in the Trade Directorate of the Organisation for Economic Co-operation and Development (OECD). In 2006-8, he was emeritus Director of Research for the IISD's Global Subsidies Initiative (GSI). Ronald's professional career spans three decades, in industry, academia, the U.S. federal government, and inter-governmental organizations, generally on policy issues related to natural resources, the environment, or trade. From 2002-6, he worked at the OECD, where he made important contributions to the WTO negotiations on environmental goods and services. He also served on UNCTAD's Consultative Task Force on Environmental Requirements and Market Access for Developing Countries and oversaw the preparation of some twenty case studies on this topic.

13. FDI Protectionism is on the Rise

Karl P. Sauvant
Columbia University

Foreign direct investment (FDI) is the most important vehicle to bring goods and services to foreign markets. The rise of FDI was made possible, to a large extent, by an enabling regulatory environment, and there is no doubt that countries continue to improve the regulatory framework for FDI. At the same time, however, there are strong and visible signs that a re-evaluation of the open framework for FDI is under way, and this is reflected in the national and international regulatory rules governing this investment.[1]

So far, this change is most distinct at the national level. UNCTAD[2] reports that, of a total of 1,550 regulatory changes made during the period 1992-2002, only 6% were unfavorable to MNEs. The share of unfavorable changes doubled to 12% during 2003-2004, and again almost doubled to 21% during 2005-2007. Overall, countries that had implemented at least one regulatory change that made the investment framework less welcoming during 2006-2007 accounted for some 40% of world FDI flows-an impressive figure that demonstrates quite convincingly that a change is underway.[3] Moreover, no data are available on the extent to which unchanged laws and regulations are implemented in a more restrictive manner, increasing informal barriers to the entry and operations of foreign investors in a discriminatory manner.

Not every measure that makes the investment climate less welcoming for foreign direct investors is protectionist. Basically, there are two situations that qualify as FDI protectionism: In the context of inward FDI, FDI protectionism involves new measures by public authorities that are taken to prevent or discourage foreign direct investors from coming to, or staying in, a host country. In the context of outward FDI, FDI protectionism involves measures directed at domestic companies that require them to repatriate assets or operations to the home country or discourage certain types of new investments abroad. In fact, the definition is more complicated because, for instance, measures taken in the interest of legitimate public policy objectives – e.g., protecting national security, seeking to increase the contribution of FDI

1 For a full discussion, see. Karl P. Sauvant, "Driving and countervailing forces: a rebalancing of national FDI policies," in Karl P. Sauvant, ed., *Yearbook on International Investment Law and Policy 2008-2009* (New York : Oxford University Press, 2009), pp. 259-260.

2 UNCTAD, *World Investment Report 2008: Transnational Corporations and the Infrastructure Challenge* (Geneva: UNCTAD, 2008).

3 This was also recognized by the G20 in their meetings of November 2008 and April 2009, when they called for a moratorium on new investment protectionist measures.

to the host or home economy – are not necessarily instances of FDI protectionism, even if they make the investment climate less hospitable for foreign investors.

Even with this caveat, there has been a rise of FDI protectionism. It predates the current financial crisis and recession, suggesting that a reevaluation of the costs and benefits of FDI had already been underway.[4] Interestingly enough, developed countries have led this change in approach, i.e. countries that, in the past, had been the champions of the liberalization of entry and operational conditions for foreign investors and the protection of these investors under international investment law. The principal approach that has been taken is to evoke 'essential security interests' or similar concepts, such as 'national interests', to screen foreign investments at the national level.

The measures taken by the US are illustrative. On the one hand, the US remains one of the most open countries for FDI, as underlined, for example, in the May 2007 statement on 'Open economies' by President George W. Bush. At the same time, though, and especially in the aftermath of 9/11, national security concerns have risen in prominence. For the US, this concept involves primarily (but not only) military security (not defined), and therefore focuses on the protection of sectors that are important from that perspective, including 'critical infrastructure' (also undefined). To ensure that cross-border M&As do not infringe on national security, the authority of the Committee on Foreign Investment in the United States (CFIUS) to screen such transactions was strengthened in 2007 through the Foreign Investment and National Security Act (FINSA). There is a presumption that any M&A by a foreign sovereign investor (be it a state-owned enterprise or a sovereign wealth fund) reviewed by CFIUS needs to be investigated, unless it is determined at the stage of the review that no national security concerns remain. Not surprisingly, the number of notifications to CFIUS and the number of investigations rose from, respectively, 55 and 1 in 2001 to 165 and 22 in 2008. It is not known how many cross-border M&As that were intended or initiated did not go forward because of the new US regulatory framework.

In other developed countries, concerns regarding national interests are more of a political and economic nature. In Europe, they involve particularly sovereign FDI from Russia (and, perhaps in the near future, from China) and, more broadly, the protection of national champions. Thus, Germany strengthened its screening mechanisms for non-EU investment early 2009 and France issued a decree in December 2005 regarding the authorization procedure for M&As in certain sectors. In Japan, legislation was strengthened in 2007 through a requirement for foreign investors to notify the Government 30 days in advance if they planned to acquire 10 percent or more of listed companies with technology that can be used in weapons systems. Australia and Canada modified their own screening mechanisms, with the former strengthening in 2008 the examination of investment projects by sovereign investors and the latter introducing a national security test in 2009.

Among emerging markets, China strengthened its review system in 2006, focusing

4 The financial crisis and recession may dampen the rise of FDI protectionism as countries seek capital to shore up local firms and to increase investment to help them emerge from the recession. But the crisis may also accentuate protectionism, especially if nationalistic impulses gain the upper hand, perhaps stimulated by fire-sales of domestic assets (as we saw during the Asian financial crisis).

on approval for transactions that, among other things, involve critical industries or may have an impact of the country's national economic security. And Russia has, since 2008, a law that requires that transactions between foreign investors and Russian companies be subject to government approval if certain conditions are met.

These national actions are supplemented by supranational efforts, although these are voluntary in nature. Thus, the EU Commission sought to complement the national approaches of members of the Community by elaborating guiding principles concerning SWFs. The OECD produced guidelines for host country investment policies relating to national security. And the International Working Group of Sovereign Wealth Funds agreed in 2008 on 'Generally Accepted Principles and Practices' and submitted them to the IMF's International Monetary and Financial Committee.

Several features characterize these actions. For one, they seek to balance support for an open investment regime with a desire to have sufficient flexibility to stop undesired foreign direct investments, typically involving cross-border mergers and acquisitions (M&As). The criterion most often used is 'national security' or related concept – but, and this is crucial, these concepts are not defined precisely but rather left open for definition by national governments. Screening mechanisms have the task to do that, but their decisions are typically the result of 'black box' deliberations and cannot be appealed. Such screening mechanisms, deciding on a case-by-case basis, make the investment climate less predictable and less transparent. However, it is clear that sovereign investors receive special attention, i.e., they are treated differently from domestic investors, especially when they are headquartered in emerging markets. Among other things, this reflects the fear that such investors pursue not only commercial interests but also political interests of the governments involved. While governments need of course the flexibility to pursue legitimate public policy objectives – be it national security or economic development – the boundary line between protecting legitimate national interests and protectionism is a fine one. This makes it all the more important to watch these new regulatory developments closely, especially also since the rules that are being put in place leave considerable discretion to national policy makers, and their decisions cannot be appealed.

The changes at the national level are also leading to changes in the nature of the international investment regime, giving governments more freedom to protect what they consider is important for them in the investment area. But this greater respect for national policy priorities is also logical from another perspective: the international investment regime as it has evolved over time has focused almost exclusively on the protection of international investors by conferring on them broad rights and few responsibilities, while host country governments assume broad responsibilities and have few rights.[5]

The critical challenge is to find the right balance between the rights and responsibilities of MNEs on the one hand and those of governments on the other. It needs to be a balance that combines the stability, predictability and transparency that firms need to make investment decisions with the policy space that governments need to pursue legitimate domestic policy objectives – and it must be a balance that does not

5 The underlying logic for this approach is, among other things, that MNEs are, in any event, subject to the laws and regulations of host countries that can be enforced through national courts and that such a regime helps countries to attract FDI.

open the door for measures that are primarily protectionist in nature. Finding regulatory solutions to this challenge is not easy. It will require international cooperation to establish rules, especially as regards the contents of such concepts as 'national interest', a very difficult task indeed, and one – if pursued at all in the foreseeable future – that will take considerable time. In the meantime, the best that can be done is to establish an FDI Protectionism Observatory to monitor new FDI protectionist measures and 'name and shame' the countries that take them.

About the author

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Section 3
Sector-Specific Policy Responses to the Crisis

14. Financial Nationalism

Stijn Claessens
International Monetary Fund

The financial crisis has necessitated many interventions to support financial systems and resume intermediation. The amounts involved with these interventions have been very large, double digit fractions of GDP on average for advanced countries. Besides large direct fiscal costs, there are many contingent costs, such as insurance schemes for assets, and implicit cost of now generalized policies that large systemic financial institutions are not allowed to fail.

While modalities for support have varied, overall approaches have been similar. This reflects that countries were forced to adopt measures because of beggar thy neighbor effects. The spillovers from the government guarantee for banks in Ireland, for example, forced many countries to adopt similar policies in a matter of a few weeks. And the recapitalization and other support approaches became loosely based on what can be called the UK approach. These beggar thy neighbor effects were the more perverse since the individual country systemic bank restructurings were not first best to begin with, as often is the case in times of intense financial turmoil. This in turn meant many "lowest common denominator" effects.

The interventions have generally stabilized financial systems and restored some measure of confidence in the system. Besides being costly, however, by nature these measures are distortive, directly-as they support intermediaries in non-market ways, and indirectly-as they distort financial intermediation and resource allocation. A clear example are the interventions by central banks in a number of (short-term) markets, either directly (e.g., through the purchases of government bonds, asset back securities or other assets) or indirectly (e.g., through the various liquidity facilities to financial institutions which aim to support specific financial markets, such as the commercial paper market). And the guarantees for new bank liabilities distort the (interbank) markets.

Measures also have had large international repercussions, most notably when governments extend guarantees to intermediaries-that directly distort financial and capital flows, and through capital and other support measures-that often favor national institutions and have a bias towards local lending. The guarantees by governments of advanced countries meant that emerging markets not able to match guarantees suffered from capital outflows and large currency depreciations as investors sought safe havens.

The implications for (international) competition are not obvious, however. Competition in the financial sector is a complex issue to begin with. Because of network externalities, sunk costs, economies of scale and scope, switching costs, substitution and complementary among services, etc., standard principles of competition (policy) do not easily apply to financial services. In turn, measures such as market

structure structures do not easily map into a degree of competition. Because of these methodological challenges, combined with lack of adequate data, the degree of competition in financial services is hard to determine empirically.

Furthermore, a link has often been made between competition and financial stability in the conduct of (prudential) regulation. Whether this link exists and why, however, is debatable. Nevertheless, this view has affected policy making. More generally, finance can suffer from many market failures, calling, at least in theory, for extensive government interventions.

Complexity, stability and market failures elements affect how one considers the effects of any public policy, including forms of state intervention in financial crises, on (international) financial sector competition. During times of financial turmoil and crises, coordination failures and adverse impact of a failing financial system on the real economy justifiably call for government interventions. Support can then enhance competition as it avoids the elimination of (non-systemic) institutions essential to contestability-today and in the future.

Nevertheless, support has led to many distortions and undermined competition, especially internationally. Most government interventions to date have been at national levels and much directed towards national "champions." Countries were also quick to "ring-fence" assets in their jurisdictions when cross-border entities showed signs of failing, reflecting the absence of clear burden sharing mechanisms for banks with international operations. Given political economy drivers, as brought out by crisis responses, it is likely that support will remain nationally-oriented and international distortions risks increase further. But, this means a move away from financial integration and fair international competition.

Policy responses to prevent this are thus urgently needed. For the short-term, greater efforts to harmonize support measures across countries can help (re-)level the playing field, avoid major distortions and thereby help restore competitive conditions. The overall general principles needed are similar. More extended retail guarantees need to cover all deposits uniformly within a jurisdiction and preferably across jurisdictions. This is especially critical where financial markets are closely integrated. Also, guarantees for interbank lending, bond issues and other wholesale funding have to be clearly stated and be available for all financial institutions. Capital injections should bring capital up to recognized standards at all institutions (with buffers for future losses), as undercapitalized institutions may undermine competition. And general programs for purchasing assets should not discriminate between institutions or nationality. There also is a need for improved coordination when exiting from the various interventions.

The premise underlying these principles is that, as long as these interventions are applied to all (national) financial institutions and all forms of financial intermediation equally, there need not be negative consequences for competition. This is not necessarily so, however. Solvent financial institutions, for example, do not benefit (as much) from guarantees. And interventions, in part as they are anticipated, condition market behavior. As such, even when applied evenly, interventions in times of financial stress can have overall negative effects on competition. Many distortions thus remain unavoidable in the short-run, with adverse consequence for competition.

For the medium term, given an ever tighter integrated global financial system, there is a need for greater cooperation and coordination across countries, also to avoid an escalation of nationalism. Existing approaches for cross-border financial

markets-aimed largely at greater convergence and coordination-do not avoid the necessary, but ad-hoc and distortive interventions in times of stress and take much time to put in place. Multilateral mechanisms with strong ex-ante commitment and ex-post enforcement powers are largely lacking-except for arrangements in closely integrated regions and even these are incomplete. This is most evident in the resolution of global banks headquartered in relatively small countries but with balance sheets that can exceed their home-country's GDP.

New approaches are therefore necessary. A few have been explored over the years, each with their own advantages and problems. Four options can be identified that can help with assuring competitive conditions, even in times of financial stress:

A World Financial Authority (WFA). This would be the first best: an international financial regulator that would regulate and supervise all large financial institutions. It is the obvious solution to any coordination issue, and thus reduces the anti-competitive effects of ad-hoc government interventions during financial crises. It could also be complemented by additional WTO disciplines on competition in the financial sector and trade in financial services. This model is very demanding to be fully consistent in all dimensions-for example, it would need to be complemented by lender of last resort liquidity facilities and international deposit insurance and recapitalization funds, similar to the requirements in a domestic context. It would also be difficult to govern as its objectives would be hard to establish. The experience of the EU suggests that, even after moving towards very close financial, economic and political integration, adopting a common, single regulatory and supervisory authority is very hard. As such, it is unlikely to materialize in the near future.

An International Bank Charter (IBC). This approach is closely related to the first best, but perhaps more feasible in the medium term. It entails establishing a separate regime for large, internationally active financial institutions, with some elements of voluntarism. Under this model international active banks would be globally chartered and under the supervision of a single regulator. There would also be an international regulatory and supervisory body. The set of actions available to this body would span the regular licensing, regulatory and intervention tools of any national financial regulator. Complementary are common liquidity support and lender of last resort facilities, shared intervention resources with fiscal backup, and an International Deposit Insurance Corporation, perhaps supplemented by a recapitalization fund, both receiving fees from the banks. The IBC banks could operate around the world (or at least in sponsoring countries) without any further permission, regulations or needs for reporting and compliance (one key issue being the level of "voluntarism"). This model would avoid the messy constellation of home and host supervision. Importantly, it assures coordinated actions, especially of measures aimed at containing and resolving a crisis. Ad-hoc and distortive interventions by governments would thus be avoided and a more level playing filed competitive landscape would result.

Decentralized, but converged approaches. A "third best" could be a decentralized approach, i.e., where actions are not coordinated, but frameworks are adapted, with the expectation to mimic outcomes similar to those under a first or second best regime. This would at the minimum involve more convergence in five areas: (i) rules

and regulations governing international active banks; (ii) clarity on who will supervise what aspects of international banks; (iii) consistency in the rules for lender of last resort, liquidity support, deposit insurance and other forms of safety net; (iv) consistent resolution regimes; and (v) ex-ante agreed upon rules on burden sharing and resolution in case of failures that require bail-outs or pay-outs.

In principle, this could reduce many of the current problems, create a more level playing field and thereby improve competitive conditions. It will not be enough to mimic the first best solution, however, since it does not consider the many externalities at the international level. Just as proper regulation and supervision of individual financial institutions does not guarantee systemic stability, similarly (proper) national regulation and supervision does not guarantee international financial stability and efficiency. Coordination issues at the international level, both among private sector participants and between national authorities, are simply too numerous. The key for this model to work is that the ex-ante agreed rules on burden sharing are binding ex post, which is obviously very hard to achieve. As such, the model will not easily assure a fully competitive level-playing field among countries.

Enhanced coordination, including through colleges. Another model is to rely on more coordination of actions, even in the absence of (further) convergence of rules. This is the model that was adopted for the EU most recently. Under this model, some entity would have the power to engage in legally binding mediation between national supervisors, adopt binding technical decisions in regards to specific financial institutions, and play a strong coordinating role, especially in financial crises. When backed up by appropriate legal changes, this structure could presumably overcome many of the ex-post coordination issues, even in the presence of national structures and rules that are still quite different.

The current approach of adopting supervisory colleges for large financial institutions is a decentralized form of this model, albeit with its own weaknesses, such as limits on information sharing, in part due to confidentiality constraints but also pure lack of willingness. Importantly, since colleges are designed to concern themselves only with individual financial institutions, they will not explicitly consider overall international financial system stability. The risks may be, however, that these measures create a false sense of security, with the possibility of financial crises remaining.

About the author

Stijn Claessens is Assistant Director in the Research Department of the International Monetary Fund where he heads the Macro-Financial Linkages Unit and a CEPR Research Fellow. He started his career teaching at New York University business school (1987) and then worked from 1987-2001 at the World Bank in various positions. He taught at the University of Amsterdam from 2001-2004, where he remains a Professor of International Finance Policy. Prior to his current position, he was Senior Adviser in the Financial and Private Sector Vice-Presidency of the World Bank (2004-2006). Mr. Claessens has provided policy advice to emerging markets in Latin America and Asia and to transition economies. His research has been widely published and he has edited several books. He is an Editor of the *Journal of Financial Services Research* and an associate editor at other journals.

15. Agriculture

Tim Josling and Stefan Tangermann

Stanford University; University of Göttingen

Government support of agriculture has been a notable feature of the economic landscape for decades. But reactions to the economic crisis in the area of agricultural policy have been relatively muted. No major protectionist measures have been announced as a result of the crisis. Several countries have increased tariffs on agricultural and food products but others have reduced them. The paper examines some forty-three policy measures contained in the list of potentially trade-distorting actions compiled by the WTO (and the supporting material provided by the WB) and in recent press reports.

Among countries that raised agricultural tariffs, only three (Ecuador, Turkey and Russia) announced widespread increases: others limited tariff hikes to single products. Some countries introduced health and safety measures and antidumping duties, though these may not have been a result of the crisis. Others removed the export taxes that had been introduced in the price boom of 2007-08. With the exception of EU antidumping duties, all reported import restrictions were introduced by developing countries.

Many developed countries already have in place support measures that act as counter-cyclical protection against lower prices. Both the US and the EU activated export subsidy measures in the market for dairy products as world prices fell. Other counter-cyclical actions were less apparent as no policy decision was necessary.

Three countries (Tunisia, India and the Philippines) reduced farm product tariffs to aid consumers, and one (Ecuador) cut tariffs on raw materials alone. Two health-related bans on meat imports were removed, though probably not as a response to the crisis. It appears that in some cases governments were reacting to the high-price period of 2007-08 rather than the economic crisis that followed.

Government stimulus packages have not in general targeted agriculture, though some additional payments have been made for rural development schemes. China in particular has set aside a significant share of its stimulus package for rural areas. Notable is the relative absence of increases in price support for farm products.

Why has the agricultural sector not been favoured by government action in response to the crisis? Why did the dog not bark? Agricultural influence in political decisions has certainly decreased in the past two decades, but is still strong in many countries. The dog is still capable of barking. The effect of the commodity boom undoubtedly left agriculture in a stronger situation when the recession hit, and prices are still high in historical terms. Food demand tends to be maintained during recessions, so perhaps the dog had no reason to bark. But the picture that emerges is that of many small actions by countries, mostly developing, that have been rather specif-

ic and less significant in relation to trade flows. The dog was barking but was drowned out by other noises.

What can one learn from this experience? First, the Uruguay Round rules on agriculture have stood up well under the strain of the economic and financial crisis: no country appears to have violated its commitments. Though it is difficult to say what would have happened in the absence of such rules, the WTO framework for agricultural policy has undoubtedly been useful. Secondly, the disciplines of the Agreement on Agriculture could still benefit from tightening and the margin for introducing trade-distorting policies should be further reduced. The completion of the Doha Round would accomplish this. Removing export subsidies, curbing drastically developed country domestic support policies that impact on trade, and cutting tariffs in half would help to prevent protectionist responses to future economic crises. But, thirdly, to the proposed improvements in the WTO agricultural rules should be added tighter constraints on export taxes. Unless importing countries can be sure that their access to supplies will not be arbitrarily curtailed they are unlikely to grant exporters significantly better access to their markets.

In agriculture, policy responses to the economic crisis have so far been mild. But the temptation to engage in protectionist action may grow. The best insurance against that is a rapid and ambitious conclusion of the Doha Round.

About the authors

Timothy Josling is a professor, emeritus, at the (former) Food Research Institute at Stanford; an FSI senior fellow by courtesy; and a faculty member at FSI's Forum on Contemporary Europe. His research focuses on agricultural policy and food policy in industrialized nations; international trade in agricultural and food products; and the process of economic integration. He is currently studying the reform of the agricultural trading system in the World Trade Organizations, including the current round of negotiations; the use of geographical indications in agricultural trade; and the problems faced by producers of Mediterranean food products. He has also recently done research on the agricultural trade policies of countries in the Caribbean Basin; reform of the farm policy in the European Union; and the question of regional integration and its role in the multilateral system, in particular in the reform of agricultural trade. Before coming to Stanford in 1978, Josling taught at the London School of Economics and at the University of Reading.

Stefan Tangermann was, until end-2008, Director for Trade and Agriculture at the OECD, Paris. Before joining the OECD in 2002, He was a professor of economics and agricultural economics at the universities of Frankfurt/Main and Göttingen. His academic work has concentrated, among other topics, on the need and options for reforming agricultural policies in OECD countries, and on strengthening the rules for agricultural trade, with a particular emphasis on the WTO. He has been a member of the Scientific Advisory Council of the Federal Ministry of Consumer Protection, Food and Agriculture in Germany, and also was a member of the Science Council of Germany. He is a Member of the Academy of Science at Göttingen. He has advised several governments and international organisations.

16. Review and Analysis of Protectionist Actions in the Textile and Apparel Industries

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The textile and apparel (T&A) industries have a long history of protectionism, including the Multifiber Arrangement (MFA) that governed world trade in these products from 1974 to 2004. Protectionist measures in T&A include: tariff barriers, non-tariff barriers, and government subsidies and support packages. Since the beginning of the current economic crisis (October 2008), a fairly large number of trade-restricting measures in the T&A industries have taken effect, especially in antidumping investigations and safeguards. However, a majority of these were initiated by only a handful of reporting countries against a small number of exporting countries. The list of products in question is quite limited, and many of the countries initiating these trade actions do not play a major role in international T&A trade. From a broader historical perspective and given the phase out of the MFA quota system by the World Trade Organization (WTO) in 2005, we are arguably in the most 'liberal' period for T&A in more than three decades.

Both short-term and long-term perspectives are needed to evaluate protectionist trends in the T&A sectors. In the short term, several statistics indicate a recent upswing in the number of tariff and non-tariff actions that have taken place in all industries. According to the World Bank, from the beginning of the financial crisis (October 2008) through February 2009, trade officials have proposed and/or implemented roughly 78 trade measures[1]. Of these, 66 involved trade restrictions and 47 trade-restricting measures have taken effect (see Table 1 for specific measures). In general, developed countries are relying on industry subsidies in response to the crisis and developing countries are more often increasing tariffs. In both cases, there has been a rise in antidumping cases and in agricultural subsidies.

However, in the case of the T&A sectors, a longitudinal perspective should also accompany analysis of the recent trends. When compared with the last four decades, one can claim that the number of trade-restricting actions is drastically reduced. According to Clothesource, since October 2008, more governments in garment-importing countries have removed barriers to the clothing trade than ever before and the last six months have represented the most widespread-and under-reported-abolition of protectionist trade barriers than any period on record. The report faults exporters who are 'unable or too slow to exploit these changes' and thus they are finding it easier to blame their governments or non-existent protectionist barriers for their lack of success (3).

1 These figures do not include anti-dumping cases.

Table 1 Trade-Restricting Measures: October 2008 through February 2009

Trade Restricting Measures	Developing	Developed	Totals
Subsidies & Support Packages	11 (31%)	12 (100%)	23
Tariff Increases	17 (49%)		17
Non-tariff Measures	4 (11%)		4
Import Bans	3 (9%)		3
Totals	**35**	**12**	**47**

Source: Gamberoni, E., & Newfarmer, R. (2009). *Trade protection: Incipient but worrisome trends: Trade Note #37*. Washington, D.C.: World Bank, International Trade Department.

When recent trends are compared to historical T&A protectionist actions, *two shifts in the center of gravity* are evident. The first shift is from *developed to developing countries* as the initiators of trade actions. In the past, the European Union and the United States were the forces promoting and implementing trade-restricting policies. Yet in the most recent actions, developing countries have been the ones responsible for initiating trade barriers, primarily aimed at limiting imports from other developing countries. Developed countries are reducing their trade remedy actions and they are moving toward a greater use of free trade agreements.The second shift is from *protecting the apparel industry to protecting the textile and raw material industries*. Almost all of the recent trade-restricting measures seek to protect textile rather than apparel producers. In the past, the major apparel-importing countries (developed economies, such as the European Union and the United States) were the primary advocates for restrictive trade measures, mainly aimed at protecting the apparel rather than the textile industry.

Now that these restrictive policies have expired and these countries' T&A production capacities are drastically reduced, three new trends can be detected: regionalism, China and diversification.

Regionalization

Regional sourcing is becoming more important and there are an increasing number of bilateral and multilateral agreements. Countries that do not actively pursue such agreements (other than China) will find it difficult to compete in the future. This trend is expected to intensify with new concerns about protecting the environment. The European Union is the most notable example of changing its focus from protectionist policies to developing regional sourcing networks with Eastern and Central Europe. For instance, in April 2009, the European Union abolished the antidumping duty on bed linens from Pakistan (3), historically one of the most protected products by the European Union (9), especially from India and Pakistan (10). Furthermore, two more countries were added to the European Union in 2007, and several other trade partnerships (Euro-Mediterranean Partnerships), preference schemes (GSP+), and customs unions (Turkey) have been created.

Focus on China

After all quotas were removed in 2008, China clearly increased its role as the leading apparel exporter and also as a textile exporter. The quota system actually encouraged China to develop the capacity to produce every item in the T&A supply chain (11).

Now China is moving up the value chain into higher value activities such as branding and marketing. In the past, these value-adding activities were seldom the target of protectionist measures because only a few countries (primarily the United States and the European Union) had the skills and market power to compete in this arena.

Currently, the United States has switched to monitoring China's recent investments in developing domestic brands because this now poses much more of a threat to U.S. apparel marketers than to pure textile and apparel manufacturers. This trend is similar to the previous lack of protection directed towards the textile industry. Since textiles are more complex than apparel, fewer countries had the capacity to integrate backwards from apparel to textiles, resulting in less competition and fewer protectionist measures.

Diversification

Japan is taking measures to diversify its sources of apparel import supply in order to move away from its extreme dependence on China. Japan would like to cut China's import market share of textiles and apparel to only 50 percent. Japan is working with factories in Bangladesh as well as Indonesia and other nations within the Association of Southeast Asian Nations (ASEAN) to take advantage of their free trade agreement there (12; 13).

In summary, compared to the last four decades, the current situation in the T&A industries is much improved and the environment is more liberal than before. If the comparison is extended to the early 1970s, when the MFA was introduced, the situation today represents the most 'liberal' period for T&A in several decades. In light of this, we see very few significant elements of protectionism compared to the past.

Recommendations to policymakers and practitioners

For the developed economies (the United States, the European Union, and Japan), the vast majority of apparel production has already moved offshore. Therefore, there is no domestic apparel industry left to protect. The main emphasis for these economies should be to strengthen innovation in their T&A sectors, including mass customization manufacturing, high quality fabrics, and technical textiles for non-traditional products (such as medical applications, the construction industry, and new textile materials).

Regional sourcing is of growing importance in the T&A industries, and it is being used extensively by the United States, the European Union, and Japan to reduce their reliance on apparel imports from China. Rules of origin should be expanded to include regional trading blocs that include the capability to produce full-package garments. Encourage relaxed rules of origin to facilitate T&A exports from the least developed countries, such as those in sub-Saharan Africa. Apparel assembly is the lowest rung on the textile-apparel supply chain and one of the best ways to stimulate export-oriented industrialization for many poor nations. A country will develop the capacity to manufacture garments long before fabric and yarn, and thus in many cases requiring 'double transformation' (in both apparel and textiles) in a country is not feasible. China is the world's largest producer of textile and apparel products. While it has been accused of various alleged trading abuses, such as using export subsidies to unfairly advantage domestic producers, it is also under great pressure as a

result of the recent economic crisis to stabilize T&A production and sales to maintain employment. China's trade actions should be closely monitored, but the country should also be encouraged to sustain its labor reforms and to continue its investments in the sector aimed at promoting social as well as economic upgrading.

Social and environmental compliance is emerging as a very important issue for the T&A industries due to the labor intensity of the apparel industry and the environmental impact of the textile industry (e.g., high usage of energy and waste water). Many of the leading global retailers and manufacturers of T&A products are establishing campaigns to create more sustainable supply chains and products, and they are in a strong position to promote improvements in labor and environmental conditions in the most important developing country exporters, such as China, India, Bangladesh, Indonesia, and Pakistan. These social and environmental efforts should be maintained and strengthened.

About the authors

Stacey Frederick is currently a doctoral candidate in Textile Technology Management at the College of Textiles at North Carolina State University. Stacey's research combines her academic background in textile science and management with her interest in economic development. She enjoys using the value chain framework and developing analytical tools to help others understand industrial organization patterns in the textile industry. She has also applied this approach to several other industries through her research with Duke University's Center on Globalization, Governance, & Competitiveness.

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17. Services (a Case Study of the United States)

Ingo Borchert and Aaditya Mattoo

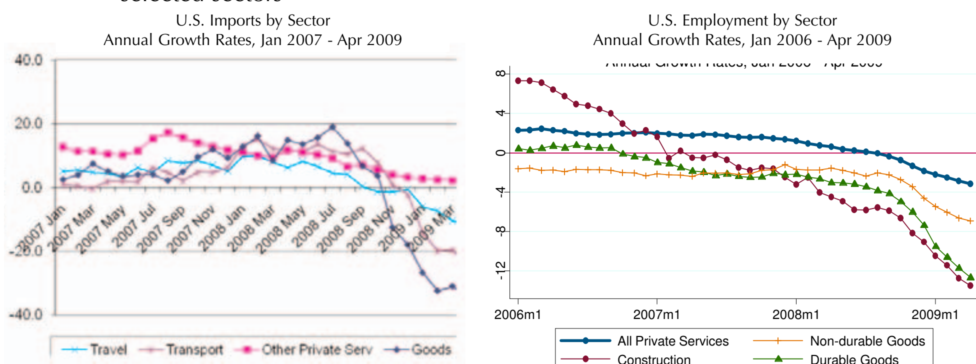
The World Bank

The US accounts for about one-fifth of the services imports and exports of all OECD countries. For many developing countries, the US is the most important market by virtue of its size and openness; for example, more than half of India's services exports to the OECD go to the US. Even more significant than the US' share of trade is the power of example it sets. Whether the current crisis is provoking the US to raise its level of protection is, therefore, an issue of both substantive and symbolic significance.

We find only few examples of explicit protection affecting trade in services. Each is of limited economic significance, and to some extent constrained by multilateral or regional trade rules. However, we also identify certain developments that could lead to more subtle forms of protection – notably, increased government ownership of, and conditional financial support to, firms, as well as the growing political and social aversion to 'moving jobs abroad.' These nascent forms of protection could have much more serious economic impact because they affect a much larger share of economic activity and are not meaningfully restrained by international rules.

An examination of recent trends in US services imports, however, reveals no sign of adverse policy effects. Even as goods imports have declined by as much as one-third since mid-2008, imports of private services have been affected much less, declining by only one-seventh (see Figure 1, left hand panel). Notably, some business services have continued to grow while imports of transport, travel and financial services have declined but that was only to be expected under the current circumstances.

Figure 1: Annual growth rates of US goods and services imports and of US employment in selected sectors



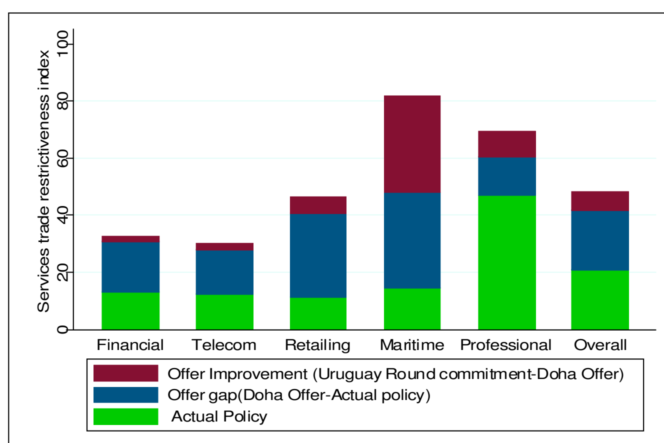
Source: Borchert and Mattoo (2009), Is the Crisis Provoking Protection in Services? A Case Study of the United States, The World Bank

The domestic services sector is, unfortunately, less resilient (see Figure 1, right hand panel). Services employment has not suffered the precipitous declines seen in durable goods and construction (of 12 per cent since April 2008), but it too has declined, by around 4 per cent. How can we reconcile sustained growth in imports of business, professional and technical services (by about 4 per cent) with significant declines in employment in domestic business/professional services (by about 6 per cent)? One possibility is that firms in industrialized countries, under increased pressure to cut costs during the crisis, are turning to outsourcing.

While growing trade and declining employment can generate pressure to protect, there are other countervailing forces. Industrial country firms have made large relationship-specific investments in outsourcing intermediate services; in turn, developing countries have become important markets for industrial country banks, retailers, telecommunications and transport providers. As a result, the business functions of customers and suppliers of services are highly intertwined. Any protectionist action would be self-defeating, because of its direct costs and because it could provoke retaliatory protection.

Nevertheless, it would be wrong to be complacent. We suggest, first of all, greater efforts to monitor new protectionist actions in services – which have so far largely escaped WTO scrutiny (with the exception of financial bailouts). Second, the Doha negotiations must aim to lock-in existing policies in at least the major trading countries; today there remain large gaps between actual policy and not just the Uruguay Round commitments but also the best offers submitted in the Doha negotiations (see Figure 2). Third, there is need for greater discussion on how to address the possible home-market bias created by the widening boundaries and increasing influence of the state.

Figure 2 Global Services Trade Restrictiveness, by Sector



Source: Gootiiz and Mattoo (2009), Services in Doha - What's on the Table?, World Bank Policy Research Working Paper No. 4903.

About the authors

Ingo Borchert is consultant with the Development Research Group of the World Bank. He has been working on a comprehensive database of regulatory measures affecting international trade in various services sectors, with particular focus on telecommunications and transportation services. Prior to joining the Bank in 2008, he has worked on North-South trade flows and the effects of preferential market access for developing countries. He holds a Ph.D. in Economics and Finance from the University of St.Gallen, Switzerland, where he has also taught development economics.

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Having reviewed the available evidence on the implementation of the G20 commitment to refrain from raising new barriers to trade and investment, this World Bank-CEPR report identifies four reasons why increased vigilance against protectionism is called for over the next 12 months.

1. Only a small portion of the stimulus package money has been spent so far. As government expenditure will be directed towards local economic activity, the incentives for trading partners to respond in kind and discriminate against foreign firms and products may rise.

2. Even the most optimistic forecasts for economic recovery imply substantial increases in unemployment in the major trading powers in 2010 and, in some cases, in 2011. In fact, the rises in unemployment experienced to date are smaller than those expected in the coming year. Rising unemployment has long been associated with government resort to protectionist measures. The protectionist temptation will almost surely intensify before it abates – a finding that will hold even if the much vaunted "green shoots" do emerge into recovery.

3. Many governments now have little margin for manoeuvre in fiscal and monetary policy, and in the event that the recession persists, they could resort to trade and industrial policies as a stop-gap.

4. A significant increase in the use of trade-distorting policy by a major jurisdiction could set off unwelcome domino effects, not unlike that witnessed for auto subsidies, diary export subsidies, and procurement nationalism in the last few months.

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