HOW SERIOUS IS THE PROTECTIONIST THREAT?

By Hector R. Torres[1]

In comparing the fiscal stimulus packages adopted by advanced economies and emerging market countries there is one big difference. Fiscal stimulus in EM is truly fiscal (i.e. tax breaks and public expenditure); this translates into more public liabilities but not in expanding the monetary base (unless Central Banks want to risk fuelling inflation).

Conversely, fiscal stimulus in advanced economies is only partly fiscal. Monetary authorities in advanced economies have actively used Central Banks` balance sheets to purchase securitized private liabilities (e.g. corporate bonds, structured debt containing commercial credit). The consequences of choosing certain private liabilities (and not others) as well as the consequences of expanding the monetary base (on top of governments' debt profile) may be felt way beyond their frontiers.

In the case of the US dollar, since it is the most important reserve currency and most of the international trade is (still) quoted in US dollars, a loss of confidence in the currency could have systemic consequences and kindle economic nationalism.

In this respect it is worth noting that as soon as some EM started having second thoughts about investing their savings (reserves) in financial assets (i.e. in promises of future flows mostly quoted in US dollars) and started purchasing "real assets", economic nationalism flourished. The crisis temporarily appeased these spells of economic patriotism, but if inflation picks up in the US and confidence in the US dollar flounders (not something

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unreasonable) we could see a revival of this process bringing new restrictions to FDI and with them a friendly environment for trade protectionism.

In the short term the most important risk is that related with the interest to ensure that public funds stay at home. In times when aggregate demand depends on the pumping of public monies (expenditures or tax breaks), politicians will naturally try to ensure that the effort becomes immediately apparent to the domestic economy. “Jobs” is the key word (and jobs and imports are not always good friends).

The MTS has trade rules that fence what Pascal Lamy coined as “High intensity protectionism”.

Between 1929 and 1934 world trade declined 66%, the NYSE lost 89% of its value and in the US GDP fell 42% and unemployment reached 25%. Much of this was caused by the vicious dynamic of protectionist measures and retaliation. This is not happening today and trade rules deserve part of the credit. "High intensity" protectionism as that of the 30s is today unlikely. WTO trade disciplines make certain protectionist policies as rising tariffs over bound levels, attaching local content conditions to subsidies, or creating new export subsidies look as obscenely unlawful; and this should be enough to deter governments.

However too much reliance on the capacity of trade rules to prevent protectionism could be misplaced and dangerous. There are limits to what WTO rules, by themselves, can do. Trade disciplines can constrain certain trade policy choices but they cannot ensure that governments will not be adopting “low intensity” protectionist policies.

For instance trade disciplines cannot prevent an increase in anti-dumping and safeguard investigations (the sheer investigations may have a chill effect of trade). Disciplines can neither ensure that governments will not use their reinforced purchasing power to pay an over-price to local suppliers (except for those countries that are parties to the Government

Procurement agreement) or to attach certain conditions or eligibility criteria (buy-hire-invest-local) to access to the money they pump into banks.

Needless to say that governments are aware that the GATS has no explicit subsidy disciplines, so they may feel free –unless they undertook specific commitments in their country schedules- to use public funds to give an advantage to domestically owned banks. The only constraints in the GATS are MFN and National Treatment and still, these constraints have not enough bite to prevent discrimination in favour of local firms.

MFN obligation is general and unconditional so, in principle, a government would not be entitled to use public funds to provide deposit guarantees only to residents in certain "friendly" countries. However, paragraph 2 of the GATS Annex on Financial services contains a sweeping and loose exception that has not yet been interpreted by Panels or the Appellate Body. It states that "notwithstanding ANY other provision [e.g. MFN] of the [GATS], a Member shall not be prevented from taking measures for prudential reasons (…) or to ensure the integrity and stability of the financial system".

The National Treatment "constraint" is a bit trickier to assess as it depends on the specific commitments undertaken financial services. Remember that GATS commitments are, precisely, to grant national treatment to foreign suppliers[2]. Consequently if there is no specific commitment obliging a member to grant NT to foreign financial institutions with commercial presence in the local market, then the government could legally choose to grant subsidies only to domestically owned financial institutions. In sum, trade rules have loop-holes and these are particularly notorious in rules applicable to financial services. Governments may choose to "legally" exploit them to the advantage of locally owned firms.

[2] Note that commitments to grand NT are undertaken with respect to each of the four modes of supply.

Admittedly the WTO is quite efficient in settling disputes that policy choices may give rise to. However, settling disputes and preventing wrong policy decisions are quite different things. Despite being very efficient and time bound, WTO dispute settlement mechanism provides no retrospective remedies. Therefore if a government needs to please domestic interests it may choose to adopt protectionist policies even knowing that eventually it will loose a case and be requested to remove the contested measure. This will only happen 3 years latter and no compensation will be required. Dispute settlement takes some time whereas wrong policy decisions have immediate effect.

So my point is, how can we limit wrong policy choices?

In our highly integrated international economy each policy decision, right or wrong, has domino consequences. However, it is ultimately up to governments to ensure that its policy choices are systemically consistent.

WTO rules by themselves cannot guarantee this; we need something more. The WTO is called to pursue greater coherence in global economic policy-making[3]. Given our economic interdependence policy coherence is crucial, particularly for developing countries that very much depend on trade to obtain financing for their needs.

With this in mind the WTO has decided to issue quarterly trade reports that map trade relevant policies taken by WTO members and acceding countries. The collective consideration of these reports provides an opportunity for members to engage in an exchange of views. However, peer pressure is not necessarily effective and in my view the "Naming and shaming" business should be avoided as it may entrench governments in their positions, triggering a perverse cycle of crossed accusations. Beyond this, the WTO very much to the

[3] Article III, 5, of the Marrakech Agreement Establishing the World Trade Organization.

difference with the IMF, has no mandate to express opinion on Members' policies. This limitation in its mandate prevents it from providing policy advice to its Members.

The crisis is calling for a closer cooperation between international institutions. In my view, due to its unique mandate and resources, the IMF (mostly if reformed to enhance its legitimacy), appears to be in the best position to serve as a centre to facilitate cooperation and ensure that national policies, monetary, fiscal and trade are internationally coherent.

I believe that there is room for more involvement of the IMF in providing trade related policy advice. This point has been forcefully made by the IEO in its Evaluation of IMF Involvement in International Trade Policy Issues. This would require a closer cooperation between the IMF and the WTO and also particular attention to avoid any possible use of policy advice to press for unilateral trade liberalization. We would need to provide guarantees to countries that in the past had to face unjustified trade conditionality when borrowing from the Fund. However the Fund cannot avoid giving policy advice to its members. It is in its mandate. On the other hand, as I will explain following, it is increasingly difficult to separate trade policies from fiscal (and even) monetary policies.

Consequently, unless we change the IMF's mandate, it is better to improve the Fund's expertise on trade and its awareness of the trade implications of fiscal and monetary policies. This will require more consultation with the WTO

The traditional divisions between monetary, fiscal and trade policies are no longer apparent. Fiscal and monetary stimulus packages have blurred these boundaries. Take the case of a Central Bank that buys corporate bonds that are virtually illiquid or that accepts as a collateral structured products that contain commercial credit. By doing this, in my view, it is incurring into policies that are close to what a government does when it wants to create a competitive advantage for certain firms. Needles to say this may have direct implications in trade flows.

This is just an illustration, the point is that the WTO has no mandate to put forward provide policy advice for its members. Conversely, the IMF is mandated to do it. The IMF oversees policies that members are implementing to cope with the crisis, and this includes trade policies. The IMF gathers first hand information, thanks to the Resident Representatives it has all over the world. Most of this information may be trade relevant, however, it has no particular expertise on trade issues and Fund's staff is not trained to relate trade measures with trade disciplines.

On the other hand, the WTO is in a better position to analyse trade related policies, but lacks the first hand information on members' measures. The WTO learns from members' trade measures through official notifications (that frequently come late, if at all) and through the press (which is not always reliable or complete). Some progress has been made since the crisis. The WTO DG is producing quarterly reports on measures (both favourable and unfavourable to trade) that Members are implementing. The G-20 has called on its members to cooperate in this process and results are encouraging. However, the amount of information that the IMF collects is beyond compare.

To put it in a nutshell, the IMF is very well informed but poorly familiar with trade issues and mandated to provide policy advice to its Members. With the fiscal and monetary stimulus frenzy much of that policy advice could have implications for international trade. On the other side of the Atlantic, the WTO is highly skilled in trade issues but not as well informed and cannot provide policy advice to its Members as it cannot express opinion on their measures.

The crisis is calling for more coherence in policies and this requires better and opportune policy advice. It is worth noting that "achieving greater coherence in global economic policy-making" by cooperating with the IMF is one of the "Functions of the WTO"[4]

In my view the IMF and the WTO are pretty complementary and getting them to work closer (even closer I should say since they are not unfamiliar one to the other) would bring a win-win situation. It would improve the quality of the IMF's policy advice and also the WTO's capacity to help its members monitor international trade developments. This would be greatly facilitated if the IMF would speed-up its reform, achieving a more democratic representation in its Board and therefore boosting its legitimacy and confidence in its policy advice.

[4] Article III, 5, of the Marrakesh Agreement Establishing the World Trade Organization.