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ECONOMIC WATCH

Crisis can only deepen with protectionism

By Deborah Kay Elms

WHILE the economic crisis was gathering steam last autumn, the leaders of the G-20 nations gathered in Washington for an emergency meeting. They pledged to enhance cooperation to restore global growth. In addition to addressing the problems of the financial sector, they committed themselves to keeping an open global system. They promised to refrain from raising new barriers to investment or trade, to avoid export restrictions or prohibited measures to stimulate exports.

Three months later, these promises are looking frayed. The United States' US$800 billion (S$1.2 trillion) stimulus Bill contains a "Buy American" provision. This insertion in the massive package requires preferential use of American-produced steel products in building contracts and US-made uniforms for the Department of Homeland Security, provided doing so does not conflict with international trade agreements.

This is by no means the only example of rising economic nationalism. Indonesia just asked all its civil servants to buy only locally-made products whenever possible, including shoes and clothing. Loan and subsidy programmes announced as part of stimulus packages in France, Germany, Spain and Sweden contain provisions to spend the money on domestically-produced goods, particularly cars.

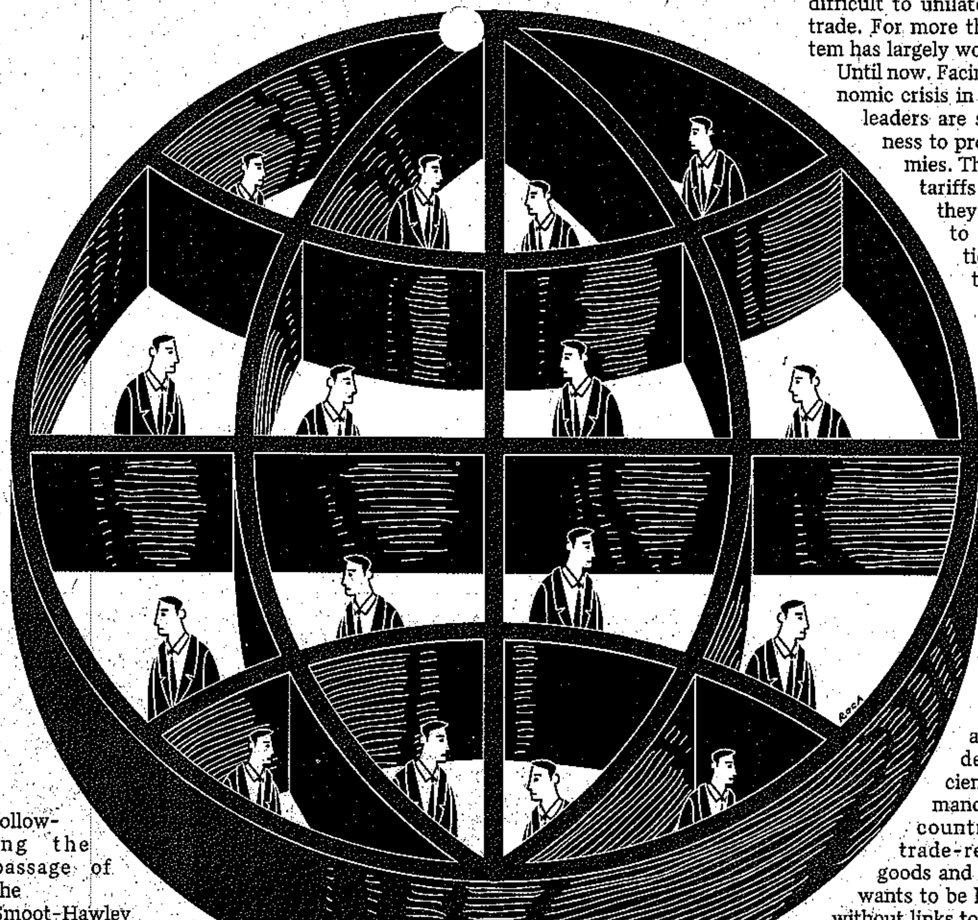
The "buy local" impulse is not the only evidence of rising protectionism. Russia has dramatically raised tariff rates for imported used automobiles. This will make cars manufactured in Russia much more competitive, though it has set off a backlash in the Far East.

These pressures for protectionism will only grow, the longer the economic downturn continues. The problem is that every leader faces similar domestic pressure. As the global economy contracts, millions of workers will be without jobs or will work reduced hours. Even consumers and companies that have money to spend or access to credit have stopped or slowed their spending. This will cause further contractions, exacerbating the crisis.

In this environment, political leaders will face enormous pressure. Every leader will be urged to save jobs at home, especially those associated with goods and services for domestic consumption or for export. They will be urged to raise barriers to cheaper imports or provide subsidies to stimulate exports. Citizens are encouraged to purchase more of "our" products and services. And these items should be produced only with "our" workers. And there will be pressure to undervalue currencies to make exports cheaper.

Leave aside for the moment the question of whether these strategies work to save domestic jobs. It is clear that, if the leadership in every country surrenders to these pressures, the net result will be a world with less trade, lower remittances, and dislocated migrant workers returning home.

The rapid end to open trade is precisely what happened in the Great Depression following the passage of the Smoot-Hawley Tariff Act in the US in 1930. Once the floodgates to protectionism were opened, the world quickly responded with increasingly higher levels of barriers to trade. The higher the barriers became, the worse the global economy became.



Doing the "right thing" for the global economy is not easy. The leaders of every state face similar pressures. But individually, rational actions will result in the worst possible result for the world. The dynamics are similar to a run on a bank. It may make sense for you to race to get your money out of a bank in times of crisis, but doing so will make it more likely for the bank to fail.

Leaders recognised this problem when they agreed to create the General Agreement on Tariffs and Trade (Gatt), the predecessor to the World Trade Organisation (WTO), in 1947. Signatory countries agreed to bind their hands by making it difficult to unilaterally raise barriers to trade. For more than 60 years, the system has largely worked.

Until now. Facing the worst global economic crisis in the Gatt/WTO period, leaders are showing their willingness to protect their own economies. They are less likely to use tariffs this time around. But they will find creative ways to use subsidies, regulations or investment rules to favour local firms.

The domestic pressures are intense and rising. Yet it is precisely in these periods of economic downturn that the global economy is most vulnerable to individual state decisions. Asia will be particularly hard hit by protectionism, as it will close off the very export markets that will drive domestic economic growth.

Many argue that closed markets are not a problem, as domestic demand will be sufficient. Stimulating local demand sounds good. But no country can meet all its trade-related demands for goods and services alone. No one wants to be living in a North Korea without links to the outside world.

In Singapore's case, the domestic market is simply too small to make up for the loss of overseas orders. Export-oriented states like Japan or China will not be able to quickly rebalance and retool to produce only enough for domestic consumption. Large numbers of firms and factories formerly producing products for export will simply go out of existence.

No collective action seems imminent from the WTO, where the current negotiations have been stuck for more than seven years. Cooperative action in the Group of 20 lasted less than 90 days. The G-7 just issued another stirring call for open markets. Apec senior officials echoed the sentiment.

For the sake of people everywhere, it would be better if these calls were heeded. The alternative could be as bleak as the 1930s.

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