

# Protectionism: Will It Take Root ?



*French car makers have been told to buy domestic components and not close factories in France*

Integration, globalization, free trade, trading unions have been the magic words linked to growth and success but all of a sudden out of the blue these words are under strain and are under the threat of being blown over by a new world order – Protectionism.

Lack of tolerance for foreign workers in the UK; French car makers told to buy domestic components and not close factories in France; a minister in Spain urging consumers to buy Spanish goods: protectionism in Europe appears to be rising by the day.

This is happening despite warnings from experts that such measures will ensure that the recession gets translated into depression.

Even during the great depression eight decades ago, both US and Europe had adopted this approach but failed to revive the economy.

However this time voices against such an approach are gaining ground. Europe has taken on the US for adopting what clearly appears a protectionist

approach and sees it as a harbinger of worse times.

However due to the WTO guidelines that limit the scope of tariffs, protectionism is unlikely to make a serious comeback.

Instead, other forms of economic nationalism are coming to the fore, from demands to reserve “British jobs for British workers” to invocations of patriotic consumption. Most sinister of all is the threat of financial protectionism. Under the obligation of government bail outs, “banks” are withdrawing to their home markets. This is adding to the political pressure for bail-outs of other industries.

## Barrier basher

According to the rules of the European Union's single market, there should be no barriers to the movement of capital and labour in the bloc of nearly 500m people. Conditions for businesses should in general be the same in all 27 member states.

The European Commission in Brussels is the guardian of the single market and can take legal action against member states.

It also oversees rules designed to ensure that there is a level playing field. Unfair trade practices to support local markets are controlled.

We will therefore see more and more activist government policies that distinguish economic activities according to the nationality of the actors as a result of unintended consequences of bail outs.

The consequences of such protectionism are likely to test Europe economically, politically and legally.

Unravelling the integration of the banking market will cause a lot of damage. Also the emergence and intensification of protectionist pressures could emerge as one of the main downside risks facing the ‘eurozone’ economy.

All the efforts of EU policymakers made during the hey days are being undone by measures such as the splitting up along national lines of Fortis.

Bank bail outs, meanwhile, have generated pressures, with France offering to inject €21bn (\$27bn, £19bn) into the country's six largest banks to ensure they are able to march competitively with UK or US rivals.

Arguably more worrying is the withdrawal of many banks from lending outside their home markets.

**Behind US fears**

During the long boom in the US economy from the 1990s, it became common to argue that the era of widespread American protectionism was over. The political clout of trade-skeptical lobbies including textiles and steel had shrunk; industries such as car making were keener on knocking down barriers to investment abroad than raising trade tariffs at home. The talk of globalization gained pre-eminence over anything else.

But things are changing now. ‘Buy American’ is gaining ground. The economy is in recession and unemployment is rising; the US continues to run a large, if diminishing, trade deficit; the dollar remains strong; and the Democrats, who never really favored global trade, are in-charge of both houses of Congress and the White House.

Opinion polls have suggested that people blamed growing inequality in wages largely on the effects of

competition from cheap-labour economies, notably China. Now that the recession has hit, observers say, the US public is looking primarily to its own government rather than world co-operation to solve things.

Thus unless the pain inflicted by the domestic issues is brought under control, Americans will continue to be skeptical of world trade and outsourcing. Hence policies need to be designed to moderate this local pain so that people at large can view globalization favorably.

At one time UK was receiving 40% of its funding from international banks. These have however ceased completely leading to the credit crisis that has come to haunt companies all across the globe. Thus liquidity which was free flowing seeking growth and value creation opportunities based purely on merit and efficiency has dried up considerably. Without funding, projects get stalled mid-way leading to more crisis of credit leading to

a kind of ripple effect.

While some may argue that the banks want to lend sensibly, others feel that under the garb of sensible lending “protectionism” is being pushed through.

In eastern and southern Europe, there are growing fears that banks could repatriate capital, particularly from the ex-communist emerging markets.

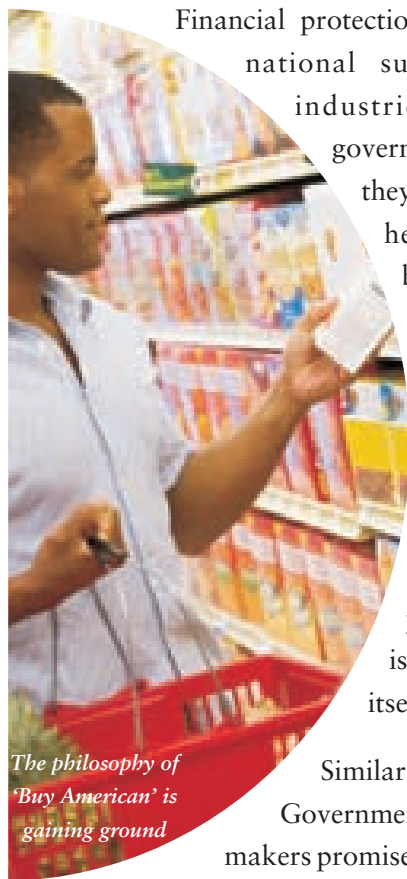
Greek banks have been warned against using funds from a €28bn government support package to support their Balkan subsidiaries. They have been asked to lend on the basis of availability of local funding, taking into careful consideration local economic conditions.



Elsewhere in the continent's east and south, financial supervisors are monitoring the local subsidiaries of international banks to ensure that they do not transfer funds abroad.

It is quite evident that they will do everything to prevent flight of capital across borders.

While the proponents of such approaches might sound like hardliners, their concerns are not baseless. Serbia's central bank injected €600m in extra liquidity into the local foreign currency market in December only to see foreign-owned banks siphon the money back into their head offices in Austria, Italy, Greece and elsewhere. This is a clear indication of government trading investment opportunities in overseas markets in order to protect their domestic markets. If this leads to a big divergence between that region and Western Europe, then it will be a big blow to the EU and will question the very basis of the Union.



*The philosophy of 'Buy American' is gaining ground*

Financial protectionism is leading to national support for other industries as European governments realize that they have to be seen to help not just the banks. Thus Sweden is putting together a package for their car industry. The key constituents of the package are loans and guarantees provided the money is spent in Sweden itself.

Similarly in France, the Government is making car makers promise not to transfer jobs

or production outside France in return for €6bn of support.

It is believed that judicious intervention by the state during a severe recession will help foster support for globalization and forestall a downward protectionist spiral. That explains actions such as launching its own sovereign wealth fund, taking a stake in a shipyard and providing guarantees to customers of Airbus, the aircraft maker.

This brings in another term which is in between that of globalization and protectionism and that is "managed globalization".

Italy's approach of "managed globalization" takes a similar tack and explains how it kept Alitalia, the loss making airline, in Italian hands but let Libya acquire 10 per cent of Eni, the state-controlled oil company.

Germany, as the world's largest exporter, has tried to avoid being seen as protectionist even if some of its moves to prop up banks and proposals for supporting industry have flirted with the idea.

Spain has taken a more unusual approach, with the government urging Spaniards to buy more local products by asking its citizens to bet on Spanish products and services.

At a European level, there is concern over what all this means for countries' commitment to the single market. It is threatening in terms of the coherence of the single market. It is creeping protectionism and it is dangerous as fiscal stimulus programmes are likely to make things worse.

Eastern European countries are nervously watching western bail-outs, particularly for the car industry, which is important for Poland, the Czech Republic, Slovakia and Hungary.

Such a backlash is also likely over immigrant labour. Experts see the UK protests as only the start and the European Union (EU) is reviewing the rules that oversee the free movement of workers.



*Protectionism in the US could herald a not-so-rosy dawn  
for other economies in the world*

Concessions have been made to the EU's state aid regime over the past six months – making it easier for governments to channel funds to banks and businesses – but the rule-book has not been abandoned. Officials have also insisted that these rule relaxations should not persist once economies pick up. Countries are at least paying lip-service to that, with France vowing to act within EU rules even if it attacks Brussels for being too inflexible.

Ultimately, however, the question of how serious the rising protectionism in Europe will become may well depend on actions elsewhere in the world, particularly in the US. It is believed that the US leadership effect is huge. If it follows protectionist policies such as the Buy American provisions then it can be seen in Europe as a licence to do the same.

Despite the rhetoric, it is believed that the Americans will not go into protectionism. There is too much at stake for them as the Americans need the world to buy their goods and services, not to mention their pitch for international support to fight terrorism. Some local industries, like auto might get protectionism, but all-in-all, America is likely to buy internationally.

While the US may not continue to buy with the same intensity as they had got themselves used to in the past, they will continue to buy. Hence it will get more challenging for foreign companies to market their products to the US. At the same time other nations too will face the heat of joblessness and shrinking profits and are bound to crave for government bail-outs. This in turn might lead to protectionist policy framing in some countries but hopefully this is not likely to be wide spread.