



The new protectionism: where does it come from and where may it go?

It seems we are in a transition towards a new international regime, a new order, finds Daniel Dăianu

During hearings in the US Congress the Commerce Secretary in the new Republican administration asserted that the United States wish 'fair trade'. Such a statement indicates a radical change of vision regarding foreign trade relations if compared with the thinking that prevailed after 1945. The denouncement of the Trans-Pacific Partnership, a new stance regarding NAFTA and TTIP go in the same direction.

There is increasing talk in Washington about entering bilateral trade agreements, using tariffs in order to protect industrial sectors. US companies are encouraged to move operations back home and repatriate their profits, and doubts have been raised concerning the reformed regulatory and supervision framework of finance.

Traditionally, the fair-trade concept is part and parcel of developing countries' rhetoric. Ironically, statements by Chinese leaders in Davos this January pleaded for free international trade and globalization although the functioning of their economy has in-built protectionist features.

Views in the United States which advocate a 'strategic' approach to international trade (Clyde Prestowitz's name comes to one's mind) were mostly marginal in public debate for decades; trade without obstacles was the dominant paradigm even if control was accepted in areas related to national security (ie. defence industry or telecoms) and currencies' swings was a permanent topic in the dialogue among finance ministers of major countries.

But what we are witnessing now could be judged in a much deeper sense and having possibly wide-ranging effects. It may also be puzzling as the unemployment rate in the US is below 5 percent (versus about 9 percent immediately after 2009), although income distribution and the quality of jobs need to be factored in. And to consider it as only a temporary anomaly would be simplistic for the liberal order has been questioned for years now¹.

In EU member states national economic concerns are on the rise too, but EU rules stipulate a free trade order. Many European leaders feel uncomfortable with the new vision that is taking shape across the ocean. Brexit however, can

be judged in the logic of changes underway in the States, even though the United Kingdom remains attached to the free markets vision.

What may be labeled as the 'New Protectionism' (NP) involves more intervention in the economy/society; it has various forms and operates at different paces. When the multilateral architecture of the international policy arrangements is questioned a radical new approach comes into being. There are nevertheless other insidious ways which, without questioning multilateralism, seek to support national firms or even economic sectors.

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Within the European Union, the Single Market rules prevail in the context of a variety of national economic situations. But vis-à-vis outsiders this framework is less so, or it may be changing. As *Reuters* reported on February 15 this year, France, Germany and Italy urge a rethink of foreign investment in EU.

It is a fact that NP undermines globalization, a liberal economic order, as it has evolved during the past half century. To see where the New Protectionism comes from it is worth going a little bit into history and relate it to the current context. What follows is an attempt to interpret and understand where the propensity for protectionism come from rather than to be normative.

A few historical benchmarks

Following WWII the US was the champion of free trade as a reflection of a system based on free markets and a tool to promote their own interests. Liberal democracy was seen in a symbiotic relationship with free trade and openness, with globalization – in stark contrast with the command systems of the communist countries. The fall of the Berlin War heightened that vision in international relations, which, when seen historically, matched the UK's role in the second half of the 19th century - when Pax Britannica epitomized the world order, an international economic system.

The 'Washington Consensus', which was promoted by international institutions (the World Bank and the IMF in particular) after 1945, espoused a strong belief in unhinged globalization as an overriding principle in the functioning of the world economy.

Notwithstanding, dissenting voices in economic and policy thinking did exist. Robert Wade, Alice Amsden, Lance Taylor and others underlined risks associated with a premature opening of markets. UNCTAD, the Geneva-based institution, which is a loudspeaker for less developed countries, had always been quite ambivalent about full com-

mercial and financial openness. In Latin America, too, views pointed out structural problems afflicting less developed economies and that demanded a nuanced approach to financial liberalization.

For decades, Harvard professor Dani Rodrik pleaded for pragmatic policies that should pay attention to market imperfections and asymmetries². The economic success of several Asian economies tested the 'Washington Consensus'; and the lessons of the financial crisis episodes of the recent decades prompted international institutions to reexamine financial liberalization when undertaken irrespective of circumstances.

It is worth to remember that the US' economic emancipation from the British Crown, after the independence war, was supported by protectionist measures in order to develop a manufacturing base; Germany, too, replicated this approach in its relationship with the UK, while Japan's response to the economic assault of Western powers was industrial development, which relied on protectionism too. In other words, protectionism was part of the toolkit for economic development, in ensuring economic security and changing an international balance of power. In Europe, Friedrich List is known for his protectionist thinking, which inspired Germany's economic policy in the second half of the 19th century onwards. In the US, the first Treasury Secretary, Alexander Hamilton, and a series of Presidents including Abraham Lincoln come to one's mind in the same vein.

The post-WWII EU and world order were aimed at bringing peace between states and preventing economic conflicts³. The decolonization process is worth mentioning in this context. This inference does not ignore the major geopolitical confrontation of the last century, military conflicts around the world.

Why does protectionism return in the developed world?

Why do 'sirens' of protectionism ring in the developed world currently? Processes and factors are to be mentioned in this regard; these can be grouped in two categories: Firstly, economic evolutions; and secondly, security threats.

Among fundamental economic developments are to be counted:

- A significant erosion of US status in the balance of power globally which is related to economic and military overstretch. It is worth to notice that economic and industrial strength underpins military and technological power;
- For the first time in centuries the economic preeminence of the Western world seems to be at threat; the rise of Asia, especially of China, but also India, are to be mentioned in this respect;
- New technologies (the Fourth Industrial Revolution) are cutting jobs massively, but economic and public policies are also responsible for social strain and unrest.
- The Financial Crisis has fragmented and divided societies and turned them inward-looking;
- The Financial Crisis has induced governments and central banks to adopt non-standard, unconventional measures; these involve hands on practices in economies;
- Bad corporate governance and tax dodging (including profit-shifting) fuel anti-globalization reactions;
- There is a widespread sentiment that external financial markets have an excessive influence over national governmental policies. This is a delicate issue as the legitimacy of those who have a mandate to articulate public policies is at stake.

The New Protectionism in developed countries comes, arguably, as a reaction to unrestrained, unmanaged globalization. More than a decade ago, Paul Samuelson, the author of *The Neoclassical Synthesis* (which is the backbone of mainstream economics), highlighted that the flow of factors of production may erode comparative advantages of industrialized states⁴; he basically restated what David Ricardo, a leading contributor to international trade theory, considered to be the reverse side of the coin when capital, investments, knowledge move to countries where wages are pretty low. One can surmise that had public policies been more attentive to the needs of those individuals and firms that are on the losing side in global competition, social stress would have been lesser.

It should be emphasized that globalization is not an automatic, mechanical outcome of technological change. Reversals can happen following social and economic distress. In addition, concerns vis-à-vis the loss of economic status can combine with worries about increasing technological and military vulnerabilities. This is why NP can signal a return of, or more state economic intervention.

Security and protection of citizens

The role of the state as a guardian of public interests comes ever higher on the public agenda in the western world. The US was badly hit in September 2001 by terrorist attacks, which led to a review of concepts regarding ways to ensure citizens' and state security. Europeans have also been hit by terrorist attacks in recent years, which has triggered anxiety and claims to public authorities similar with the ones across the Atlantic.

Terrorism, unconventional threats (cyber attacks, hybrid wars, etc), fear for the future, big uncertainties, are pushing many citizens to ask for firm measures from their national governments to protect them and protect national interests. In France and Belgium state of emergency measures operate. New security measures are proliferating. The refugee/migrants crisis in Europe has posed major difficulties for the Schengen space to function. And in the US the new Administration has a new approach, be it highly controversial, regarding immigration.

How open societies can answer to such challenges is an open question⁵; without balanced policies, outcomes can be largely suboptimal. Authoritarian temptations come up in liberal democracies during hard times – these propensities are similar to what happens to state conduct in times of heightened tensions, of war (the *war economy* syndrome). For there is a big difference between the fear for tomorrow as regards one's job and the one that is linked with terrorist threats and military conflicts. But isolation, exacerbated protectionism may act as a boomerang and worsen things – as opposed to the aimed ends.

Simple analytics of a trade-off

Dilemmas that an open society has when facing threats and trade-offs may be captured by economic analysis. More specifically, one can relate protection/security to openness (economic freedom) as public goods. This may be illustrated as a social utility function which includes protection/security (S) and economic freedom (O) as an expression of economic openness, as public goods. A function $F = F(S, O)$ would indicate levels of citizens' comfort in terms of these public goods; it could look like $F = ((1 - a) \times S + a \times O)$, where (a) would be a variable in consonance with people's attitude toward the two public goods; this variable could not be higher than 1 and not lower than 0.

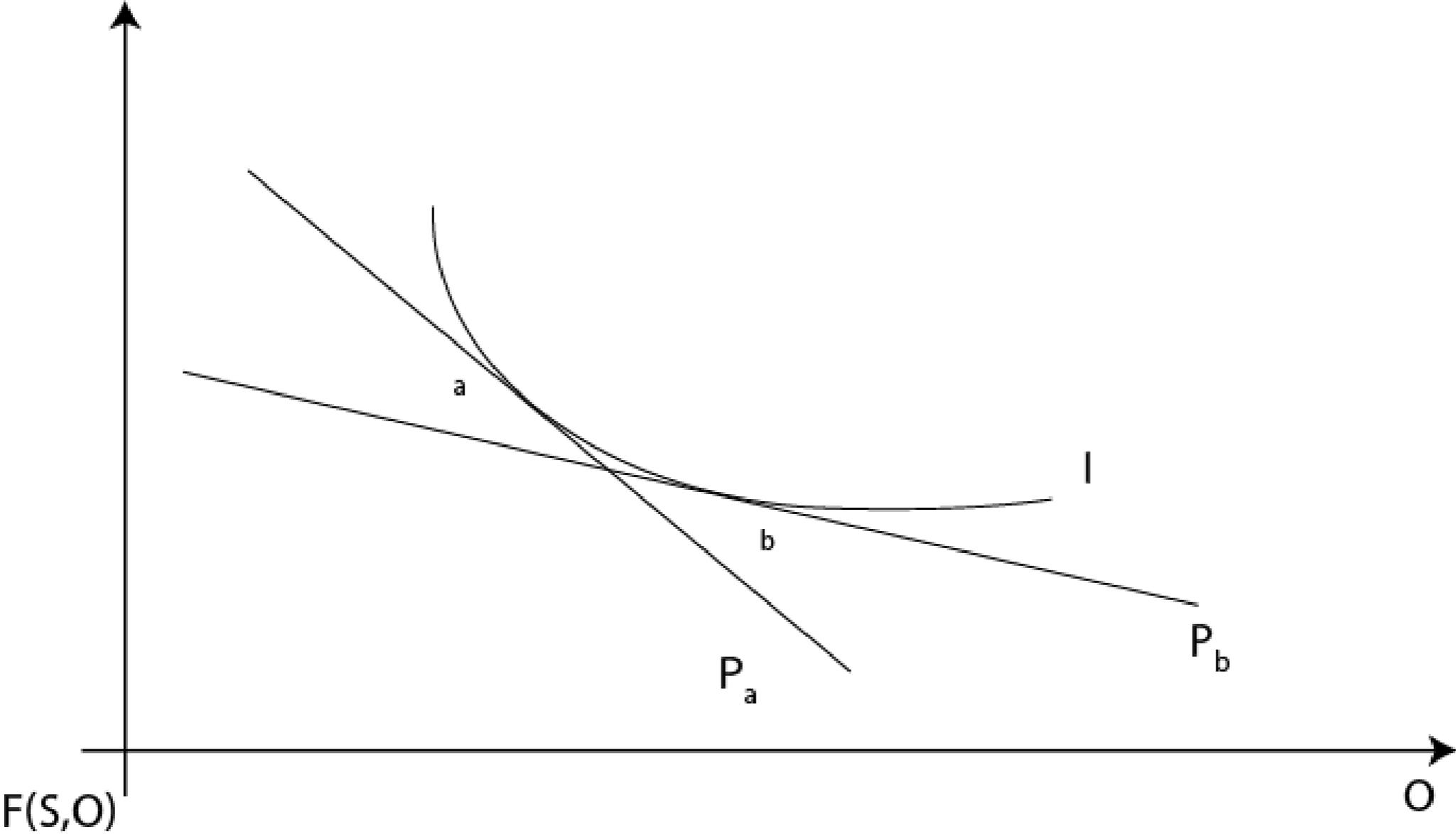
The substitution between protection/security measures and economic openness (economic freedom) has limits because these two public goods (as a state of the social and economic system) are not completely independent of each other; from a certain level, protection measures, or restrictions may distort open society (democracy) exceedingly. Likewise, a total openness of the economy/society, with no rules and protection measures, may cause enormous costs, social anomia.

Graph 1 illustrates citizens' growing need for protection in times of hardships, when threats abound. Various combinations of (S) and (O) may be imagined so as to ensure a degree of citizens' acceptance that would minimize discontent/discomfort in given conditions. An optimal combination is where the price line (S, O) is tangent to the preference (social choice) curve (I). The (a) point refers to an initial level of economic freedom – as flows of capital, workforce, investment, and the range and scope of regulations. At point (a) things are relatively good, calm, and this is revealed by the price line between (S) and (O); a steeper slope, Pa, shows that (S) is regarded as being sufficient (people feel safe) and economic openness as a public good is in high demand.

When times worsen a more inward looking society emerges; such a turnaround is revealed by the change in preferences in favour of (S). When the need for protection measures grows, the change is reflected by a less steep slope of

Graph 1. The relation between protection (S) and economic openness (O)

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the relative price, (P_b), between (S) and economic openness (O); this may involve protectionism and other restrictive measures and their combination is indicated by point (b) on the indifference (utility) curve.

The graph simplifies reality not least because it refers to people in general, but, nonetheless, is not irrelevant. Who decides and how decisions are made regarding the two public goods brings politics into the limelight, as citizens may have different options, may share different political views or values; a community may be made up of different ethnical groups and religions, a large part of the population could be made up of immigrants, etc.

In a democracy, one is accustomed to think that the social collective option (social) is given by the majority vote. But things are much more complicated if society is profoundly divided and various values are guiding people's choices⁶. Moreover, economic interdependencies between countries may be very strong.

It is also a fact that the way people value protection vs. openness may vary over time. What is abnormal, unpalatable today, may be termed differently at another moment in time; it may be that people adjust to different circumstances, their habits and perceptions change.

Protection measures can trigger similar responses from partners - and trade wars will likely lead to damages for all parties involved. Therefore, any measures at a national level should be pondered given potential answers from partners. Widespread protectionism comes along with significant dangers; beggar your neighbour policies can easily backfire. It is worth recalling that the globalism of the 19th century Victorian Era was followed by commercial and 'hot' conflicts.

The analysis should be adapted for the case of economic and military alliances. For example, within the EU there is a pressing need for common efforts in the area of intelligence, border protection, military defence - as all these are European public goods.

A resurrection of national interests

The context outlined above might explain why some developed states seem to be seeking to regain a former power status via a journey back in time. There are additional aspects that can help to see through future trends:

- The global economy gets multipolar;
- The EU is fragmented by centrifugal forces and weakened by Brexit. However, it is not improbable that, after a while, Brexit could stir up the appetite for deeper integration amid growing dangers in the global space;
- The post WWII institutional economic arrangements (Bretton Woods's arrangements) are under siege due to alternative accords and institutions promoted mainly by China;
- Unrestrained globalization has brought benefits, but it has also damaged social cohesion by neglecting distributional effects (see also IMF⁷, OCDE and World Bank pieces of analysis);
- 'Realpolitik', as a way to articulate foreign policies, increases at the expense of placing moral values and the interests of what is called the international community at centre stage;
- There is a revival of national interests (of nationalism) in a world faced with large disturbances, with a redistribution of economic power (multipolar and disorder – Ian Bremmer calls it 'G-0'), with conventional and unconventional threats that proliferate.

Can an open international system, which is based on multilateral accords, be saved under such circumstances? Such a question begs others:

- Are there international arrangements that can address and redress flaws of unrestrained globalization?
- Is it possible to reinvent the EU, to make it fit the new conditions in the global economy?
- Can the eurozone be turned into a genuine monetary union, with proper fiscal arrangements? For this to happen the German-France nexus is vital.

- Can the EU get safer security arrangements? This involves its relations with the US and NATO, with Russia, and US-Russia relations.
- How should military conflicts, in different areas of the globe, be tackled?
- How would the new big rivals in the world (the US and China) cooperate on issues of interest for the whole world (such as climate change) in a systematic way?

What seems to be going on now in the United States is to be judged in conjunction with rivalries that grow in an ever more uncertain world. As in the Cold War decades, the control of the transfer of sensitive technologies may be put in place and adapted to the new context. Trade blocs may proliferate simultaneously with an erosion of multilateralism. As a matter of fact, the EU is a de jure and de facto commercial bloc, be it of a benign sort and attached to multilateralism in world economic affairs.

A resurrection of national interests should not be ascribed exclusively to the American territory; it happens in Europe as well. Theresa May's industrial policy measures do not see eye to eye with the vision promoted by Margaret Thatcher decades ago. France has always been attracted by the mirage of its perceived national interests. It is worth noting here Thierry de Montbrial's interview in *Le Figaro*⁸ in which he underscores the significance of national interests in today's world.

Germany has been a strong supporter of economic globalization over the past decades given its overperforming industrial structure, in a eurozone that helped it boost its exports and keep its jobless rate low; its current account surplus, nearly 8.5 percent of the GDP currently, is by far the largest in the world. But what would happen were this economic situation to change significantly with ensuing high unemployment? Fortunately, Germany is still a stronghold of the liberal order while being the economic mainstay of the EU. In several emerging economies from Central and Eastern Europe, national prerogatives are getting stronger despite their EU membership.

In Europe, forms of NP can also be related to waves of immigrants during the past two decades; in some developed EU member states there is growing discontent over the free movement of labour from Central and Eastern Europe, even though that human capital inflow was positive for host countries. But it is fair to acknowledge that macro data may be at odds with some granular, micro data.

NP should be judged not only in commercial terms. A bunch of crises demand a state to intervene more in the economy. Consequently, the crisis of globalization is to be examined from a ampler perspective, one that goes beyond economic issues.

The New Protectionism: whither?

NP can be interpreted in a narrow sense, along the lines of trade/economic relations and in a broader sense, when it covers a vast array of measures targeting national security (which has other dimensions, too, than the pure economic one). In both senses, the liberal order, as it was set following the WWII, is questioned. It should be emphasized however, that a liberal order is not synonymous with market fundamentalism.

The world that we seem to be bumping into shows signs of fragmentation, with societies more polarized. Not a few developed states feel threatened and seek self-protection via various measures; protectionist measures are part of a return of the state in the economy. There is a competition between the developed world and the one that is arising, and this contest needs to be managed through clear rules. And rules imply a world order.

What would be the result of NP as an economic defence response? It may probably open the door to a prolonged interregnum, with a corrosion of international, global institutional arrangements. Such an evolution is likely to lead to a precarious balance, an unstable equilibrium in international relations.

The global trade slowdown can be a proof in this regard, although some may say that it was only a matter of time before reaching a peak with regard to the share of global trade as against global GDP. Currency wars may heighten. Big uncertainties and exacerbated volatility are already features of the new international environment. Such a bad equilibrium, which some may call disorder, is worrisome for those who believe in the virtues of multilateralism, of rules. Europeans know from their own history where unrestrained rivalries may lead to.

If those who lose in the global economy and inside their societies are not given the chance to not be left stranded (the role of the public policies is desirable here), if exclusion gets deeper and spreads, tensions will rise and conflicts will intensify. Inter-ethnic and religious conflicts add to the social and political picture. And the New Industrial Revolution does not make efforts to adapt to shocks easier. This is why protectionist propensities increase.

If national security reasons, geopolitical rivalries, are brought into the picture one understands why global optimizations (similar to the logic of global supply chains and win-win games) may lose relevance; and competition may turn into a win-lose game. This is likely to occur especially when economic growth is quite feeble and income distribution becomes an acute social and political issue.

Central and East European countries would suffer a double blow: via global arrangements that are cracking because of protectionist measures; via what may happen in in the EU. Globally, the effects on trade and investment flows, technology transfers are to be taken into account. Within the Union, the Single Market functioning, changes in the EU framework, the fate of the EU budget, are to be examined.

For example, a minimum wage imposed all across the EU may be seen as a tool for dealing with highly skewed income distribution as well as a measure to combat social dumping. Emerging EU economies would suffer following a deteriorating climate in Europe and across the world. Dismantling the EU would be dramatic for Europeans if we

consider what the Union meant for economic recovery and peace after 1945. Jean Claude Juncker, the EC President, talks about a 'fair deal' for the UK; this heralds not a simple Brexit negotiation while both parties have common needs in terms of security and military protection.

Terrorism, other unconventional threats, increase citizens' needs for protection; safety is more valuable in peoples' preferences and this could lead to restraints on economic openness. It remains to be seen how such a possible evolution will impact open societies. The deterioration of trade relations on a large scale is likely to fuel animosities and mistrust and may cause conflict.

There may be an optimal degree of economic openness that varies according to circumstances. The New Protectionism may be tied to tides of economic openness in the inter-state system, with alternating upswings and downswings along secular cycles (as defined by Nikolai Kondratieff and Joseph Schumpeter).

Realpolitik will probably put a firmer imprint on the relations between states, including EU members; Realpolitik is to be linked with divergent and conflictual interests, that emerge from multiple roots and which cannot be summed up only as economic gains and losses. Moreover, economic assessments are not infallible and are not always decisive for decisions made in the area of public or foreign policy.

What will be the new economic order is a big question. What will remain from the Liberal Order? Will multilateralism survive as a basic principle? What will happen with the institutional arrangements created after the WWII? What will be the rules and norms in the future world? It seems we are in a transition towards a new international regime, a new order; and it is vital that big conflicts and large damages be avoided.

To conclude by returning to Europe. The EU is a public good in itself; it has to be saved despite phenomena that undermine the traditional order in the international system. As Javier Solana puts it, the EU may be the world's best

line of defence against what threatens the multilateral, liberal order⁹. It is nevertheless true that the EU itself needs reforms; it has to be reinvented. And the *Five Presidents Report*¹⁰ offers an inspiring perspective to this end. Europe also needs security arrangements adapted to the new reality. ■

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1. In his introduction to a special issue of *Foreign Affairs*, "Out of Order: The Future of the International System", Gideon Rose echoes the view that "the liberal order has been fraying around the edges for years" (January/February, 2017)
2. Dani Rodrik, "The New Global Economy and Developing Countries: Making Openness Work", Washington DC, Overseas Development Council, 2000. See also his "One Economics, Many Recipes", Princeton University Press, 2007, and Justin Yifu Lin "The Quest for Prosperity", Princeton University Press, 2012
3. For references to economic relations and interdependences in the post-war free world see Richard Cooper: "The Economics of Interdependence", New York, McGraw Hill, 1968.
4. Paul Samuelson, "Where Ricardo and Mill rebut and confirm arguments of mainstream economists supporting globalization", *Journal of Economic Perspectives*, 2004
5. See also my text "Open Society and Wars", *Curs de Guvernare/Adevarul*, 29 January 2015
6. The Nobel Prize winner John Kenneth Arrow explained the difficulties of building social utility functions in "Social Choice and Individual Values", Wiley, 1951
7. See Thomas Piketty and Emmanuel Saez "Top incomes and the Great Recession: recent evolutions and policy implications", *IMF Economic Review*, 61(3); Jonathan Ostry, Andrew Berg and Charalambos Tsangarides: "Redistribution, Inequal-

ity and Growth”, IMF Discussion Note, February 2014

8. Thierry de Montbrial, “La France ne devrait pas avoir honte de defendre ses interets”, La Figaro, 27 Janvier 2017

9. Javier Solana, “The European Union First”, Project Syndicate, 20 February, 2017

10. Report signed by European Council President, European Parliament President, European Commission President, ECB President and Eurogroup Chief, 2015.

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