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THE WALL STREET JOURNAL.
WSJ.com

OPINION | NOVEMBER 27, 2008, 11:26 A.M. ET

1970s Déjà Vu

Creeping protectionism is on the rise.

By FREDRIK ERIXON and RAZEEN SALLY | From today's Wall Street Journal Asia

World leaders have sounded alarm bells against a repeat of the 1930s, when tit-for-tat protectionism followed hard on the heels of the Wall Street crash. But they are fighting the wrong enemy. Current events suggest a different, but still vexing, scenario: the creeping protectionism of the 1970s, rather than the spiraling protectionism of the 1930s.

In the 1970s, oil-price hikes and other shocks triggered inward-looking, mercantilist policies, including in Europe and the United States. Immediate policy responses were not overly protectionist: There was no equivalent of America's 1930 Smoot-Hawley tariff. But escalating domestic interventions on both sides of the Atlantic exacerbated economic stress and prolonged stagnation. Not least, they spawned protectionist pressures. Industry after industry, coddled by government subsidies at home, sought protection from foreign competition. The result was the "new protectionism" of the 1970s and 1980s.

Then, as now, manufacturers of gas-guzzling cars faced bankruptcy. Congress bailed out Chrysler in 1979. The British government bailed out Rolls Royce and British Leyland, and Renault was saved by French taxpayers. Several other sectors -- timber, energy, minerals, railways, airlines, shipbuilding -- received government subsidies in the 1970s, in both Europe and the U.S. Many companies were nationalized.

On both sides of the Atlantic, "voluntary export restraints" and other nontariff barriers were also deployed to "manage trade." The sectors that received subsidies at home were also protected from foreign competition. Through the 1980s, American car manufacturers were protected by VERs that restricted the number of Japanese cars exported to the U.S. Europe negotiated a similar agreement with Japan in 1983. Many other sectors, such as semiconductors and VCRs, were also protected. The French government even demanded that all Japanese VCR imports enter France via Poitiers, a small town hundreds of miles from the nearest shipping port.

Now, as in the 1970s, there is a big global push to expand domestic regulations which "manage" the market. Most new regulatory proposals are not directly protectionist, but they do have subtle and indirect consequences for global economic integration. New financial-market regulations are brewing in OECD countries as well as in emerging markets. They concern everything from a global college of financial regulators and stricter capitalization requirements to limits

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on executive pay and directions to lend to small enterprises. Unless current regulatory ambitions are scaled down, they run the risk of stifling market signals and emasculating the entire global economy.

Regulatory agendas are also becoming cluttered with government subsidies. These measures comprise bailouts for ailing corporate behemoths (such as the U.S. car industry), and funds to protect "national champions" in "strategic" sectors from foreign takeover (as President Nicolas Sarkozy has proposed for France and the EU). Such measures inevitably distort global commerce and trigger retaliatory responses: If one country subsidizes, others follow; if one sector gets subsidized, others will demand like treatment. That will in turn lead to a clamor for other forms of protection against foreign competition, such as antidumping and safeguard duties, export subsidies, and discriminatory product standards.

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Where will this creeping protectionism lead next? Financial services remain first in the line of fire. Tighter prudential regulations may be called for in some cases, but they should be distinguished from the rules that underpin market access for financial services firms, whether domestic or foreign. This distinction is now being ignored. Politicians and regulators -- including those in China and India -- will likely use the financial crisis as cover to block further market opening to foreign financial-services providers. Indian commerce minister Kamal Nath said after the EU-India summit in September that the financial crisis has vindicated his government's policy of avoiding a comprehensive liberalization of the country's banking system.

Creeping protectionism will not be restricted to finance: It can also be directed at specific countries and other economic sectors. Much Western protectionism in the 1970s and 80s was directed at blocking imports from Japan and other East Asian Tigers. Now, on a much grander scale, there is a protectionist backlash against the global integration of China and India. In the U.S. and EU, allegations against China of "unfair trade" linked to "currency manipulation," bilateral trade deficits, hidden subsidies, and low labor and environmental standards are resurfacing.

Investment nationalism, often combined with energy nationalism, is also on the rise. The United Nations Conference on Trade and Development has recorded an increase in the number of new laws unfavorable to foreign direct investment. Since 2005, a quarter of all new FDI laws are considered to be unfavorable to FDI, compared with an average of 7.5% from 1992 to 2004. These restrictions are bunched in energy-related sectors, but they are spreading to other sectors. Congress, for instance, blocked a bid by China National Offshore Oil Company for Unocal, and it scuppered Dubai Port's attempt to take over the management of six U.S. ports. Meanwhile, the Chinese government has recently tightened foreign-investment restrictions to protect national champions in a range of industrial, energy and service sectors.

Last but not least, the climate-change agenda appears set to become the Trojan

horse of "standards protectionism" in the 21st century. Technical standards have long been a popular form of protectionism because they aren't as obvious as tariffs or quotas, and can be disguised politically as matters of "safety" or "quality." The EU has an emissions-trading scheme in operation. Congress will probably pass a similar cap-and-trade scheme next year. Because such schemes will impose substantial compliance costs on energy-intensive sectors at home, the EU and the U.S. will seek to impose similar costs on cheaper, carbon-intensive production elsewhere that is not subject to carbon-reduction policies. Hence the threat of trade sanctions on "free riders" -- China in particular.

Because we've been down this road before in the 1970s, we can see where it is leading. Giving way to protectionism will deepen and prolong the global recession. Containing protectionism, and extending open markets, will facilitate flexibility and adaptation. It will speed up recovery and lay the foundations for future prosperity.

Messrs. Erixon and Sally are co-directors of the European Centre for International Political Economy in Brussels.

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