Protectionism and global dialogue

Raghuram Rajan

As governments do more, the danger of protectionism is becoming more real. It is emerging in ways that were unforeseen by those who founded our existing global institutions. Unfortunately, the dialogue between countries is very much the dialogue of the deaf, where countries spout platitudes at one another at infrequent summits, and no enforceable and verifiable commitments are agreed upon. There is an urgent need to reform global institutions, and more dramatically than envisaged by the G-20 thus far.

Protectionism is not just about raising tariffs on imports, it is any action by a government that distorts the global production and allocation of goods, services, and capital to favor domestic producers, thereby reducing overall efficiency. So, for example, government pressure on multinational banks to lend domestically, or to withdraw liquidity from foreign branches, is protectionism, as is a capital injection into a multinational with the explicit requirement that domestic jobs be preserved.

Such actions are problematic. First, inefficient forms of production are protected, reducing world incomes. Second, foreign countries respond by adopting similar measures towards their national champions, so that everyone is worse off – the inefficient workers the domestic government protects through these measures are offset by efficient workers lost as foreign multinationals fire more domestic workers, responding to political pressures in their home country. Perhaps of greatest concern, however, it will cause the public, especially in poor countries that cannot undertake offsetting measures, to distrust global integration in the future – multinationals will be viewed as Trojan horses.

In addition to explicit protectionist measures, governments now plan actions that will affect others across the globe. For instance, the large volume of public debt that will be issued by industrial countries will undoubtedly raise rates and affect issuances by some developing country governments. There is little dialogue on how industrial country issuances can be staggered to minimize the impact on global market, and what alternatives can be developed for those countries that are shut out. And if developing countries are left to their own devices, they will conclude they should self insure by rebuilding foreign exchange reserves to even higher levels, a strategy that has clearly hurt global growth.

We need a moderate sized representative group of the leaders of the largest economies of the world to meet regularly to discuss such economic issues, informed by an impartial secretariat that will place its analysis before the group. Initially, the group should only exert peer pressure on its members to comply with international responsibilities. But as confidence in the decision making of the group, as well as in the impartiality of the secretariat, improves, members might be willing to allow it some teeth, such as the ability to impose collective economic sanctions on recalcitrant members.

The UN is too large, the obvious candidate for the group, the G-20, is not representative. There is, however, a representative alternative – the International Monetary and Financial Committee (IMFC), a group of finance ministers and central bank governors that meets twice a year to advise the IMF. While the IMFC could be shrunk (for example, if Euro area countries agree to a common seat), the real challenge is to make it a venue where countries talk to one another rather than at one another.

Some changes could make it so. First, the frequency of meetings needs to be increased, especially in times of crisis, and the level of a few of these meetings enhanced. So, for example, two meetings a year at the
head-of-government level and quarterly meetings at the finance minister level (with more at the deputy minister level) would allow ample time for dialogue, and thus trust to build, and would allow the commitments made by the heads of government to be monitored.

Second, the IMF’s permanent executive Board, set up in an era when travel was costly and communications difficult, and consisting of mid-level government functionaries, should be abolished. Important decisions should be vetted by the IMFC and others delegated to IMF management. Current executive directors typically do not have the authority to make commitments on behalf of their countries, so their effort is often diverted into minutiae. And in an attempt to preserve the turf it has, the Board constantly attempts to keep the IMFC from discussing anything of substance.

Third, the obvious secretariat is the IMF. Unfortunately, it is not regarded as impartial, especially by countries seared by its past conditionality. The IMF has become far more neutral than it is given credit for, but it could take more steps to distance itself from its past. These include abolishing any region/country’s right to appoint IMF management; allowing the Fund to borrow from markets so it does not have to keep going back to key countries for permission to expand; eliminating any country’s official veto power over major decisions; and having the Fund’s agenda set by the IMFC rather than outside bodies.

Industrial countries should be happy that developing countries have to take responsibility for global economic outcomes, rather than simply sulking about their lack of voice and representation. Developing countries, in turn, will gain voice but be forced to contribute ideas (and resources) to deal with global problems. And may be, just may be, we will preserve faith in globalization.

*The author is a professor at Chicago Booth and a former chief economist of the IMF.*