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OP-ED CONTRIBUTOR

The New Face of Protectionism

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At summit meetings in Washington and London, the G-20 leaders highlighted two threats to economic recovery: trade-contracting protectionist measures, and uncoordinated reforms that could impede global investment. They pledged to reject protectionism, resist measures that constrain capital flows, and strive for consistency and cooperation in regulatory reform.

Unfortunately, these aspirations have foundered on a new political reality: The developed world, formerly the champion of global economic integration, has become its principal skeptic. The result is regulatory reform measures that, if unchecked, will foster a disintegration of the global economy and re-raise the very barriers to cross-border trade and investment that the world has spent the past 60 years dismantling.

Trade protectionism is all too familiar, with the World Bank reporting that 17 of the G-20 countries adopting measures that either limited imports or favored local products. These actions disrupt global supply chains and mark a retreat from international trade negotiations that have progressively lowered tariffs and other import restrictions, and have ensured that imported goods will not be discriminated against by taxes or subsidies that favor local products.

Less well known is the similar process underway in financial regulation. Here, too, reform efforts roll back the benefits of globalized financial markets that were made possible by (1) rules that allow financial institutions to operate across borders without the need for a brick-and-mortar presence in every country where they have customers, and (2) international cooperation to reduce regulatory conflicts and discrimination. For example:

The European Union recently proposed regulations that require all investment fund managers who wish access to European investors to establish a physical presence in the E.U., regardless of whether those customers can be adequately served from a fund's existing offices.

Several countries have implemented rules designed to increase domestic lending at the expense of cross-border lending. This is the "lend local" analogue to "buy local."

The European Commission has enacted regulations that in effect limit or prohibit foreign participation in certain financial activities. The Commission's new rules on credit default swaps (CDS) require that all CDS transactions be cleared through E.U.-domiciled entities. Similarly, credit ratings issued by non-E.U. domiciled credit rating agencies cannot be used in the European Union unless those ratings are "endorsed" by an E.U.-registered and domiciled credit rating agency.

More stringent rules to reduce systemic risk can be achieved without sacrificing the benefits of access to lower-cost capital. And de-leveraging need not mean de-globalizing. But that is what is happening.

The World Bank recently reported that private investment flows to developing countries decreased by more than 40 percent in 2008, and estimates they will fall almost three-quarters this year to \$363 billion from a peak of \$1.2 trillion in 2007. The drop-off not only threatens to undermine investment in developing economies but will slow recovery efforts worldwide.

While some decline in global capital flows is to be expected, regulations that discourage cross-border lending and investment and impede the functioning of the global capital markets surely accelerate this trend. This month, the G-20 leaders will have an opportunity at their summit in Pittsburgh to return to their anti-protectionist mandate and halt such measures.

First, the G-20 should emphatically renew its commitment to open markets and commit to phasing out protectionist measures.

Second, the G-20 should charge an international organization with responsibility for “naming and shaming.” In this case, the Financial Stability Board should be mandated to report publicly on financial reform measures that are protectionist or that disrupt the beneficial operation of global financial markets.

Third, the F.S.B. should be tasked with ensuring coordination of regulatory reform efforts and encouraging the development of practices, such as mutual recognition, that reduce the risk of fragmented or contradictory approaches.

Efforts to address the economic crisis demand a high degree of coordination. Measures that close markets and discourage cross-border investment will only impede recovery. And beggar-thy-neighbor policies are no less a risk in financial regulatory reform than in stimulus programs. If every country regulates financial institutions or products without regard to impacts on global markets, a downward spiral is sure to result.

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