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Tough times ahead as US moves towards protectionism

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The recently announced stimulus package by the new found messiah of the world, Barack Obama makes people wonder whether too much hope is being pinned on a person. Seemingly, his political compulsions have forced him to take a stance that appears protectionist in many ways.

The crisis that has been engendered in the US, fuelled by lackadaisical US regulators and threatens to endanger the global economy is sought to be addressed by the US in a manner which is much too localized for everybody's comfort.

Last November, as the global crisis deepened, the G-20 leaders gathered in Washington. They vowed to work together and avoid the temptation of protectionism. These pledges started to crumble almost as soon as these reached their homes. A number of countries have raised tariffs and the revival of Doha trade talks is hardly in anybody's radar.

Initially it was the smaller economies that started raising the spectre of protectionism. Then the bigger economies joined the fray. When, for example, there was a chorus of calls for a Pan-European response to the crisis, most of those proposals have been vetoed by a group of countries led by Germany, the European Union's biggest economy. Hence we have not yet seen a Pan-European response to the crisis.

It's pretty much each for oneself. In a globalised economy, globally coordinated effort could have possibly helped. More so when there's a domino effect as we are currently experiencing what with the virus spreading from one region to the other. And, now this US policy.

The question uppermost in the mind is whether it is the beginning of the end of international coordination. While this does not look likely, the signals are still ominous. The newly announced stimulus package by the US contains explicitly protectionist language in its call to use only US made steel in infrastructure projects.

This likely violates US commitments under global trade agreements and will certainly be taken as a bad sign by the rest of the world. The world can deal with a protectionist India or Indonesia. The trading system, however, will have much more trouble if the United States starts to renege on its traditional leadership role. More so when it has been proved beyond any doubt that the world has not decoupled from the US economy.

The President's proposed legislation termed as 'Patriot Employer Act' is another such instance. As per the legislation, a tax credit equal to one percent of taxable income would be provided to those employers who fulfill the following conditions:

- Employers must not decrease their ratio of full-time workers in the United States to full-time workers outside the United States and they must maintain corporate headquarters in the United States if the company has ever been headquartered there
- They must pay a minimum hourly wage sufficient to keep a family of three out of poverty: at least $7.80 per hour

- They must provide a defined benefit retirement plan or a defined contribution retirement plan that fully matches at least five per cent of each worker's contribution
- They must pay at least sixty percent of each worker's health care premiums
- They must pay the difference between a worker's regular salary and military salary and continue the health insurance for all National Guard and Reserve employees who are called for active duty
- They must maintain neutrality in employee organising campaigns

Leave aside every other requirements, the first requirement itself would be a big blow to outsourcing. In a world as highly competitive as it currently is, any concerted effort to reverse the trend of outsourcing will not only impact the US corporations (for many of who, outsourcing is a way of being competitive in the global market) themselves but also impact a whole host of companies outside the boundaries on the US.

Of course only time will tell whether the impact would be as dramatic as it might seem in the first place, since the employers would have the option of continuing outsourcing and forgoing tax benefit. However, the intent itself can lead to undesired and protectionist reaction by other countries.

And the problem does not stop here. In a written submission to the Senate Finance Committee recently, Mr. Geithner, the Treasury Secretary Designate, said that the Obama Administration "believes that China is manipulating its currency."

A statement made by Mr. Geithner who will soon be the Treasury Secretary, invoking Obama and alleging manipulation of currency by China can bring to boil relationship between the largest and the third largest economy in the world, a situation the world can ill afford.

It is important to realize here that the two major reasons for global imbalance is US reluctance to save while consuming more and Chinese reluctance to consume while saving more. While for China it is important to move more and more toward domestic consumption led growth, for them it is more important to ensure that their growth rate remains in the high single digit (if not double digit) to take care of the huge social imbalance they are facing.

For the US, it is important to understand their consumers will be more and more inclined towards increased savings given their recent experience.

In essence, the US needs to live with the fact that demand will slow down (as consumers start saving more) and despite all counter cyclical policies, recovery will be muted. Policies that can address the systemic imbalance should be encouraged. But forcefully trying to follow policies with debilitating implication, just to score a few brownie points, is not the way to move forward.

Let's consider the position of Mr. Geithner. In effect, what his rhetoric implies is that China should allow the Reminibi to appreciate and, by corollary, the Dollar to depreciate. Can the US economy really afford that? Remember, US Treasury will need to issue dollar debts of close to $3 trillion in the next few years. Will it have takers if the Dollar depreciates? Also, a stronger Reminibi would accelerate Chinese deflation and lead to slower growth for China, which the world can ill afford at this point in time.

Which is why, there is a need for concerted effort with a proper understanding of the global dynamics and not standalone policies that can trigger protectionist instinct among countries. However, it is easier said than done since political compulsions quite often forces policy makers to have blinkered views. So, dear readers, brace yourselves for a tough journey ahead.

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