Swiss Institute for International Economics
and Applied Economic Research

University of St.Gallen

After the Crisis:
Is There a Comeback of Economic Interventionism?

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Abstract

This presentation reviews the economic interventions by governments and central banks in response to the 2007-2009 financial and economic crisis.

In the area of trade policy, we find that protectionism has increased substantially, with governments targeting in particular the products of declining industries and financial services. Nevertheless, spiralling protectionism as in the 1930s has so far been avoided.

In investment policy, the crisis has not led to a general increase of protectionist pressures for the time being, although the long-term general trend towards liberalisation has recently been complemented by a parallel trend towards re-regulation.

The main areas of economic interventionism, however, have been fiscal policy (mainly through stimulus programs and emergency actions to stabilise the financial system) and monetary policy (mainly through interest rate cuts, quantitative easing and various other actions).

Given their cumulative size, these interventions hold a substantial potential for distortions and undesirable side-effects on both the microeconomic and the macroeconomic levels. These include protectionism, political mismanagement and state failure, the degradation of government finances, massive tax increases, and the threat of future inflation.

These concerns can be addressed, but this requires constant monitoring of the policy areas affected and decisive actions towards achieving a timely exit.

Journal of Economic Literature (JEL) Classification Codes: *E52 (Monetary policy), E58 (Central banks and their policies), E62 (Fiscal policy), E63 (Comparative or joint analysis of fiscal and monetary policy; stabilization), F13 (Trade policy; international trade organizations); F21 (International investment; long-term capital movements).*

Keywords: *financial and economic crisis, government, interventions, trade policy, protectionism, WTO, investment policy, fiscal policy, stimulus measures, emergency measures, bailouts, deficits, debt, monetary policy, central banks, interest rates, quantitative easing, exchange rates, inflation, exit strategies.*

**** Important Notice: All the views expressed in this paper are exclusively those of the author and shall not be attributed to any institution to which the author is affiliated.***

Version information: These slides have been updated to reflect developments until 20 January 2010.

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1 Introduction

1.1 Research objectives

- Assess whether the economic crisis has brought a **return of economic interventionism**.
- If so, analyse:
  - the major **instruments** used in this context;
  - any underlying **trends and concepts**
  - the **extent** of economic interventionism
  - the **risks and costs** of economic interventionism
  - options to **roll back** economic interventionism

➡ ***This topic is a "moving target".***

1 Introduction

1.2 What is "economic interventionism"?

- **Definition:** There is no clear, widely used definition of the term.
- **Underlying concepts:** i.) the preference for supporting a country's own firms, industries, workers, capital owners as well as for keeping jobs, capital, economic activity, and tax revenue within the country; and ii.) the desire by political leaders to exercise political control over the economic cycle.
- **Implementation**: government intervention in the economy at two levels: i.) restrictions of the freedom of transaction of individuals by treating international economic transactions less favourably than national transactions (protectionism); and ii.) fiscal and monetary policy interventions with a view of controlling the business cycle.

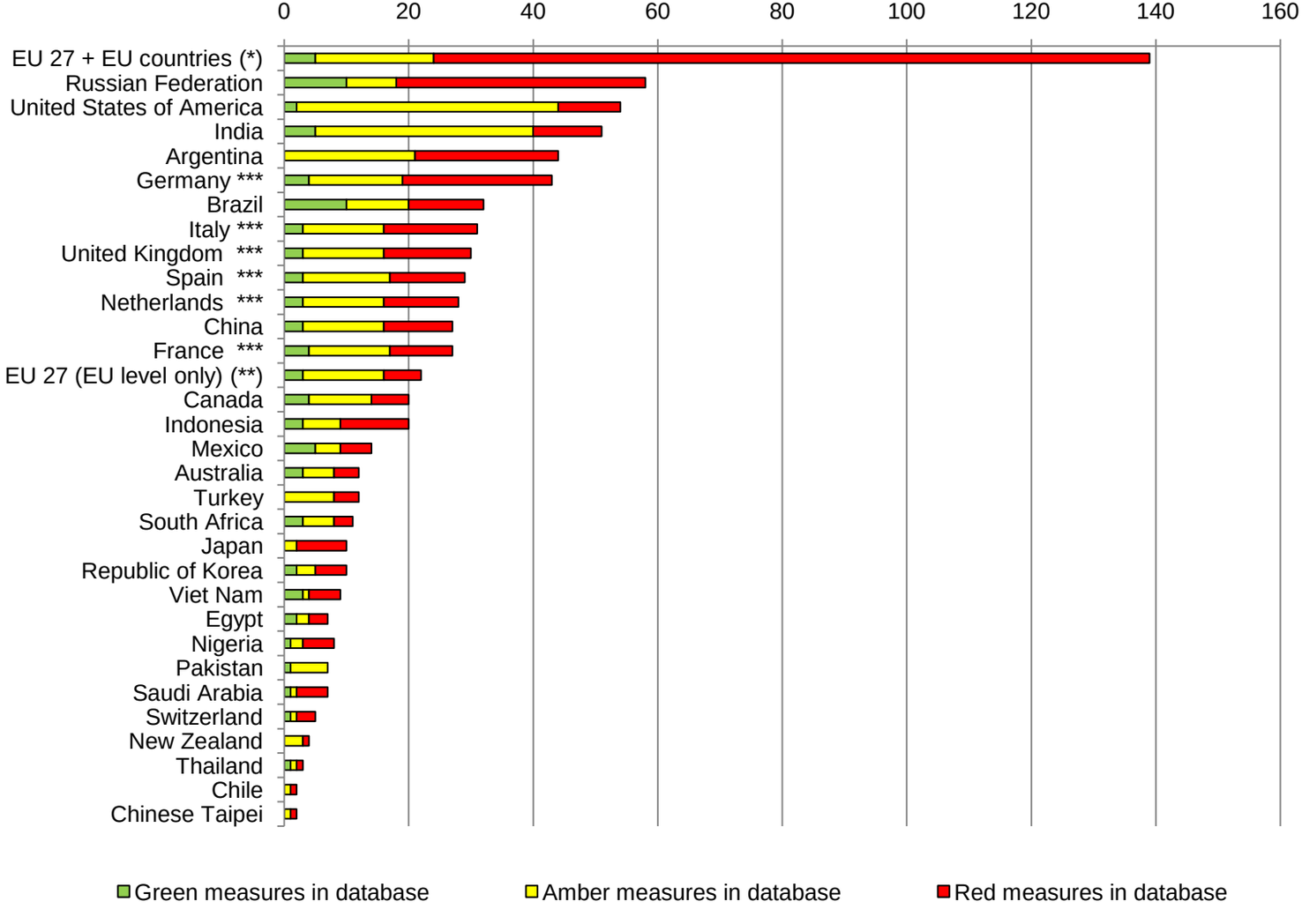
1 Introduction

1.3 Sources

- Studies and data from international organisations:
  - WTO (Reports by the Trade Policy Review Body)
  - OECD (Country Reports and different studies)
  - UNCTAD (WIR; Joint Study WTO/UNCTAD/OECD)
  - IMF (GFSR, WEO, WEO database, other research)
- Official documents / national data
- Global Trade Alert (GTA): Reports and database
- Specialised Press
  - World Trade Online
  - Inside Trade
  - BRIDGES Weekly Trade Digest
- General press (The Economist, Newspapers, etc.)

2 Trade Policy

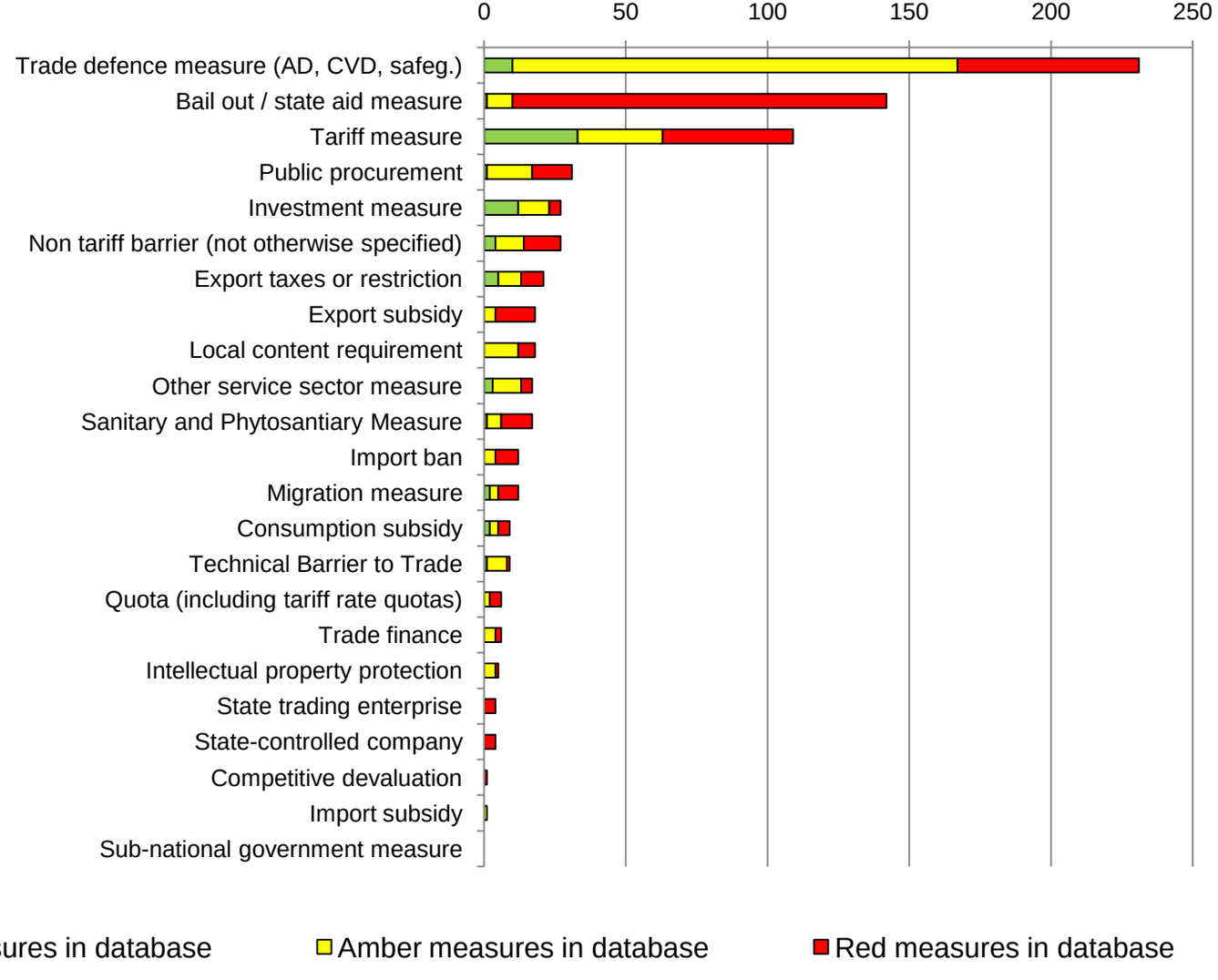
2.1 Jurisdictions Implementing Trade Measures



Graph by Thomas A. Zimmermann; Statistical data drawn from the "Global Trade Alert" database per 20 January 2010; http://www.globaltradealert.org. Remarks: *) The bar "EU 27 + EU countries" counts both the measure taken by the EU on the Union level and the national measures of all EU members; **) The bar "EU 27 (EU level only)" counts only the measures taken by the EU on the Union level; ***) The bars for the individual EU member countries count both the measures taken by the EU on the Union level and the national measures taken by the corresponding EU member at the national level.

2 Trade Policy

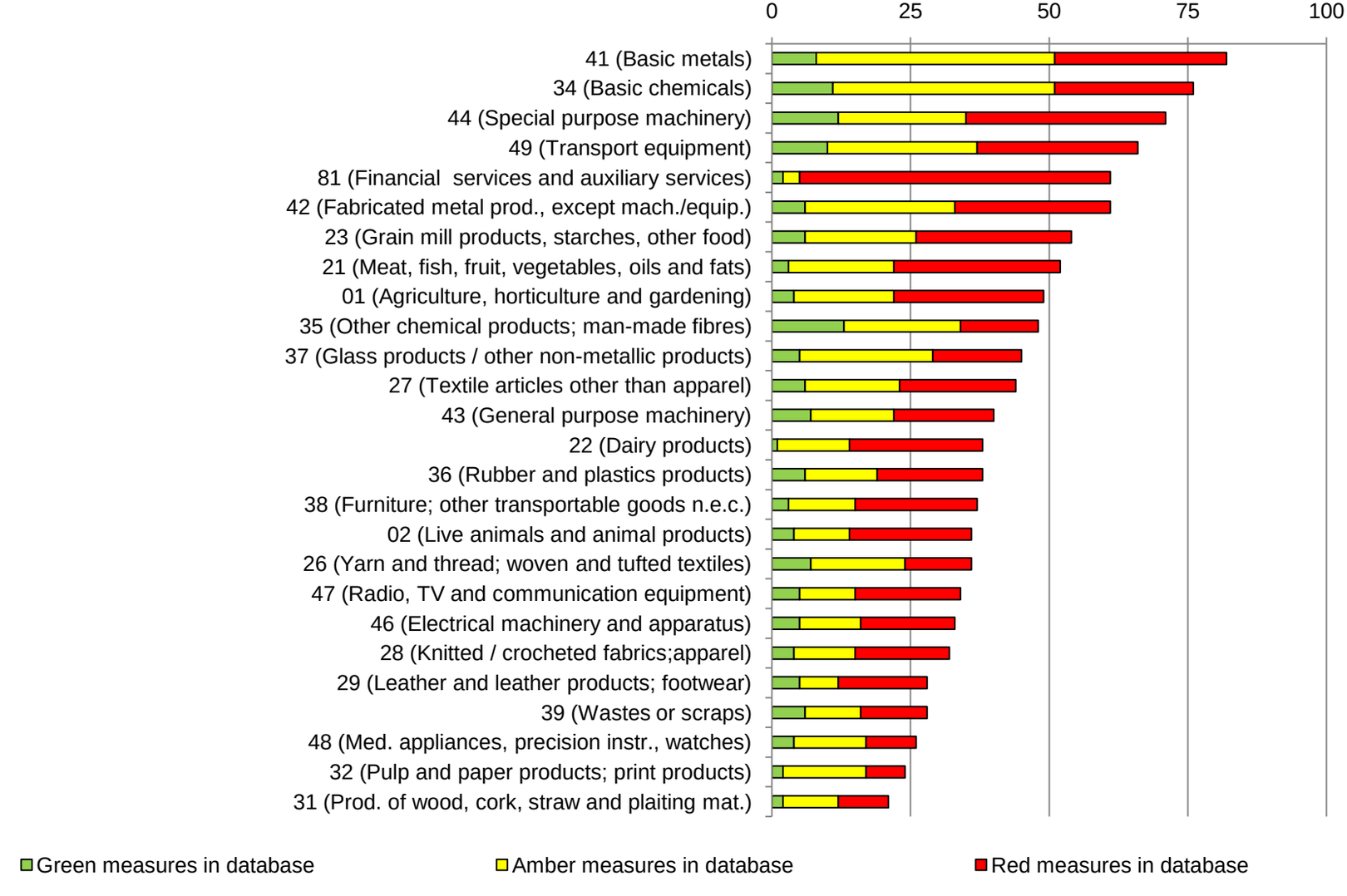
2.2 Measures Used Most Frequently



Graph by Thomas A. Zimmermann; Statistical data drawn from the “Global Trade Alert” database per 20 January 2010; http://www.globaltradealert.org.

2 Trade Policy

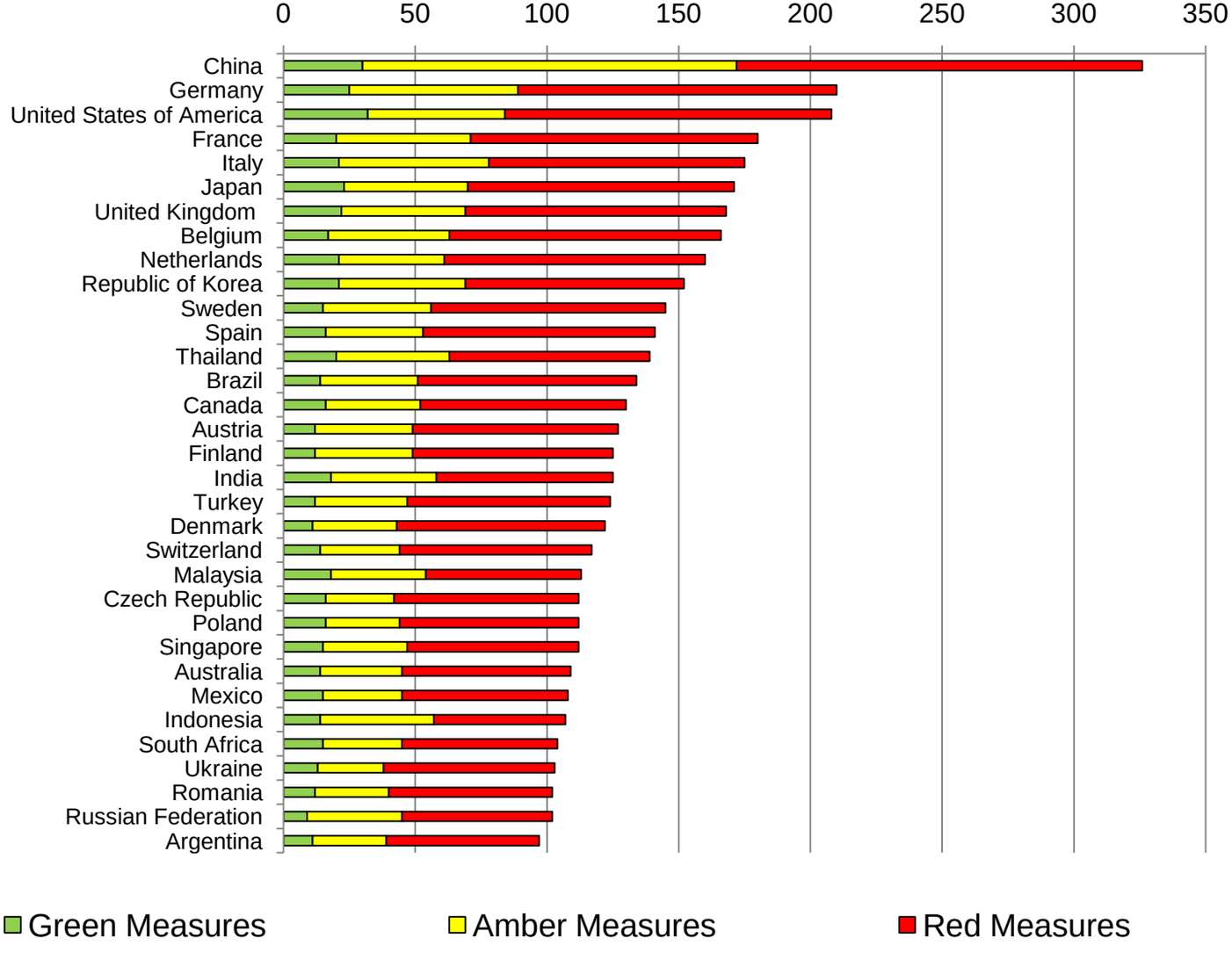
2.3 Sectors Most Affected



Graph by Thomas A. Zimmermann; Statistical data drawn from the “Global Trade Alert” database per 20 January 2010; http://www.globaltradealert.org.

2 Trade Policy

2.4 Most Affected Trade Partners



Graph by Thomas A. Zimmermann; Statistical data drawn from the "Global Trade Alert" database per 20 January 2010; http://www.globaltradealert.org.

2 Trade Policy

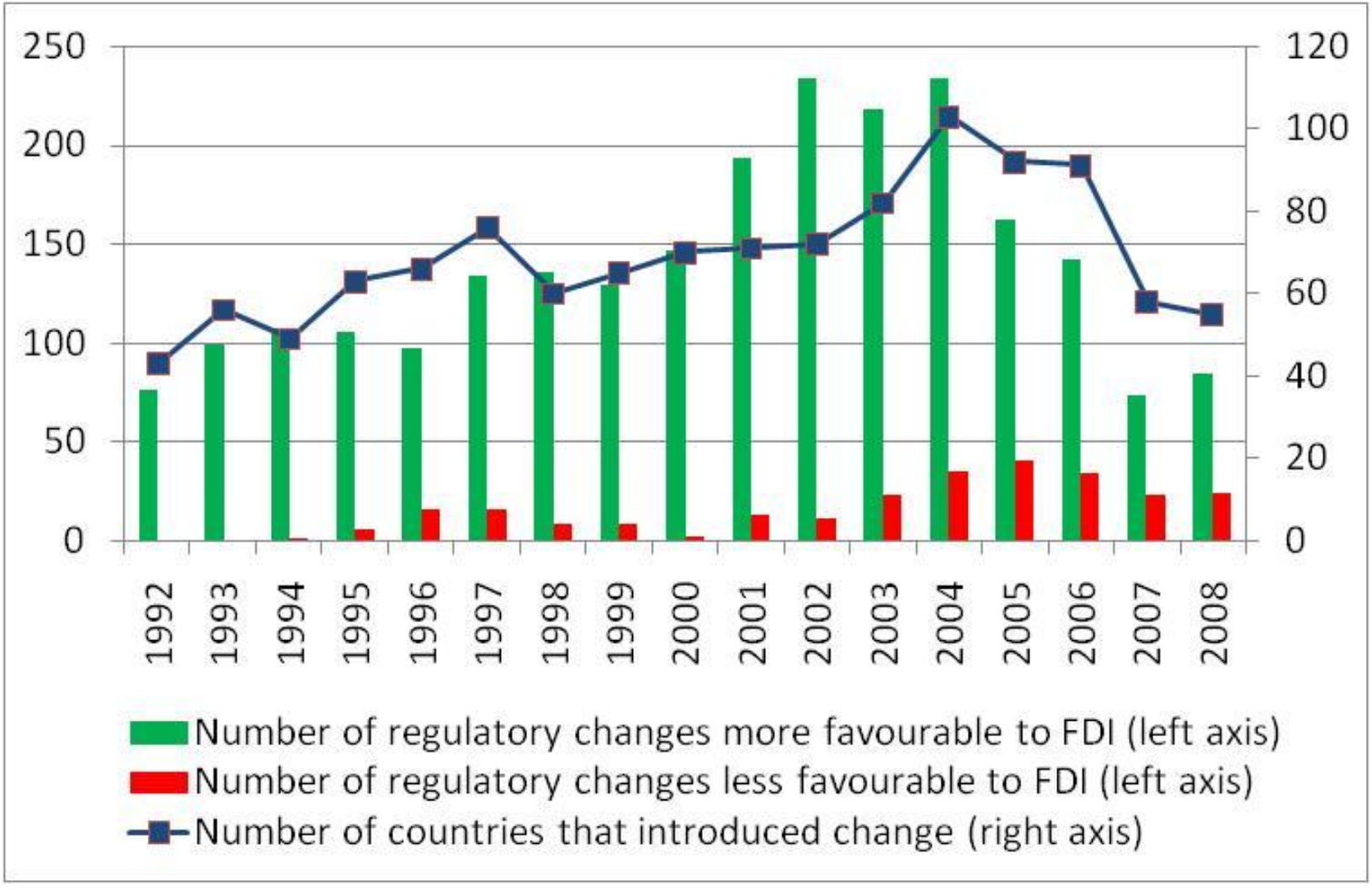
2.5 Trade Policy: Summary

- There is no uncontrolled “1930s style” protectionist spiral so far
- **But:** strong increase of protectionist measures; the G-20 “no protectionism” promise is broken frequently.
- Relationship between trade-restrictive and liberalising measures fell to 6:1 during the financial and economic crisis
- The overall trend towards liberalisation that dominated since the 1980s appears to have been reversed.
- Industries with overcapacities and mature mass products as well as agriculture and financial services are frequent targets of protectionist measures.
- In light of upcoming capacity adjustment and persistent unemployment, protectionist pressures could rise further.

➡ Protectionism has returned and could rise further.

3 Investment Policy

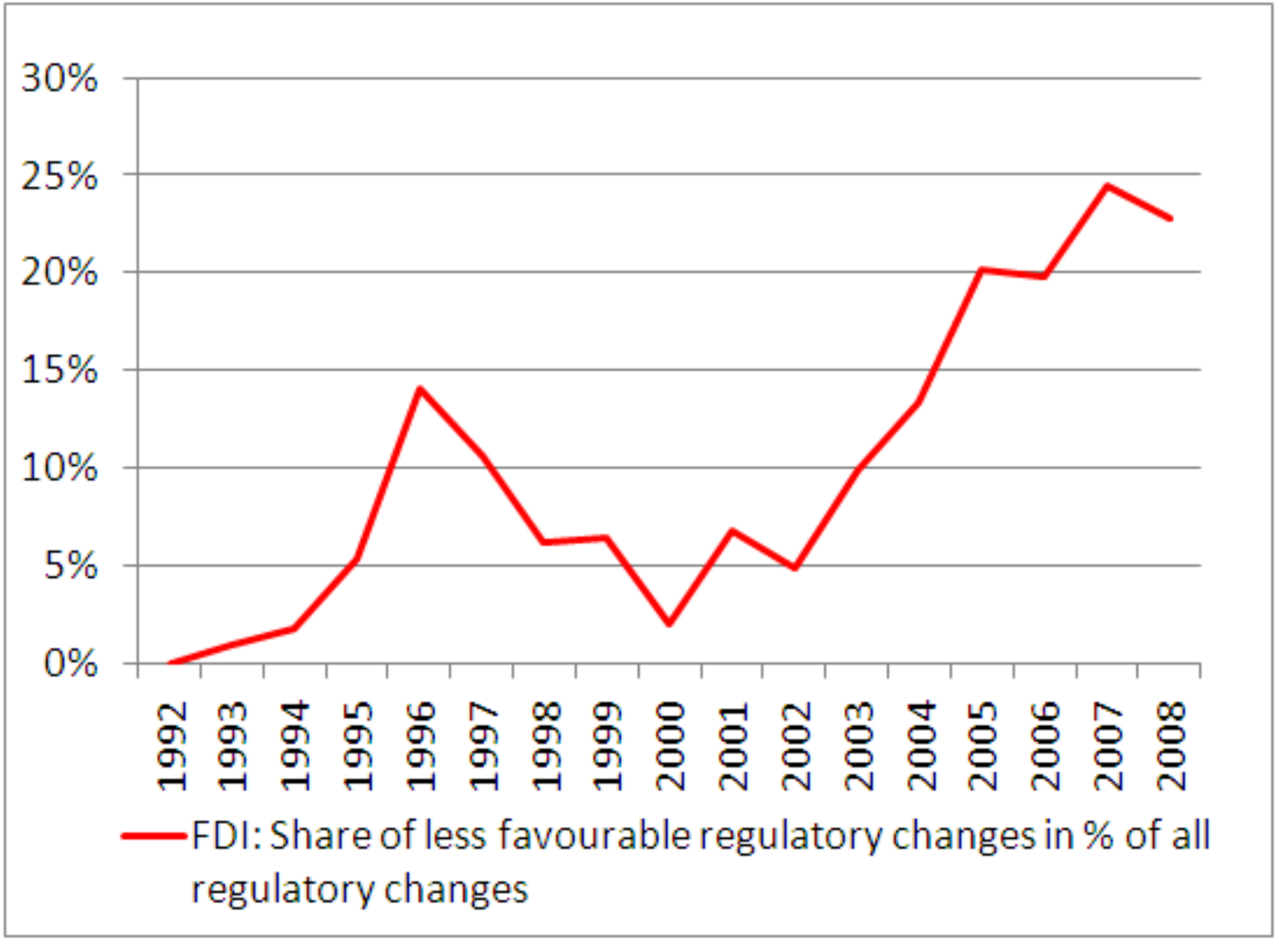
3.1 Recent Trends in Investment Policies: National Regulatory Changes, 1992-2008 (I)



Graph: Thomas A. Zimmermann.
Data source: UNCTAD: World Investment Report 2009, p. 31; http//www.unctad.org

3 Investment Policy

3.1 Recent Trends in Investment Policies: National Regulatory Changes, 1992-2008 (II)



Graph: Thomas A. Zimmermann.
Data source: UNCTAD: World Investment Report 2009, p. 31; http//www.unctad.org

3 Investment Policy

3.2 Examples of Protectionist Measures in 2008/09 (I)

- **Denunciation of Bilateral Investment Treaties** (BITs) (e.g. by Latin American countries)
- **Increased scrutiny of FDI** for national security reasons and restrictions against Sovereign Wealth Funds (SWFs), e.g. by the U.S., Germany, Canada, France; India
- **Nationalisations** (e.g. several nationalizations in Latin America, particularly in the extractive industries; telecommunications industry and oil and gas industry in Bolivia; cement industry in Venezuela; nationalization of the pension system in Argentina;
- **Adverse tax developments** (e.g. rising tax rates in the mining industry in Zambia; increased taxes on windfall profits on oil in Ecuador of up to 99%;)

Data source: UNCTAD: World Investment Report 2009

3 Investment Policy

3.2 Examples of Protectionist Measures in 2008/09 (II)

- **Discrimination in bailout / stimulus packages**
- **New restrictions** for foreign investors (e.g. Indonesia's ban on foreign investors to invest in the construction and ownership of wireless communications towers; Russia's expansion of the definition of "strategic industries" to 42 industries)
- **Other measures** (e.g. Anti-monopoly law in China which led to the rejection of an M&A bid by Coca Cola; reservation of intermediation in the supply of liquid fuels between the state-owned Venezuelan oil company PDVSA to the state; stopped facilitation in the exploration and exploitation of the Amazon and other resource-rich areas by foreign investors in Peru; Ecuador's withdrawal from the Convention of the International Centre for Settlement of Investment Disputes (ICSID);

Data source: UNCTAD: World Investment Report 2009

3 Investment Policy

3.3 Examples of Liberalisation in 2008/09 (II)

- **Conclusion of new agreements facilitating international investment** (e.g. Bilateral Investment Treaties (BITs), Double Taxation Treaties (DTTs), and other international agreements (e.g. Free-Trade Agreements with investment provisions))**.**
- **Various other measures aiming at liberalisation** (Examples: a softer stand towards Sovereign Wealth Funds (SWFs) in OECD countries; raised or abolished FDI ceilings or foreign equity limits (e.g. India, Malaysia); eased or streamlined licensing and review processes (e.g. China, Australia); eased requirements for the purchase of real estate by foreigners or easier access to land (e.g. Australia, Korea, Mexico); tax reductions and simplifications (e.g. Kuwait, Switzerland, Japan); relaxation of visa requirements (Saudi Arabia) etc.).
- **Lock-in decision** by G-20 OECD Members on 16 July 2009.

Data source: UNCTAD: World Investment Report 2009

3 Investment Policy

3.4 Summary: Measures in Investment

- The general trend towards investment liberalisation has not been reversed. So far, **liberalisation still appears to dominate.**
- However, there are **important exceptions**:
  - **Regionally**, with regard to Latin America
  - **Methodically,** with regard to investment restrictions for alleged “security purposes”.
  - **Sectorally**, with regard to natural resources

4 Fiscal Policy

4.1 Stimulus Measures (I): Overview of Measures Taken in G-20 countries

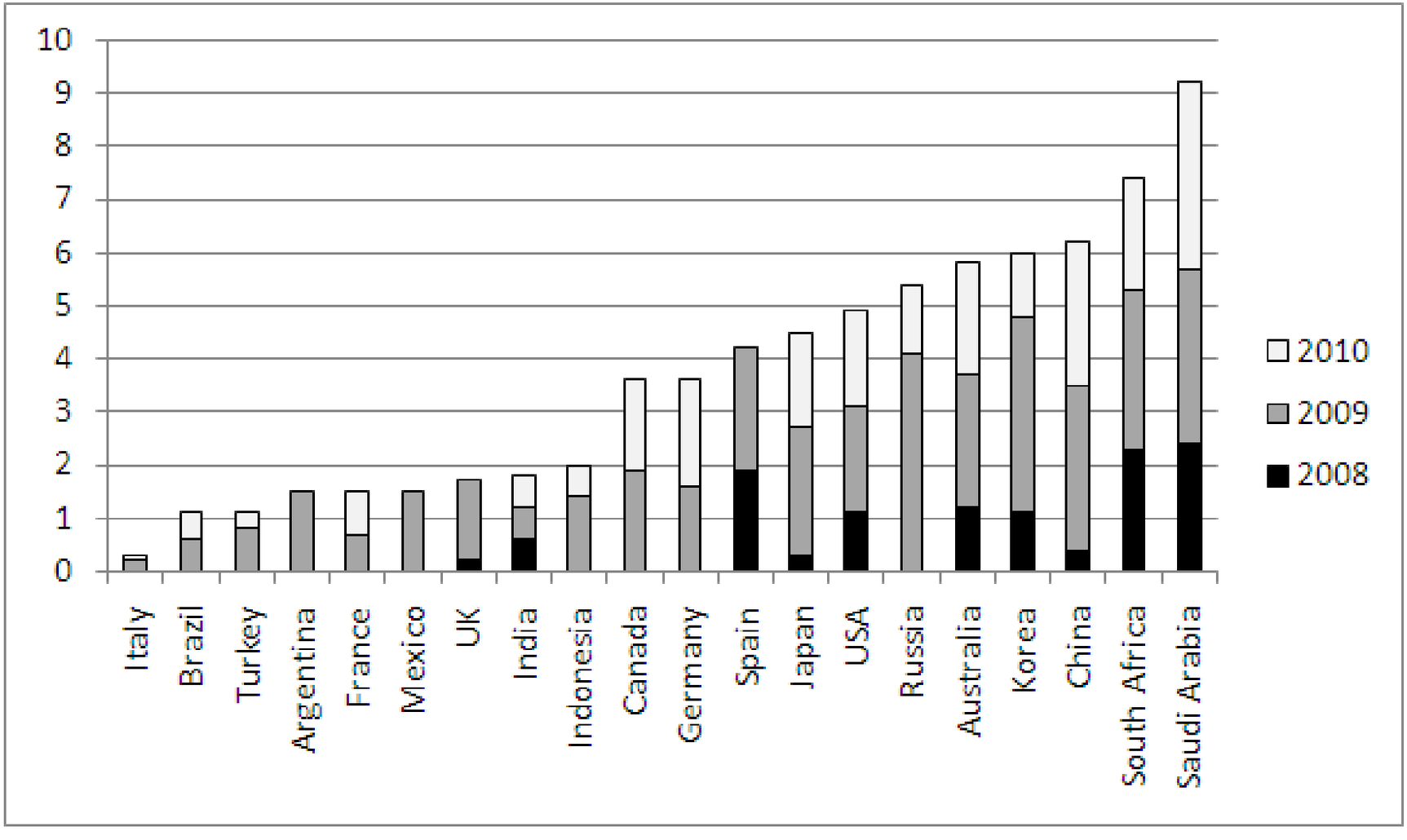
Measure	Argentina	Australia	Brazil	Canada	China	France	Germany	India	Indonesia	Italy	Japan	Korea	Mexico	Russia	Saudi Arabia	South Africa	Spain	Turkey	UK	US
Expenditure																				
Infrastructure investment	T	T		T	T	T	T	T	T	T	T	T	T		T	T	T		S	T
Support to SMEs and/or farmers				T			T				T	T		T				T		
Safety nets	T	T	T	T	T	T	P	T	T	T	T	T	T	T		T	T	T	T	T
Housing/construction support		T	T	T	T	T	P	T		T	T	T		T		T	T		T	
Strategic industries support				T	T		T			T				T			T	T		
Increase in public wage bill																				
Other		T	T	T	T	T	T	T	T	T	T	T	T	T			T	T	T	T
Revenue																				
CIT/depreciation/incentives 2/		T	P	P			P		P	P	P	P		P				P		P
PIT/exemptions/deductions 3/	P		T	P		T	P		P	T	P	P		P			P	P	P	P
Indirect tax reductions/exemptions 4/	P		T		P	P	P	T	P	T		T					S	T	S	
Other		T								P	P	T						P	P	

Sources: Country authorities; and IMF staff estimates.
Note: T = temporary measures (with explicit sunset provisions or time-bound spending); S = self-reversing measures (measures whose costs are recouped by compensatory measures in future years); and P = permanent measures (with recurrent fiscal costs).
1/ Measures announced through early May 2009.
2/ Some of the corporate income tax (CIT) reductions in Germany, Italy, and Korea are temporary.

INTERNATIONAL MONETARY FUND (IMF) ed. (2009b): *Fiscal Implications of the Global Economic and Financial Crisis*; Washington, D.C: IMF; IMF Staff Position Note, Doc. SPN/09/13, 9 June 2009; p. 17;
http://www.imf.org/external/pubs/ft/spn/2009/spn0913.pdf

4 Fiscal Policy

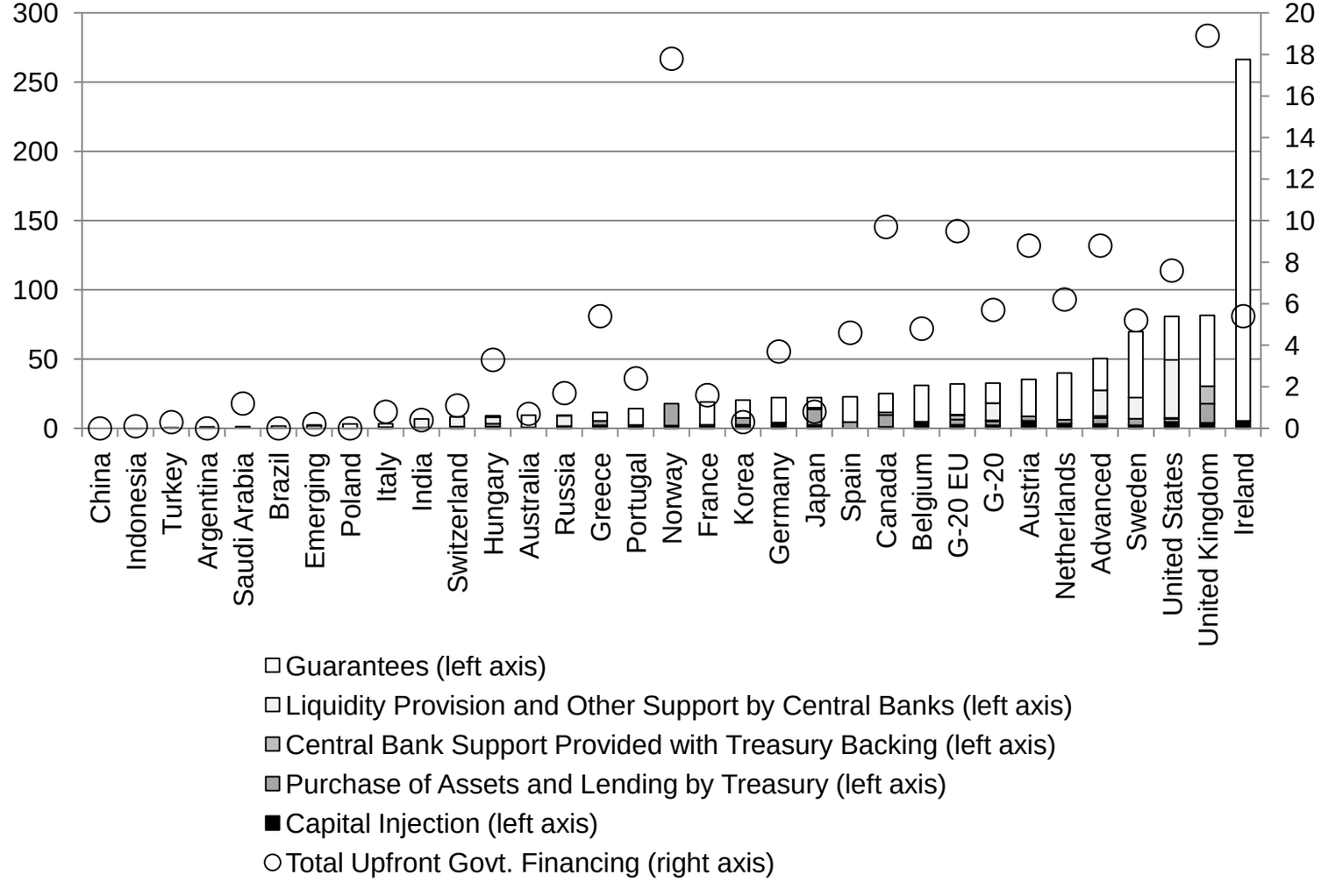
4.1 Stimulus Measures (II): Size of stimulus measures (G-20) in % of 2007 GDP



Graph: Thomas A. Zimmermann; data source: INTERNATIONAL MONETARY FUND (IMF) ed. (2009b): *Fiscal Implications of the Global Economic and Financial Crisis*; Washington, D.C: IMF; IMF Staff Position Note, Doc. SPN/09/13, 9 June 2009; Table 3.4, p. 15; http://www.imf.org/external/pubs/ft/spn/2009/spn0913.pdf

4 Fiscal Policy

4.2 Headline Support for the Financial Sector (in % of GDP; as per 19 May 2009)



Graph: Thomas A. Zimmermann; data source: INTERNATIONAL MONETARY FUND (IMF) ed. (2009b): *Fiscal Implications of the Global Economic and Financial Crisis*; Washington, D.C: IMF; IMF Staff Position Note, Doc. SPN/09/13, 9 June 2009; Table 2.1, pp. 7ff; http://www.imf.org/external/pubs/ft/spn/2009/spn0913.pdf

4 Fiscal Policy

4.3 Sources of Discrimination – Examples (I) Stimulus and non-financial sector support

- **"Buy American"** rules in U.S. stimulus programmes
- June 2009: China calls upon its provinces and cities to **buy Chinese**-made goods.
- **France** has allegedly linked aid for its car industry to the maintenance of jobs in France.
- **Germany** has allegedly favoured the sale of Opel to Magna because the deal was favourable to keeping jobs at German Opel plants.

4 Fiscal Policy

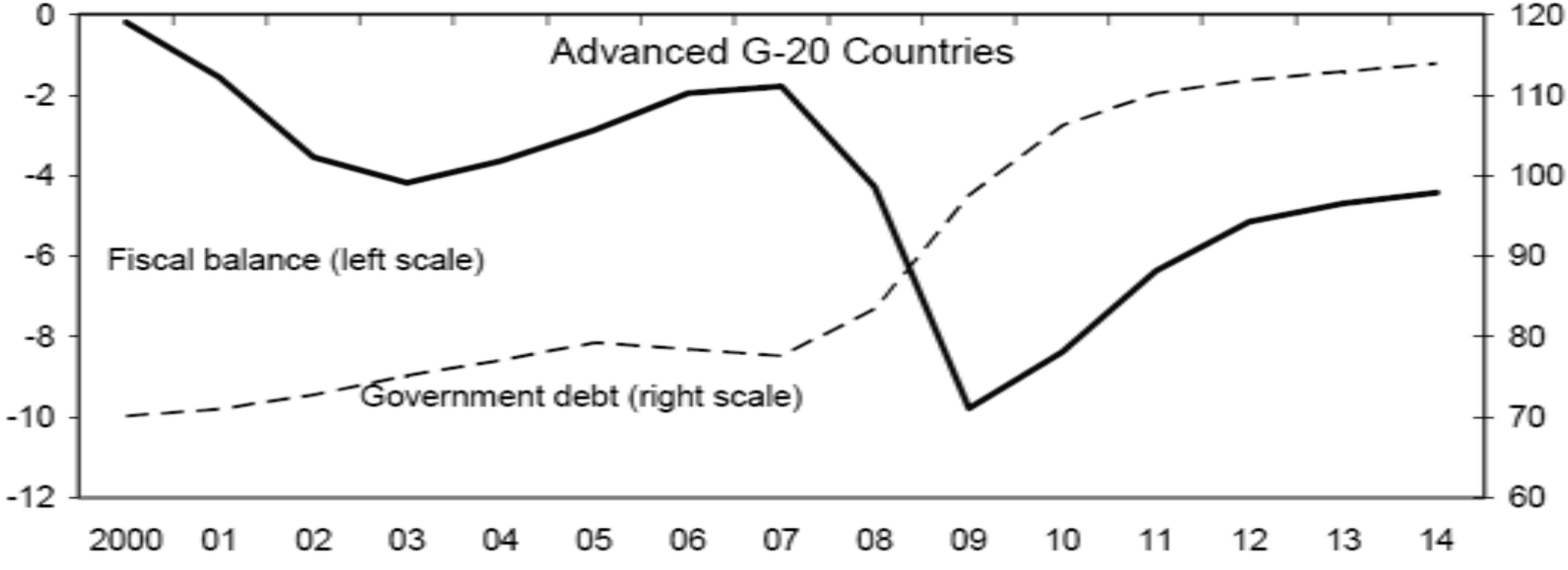
4.3 Sources of Discrimination – Examples (II) Financial sector support

- The **UK Government** has required banks receiving public assistance to agree to domestic lending growth targets.
- **French banks** that tap government assistance have pledged to increase domestic lending by 3-4 per cent annually.
- ING, a **Dutch bank**, which has received government assistance, has promised to extend €25 billion in loans to Dutch businesses and consumers.
- **Austria** requires assisted banks to strive to make available 200 per cent of (government) participation capital to provide credit to Austrian businesses. Similar requirements are in place in Greece.
- The **US government** has asked TARP-assisted banks to report regularly on the growth of domestic lending.

WTO ed. (2009): Report to the TPRB from the Director General on the financial and economic crisis and trade-related developments; Geneva: WTO (Document WT/TPR/OV/W/2), 14 July 2009, p. 27 and footnote 20.

4 Fiscal Policy

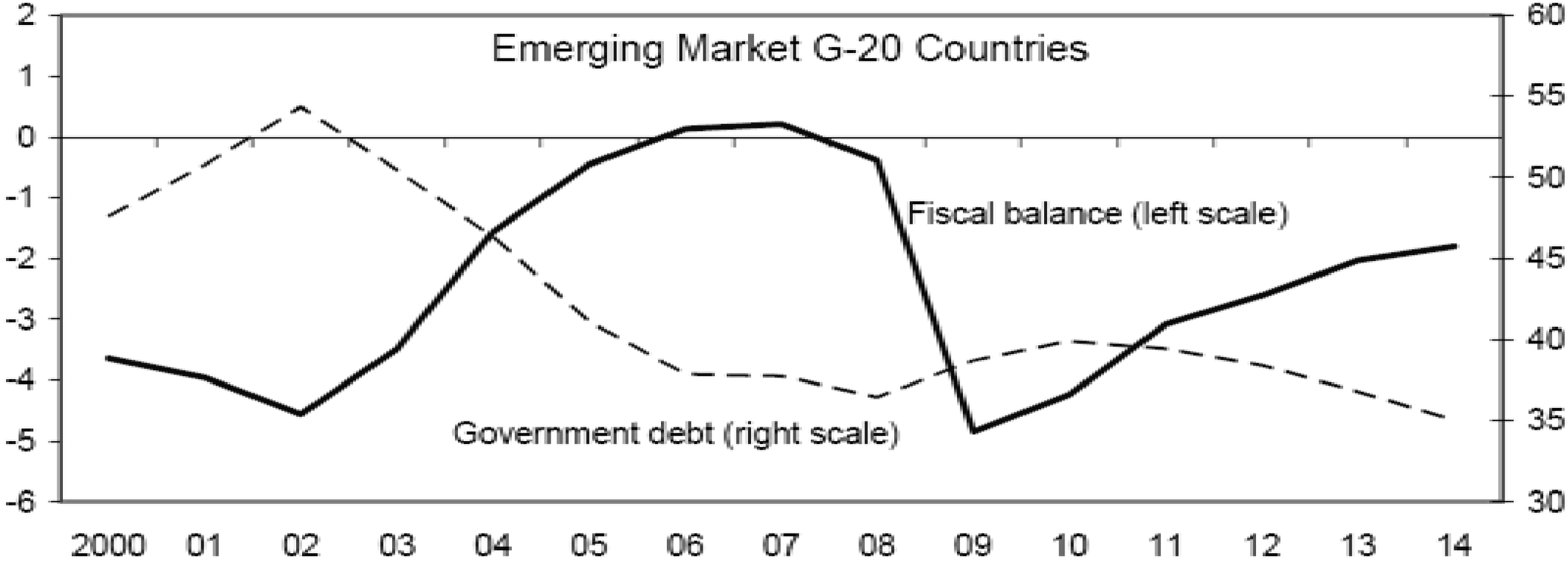
4.4 Consequences on Public Finance (I): Forecast for Public Debt and Deficits 2010-2014, Advanced G-20 countries; in % of GDP



Source: INTERNATIONAL MONETARY FUND (IMF) ed. (2009b): *Fiscal Implications of the Global Economic and Financial Crisis*; Washington, D.C: IMF; IMF Staff Position Note, Doc. SPN/09/13, 9 June 2009; p. 23; http://www.imf.org/external/pubs/ft/spn/2009/spn0913.pdf

4 Fiscal Policy

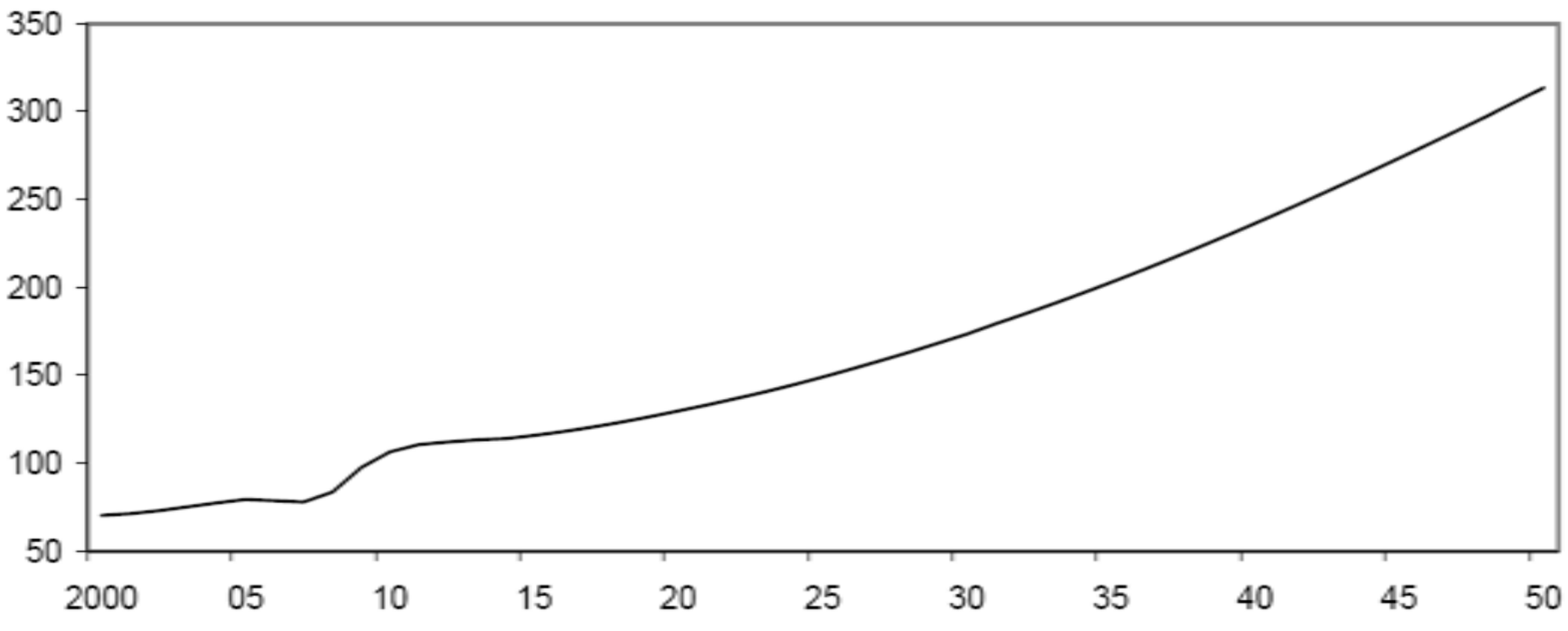
4.4 Consequences on Public Finance (II): Forecast for Public Debt and Deficits 2010-2014, Emerging G-20 countries; in % of GDP



Source: INTERNATIONAL MONETARY FUND (IMF) ed. (2009b): *Fiscal Implications of the Global Economic and Financial Crisis*; Washington, D.C: IMF; IMF Staff Position Note, Doc. SPN/09/13, 9 June 2009; p. 23; http://www.imf.org/external/pubs/ft/spn/2009/spn0913.pdf

4 Fiscal Policy

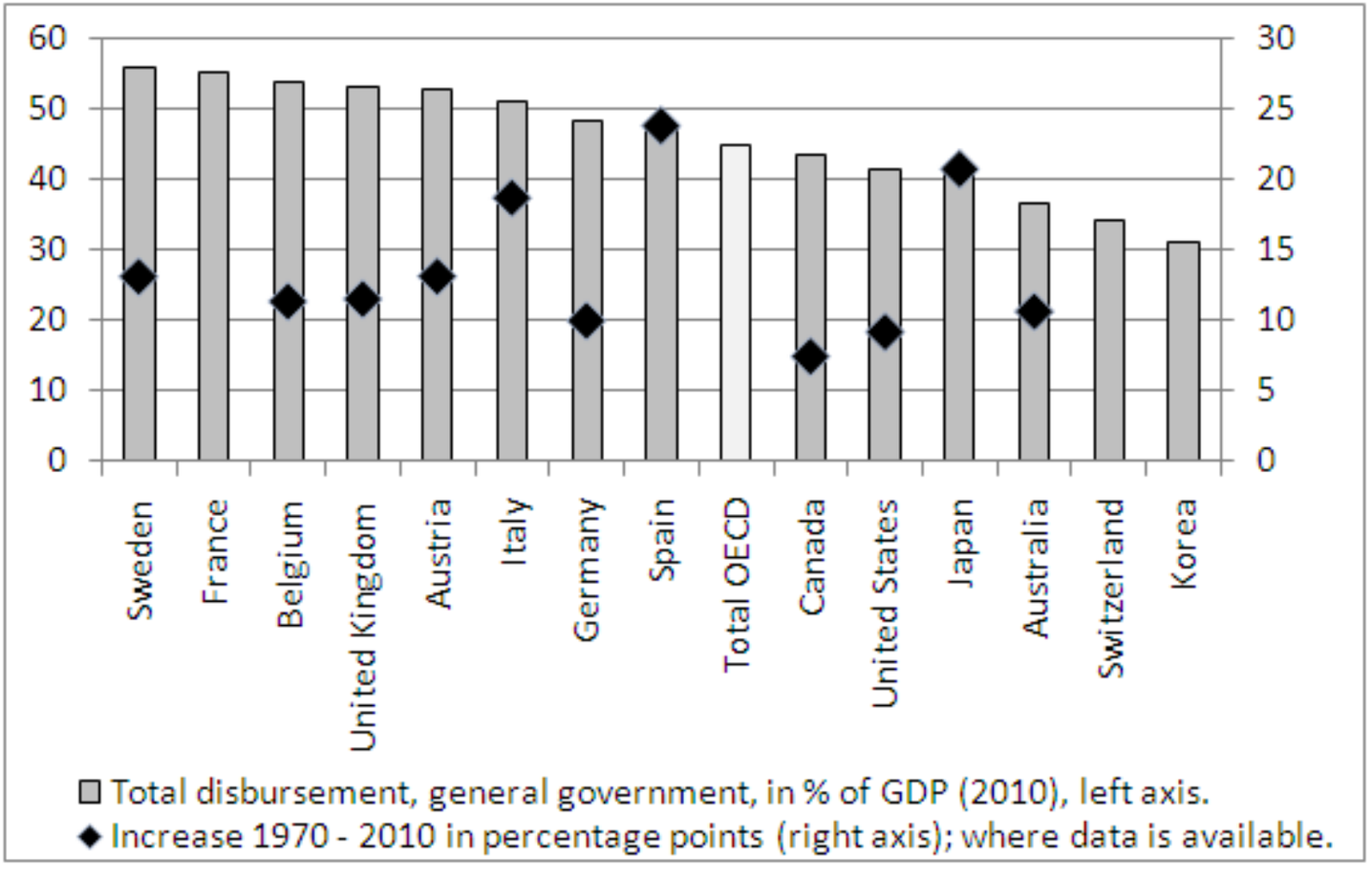
4.4 Consequences on Public Finance (III): Long-Term Forecast for Public Debt until 2050 Advanced G-20 countries, in % of GDP



Source: INTERNATIONAL MONETARY FUND (IMF) ed. (2009b): *Fiscal Implications of the Global Economic and Financial Crisis*; Washington, D.C: IMF; IMF Staff Position Note, Doc. SPN/09/13, 9 June 2009; p. 39; http://www.imf.org/external/pubs/ft/spn/2009/spn0913.pdf

4 Fiscal Policy

4.4 Consequences on Public Finance (IV): Memo item: Total disbursements, general government, in % of GDP: Situation in 2010 and Change from 1970 to 2010



Graph: Thomas A. Zimmermann; Data: SourceOECD / OECD Economic Outlook Database, No. 86, Annual Data; Vol. 2009 / Issue No. 3 as per 4 January 2009; SourceOECD: http://titania.sourceoecd.org/database/oecdeconomicoutlook

4 Fiscal Policy

4.5 Summary: Fiscal Policy

- **Massive interventions to prop up the economy** and to influence the business cycle
- **Strongly increased involvement of the state** in certain sectors of the economy (e.g. British Banks)
- **Massive transfer of risks** from the private into the public domain
- **High costs and large potential risks for public finances**, with the consequence of **rising budget deficits and debt**
- **Large potential for state failure, political mismanagement, moral hazard and discrimination.**

➡ Fiscal policy as a **key area** of economic interventionism.

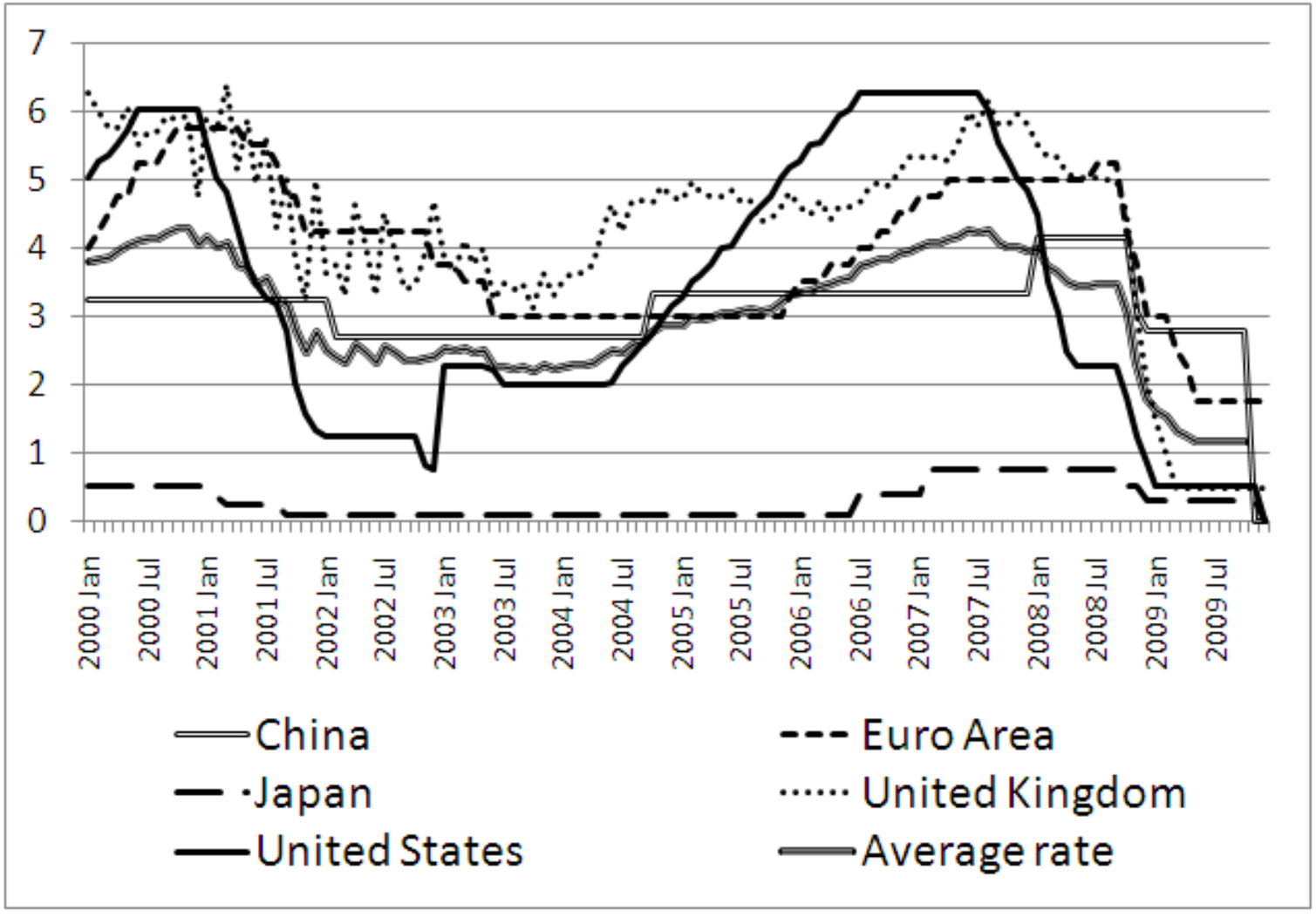
5 Monetary Policies

5.1 Instruments in monetary policy

- **Very low interest rates in most countries**. (e.g.: lowest interest rate in the 300+ year history of the Bank of England)
- **Quantitative easing** (e.g.: purchases of bonds and other assets by central bank)
- **Other measures** (e.g. adjusted reserve requirements, longer funding terms, more frequent auctions, wider collateral rules, establishment of FOREX swap lines between central banks)
- **Currency pegs and/or FOREX interventions** (e.g. China (USD), Switzerland (EUR), others)
- **Related measures to make capital imports less attractive** (e.g. Brazilian tax of 2% on foreign portfolio investments; Taiwanese ban of foreign inflows in time deposits)

5 Monetary Policies

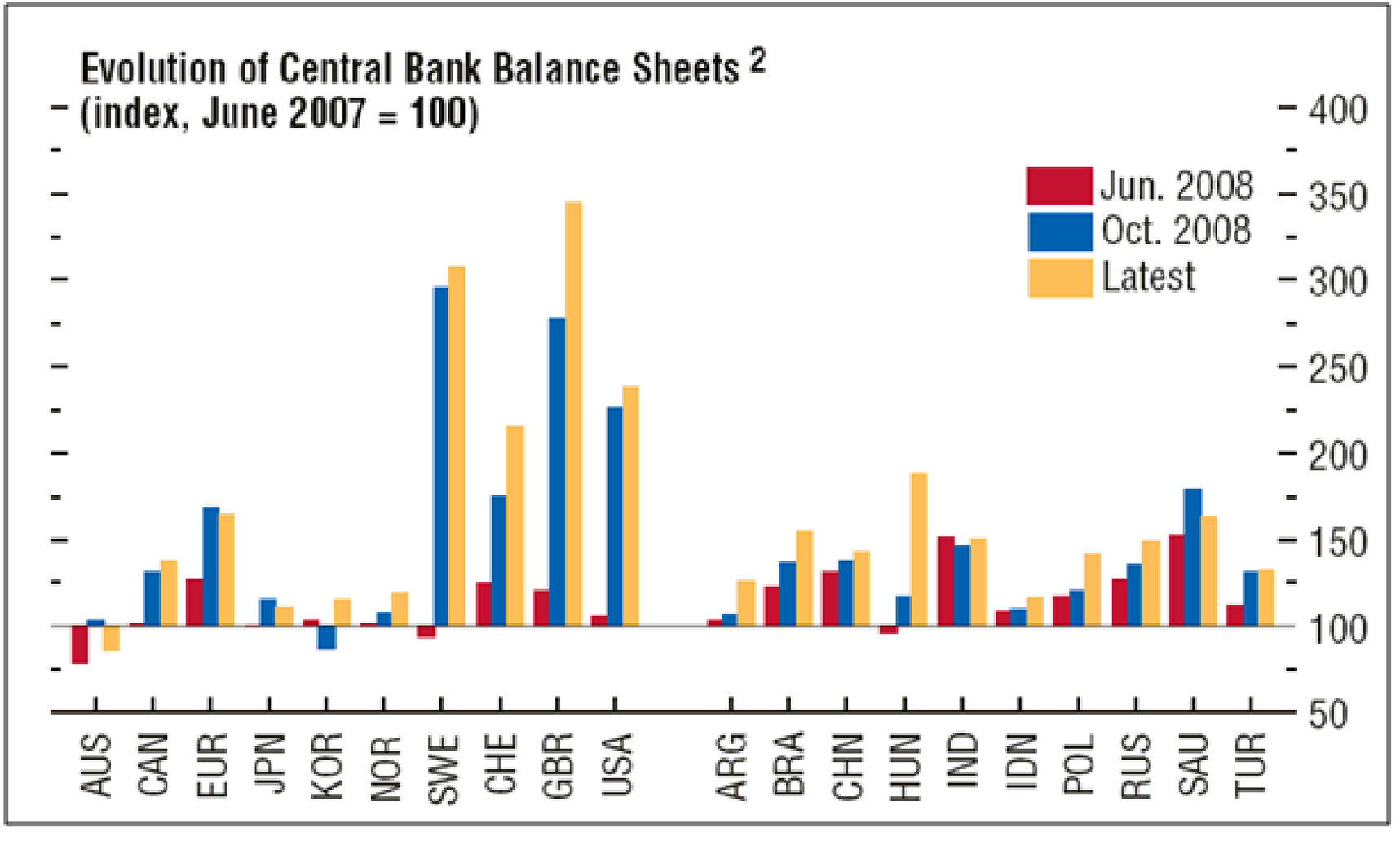
5.2 Interest Rate Cuts



Graph by Thomas A. Zimmermann; Data source: International Monetary Fund (IMF) / International Financial Statistics (IFS); provided through Principal Global Indicators; http://www.principalglobalindiactors.org

5 Monetary Policies

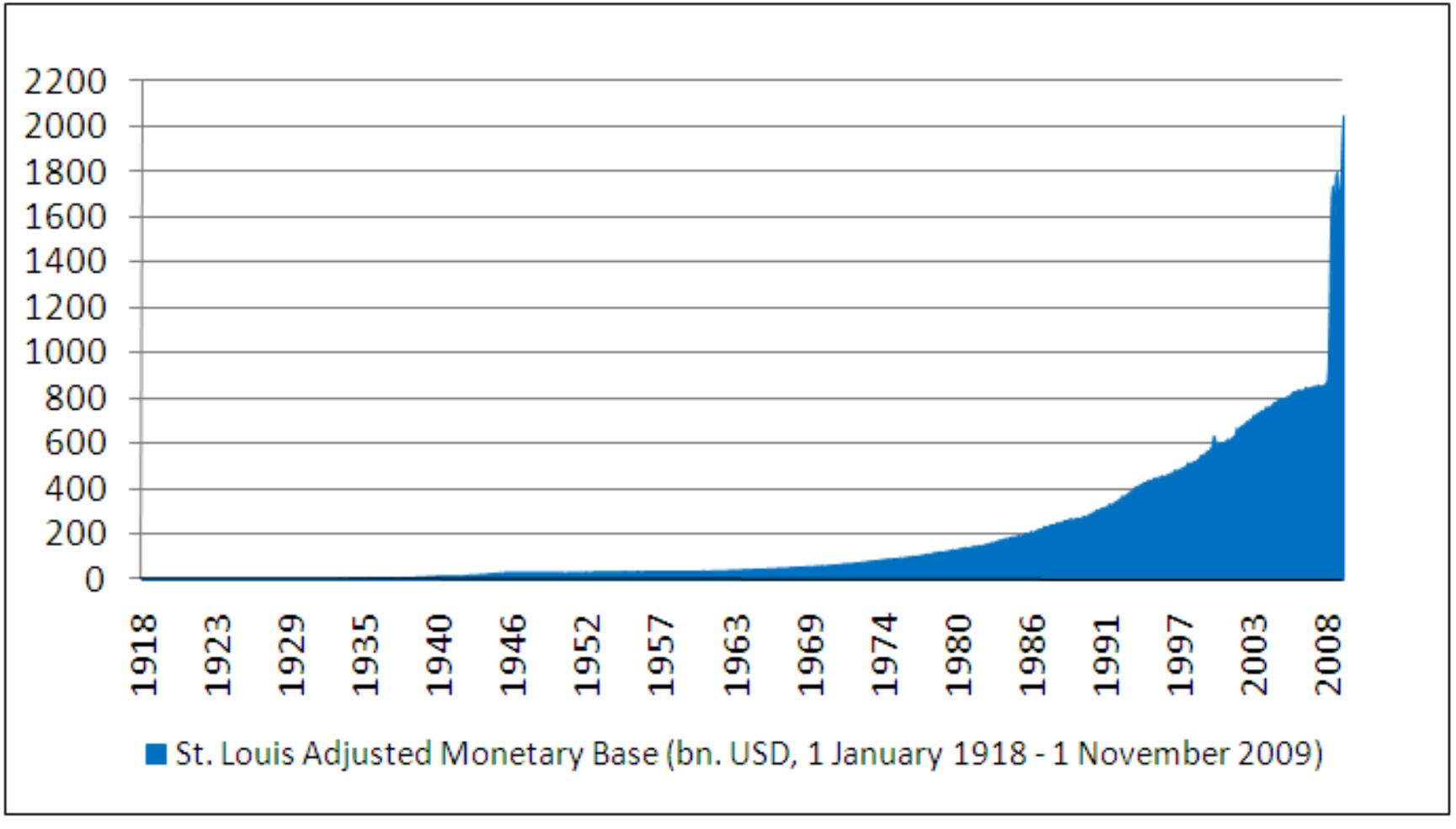
5.3 Quantitative Easing (I): Evolution of Central Bank Balance Sheets



Source: IMF World Economic Outlook, October 2009; p. 28; http://www.imf.org

5 Monetary Policies

5.3 Quantitative Easing (II): Evolution of U.S. Adjusted Monetary Base

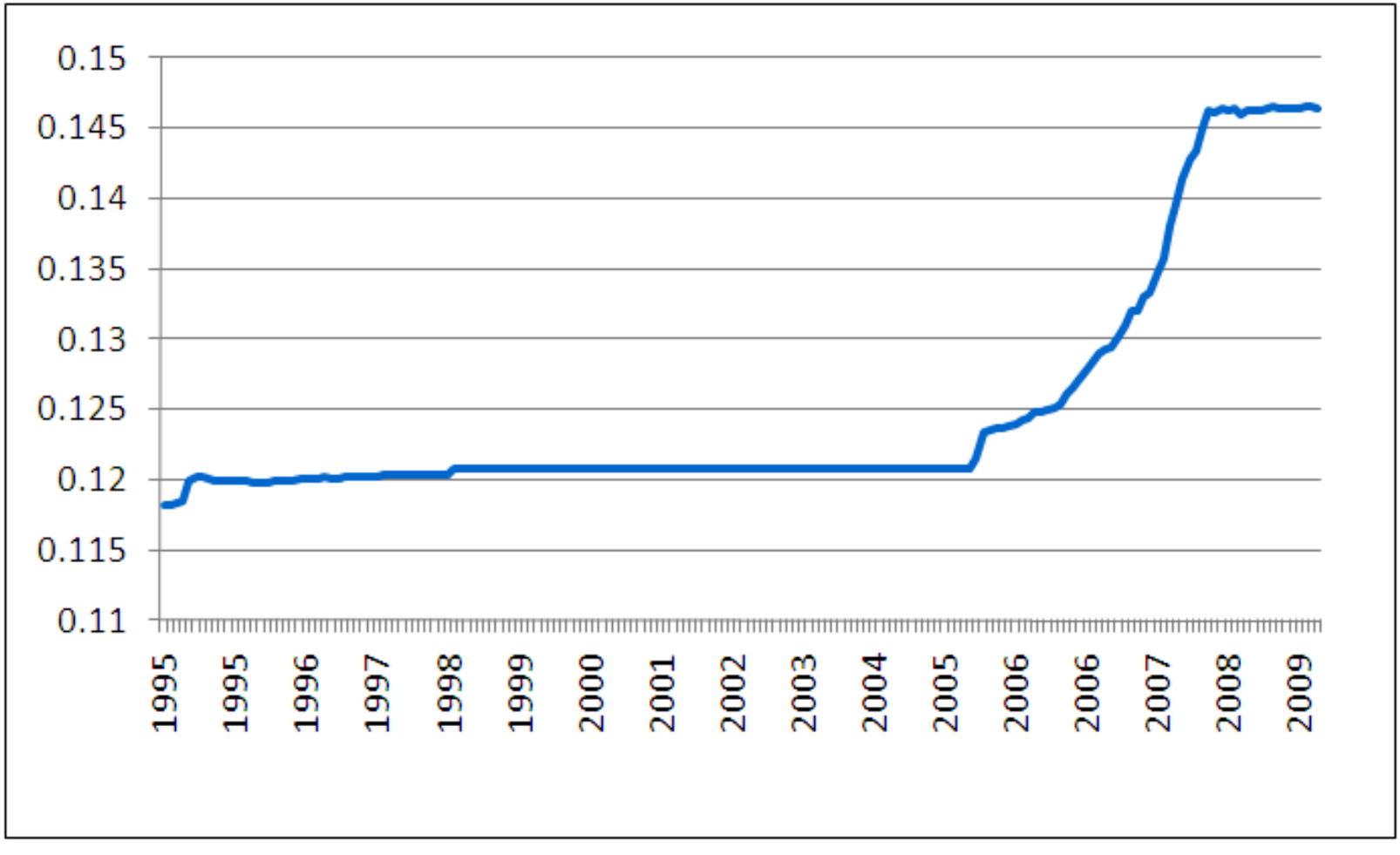


Graph by Thomas A. Zimmermann; Data source: Federal Reserve Bank of St. Louis: Data downloaded on 6 January 2010; Series AMBNS, St. Louis Adjusted Monetary Base; http://research.stlouisfed.org/fred2/series/AMBNS?cid=124

5 Monetary Policies

5.4 Currency interventions (I): The Chinese exchange rate policy

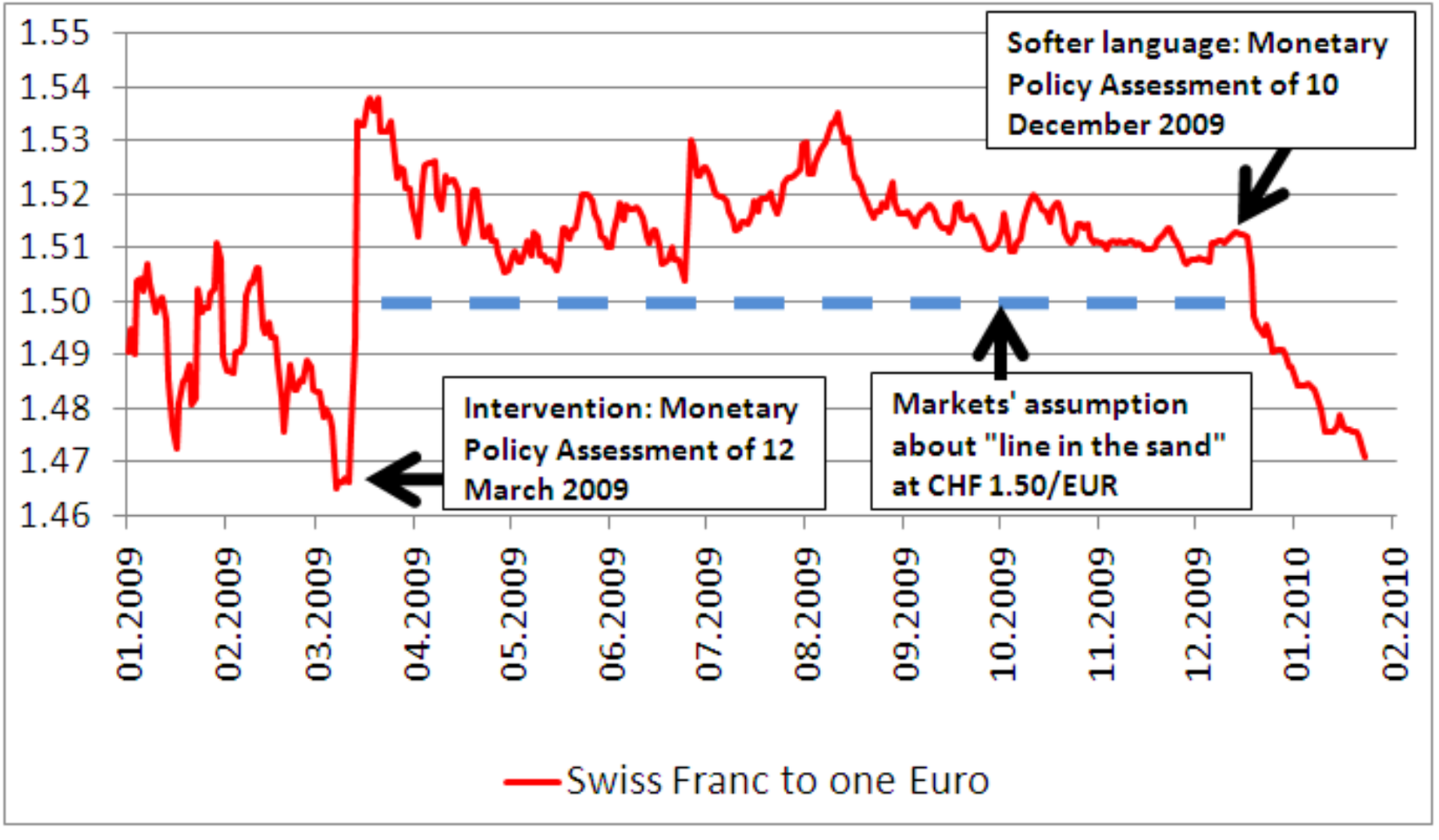
Cost of 1 Yuan-Renminbi in U.S. Dollar (CNY/USD)



Graph by Thomas A. Zimmermann; Data source: Federal Reserve Bank of St. Louis: Data downloaded on 6 January 2010; Series AMBNS, St. Louis Adjusted Monetary Base; http://research.stlouisfed.org/fred2/series/AMBNS?cid=124

5 Monetary Policies

5.4 Currency interventions (II): Cost of 1 Euro in Swiss Francs (CHF/EUR)



Graph by Thomas A. Zimmermann; Data source: OANDA website, historical exchange rates (interbank rates; 1 January 2009 – 22 January 2010), http://www.oanda.com/lang/de/currency/historical-rates; Swiss National Bank.

5 Monetary Policies

5.5 Summary

- The monetary easing has arguably been without precedent, regarding:
  - the speed of easing
  - the extent (e.g. the quantitative easing)
  - the combination of various instruments
  - the international co-ordination and participation
- High coherence between fiscal and monetary policies
- Still open: The longer-term consequences of these policies and the details of the exit.

➡ Monetary policy as a **key area** of economic interventionism.

6 Effects, Risks and Side Effects

6.1 Effects

The interventions contributed to stabilisation in many ways:

- U.S. house prices have stabilised.
- The financial sector has stabilised.
- The stock market stabilised and turned into positive territory.
- Balance sheets have stabilised.
- Spiralling deflation has been avoided so far.
- Sovereign bond yields have remained low so far, allowing states to re-finance themselves at advantageous costs
- The downward dynamic of the recession has been stopped, and some countries are growing again.
- In some countries, the rise in unemployment has remained surprisingly moderate (e.g. Germany).
- The international economic order has remained stable.

Given the severity of the crisis, these achievements in terms of stabilisation are far from obvious!

6 Effects, Risks, and Side Effects

6.2 Risks and Side Effects (I) Micro-economic level

- **Distorting effects** of discrimination and protectionism, affecting consumption, production, trade, investment, and capital markets.
- **Distortion of competitive conditions**, arising from support measures
- „**Moral hazard**“ and adverse incentives, arising from the implicit state guarantee for the financial sector
- Lower growth dynamics due to a **higher future tax burden**.
- The **risk of political mismanagement** (e.g. in the management of state-owned enterprises, in the credit industry, or upon divestment)

6 Effects, Risks, and Side Effects

6.2 Risks and Side Effects (II) Macro-economic level

- **High deficits** and **increasing public debt**
- **Refinancing difficulties of states** and **sovereign default risks.**
- Tensions inside **currency areas** (e.g. the Euro area)
- Increasing **inflation expectations** or **inflation rates** (the high gold price as a possible indicator?)
- **Crowding-Out** of the private sector on capital markets
- **Increasing interest rates** and cost of capital
- Lower bond prices with adverse effects on **bank balance sheets, pension funds and other portfolios**
- **Currency turmoil** with further negative consequences
- Lack of investment opportunities, flight of investors into real assets (e.g. real estate, commodities, gold), **new bubbles**.

6 Effects, Risks, and Side Effects

6.2 Risks and Side Effects (III) Political and Other Risks

- Increased **dependence** of large sectors of the economy and large segments of society on public support, interventions, and/or redistribution schemes.
- **Reduction of public services** to offset the higher costs of servicing debt or to compensate for refinancing difficulties
- **Political instability** if governments cannot live up to their "duties" or have to deceive their peoples' "high expectations."
- Loss of **public support for market-based economic systems and/or democracy**
- Changes in the **international balance of power** with potentially far-reaching consequences.

7 Options for Economic Policy

7.1 Trade Policy

1. Monitoring
2. Use of dispute settlement and conflict resolution systems (e.g. World Trade Organisation, free trade agreements (FTAs))
3. Continuing the Doha Round negotiations
4. Concluding free trade agreements (FTAs)
5. Unilateral Liberalisation (e.g. *Cassis de Dijon*)
6. Reforms at the WTO (e.g. decision rules, access to WTO dispute settlement, etc.)

7.2 Investment policy

7. Monitoring
8. Enforcement of disciplines (e.g. under ICSID)
9. Negotiating Bilateral Investment Treaties (BITs), Double Taxation Treaties (DTTs), and investment rules in FTAs.
10. What about a second attempt to negotiate a Multilateral Agreement on Investment (MAI)?

7 Options for Economic Policy

7.3 Fiscal Policy

11. Communicating the exit from expansive fiscal policies
12. Divestment of government-owned enterprises
13. Use of international agreements to challenge (discriminatory) fiscal activism and/or subsidies
14. Budget consolidations through reduced expenditure and a review of government activity domains
15. Introduction of budget rules (e.g. the Swiss debt brake)
16. Tax, health and pension reform; tax increases as „ultima ratio“; removing the debt financing bias from tax systems

7.4 Monetary Policy

17. Timely exit from monetary easing (e.g interest rates)
18. Timely exit from quantitative easing
19. Transition to floating exchange rates (particularly in China)
20. Considering asset prices in monetary policymaking?

7 Options for economic policy

7.5 Further policy areas

21. Improved bank regulation (e.g. higher capital requirements, more transparent leverage ratios, improved risk management)
22. Review of bankruptcy regulation
23. Maintenance of labour market flexibility
24. Attaining a sustainable economy through adequate definitions of property and usage rights.

A Last Word …

Thank you for your kind attention!

These presentation slides as well as a more detailled paper („*The Dangerous Rise of Economic Interventionism*“) are available in the internet at the following addresses:

- http://www.zimmermann-thomas.ch
  (Subsite „Veröffentlichungen“ / „Publications“)

- http://www.zimmermann-thomas.de
  (Subsite „Arbeiten, Veröffentlichungen und Vorträge“ / „Academic Work, Publications and Presentations“)

*** For spiders: ***

Old title of this presentation: *„After the crisis: Is There a Comeback of Economic Nationalism?*