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Coordinated Fiscal Stimuli: An Antidote To Protectionism

The need for increasing government expenditure for overcoming the current recession is widely recognized. But when such expenditure increase is undertaken in one particular country, part of the stimulus leaks out to other countries through increased imports. The original country therefore finds its external debt increasing for the sake of creating jobs in other countries, and is tempted to be more protectionist. This then induces other countries to also adopt protectionist measures as they increase their own government expenditures. We thus end up with a scenario of sequential uncoordinated fiscal stimulus packages, each accompanied by protectionism.

This is clearly not desirable in these circumstances as world trade is rapidly contracting and most developing countries have become very export-oriented. Since such "beggar-my-neighbour" protectionism would be introduced together with fiscal stimuli in each country, any facile comparison with the 1930s' period -- and conclusions drawn on that basis about all countries ending up with worse slumps as a result of such protectionist policies than they otherwise would have had -- are unwarranted. Nonetheless, protectionism of this sort must be avoided in a crisis.

Why? For any given vector of money wages across countries, a regime of protection -- by making goods and services more expensive than they would otherwise have been -- entails a lower vector of real wages. It entails, in other words, a shift of income distribution away *from* wages *to* profits or tax revenue. Since autonomous expenditures (like government expenditure and private investment) may be considered to be given in any period, determined by decisions taken earlier and unaffected by currently-accruing taxes or profits, the marginal propensity to spend out of wages -- than out of profits or taxes -- is higher in the short-run. Such a regime of protection then has the effect of lowering the impact of the Keynesian "multiplier" within each country.

If each country had an identical "multiplier" value to start with, then this means an overall demand-compressing effect on the world economy. For given levels of government expenditures, private investments and other autonomous expenditures across countries, a regime of protection causes a lower level of world output and employment than would be the case without such protection.

Of course, the "multiplier" values are not identical across countries to start with, so that if protection results in a shift in the distribution of world output *among* countries, then this could conceivably offset the demand-reducing effect of a lower multiplier value *within* each country. But if the resort to protectionism is pervasive among major countries, then its effects in this respect will cancel one another out. No significant *net* shift of aggregate world output across countries can therefore be expected in the short-run, in which case it has an unambiguously demand-reducing effect.

The reduction in the vector of real wages arising from protectionism is not only undesirable in itself, but should be particularly shunned for its demand-reducing effect during a recession. Hence, any accentuation of protectionism in the midst of the crisis only makes it that much more difficult to get out of the crisis.

Qualifications

Two clarifications are necessary here. The initial pre-crisis, or base level, trade policy regime in the world economy was by no means optimal, characterized, as it was, by pervasive non-tariff barriers, a plethora of unfair trade practices, and by the imposition of unfavourable trade policies on developing countries with limited bargaining strength. The need for a change in the base-level regime itself -- including the need for greater protectionism in less developed economies to ensure food security or to develop new productive capacities and capabilities -- is not being questioned here. Rather, what is being questioned is the likely *increase* in protectionism *by the major economies*, typically the richer countries of the world, which should be spearheading the fiscal effort to overcome the crisis.

Secondly, since recessions are typically associated with price crashes in the world market for small producers of primary commodities, efforts by national governments to protect such producers by offering guaranteed "procurement prices", backed by appropriate tariffs, must not be prevented in the name of preventing increased protectionism. On the contrary, in the case of all commodities whose prices in the world market are "demand-determined" -- as opposed to "cost-determined" (to use a distinction introduced by Kalecki) -- national price support efforts should be internationally supported. After all, the producers concerned belong to the world's poorest, and any increase in their incomes is likely to have significant multiplier effects, since their "propensities to consume" at the margin are very high. The apprehensions expressed about protectionism in the present note do not refer to them. On the contrary, if protectionism among the major economies raises, through cost-push effects, the prices of a whole range of commodities produced in these economies and demanded by small primary commodity producers, then the terms of trade shift against such producers would be even greater. Protectionism in major economies would therefore be against the interests of small primary commodity producers.

In short, the concern here is with an increase in protectionism over the base level in the major economies of the world undertaking fiscal stimulus efforts sequentially. Such protectionism blunts the impact of the fiscal stimulus efforts, makes recovery from the crisis that much more difficult, adversely affects the real wages of the workers within these economies, and turns the terms of trade against primary commodity producers to an extent even greater than would have been the case without such protectionism.

Such protectionism must be prevented. The only way this can be done is by having a *coordinated* fiscal effort among the major economies, rather than individually and sequentially undertaken fiscal efforts by particular countries. The fact that such efforts would be simultaneous, if they are coordinated, will ensure that no country will be unduly concerned with the leakage of demand through imports; each country will know that while part of its demand is leaking out to others, part of the increased demand of the others will be leaking into its own economy. And the fact that such efforts would be coordinated would mean that any residual fears on this score would be allayed beforehand.

Of course, even with a coordinated and simultaneous fiscal effort, there will be increased current account surpluses and deficits. But such deficits need not tempt countries into protectionism, if a suitable arrangement for re-cycling the corresponding surpluses is put in place, which ensures that there are no additions to foreign exchange reserves starting from the base level. With a recycling arrangement, like the one suggested in the G24 Policy Brief 43, current account deficits and surpluses will be continually tending to disappear; indeed, if the recycling is fast enough, then there will be no increase in the net external indebtedness of any country on account of a coordinated fiscal stimulus.

Protectionism among the major countries is a symptom of accentuated rivalry. The tendency towards such accentuated *rivalry* can only be overcome if an alternative scheme, based on *cooperation* among major countries, is put into effect. A coordinated fiscal stimulus, suggested in the context of the Great Depression of the 1930s by several, including John Maynard Keynes, constitutes such an alternative scheme based on cooperation.

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