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Defining protectionism down

Daniel Davies

Economic "protectionism" is back in the news, with the conventional wisdom saying that it's bad. Trouble is, this isn't really what "protectionism" means.

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Economic "protectionism" is back in the news with a vengeance, with France objecting to takeovers in the steel sector, Spain putting together national champion utilities and the USA crying blue murder over Dubai Ports World's proposed acquisition of P&O. James Surowiecki had an article in the Saturday Guardian painstakingly setting out the conventional wisdom on this subject (ie that it's very bad). Trouble is, this isn't really what "protectionism" means.

Basically and historically, "protectionism" (and "mercantilism" and related terms) always used to refer to tariff policy, with respect to goods markets and trade between buyers and sellers. The use of the terms to refer to policies about capital markets and ownership of companies is a new one; I spotted it beginning to arise in the FT and Economist around the beginning of the 1990s and have been writing Mr Angry letters on the subject ever since. Because capital markets "protectionism" is much less bad than the goods market type and might not even be bad at all.

It's easy to explain why tariffs are bad. They're a tax on a particular economic activity - trade. Because of this, they cause people to do things that they wouldn't otherwise do in order to avoid the tariff, or not to do things they otherwise would do because the cost of the tariff means it isn't worth their while. There is a deadweight loss associated with this, and empirically it turns out that this deadweight cost is substantial. That's why tariffs are bad, and why we have a WTO dedicated to removing them.

On the other hand, ownership of a company isn't an economic activity at all (because "ownership" isn't an activity, it's something you can do while sleeping, in a coma or even dead). So it is much harder to see how any deadweight loss can be created by placing taxes or other kinds of barriers on overseas investment in domestic companies. The very fact that James Surowiecki in his article has to appeal to "the discipline of the takeover market on inefficient managements" ought to raise eyebrows here. If there is one thing we do know about the discipline of the stock market, it's that it's a very weak force for good indeed, if it's a force for good at all. And the empirical evidence bears this out as well; while the gains from goods markets liberalisation are big and definitely there, the gains from capital account liberalisation are small and frustratingly difficult to detect, no matter what econometric techniques you bring to bear.

Set against this, there are on occasion quite legitimate reasons why one might want to put curbs on the foreign ownership of domestic industries. Most particularly, you might want to be absolutely sure that you can govern them via domestic national laws. There is a lot of ill-founded paranoia about "multinationals", but it is true that a company with multinational operations has a lot more wriggle room when it comes to regulations it doesn't like. Furthermore, you can keep a lot more control over the tax base, and over things like shipping records and accounts which are usually stored in head office. Even the Thatcher governments recognised this, which is why the government used to have a "golden share" in a lot of privatisation companies. There are, quite feasibly, a lot of uncommon but not impossible situations in which a democratic government might want to pass a law about the operations of a company, and not want to find itself being taken to a WTO tribunal for doing so.

And this is what the root of the problem is, I think. The rise of cross-border ownership of companies has gone hand in hand with the rise of a lot of bogus WTO cases trumped up by multi-national companies which don't like the way in which they are being regulated in one of their countries of operation, and have managed to convince someone that it is a restraint of international trade. At about the time that the new usage of the word "protectionism" was being popularised, the international civil service was trying to negotiate something called the Multilateral Agreement on Investment (MAI). If it had been passed, this would have more or less guaranteed to foreign investors in any country that they would be able to carry out business in the same way in which they did in their own country. The fact that this would lead to a lowest-common-denominator effect pretty quickly was, of course, not an unintended consequence - this was the grand high era of neoliberalism, after all. However, more or less for this reason, the MAI was incredibly unpopular (particularly in the USA, where there are all sorts of local regulations and industry sweetheart deals which everyone wanted to preserve) and it died the death of a thousand committees.

Ever since the death of the MAI, global civil servants at places like the EU and the WTO have been trying to resurrect it. They've been doing this, as far as I can see, by attempting to blur the distinction between goods market and capital market protection. I've mentioned that the WTO is chock full of bogus cases where regulations on a local subsidiary of a large company have been portrayed as a restraint of trade, but the EU is if anything worse; the office of Charlie McCreevy and the Single Market Directorate Generale of the EU have a really nasty habit of claiming that the "right of establishment" of the Treaty of Rome gives them the power to force through any cross-border merger in Europe in the face of government opposition. So the linguistic confusion between "protectionism" in the sense of tariffs and "protectionism" in the sense of local ownership restrictions is not really all that innocent.

Of course, there is not really all that much to be said for local ownership restrictions in most cases. If someone wants to buy shares in a company, the fact that he comes from overseas is usually not a very good reason to stop him. But on the other hand, nor is it "protectionism". Even Adam Smith had very different opinions on free trade in goods markets, versus international investment. The case for capital market openness is very much weaker than the case for goods market openness and we should all resist the attempt to define down protectionism.

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