ARTNeT POLICY BRIEF

An initiative of UNITED NATIONS ESCAP
Economic and Social Commission for Asia and the Pacific

Asia-Pacific Research and Training Network on Trade • www.artnetontrade.org • Tel: +66 2 288 2067 • Email: artnetontrade@un.org

The Global Crisis and Protectionism in the Services Sector: Implications of Current Findings

Martín Molinuevo*

Brief No. 25, March 2010

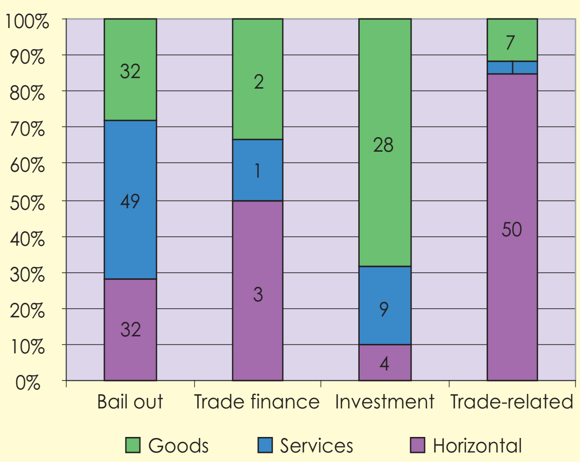
Amongst the several alarms triggered by the global economic crisis, the one alerting to a possible global return to protectionism sounded particularly loudly. As the crisis spread geographically and affected more economic sectors, fears that domestic pressures for protectionism would not be resisted gained intensity.

There have been a number of indications that trade protectionism has indeed increased during the course of the now-receding crisis. Available empirical evidence focuses largely on the impact of the crisis on merchandise trade, and, to some degree, on foreign investment.[1]

Protectionist measures taken in the area of service trade

In an attempt to monitor the implications of the economic crisis, governments (mostly from the G-20 group) collaborated with international organizations by reporting the measures that they have undertaken in the ambit of international trade and investment. Over 100 measures affecting the services sector taken between September 2008 and August 2009 were reported to the WTO, UNCTAD and the OECD (see Chart 1).[2]

Chart 1. Measures on trade and investment



Source: Based on OECD, WTO and UNCTAD, 2009; WTO, 2009a; and WTO 2009b.

Private initiatives have also contributed to tracking trade policy developments during the economic crisis and acted as a watch-dog over protectionist actions. The Global Trade Alert website accounts for over 150 measures introduced between December 2008 and December 2009.[3]

The combination of these different sources results in a total of over 260 non-tariff, behind-the-border measures affecting different areas of international trade and investment.

A brief consideration of their nature further allows us to group the reported measures according to their dominant effect on international trade and investment. Where they are favourable to international trade and investment because they lift restrictions, ease procedures, or eliminate discrimination, they are classified under the "green" category. Measures that maintain or increase trade and investment restrictions fall under the "red" category. Measures with ambiguous or undetermined outcomes form the "yellow" group.

General trade and trade-related measures

Trade and trade-related measures encompass different forms of behind-the-border, domestic regulations that may affect trade. Reported regulations include licensing procedures, taxation measures (excluding border tariffs), trade facilitation measures, and some trade-related aspects of government procurement regulations.

As illustrated in Table 1, the great majority of the domestic regulation measures affecting trade and investment adopted during the 2008-2009 economic crisis relate to merchandise trade.

---

[1] See Evenett, 2009b, and OECD, 2009.

[2] The figures are based on OECD, WTO and UNCTAD, 2009; WTO, 2009a; and WTO 2009b. Given the ample spectrum of the notified measures, from individual measures to very general ones, or notifications that included several different measures, a strict reading of the figures involved would be inappropriate. However, the figures do serve to identify the sectors in which governmental measures focused most prominently during the crisis. See also OECD 2009.

[3] The Global Trade Alert features over 600 measures reported in the course of 2009. For the current study, however, we have limited our sample to the types of measures more directly relevant to trade and investment in services.

* This policy brief was written while the author was with ESCAP's Trade and Investment Division. The author is grateful to Mia Mikic, Gloria Pasadilla, Simon Evenett, and the participants to the ARTNeT Research Workshop held in Macao, China on 14 and 15 December 2009, for valuable comments. He can be contacted at martin.molinuevo@gmail.com. The views presented are those of the author and do not necessarily reflect the views of the United Nations, the author's employer or other ARTNeT members and partners.

Table 1. Trade and trade-related measures
September 2008 / August 2009

	Red	Yellow	Green	Total
Goods	22	16	12	50
Services	1	--	--	1
Horizontal	6	--	1	7
Total	29	16	13	58

Source: Based on OECD, WTO and UNCTAD, 2009, and WTO, 2009b.

Out of almost 60 behind-the-border laws and regulations introduced in 2009, only one pertains to cross-border trade in services – confirming in part the traditional difficulties in regulating international trade in services. This suggests that cross-border trade in services falls largely off the radar of international trade regulation, even in times of crisis. The only trade-related measures directly oriented to the services sector concerns a service typically sensitive to foreign intervention – postal services –, which re-states an existing ban on foreign courier companies to deliver express letters.

Restrictive horizontal measures affecting trade in services relate to government procurement procedures strengthening "buy local" directives – an instrument that gained great popularity during the crisis,[4] as well as measures relating to limitations on foreign ownership of domestic companies. The only "green" horizontal measure was reported by Canada, which lowered restrictions on foreign participation, including in the transport sector.

Arguably, none of these measures features an evident link with the economic crisis, or is an obvious emergency measure. Only one trade-related measure, introduced by Indonesia, seems to fall outside the everyday, ordinary trade regulation: a requirement to support exports of certain products with a value exceeding US$ 1 million by letters of credit issued by domestic banks.

Investment measures

Domestic regulations on foreign direct investment (FDI) are one of the most relevant components of domestic rules on trade and investment in services. Foreign investment policies, however, tend to affect investment in goods and services alike, setting an overarching, common framework to all investment in all sectors of the economy. This is reflected in Table 2, which shows that almost 70 per cent of the investment regulations passed during 2009 was horizontal in nature.

The figures confirm a traditional perception: countries strive to attract foreign investment. Indeed, it could be argued that, in times of economic downturn, the urge to receive external funds to increase employment and expand domestic demand is even more acute. From an economic perspective, it would make little sense to inject public funds into the economy while restricting private investment.

Accordingly, only four measures unfavourable to foreign investment have been introduced during the course of the crisis. The only measure focused specifically on the services sector consists of the investment angle of postal services regulation mentioned above, which restates restrictions to foreign participation in the area.

Table 2. Investment measures
September 2008 / November 2009

	Red	Yellow	Green	Total
Goods	--	3	1	4
Services	1	4	4	9
Horizontal	3	5	20	28
Total	4	12	25	41

Source: Based on OECD, WTO and UNCTAD, 2009, and Global Trade Alert database.

Instead, almost 15 countries have passed general regulations improving investment conditions in their territory, including four specifically in the services sector. Measures range from elimination of restrictions on real estate acquisition by foreigners (Australia, Republic of Korea), to facilitation of foreign investment procedures (Indonesia), and increases in foreign ownership (Malaysia).

Like in the case of measures related to trade in services, no clear signs of protectionist intent can be found among domestic regulations on foreign investment. On the contrary, the great majority of policy changes have been directed to attracting foreign investment by relaxing restrictions and facilitating investment procedures.

Bail-out measures

The measures that will distinguish the 2008-2009 global economic crisis will undoubtedly be the introduction of multi-billion-dollar bail-outs for financial institutions by governments alarmed at the prospect of a massive collapse of the global financial system.[5]

The implementation of bail-out measures would, almost by definition, be considered a trade- and investment-restrictive measure to the extent that they are aimed at ensuring the continued presence of economic agents that would otherwise be driven out of the market. Furthermore, to the extent that such bail-outs are granted only to domestic companies, they are discriminatory[6] in nature, enhancing the distortive effects of other measures. It is thus unsurprising that 104 out of 113 reported bail-out measures fall in the trade-restrictive category.

[4] On the discriminatory use of government procurement procedures during the crisis, see Evenett, 2009a.

[5] For a more in-depth review of bail-out measures and their compliance with the international trade and investment legal framework, see van Aaken and Kurtz, 2009.

[6] The non-discriminatory, trade-friendly use of rescue measures would consist in the adoption of subsidies to consumers for the purchase of domestic or foreign goods according to their preferences. The overwhelming majority of bail-out measures, however, consist of producer subsidies limited to domestic companies; they are, thus, discriminatory in nature.

Table 3. Bail-out measures
September 2008 / November 2009

	Red	Yellow	Green	Total
Goods	29	2	1	32
Services				
– *Financial*	44 (18 specific + 26 general)	--	--	44
– *Non Financial*	5	--	--	5
Horizontal	26	6	--	32
Total	104	8	1	113

Source: Based on Global Trade Alert database.

Financial institutions were clearly the primary candidates for the rescue packages, and indeed, as expected, the majority of bail-outs were directed to banks and, to a smaller degree, insurance companies. Perhaps unsurprisingly, all 25 bail-outs for financial institutions reported in OECD, WTO and UNCTAD (2009) where granted to *domestic* banks or insurers. The same is true for the 18 specific measures reported on the GTA database mentioned above.

It is significant that only slightly fewer measures were used in industries not directly related to financial services. While 44 bail-out measures were directed to banks and insurance companies (the companies at the core of the financial crisis), 34 stimulus packages were used in other areas. Five were directed to other (non-financial) services companies, and the remaining 29 measures were applied in the goods-producing industry. Horizontal measures, establishing mainly increased funding for government procurement and general schemes of direct grants to companies in financial difficulties accounted for 26 measures.

State-aid measures in non-financial services sectors concerned transport and logistics services and construction. In the goods sector, the bulk of bail-out measures fell on the automotive and machinery industry and on agriculture. While it may be argued that these measures were required to expand aggregate demand, the systemic necessity for the rescue of those producers remains unclear.

Main findings: where has the protectionist threat gone?

While an element of protectionism could be discerned in the bail-outs directed to bank and insurance companies, the review of behind-the-border regulations affecting trade and investment in services suggests that protectionism of local services suppliers has been remarkably absent from the regulatory agenda during the 2008-2009 global crisis.

Several factors may have contributed to this outcome.

- International trade in services has performed very well during the crisis (at least during the first several months), without showing the steep plunges that have affected trade in goods. Therefore, governments may not have felt strong pressure to introduce restrictions in this field.

- The traditional challenges in regulating cross-border trade in services and difficulties in the actual implementation of restrictions may have acted as an effective deterrent to protectionist considerations.

- The nature of some services sectors presents additional challenges for the immediate implementation of cross-border restrictions. Business services, for instance, are typically based on standing contracts which cannot be easily terminated; furthermore, business services tend to be tailored to the needs and conditions of the consumer, so that they are usually not immediately fungible.

- Other services sectors are complementary to other economic activities, and therefore fluctuate. That is the case of transport services, the services sector most heavily affected by the global crisis due to its inherent link to international trade in goods.[7] With international trade in goods having plunged by around 20 per cent, protectionist regulations would have done little to shield the transport services industry from the fall in global demand.

With regard to investment in services, the regulatory trends observed in this study confirm that economic crises create incentives to maintain and enhance the level of openness towards foreign involvement – rather than to introduce restrictions. In this sense, foreign investment policies seem to follow patterns contrary to international trade in merchandise: protectionist pressures are more likely to gain momentum in periods of economic expansion, while times of economic downturn tend to foster greater market opening.

In brief, the analysis suggests that a number of economic, legal and institutional factors complement each other to create strong incentives against a general surge of protectionism in trade and investment in services. These elements, indeed, de facto eliminate a number of instruments that would allow governments to protect domestic industries and isolate them from the global economy. In such a legal, economic and institutional context, a trade war seems unlikely.

Main lessons and implications

The above findings confirm the general perception that international trade in services remains an area which is less accessible to direct governmental intervention. While in the area of trade in goods the governments have a number of instruments to affect particular, chosen goods, at their disposal, when it comes to trade

[7] Borchert and Mattoo (2009), p. 6

in services, regulatory action for individual sectors tends to be more costly and less readily available, which acts as a disincentive for the introduction of protectionist measures. National policymakers are better equipped to focus on the development of general legal frameworks, leaving sector-specific matters to be developed by specialized agencies with expertise in the individual sector. In the negotiating context, this translates into a need for trade and foreign ministries to maintain close contacts with specific regulatory agencies.

Another implication relates to the strengthening of the multilateral trading system, and highlights apparent contradictions between negotiations and actual policy needs. The above observations suggest that services generate less protectionist pressures than trade in goods. Yet, at the multilateral level, a number of developing countries seem reluctant to advance in international commitments in this area. This may in part be due to particular regulatory concerns associated with certain services industries. However, more active discussions on trade and investment in services in multilateral negotiations would sustain the international trading rules and would enhance coherence of the system, in particular vis-à-vis the proliferation of preferential trade agreements.

The regulatory developments on trade and investment in services observed during the crisis also have strong implications for two matters on the multilateral agenda on services disciplines. Some Asian WTO Members have devoted significant efforts to gather support for the introduction of a special safeguard mechanism under the GATS, with limited success. Such an instrument seems to offer few advantages for regulators for the defense of domestic services in emergency situations. Indeed, no measure taken during the economic crisis was aimed in that direction, not even in the financial sector. Trade negotiators would hence be well advised to consider whether an emergency mechanism that does not seem to attract major interest from their own regulators in times of economic crisis is worth investing such negotiating capital in.

Conversely, the most popular emergency measure resorted to during the crisis, subsidies, has received little interest at the multilateral table. However, the GATS disciplines on non-discrimination do apply to state aid measures. The regulatory practice during the global crisis has shown that "emergency subsidies", temporary in nature, can prove a valuable instrument in times of crisis – promoting trade and investment rather than restricting it. WTO Members may draw on this experience in developing joint rules that would ensure that subsidies remain a valuable tool in the policy options for governments in times of crises, while setting limits to the discriminatory and distortive effects that they may bring about.

References

Borchert, Ingo and Aaditya Mattoo, 2009, The Crisis-Resilience of Services Trade, World Bank Policy Research Working Paper No. 4917.

Evenett, Simon, 2009a. The Devil Is in the Details: The Implementation of Stimulus Packages and Their Effects On International Commerce, Aussenwirtschaft; Zeitschrift für internationale Wirtshaftsbeziehungen (June 2009)

Evenett, Simon, 2009b, The Unrelenting Pressure of Protectionism: The 3rd GTA Report, Centre for Economic Policy Research (CEPR), available at www.globaltradealert.org

OECD, WTO, and UNCTAD (2009), Report to the G-20. Trade and investment measures.

UNCTAD, 2009, World Investment Report. Transnational Corporations, Agricultural Production and Development, United Nations.

van Aaken, Anne and Kurtz, Jürgen, 2009, The Global Financial Crisis and International Economic Law, University of St. Gallen Law & Economics Working Paper No. 2009-4.

WTO, 2009a, Report to the TPRB from the Director-General on the financial and economic crisis and trade-related developments, WTO document JOB(09)/30.

WTO, 2009b, Report to the TPRB from the Director-General on the financial and economic crisis and trade-related developments, WTO document WT/TPR/OV/W/2.

What is ARTNeT? *The Asia-Pacific Research and Training Network on Trade (ARTNeT) is an open*