NEW STATE PRACTICES AT A TIME OF SYSTEM DISTURBANCE AND THE NASTY BUSINESS OF PROTECTIONISM -- THE EXPECTATION FOR GLOBAL DEMAND MANAGEMENT

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Goals and Objectives of this Paper

This paper examines the new state practices of demand management and rescue policies. States have become innovative in the current crisis developing highly divergent responses to re-insert government in the management of the economy (Rodrik, 2008). The paper will argue that protectionism of the classical variety is a peanut-sized problem today and that states learned from the mistakes of the Great Depression when Everest-sized trade walls brought global trade to a halt.

The new state practices of the Great Recession of 2008-09 require attention and analytical scrutiny for two important reasons. First, global neoliberalism had reduced the role of the state in the economy through downsizing and privatizing many of its activities (Rodrik, 1997). However, the state is no longer missing in action in the global south or north. It is back in full throttle with a massive presence in all leading jurisdictions. Secondly, governments are gaining valuable experience in managing structural change. The twin ideas of the need to map new state practices to take account of new policy communities and the need for far-reaching institutional stabilization and re-regulation

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have shifted the focus from deepening market access to getting the institutional response right.[1]

Figure 1

The Policy Importance of Rule Bending Rescue Measures			
	Leverage	Multiplier effect	Bad effects
Stimulus package	High	Very High	Debt Overhang
Wage subsidy	Moderate to High	High	Smallish Difficult to Phase Out
Industrial subsidy	High	Strong	Unclear and Difficult to End
Innovation	Low Weight	Unclear	Low for the Moment
Capital controls	Effective for Brazil	Across The Financial Industry	Neglible
Quotas/ antidumping	Small and Merit Tracking	Neutral	One offs Subject To National Interest and WTO discipline
Credit Expansionary Policies	Strategic and Very Focused For Both Private And State Enterprises	Large and Continuous For Corporations and For Offsetting GDP Contraction	Loans and Bailouts Leave A Decade of Legacy Costs

Source: Drache 2009

On first examination, many of these new state policies seem to be strongly Keynesian in inspiration -- state aids to take workers off the unemployment lines (wage subsidies in Germany, France and Netherlands), massive bailouts of near failed banks and investment

[1] The cornerstone of free trade simply defined is the principle of non-discrimation between domestic and foreign goods. When the principle is bent, finessed, or ignored a degree of protection exists in the system. In addition to this cornerstone principle, free trade involves other goals including the free movement of goods and services ~~as a start?~~, international harmonization of laws and regulations to eliminate trade barriers and the international regulation of policy areas that directly affect the movement of goods and services and in the case of the EU capital and labour (Lester, 11 September 2009).

firms (Eurozone and United States), deficit spending and macro stimulus packages to restore consumer demand and battered industries (Eurozone, China, and the United States) and new programs and initiatives to strengthen social benefits, reduce poverty and protect the most vulernable from the global chaos (Brazil and France) (IMF, April 2009).

Countries around the world are ready to use any means available to protect their industries from the devastating consequences of a contracting world economy, unparalleled systemic change, and rising mass unemployment (See Figure 1 The Policy Importance of Rule-bending Rescue Measures). The painfully learned lesson is that "not all financial innovation is valuable and that a bigger financial system is certainly not a better one," in the words of Adair Turner, United Kingdom Chair of the Financial Services Authority, the independent body charged with regulatory oversight (London Address, 22 September 2009). In a demand-constrained world with record high jobless rates, governments are struggling to find a new equilibrium point between states and markets.

In the present crisis, Paul Krugman (2009) argues that, in the absence of international co-ordination, a little bit of protectionism is needed when global growth plummets. The tough but relevant questions for a framework of stability and development are -- do these these new state practices deliver desireable outcomes? Do we need better rules governing the deployment of state subsidies, rescue packages, and financial bailouts? Finally, the past year has restored neither the financial system nor the economy to health. In the tough language of Martin Wolf (2009), "We have avoided the worst. That is good. It is not good enough;" so what are the lessons for policy coherence when states actively work to design policies across sectors to capture benefits and minize negative impacts?

This paper is going to examine the important justifications for public sector intervention. The first section focuses on the different models, strategies of social protection and stimulus measures taken in Germany, the United States, Brazil and China recently. It would appear that the global financial meltdown has pushed governments and other actors toward a regime change in which the existing rules of demand management are being modified incrementally. Section two discusses a different logic for state action namely rescue protectionism. Legalized protectionism as a form of state governance is often confused with beggar-thy-neighbour kinds of policies. Modern 'rescue' policies differ greatly from the beggar-thy-neighbour variety of the 1930s when mile-high tariff barriers were erected that brought the world trading order to its knees. These differences are put under the microscope. The final section takes a Braudellian view of the long-term structural lessons implemented when governments not markets are leading the recovery. Nations have faced a lot of structural transformation in state-market relations under both Keynesianism and global monetarism. Whether states will be able to institutionalize the larger framework for demand management without global governance reforms adds a new layer of complexity to an already over-crowded agenda.

Brave New Intentions: The 'Nasty' Business of Protectionism and Demand Management

At their April 2009 meeting, the leaders of the G20 countries reiterated the promise they made in November 2008 not to establish any news barriers to trade. This time they added the proviso that they would report any such measures to the World Trade Organization (WTO). The G20 leaders vowed to oppose the beggar-thy-neighbour policies that acerbated and prolonged the Great Depression of the 1930s and to continue, as stated in November, "refrain[ing] from raising new barriers to investment or to trade in goods and services, imposing new export restrictions or implementing measures inconsistent with the need to stimulate exports"(ITCTSD, 2009). Brave words coming from G20 leaders who did not actually heed their own advice after the November meeting.[2]

Joesph Stiglitz got it right when he wrote recently "the world economy will go through a long recession and a very deep depression" before there is a return to global health (Stiglitz, 2009). Indeed, market fundamentalism may still be 'the beacon on the hill' in the minds of some orthodox economists, but its day appears to be over as the unassailable gold standard of public policy (Akerlokoff and Shiller, 2009). The 'animal spirits of capitalism' are not going to pull the world economy back from the precipice. The dilemma for policy makers is that over the last four decades the potential for enhanced demand management has been constrained by the goal of open markets and deregulatory state practices. Policy coherence has been wanting, particularly with respect to economic security as part of a wider agenda for developmental goals (Stiglitz, 2002).

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[2] In their final April 2009 communiqué, the G20 leaders called on global governance institutions, "to monitor and report publicly on [our] adherence to these undertakings on a quarterly basis." The WTO, UN, World Bank, IMF, and UNCTAD have their work cut out keeping track of the vast number of initiatives.

Structural Change Requres a Flushing of the System

Since the end of WW II, nations have faced a great deal of structural transformation as laissez-faire capitalism morphed into full employment capitalism in its aftermath. Keynesism was the product of a transfer of power from the market to the state. The monetarist Hayackian revolution reversed course and freed people to seek greater investment returns in foreign markets while 'things public' gave way to 'things private' (Drache, 2007). Today, the global order has drawn a new line-in-the sand of state-market relations with power due to be siphoned off the financial system. The state is poised to beome the catalyst rather than simply revert to the more convential role of manager of the economy.

In the WTO and beyond, countries belonging to different international organizations now spearhead coalitions with numeric names such as the G33, the Cotton 4 and the G101. Dozens of southern countries are demanding new international norms and equitable treatment in the international arena (Shaw, Cooper and Chin, 2009). Marx referred to these infrequent hinge periods of structural change as a 'flushing of the system' making new narratives, institutions, and configurations of authority possible and necessary. Helfer calls it 'regime questioning' as governments currently contest the legal prescriptions that largely left the state missing-in-action. This newfound scepticism fuels creativeness and innovation (Helfer, 2004). When these hinge moments occur, they trigger even larger changes in the policy order.

In the depths of a massive global recession, governments have intervened to reshape labour markets and rescue failed financial institutions with massive public spending. The object is to stabilize the international economy and assist industries, individuals and communities at a time of extraordinary economic peril (IMF, 2009). In comparison to responses in the Great Depression of the 1930s, the state is very much present. According to Eichengreen and O'Rouke (2009), "the fundamental difference is that fiscal policy across the globe is far more aggressive this time." 'Figure 2: Demand Management Budgetary Deficits' presents an overview of the fiscal stimulus spent in leading jurisdictions highlighting the new role of the state in the management of the economy.

Figure 2

Demand Management Budgetary Deficits

Country	**Fiscal Deficit** (% of GDP)	**Discretionary Fiscal Stimulus Contribution to Deficit** (% point change vs. 2007 level)	
	2009	**2009**	**2010**
US	12.5	2.0	1.8
UK	11.6	1.6	0
Japan	10.5	2.4	1.8
India	10.4	0.6	0.6
France	8.3	0.7	0.8
G20 Average	7.9	2.0	1.6
Russia	6.6	4.1	1.3
Germany	4.2	1.6	2.0
China	3.9	3.1	2.7
Brazil	3.8	0.6	0.6

Source info: *Financial Times* 26 November 2009; IMF 2009

"In the early 1930s, the weighted average deficit for 24 significant countries was less than 4 per cent of GDP."[3] In the current crisis, the fiscal deficits will be far higher. In the

[3] The Eichengreen and O'Rouke article received over 450,000 readers on the policy blog http://www.voxeu.org/index.php?q=node/3421

United States, the general government deficit is expected to be over 12 per cent of GDP. The comparable figure for the G20 is almost 8 per cent. Many economists are of the view that the stimulus packages require a second injection of public funds. What a turnaround in the state's responsibility for economic management and what an end to the core ideas of the Washington Consensus!

Still governments are struggling with a variety of challenges:

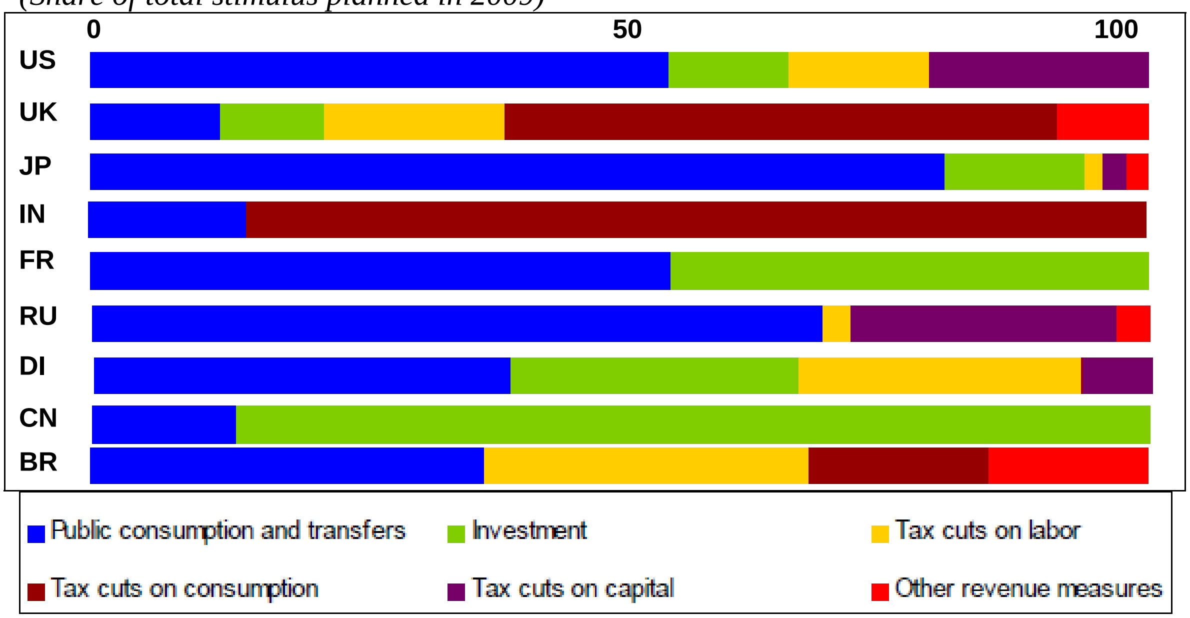
- The debt overhang is large and will require government attention and spending restraint once the peak of the Great Recession has receded. In the United Kingdom, Canada and the United States, public authorities are looking to make deep cuts to the public sector as part of their exit strategies. In social democratic economies, like Germany, restraint measures have yet to be spelled out. The IMF is warning of a decade of tax increases and massive spending cuts (IMF, 2009).
- Policy autonomy has led to very different kinds of discretionary spending strategies amongst the state rescue initiatives. Since the implosion of the financial markets, China has barely suffered a growth slow-down. It injected billions into the economy to strengthen its competitive edge and push state enterprises to the next stage of its industrial revolution. China's response, massive infrastructure program and expanding credit for distressed industries, was breathtaking in its boldness.
- Germany proved to be innovative and strategic in its reponse to the credit crunch. It has kept more than a million people off of unemployment insurance through a labour market strategy of time subsidies.

- Brazil has been shielded from much of the negative fallout from global financial markets and the collapse of export markets. It imposed capital controls on foreign investment as well as deepening social security nets in order to prevent a collapse that would have devastated much of Latin America.
- Expert opinion is now of the view that in the United States the impact of the recession would have been much worse had it not been for the interventionist role of the Federal Reserve and the US government providing an extraordinary level of public funds when private demand collapsed under the weight of huge indebtedness. The United States spent more than a trillion dollars in tax payer money bailing out banks and near banks, rescuing the US auto industry from collapse, and aiding distressed homebuyers with sub-prime mortgages. Many experts believe that additional funds will be needed to restore the US economy to health and that the capacity of banks to lend and keep mortgage and interest rates at historic lows will be critical for a full recovery.

The mix of stimulus measures has varied from country to country, but the common thread is that the leading economies have relied on public consumption transfers, massive investment in infrastructure, tax cuts on labour and capital as well as reducing the tax burden on consumers. The economic incentives tabled by governments around the world in November 2008 to kick-start their failing economies came to a record high of 19 per cent of British GDP and 10 per cent of US GDP. France and Germany spent a combined $500 billion to pull their financial institutions back from the brink. In 2009, they redoubled these efforts with infrastructure spending and support for workers facing layoff. Arvind Subramanian makes the point that this large-scale assistance was "aim[ed] at averting extinction rather than providing a competitive boost" (Subramanian, 2009) Certainly, our understanding of this new role of the state in rescuing distressed domestic industries and reassuring worried consumers is far from adequate. Governments must anticipate the needs of different policy communities and monitor their distributional consequences. A summary table from the IMF shows the breakdown of stimulus measures in Figure 3.

Figure 3 'Rescue Protectionism': A Generic State Practice

Gain and Pain -- Composition of Fiscal Stimulus Measures
(Share of total stimulus planned in 2009)



Source: IMF (2009). Staff Position Note – The State of Public Finances Cross-Country Fiscal Monitor: November 2009. SPN/09/25. Accessed on December 7, 2009, from http://www.imf.org/external/pubs/ft/spn/2009/spn0925.pdf

So far, the 'animal spirits' of capitalism are not driving the recovery. Instead, the driver is the logic and calculus of governments with their unprecedented transfers, new investments, tax cuts on consumption, capital and labour, and other revenue measures. Governments have spent trillions to bail out the private sector and create the effective demand needed to restart the engine of capital accumulation. With such a change in state practice the message in the bottle is that *new rules* of the game are necessary to repair a system crippled by regulatory short-sightednesss.

It is valuable to look, if somewhat briefly, at the range of state practices and strategies deployed by Germany, the United States, Brazil, and China to determine whether there is policy coherence behind these highly diverse responses to the global financial crisis and to gain some insight into the flexibility of their policy cultures. The difficult question to answer is whether any of these new state practices will become embedded over the long term?

Demand Led Growth and Social Protection Strategies

a. Germany's Short-Time Working Schemes

The multiple crises in Europe triggered a sea change in prevailing policy and placed the state at the centre of the rescue agenda. Berlin's 500 billion euros bank rescue operation, 80 billion euros fiscal stimulus package, and the liberal wage subsidies to employers to keep people on the job have helped keep the German economy from contracting further.[4] The new government course so far has avoided any spending cuts and has aggressively followed a path that concentrates on growth. The federal deficit is expected to exceed 100 billion euros in 2010, more than double the 40 billion peak reached in 1996 when Germany was struggling to deal with the costs of reunification.

[4] Initially, German Chancellor Angela Merkel was quite slow to come to the rescue of German banks, but as the crisis unfolded and economic circumstances worsened, she made a complete u-turn in her thinking about the need for a rescue package.

The stimulus measures are in response to what Merkel warns are “exceptionally challenging times.” As the crisis deepened, Merkel softened her beliefs as a fiscal conservative and chose instead to fight the crisis with an injection of public funds on an unprecedented level. Her planned reforms to the labour market and health system have been put on permanent hold while the state plugs the multi-billion euro hole in health and labour social security contributions (Byrant, 2009). She has ignored the policy ideas of her coalition partners who wanted to cut welfare spending and tighten labour market rules for the unemployed. Instead Merkel has ramped up spending to revive lending markets and has proposed other measures to help banks securitize risky loans with state guarantees (Benoit, 2009). A major component of the rescue package is designed to strengthen Germany’s very extensive social market and extend employment benefits to millions of workers. Merkel has remained purposively vague on how the government intends to pay down the record-setting deficit and has not rule out raising social security contributions or increasing taxes on families and corporations in the future.

Germany (along with Spain and the Netherlands) has taken a very distinctive approach to shielding its workforce from the worldwide recession. Merkel has used government-funded, short-time working schemes to protect jobs and promote social cohesion by “implementing short work” or *Kurzarbeit* to keep workers on the job rather than collecting unemployment insurance. Government wage subsidies cover more than 1.4 million workers with up to 60 percent of lost salary as well as an important part of employer contributions to health and pension benefits (Benoit, 2009). An additional one million workers are on reduced working hours across the EU. Workers receive compensation for about half their lost income and work a four-day week or less in about a dozen European countries (Pignal and Schafer, 2009). In the face of a jobless recovery, the short-time work schemes have proved effective in reducing redundancies. It is not known what will happen when these schemes end. Are they merely postponing the inevitable job cuts, or will they help keep labour costs down until the recovery arrives?

Germany has been an innovative leader in social protection for workers in core industries. By protecting its core export industries, Germany, one of the most active countries with labour market policies, has suffered less in a recession than other Euro-zone economies like Spain and the United Kingdom. German unemployment at 7.7 per cent in July 2009, according to the OECD harmonized measure, was only slightly above the September 2008 low-point (Groom, 2009). In the absence of similar policies, the jobless rate in France has risen two percentage points since the end of 2007; evidence for many observers that Merkel’s stimulus policies are effective.

In late 2009, Merkel renewed wage and employment subsidies for another year, at an estimated cost of over 2 billion euros, in order to keep workers on the job instead of on unemployment insurance. Proof that the shorter working time initiative demonstrated its worth, German unemployment fell against the general trend in all countries of large and persistant job loss. Most importantly, Merkel pulled back from her goal of a deregulated labour market although she increased retirement age to 67 and cut corporate tax rates.

Many of these measures are designed to support a recovery through demand measures and give consumers relief on the tax front. The generous wage subsidies are also intended to protect German exporters' competitive advantage by shielding them from the worst aspects of the recession. German economic growth actually acclerated in the third quarter of 2009 and is doing better than any of its rival European economies are. The German government has pledged not to reduce public spending until the economy has emerged from the recession. Merkel's fiscal heterodoxy to 'boost growth, save jobs and create new ones' is designed also to bolster German competitiveness and raise productivity. German pay raises have been modest in recent years and have lagged productivity growth. The wage restraint policies have helped German companies win market share but consumer spending is sluggish as Germans save for better times..

Some critics warn that the very success of Germany in moderating labour costs has exacerbated the structural imbalances witin the Euro-zone. In March 2010, the French finance minister Christine Lagarde issued a blunt warning that the crisis has exposed the need for closer policy co-ordination (Hall, 2010). She charges that stagnant German domestic consumption has not helped weaker European nations boost exports and improve finances. Lagarde suggests that Germany has to increase domestic demand in order to help struggling EU countries and boost their export industries. Germany has rejected her criticism and remains on the defensive insisting that domestic consumption needs another stimulus jolt.

b. Rule-Bending 'Buy America' Gives Local Producers Preference

Washington has embraced Keynesian countercyclical principles in the expectation that the multiplier effects embedded in these stimuli package will reenergize markets and reassure consumers (Skidelsky, 2009). Faced with the unparalleled collapse of trade, the Obama Administration has dispensed relief on a massive scale: $70 billion on a housing plan, $700 billion on bank recapitalization, and another $800 on the stimulus package. Restructuring at General Motors and Chysler will cost the US taxpayers billions more. Economists have run models to show that without the injection of stimulus dollars, the US unemployment rate would have risen three to five points, well above the ten percent mark (Calmes and Cooper, 2009).

The larger issue is whether the amount of dedicated stimulus is sufficient to change the underlying conditions in the labour and housing markets in the United States. Ben Bernanke, chairman of the United States Federal Reserve used conventional and non-conventional practices -- being both a micro-allocator of credit and a macro-manager of the economy. Some suggested that the massive intervention ressembled ‘a Soviet Gosbank,’ but in fact, the rescue efforts saved Wall Street from extinction.

In December 2009, President Obama announced what amounts to a second stimulus package using $175 billion in TARP money (Troubled Asset Relief Program). The funds are to go to small employers to hire back those who were laid off as well as create new jobs. The extension of unemployment benefits and tax reductions on investments represent an additional incentive intended to get more money to those at the bottom of the economic pyramid (Guha, 2009). Still, it is far from certain whether the discretionary stimulus programs are large enough to end the Great Recession in the United States. Consumer spending has picked up moderately but the housing and labour markets remain weak, and unemployment remains at a post-World War II high.

‘Buy America’ is an integral part of the Obama social protection rescue strategy. The provision favours a US supplier over a foreign one for awarding public procurement contracts. The original program was a product of the Cold War, and no country has successfully challenged its intent to discriminate in favour of US firms[5]. Currently, the Obama administation’s much-expanded Buy America Act hands out approximately $260 billion to states and cities on the condition that all the steel and other manufactured products are American-made.[6]

However, Washington’s trade arsenal is much broader than the Buy America provision and much of the system is institutionally protected in law. Super 301, the 1988 Omnibus Trade and Competitiveness Act, gave the US Trade Representative a specified timetable for investigating unfair foreign trade practices by US trade partners or face sanctions.

[5] Buy America fulfills a number of purposes. Post-9/11 it establishes security of supply for both essential and non-essential goods from US sources. Shoring up US industries is consistent with the Homeland Security Doctrine that security is first. Buy America is also part of a regional strategy in which local firms and industries are given contracts because of the fact that they are American and the plant or facility is located in a particular state. Politcally, the provision gives members of Congress a deep public well from which to award local constituents and lobbyists with much sought after funds. US lawmakers have passed hundreds of laws supporting local industry and granting them special rights and exemptions.

[6] Quite unexpectantly, the US Chamber of Commerce publicly criticized the Buy America policy arguing that government should not decide where goods are sourced. It is worried that the employment gains from the controversial provision will be erased once other countries implement their own local procurement rules (Clark and Mckenna, 2009).

With this ‘crowbar,’ Washington forced negotiated settlements with Japan, Brazil, and India. The United States forced Japan to agree to ‘voluntary’ restrictions on Japanese auto producers.

Super 301 lapsed as many observers believed it was in direct conflict with the United State’s new obligations to a multilateral trading system and the General Agreement of Tariffs and Trade (GATT) rules, now part of the WTO. The WTO’s founding purpose was to strengthen the multilateral trading system and make it more rule-based. However, Washington’s renewed trade authority under Clinton gave it the right to mount unilateral retaliatory actions independent of the WTO legal order and the treaties that had been negotiated. Clinton reinstated Super 301 through an executive order in 1994 just after the completion of the controversial Uruguay Round. The Act empowered the president to target industries and countries that the United States deemed guilty of unfair trading practices. Business organizations such as the Chamber of Commerce have been big supporters of this protectionist instrument. With such powerful retaliatory weapons in its policy arsenal, the United States could embrace a more fully administered protectionism as part of its massive stimulus package.

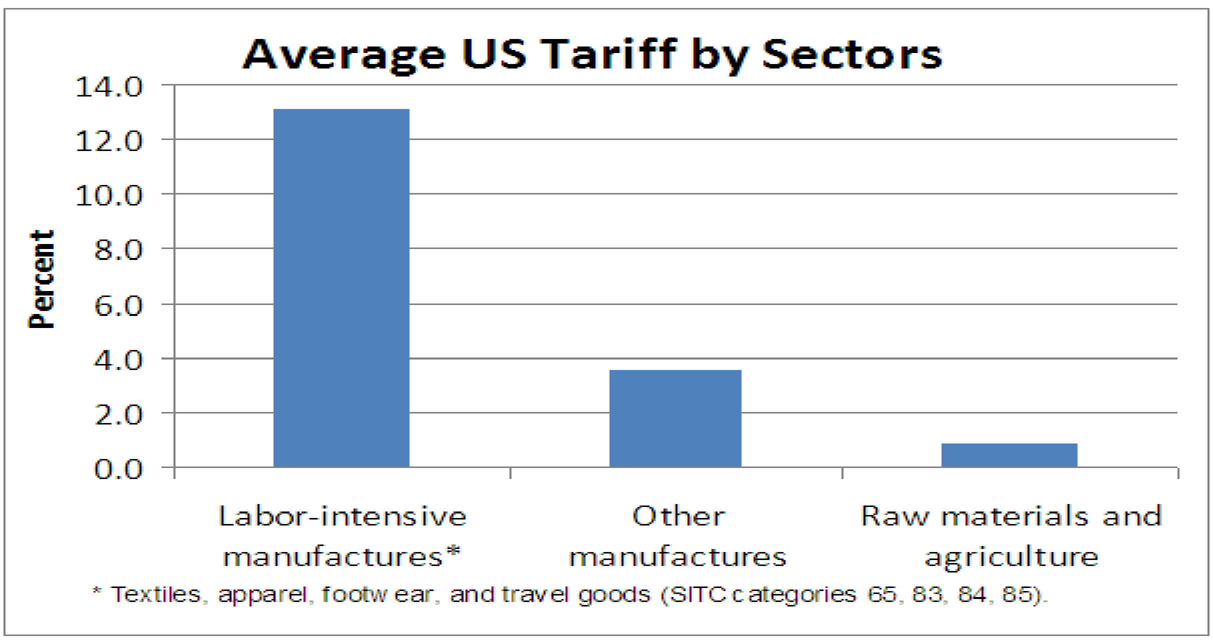
The Obama administration has not backed away from liberalization commitments with their stimulus packages but is luke-warm about the Doha Development Round. Obama has signalled that his administration will sign more bilateral agreements with global south countries with TRIPS-plus kinds of protection for intellectual property rights. It remains a concern that US policy continues to discriminate against the poorest countries and poorest people. In a recent paper Kimberly Elliott (2009) delivers this stinging indictment: “The highest US tariffs fall on agricultural products and labour-intensive light manufactures, where many developing countries have a comparative advantage.” She notes that Bangladesh and Cambodia, for example, are LDCs with average annual per capita incomes of around $500, but the dollar value of duties paid on their exports was almost $1 billion in 2006 for the two countries combined (See figure 4). Compared to the value of the aid they received from the United States in that year, the duties were six times the value of the aid.

Compared to the discriminatory policies imposed on some of the poorest countries in the global south, China is a major priority for Washington. Significantly, trade tensions between the G2 – the United States and China -- have escalated. The immediate threat of system disturbance to future global stability comes from the fact that today Chinese unit labour costs are about 40 per cent lower than a decade ago, while the nominal exchange rate has only appreciated by about 15 per cent. This leaves a net gain in wage competitiveness of 25 per cent (Ferguson and Schularik, 2009). In the current economic turmoil, the United States has already lost 10 million jobs, and further hollowing out of American industry is a certainty given that global supply chains are driving the process and looking for the cheapest place to manufacture standardized products and components. Manufacturing production in China remains much cheaper in dollar terms than it was eight years ago. Given that the United States has no immediate policy strategy to restructure its industries, it will remain exposed to a level of competitiveness from the global shift in supply management never previously experienced, not even when the

United States and Japan went head to head in the 1980s and US competitiveness went into decline.

In November 2009, President Obama issued an executive order to levy tariffs against a variety of Chinese imports with the inevitable result of more pushing and shoving at the interstate diplomatic level. Significantly, this kind of ‘controlled bruising’ keeps trade disputes from spilling into full-fledged confrontation, and despite rising tensions China and the United States remain best trading partners.

Figure 4



Source: Elliott 2009

c. Brazil’s Family Bolsa Program and Financial Reform Measures

Brazil has escaped the worst effects of the global crisis by using its increased policy autonomy to implement expansionary macroeconomic policies that encourage consumption and by increasing public investment to key sectors of the economy such as energy, construction, and social and urban infrastructure. The centrepiece of Brazil's state-led model is the growth acceleration program or PAC, an innovation of Lula da Silva's government. The PAC gives the Brazilian government the capacity for leverage and policy coherence across sectors.With a sluggish average growth rate of 2.6 per cent since 2000, the PAC is an initiative designed to "unlock the country's economy" and boost its growth rate to five per cent. It is useful for both government demand management and creating a stable macroeconomic environment (Wheatley, 2009). The purpose of the growth accelerator program is to initiate measures that encourage private investment, increase public investment in infrastructure, and remove bureaucratic and other bottlenecks to growth.

In the 1990s, Brazil undertook regulatory reforms in the financial sector, and equity investors benefited from the new rules for publically traded companies as a boom in public offerings followed. Reform in the banking sector brough a lot of sophistication and liquidity to Brazil's financial markets (*Economist,* 2009). *The Economist* points to the overarching importance of institutional reforms for lessening the impact of fluctuating exchange rates on domestic prices. The decline of real interest rates to 8 per cent has allowed for better management of public policy and reassured investors. Most importantly, the tight regulation of the banking sector has provided Brazil with a high degree of protection from the collapse of global financial markets and new policy space.

Reform of the Brazilian Financial Sector: Leading Roles for the Market and the State

In the wake of frequent banking crises, Brasilia has made itself less dependent on private capital markets by expanding the role of the Brazilian Development Bank (BNDES), the government's development bank, a move considered by many as a positive indicator of future growth. The BNDES has become a primary source of long-term capital although for many experts the pubic debt to GDP ratio remains a defining issue (Brazil Institute, 2007). Having a stable source of long term funding and that lending is well capitalized is advantageous for both the government and Brazilian banks. The government has expanded the maximum period from 14 to 20 years for long term state loans, increased the lending capacity of BNDES to finance projects from 60 to 80 per cent, and used its resources to reduce the risk spreads charged to infrastructure projects.

The driving idea behind the institutional reform of leading state agencies was to provide finance for private sector projects of national interest. Recently, Brazilian domestic investment averaged 17.5 per cent of GDP, which may explain Brazil's modest growth rate of 3.3 per cent compared to China's 10 per cent (Deutsche Bank, 2009). At other times in the past decade, Brazil's growth rate has exceeded 5 per cent. Brazil has made long-term expenditure commitments to invest in the next generation of bio-fuels as well as in oil and gas. It has also invested billions of dollars in road, airports and railway building as well as other infraststructure projects. The Brazilian strategy is to use the state as a catalyst for development partnerships with the private sector. These measures seem to be working, as Brazil was able to let automatic stabilizers absorb a good part of the shock from the global financial markets.

In October 2009, Brazil surprised the capital markets with a 2 per cent tax on capital inflows to both equity and bond markets. The imposition of capital controls runs against dominant orthodox thinking that markets will allocate capital efficiently and price risk accurately. Capital controls are helpful in easing volatility and in a major study on capital controls, Reinhart and Magaud (2006) found that "capital controls make monetary policy more independent, alter the composition of capital flows, and reduce real exchange rate pressures." The downside is that they hurt the credibility of the central bank as they are seen as punitive measures against capital markets. Massive capital inflows in 2009 caused the Brazilian real to appreciate 34 per cent on the US dollar and over 40 per cent on the Chinese yuan. If the government had not acted with the tax on capital inflows Brazilian exports would have been less attractive in foreign markets, and this would have aggravated the current account balance and left the country much more vulnerable to highly volatile capital flows (Roubini, 2009).

Imposing Capital Controls and Expanding Social Transfers

Brazil was no stranger to capital controls having imposed them previoiusly in 2008 with only partial success because investors invented creative ways to circumvent them. This time, the controls were implemented to cover short-term foreign investment targetting American investors who use American depositary receipt in the United States – investors buy Brazilian shares in New York not São Paulo (Gallagher, 2009). Immediately after the announcement, Brazil lost 3 per cent against the US dollar before appreciating 3.7 per cent four days later (Roubini, 2009).

Brazil is also very aggressive in social spending, and income transfer programs to poor people have been made a priority. The government has expanded programs to provide family allowances to mothers who keep their children in school and have regular medical check-ups. These 'Bolsa Familia' payments are very modest cost for government, at a cost of less than one percent GDP, yet they reach over 12 million families. Additionally the government has embarked on a home building program for the homeless (Wheatley, 2009). The minimum wage has been boosted by 100 percent by the government.
New studies show that these policies have had an effect on Brazil's highly skewed income distribution as the country claims ownership to one the highest gini co-efficients in Latin America. "According to the Institute of Applied Economic Research, extreme poverty halved between 2003 and 2008" but income polarization remains unacceptably high.

So far, Brazil has been successful in both expanding public spending and stimulating growth. Although a decade of reforms have not changed the parameters of the pension system nor led to major reforms in Brazil's labour laws, the state-led model of development has proven remarkably effective in wrestling inflation to the ground and achieving a high degree of financial stability. The significant progress in poverty reduction is impressive by international standards. Brazil has not yet reached its full potential, but it has adopted a heterodox mix of market and state that has not adhered to

IMF rules. As an alternative, Brazil has leveraged its institutional reforms to cushion the impact of global markets on its policy agenda.

d. Ramping Up China's Competitive Advantage

In 2008, China put together a huge stimulus package to revive its economy, which had lost much sparkle and vigour, as the global crisis spread across the world. State institutions led by the Communist Party of China and the People's Bank of China increased their control over China's economic machine during the recession. Not surprisingly, the main state response was to expand the supply of credit massively and to invest especially in infrastructure that would help the economy recover quickly from global turmoil. Experts projected an 8 per cent growth for 2009 compared with the ten per cent plus of recent years, However, confounding its critics, economic growth accelerated by almost 9 percent in the last quarter of 2009 and the rate may well be in double digits once final quarter results are known. The Chinese stimulus program could be larger than 15 per cent of GDP for 2009 (Dyer, 2009a).

Infrastructure investment in urban areas increased 33.3 per cent in 2009 and national spending on roads, ports and other facilties was an amazing 72.9 percent higher than in 2008. The increase in bank lending is credited with the speed which the Chinese economy has rebounded compared to other countries; however, there are clear inflationary dangers in the aggressive spending program. The money supply rose by almost 30 per cent in October 2009.

Property and equity markets have siphoned off some of that money fuelling the belief that future bubbles will result in more bad loans for the banking system. China's financial markets have grown very rapidly since the early 1990s, playing a crucial role in its dynamic development. China's Securities Regulatory Commission regulates and supervises the financial sector, and a whole series of reforms enacted between 1993 and 1998 strengthened its institutional and supervisory framework.

By 2007, China had introduced a series of reforms strengthening the legal state of China's capital markets. In a recent research note, Deutsche Bank analysts underline the fact that "regulatory bodies have followed a careful and gradual reform path and will likely continue with this approach" (Deutsche Bank, 2009). According to the report, Chinese capital markets are not deep in relation to nominal GDP and there is a lack of institutional investors. Many investors prefer short-term investment profit taking to more diversified, longer-term strategies. This kind of behaviour fuels speculative booms and a great deal of volaility. Despite all the market corrections in the wake of the global financial crisis, China's capital markets are still slated for further vigorous growth in 2010 onwards. It is expected that China will become "one of the dominant financial markets in the world by 2018, alongside the United States and the European Union, with a 13 per cent share in global bond markets, more than 40 per cent of global stock markets, and 18 per cent of global banking markets" (Deutsche Bank, p. 22, 2009).

Strengthening State Enterprises a Priority

The crisis has given the Chinese government a commanding position from which to channel loans to large state enterprises and conglomerates. Over the last three years, treasury bonds accounted for almost 80 per cent in total issuance all linked to the state and state institutions. The commanding presence of the state is refleceted in two pieces of information. Corporate bonds from state-owned enterprises comprise more than 70 per cent of the total issued while commercial bank bonds make up only 10 per cent according to Deustche Bank. Flagship state enterprises like CNOOC (China National Offshore Oil Group), one of China's biggest energy groups, has gone on a buying spree in Nigeria, Kazakhstan, Russia, Brazil, Venezuela and Angloa securing oil and gas rights for its energy-dependent economy. China has billions in foreign currency reserves to target a range of strategic acquistions.

Another area of aggressive state activity has been the expansion of state presence in the economy as private sector actors retreated in the downturn. The country's largest food export enterprise bought 20 per cent of China's largest milk exporter. A few months after the purchase, a state-appointed executive replaced the dairy's founder (Pilling, 2009a). State conglomerates have benefited from the cheap loans available with the government's stimulus program. They have grown bigger in size and importance inside China and will be formidable players at the global level. Reports suggest that the state-owned Assets Supervision and Administration Commission, a powerful regulatory body, has supported efforts by Chinese companies to break unprofitable derivative contracts with foreign banks. This move is regarded as another example of China's powerful administrative machinery interfering in market transactions in the national interest (Pilling, 2009a).

Certainly, the government has increased its role in the management of financial markets and has used the crisis as a basis for further expansion. All of the evidence is that China is emerging more resilent and is a financial giant in the making.

The bulk of China's aggressive government stimulus spending is intended to upgrade the country's infrastructure, which is already regarded as one of the best in Asia. China has budgeted $182 billion for upgrading and building new rail lines -- adding 17,000 kilometres to the existing 75,000 kilometres, 7,000 of this for passengers and the rest for freight (Anderlini, 2009). Another 6000 kilometres of rail line will be upgraded or built to high-speed levels. China's three largest state-owned construction companies will carry out the construction operations. Although in theory, foreigners are permitted to invest in rail construction, in reality, this dynamic sector remains dominated by a handful of state-owned firms.

As China's growth continues to rebound as a result of the government's aggressive stimulus package and credit expansion, the government has given no hints that it plans to end its stimulus strategy immediately despite concern for inflationary expectations should there be strong price rises. This explains the textbook reliance on an array of monetary, regulatory, and exchange rate tools for fine-tuning the economy in the crisis (Dyer, 2009). At present, the impressive transformation of the last two decades shows no signs of slowing down. China's share of financial markets is likely to grow and this growing share of global export markets reflects a powerful new competitive drive that will position China as a major economic power in the decade ahead.

China is experiencing a second great wave in the transformation of its market structure, much of it driven by the government's strategic response to the global financial crisis. For the time being, Beijing has shifted its economic focus to the domestic economy to ensure a strong recovery. Chinese consumers are often criticized for their high level of savings. In this recovery, China is trying to find a new equilibrium point between its powerhouse export model and increased consumer spending. So far, it has not found the optimal trajectory and while it has increased social spending on health and education in the countryside, many doubt that these one-off initiatives will be retained or increased in the future (Dyer, 2009).

Looking Forward: New State Practices in a Time of System Crisis

The rediscovery of these rule bending rescue measures by governments for shoring up the economy from the collapse of financial markets has been nothing short of dramatic. Governments need to monitor their distributional impacts on society. As yet we do not have a sophisticated theory of the role of the state in the current phase of globalization, and there is still a propensity to conflate legitimate government intervention with the trade distorting use of subsidies and other measures. Among the state practices with long-term impacts include:

- The unparalleled use of taxpayers' money rescued global capitalism from total collapse by injecting liquidity into a financial system on the point of collapse from a global slump in aggregate demand.

- The unprecedented commitment by states to invest billions in infrastructure projects on an unparalleled scale will have transformative impacts for years to come.
- The generous European social welfare nets have been a key component in the Eurozone's road to recovery but consumer demand is in need of further stimulus.
- Rescue packages tailored by governments for specific industries such as auto and other sectors facing bankruptcy and closure have been dramatic in their cost to the public treasury but successful in the short-term.
- In the process of avoiding 'protectionist' policies, the state has acquired a new legitimate role as countries across the globe look for co-operative solutions to the crisis.

Importantly, governments everywhere continue to rely on the tax system, competition policy, state enterprises, social policy, technology, and research policy to hold back the full play of free trade dynamics (Hollingsworth and Boyer, 1997). One of the consequences of effective demand management is that the 'free of the public sector' approach has lost is credibility as a viable policy option. With the passage of the Lisbon Treaty in 2009, the European Union and the process of European integration with its large social market now serves as a positive model for many other regions particularly Brazil. Notably, the Indian government has guaranteed each family in the rural sector more than one hundred hours paid annually at a minimum rate established by the central government (Dailami and Masson, 2009).

Policy co-ordination at the national level has become at once more challenging and complex. One important development to note is India's and China's very different strategies in this regard. With China ascendant and moving to the pole position globally, it is intent on leading Asia's industrial revolution (Ferguson 2009). India has also taken a leadership role particularly in the formation of coalitions inside the WTO, using its influence to increase the leverage of the global south in the Doha negotiations. So the question is, will these new power dynamics transform the multilateral agenda of trade governance and push the WTO in new and challenging directions (Zakaria, 2008)?

In many regions of the world, new state practices are requiring governments to take other policy communities into account so as to maximize synergies and minimize the negative impacts of increasingly open economies. Certainly the US, the Eurozone and Japan, the most powerful actors inside the WTO, are no longer able to take for granted that their policy preferences will automatically prevail and that they will reap all the rewards from negotiations as they have in the past (Blouin, 2007). Giving consumers and social movements a voice for their highly diffuse interests is a policy idea that has gained a great deal of credibility. The policy environment has changed markedly. The move away from un-coordinated market liberalism to a modern regulated form of co-ordinated market capitalism requires new forms of co-ordination and different sorts of institutional mechanisms to slow down the pressures of` global integration.

A History Lesson

Economic historians have shed important light on the difference between legitimate state interventions and beggar-thy-neighour policies. The essential difference is that when countries believe there is no alternative to shield themselves from the volatility of international capital markets and other global forces that cause massive haemorrhaging of labour markets; they erect tariff walls and other non-tariff barriers to prevent countries from dumping their export surpluses in their domestic market. Economists remind us that the world economy has lived through two great periods of unorthodox trading practices -- each very different-- that had huge consequences for the world trading system.

The first free trade countermovement was lead by Otto vonBismarck against Pax Britannica in the 1880s. His objective was strategic and hegemonic – to build German industries and compete militarily, economically and commercially against Britain and its allies. Bismarck won his gamble and his industrial policy, designed to build a German war machine behind high tariff walls, succeeded beyond expectations (Borchardt, 1991). The British free traders lost the first great commercial battle to establish an imperial, centeralized, liberal trading order. Germany taught the industrial world the lesson that tariffs and industrial stategy were indispensible instruments to challenge Anglo-American global dominance (Kindleberger, 1975).

Round two came in the 1930s when interwar free trade came to a jolting halt as international capitalism imploded in the 1929 Wall Street crash. Countries erected mountain-sized tariff walls that squeezed the commercial air out of the world trading system in a panic attack of tit-for-tat retaliation (Carr, 1939). The victor in this round, ironically, was full employment capitalism. At the end of the Second World War, US laissez-faire capitalism morphed into regulated capitalism. The rehabilitated post-war trading regime found a way to institutionalize open markets with a rapidly expanding Keynesian welfare state (Hobsbawm, 1994).

Compared to the post-war period, the post-Washington consensus world has greater legal stability in trading relations because of the GATT and WTO agreements. With increased transparency and public scrutiny, contingent legalized protectionism has a very large place **inside** the WTO. Countries have learned, in the words of India's ambassador Ujal Singh Bahatia, that "doomsday predictions of a return to the Smoot-Hartley era are out of place. Domestic pressures toward protectionism are offset by the voices of the many people who have benefited from globalization" (*Bridges Weekly*, 22 April 2009).

The Lexicon of Modern Protectionism

The role of the WTO as the global watch dog is to keep creeping protectionism on a short leash (Goldstein 2006). It has to assess the impact anti-dumping and safeguard measures will have on commerce even though the line between domestic permissible measures and injurious discrimation is difficult to untangle (Staiger and Skyes, 2009). In fact, protectionism has always been a structural element of the free trade system – and institutional safety net for the liberal trading order -- and should not be considered in the category of aberrant behaviour by desperate governments. Jadish Bhagwati notes (1989, 53), "if you reduce one kind of protection, another variety pops up elsewhere." Various kinds of legalized protection remain integral to the institutional practices of the multilateral world trading system.

States have a battery of policy instruments with which to protect their industries and work forces ranging from quantity restrictions such as import quotas, export limitations, and voluntary export restraints, to regulatory restrictions such as domestic content requirements, sanitary and phytosanitary requirements, and safety and health regulations. Restrictive rules vary widely and cover every domain of public policy (Trebilcock and Howse, 2005). Rules and regulations restricting foreign investment in the national interest or on grounds of national security is another critical front-line area of state regulation. Currency management is a formidable weapon with which to gain a competitive edge over trading partners. Countries regularly rely on a devalued currency to lower the cost of their exports and increase market share; such undervaluation can be thought of as dumping or tough competitive practices.[7] The danger is that at times of high unemployment currency misalignment can escalate into a full scale trade war.

Bending the Rules in Un-Normal Times

[7] Canada's access to the US market for much of the post-NAFTA period depended on a weak but highly competitive dollar --(Can) $.63. (Drache 2009). China's exchange rate is a cause of concern in Washington which regards the renminbi as undervalued and its exchange rate policy tantamount to protectionism. If US Congress decides that China is a 'currency manipulator', it is likely to restrict Chinese exports in the US market. China has depended on US corporations with major production facilities in China to tone down the US perception of China as undervaluating its currency to gain 'unfair' market advantage. US business groups no longer believe they can resist the pressure from Congress for a tougher stance against Beijing. See James Politi and Patti Waldmeir, "US business shifts stance on China," *Financial Times* March 22 2010.

In light of the need for legitimate government intervention, modern forms of social protection can be be analytically distinguished from mercantilist protectionism designed to put the boots to one's trading partners and choke off exports. The most toxic of these beggar-thy-neighbour tariff walls is the indiscrimate use of quotas. Other measures such as safeguards, anti-dumping, state aids and subsidies, while contentious and subject to retaliatory action, are legal and long established. A third category of stimulus driven measures adopted by states in crisis situations include bailouts, wage subsidies, cheap credit and industry rescue packages (See Figure 5 The Extended Range Of Modern Protection(ist) Practices).

Countries have found a way to use protection policies not to choke off trade but to deal with exceptional circumstances when they arise. Unmanageable surges in imports, calamitious price rises in basic food items, currency spikes and other structural and cyclical 'disasters' have forced states to bend and sometimes flout the WTO rule book which is opposed in principle to the use of subsidies and rescue packages. It would help to have better WTO rules governing the use of state subsidies, rescue packages and final bailouts but it is unlikely that there will be any new framework agreement. Simon Lester looked at the current draft of the revision to WTO subsidies (TN/RL/W/236) and found that it still does not allow governments to rescue industries in a crisis (IELP, 2009). He proposes an exemption for situations where imports have caused harm to domestic markets or world markets. So far even this modest proposal is not part of the negotiations. Even if there is a Doha-lite agreement sometime after 2012, the legal and political boulders on the path to reform of subsidies and other interventionist measures are formidable.

Figure 5

THE EXTENDED RANGE OF MODERN PROTECTION(IST) PRACTICES

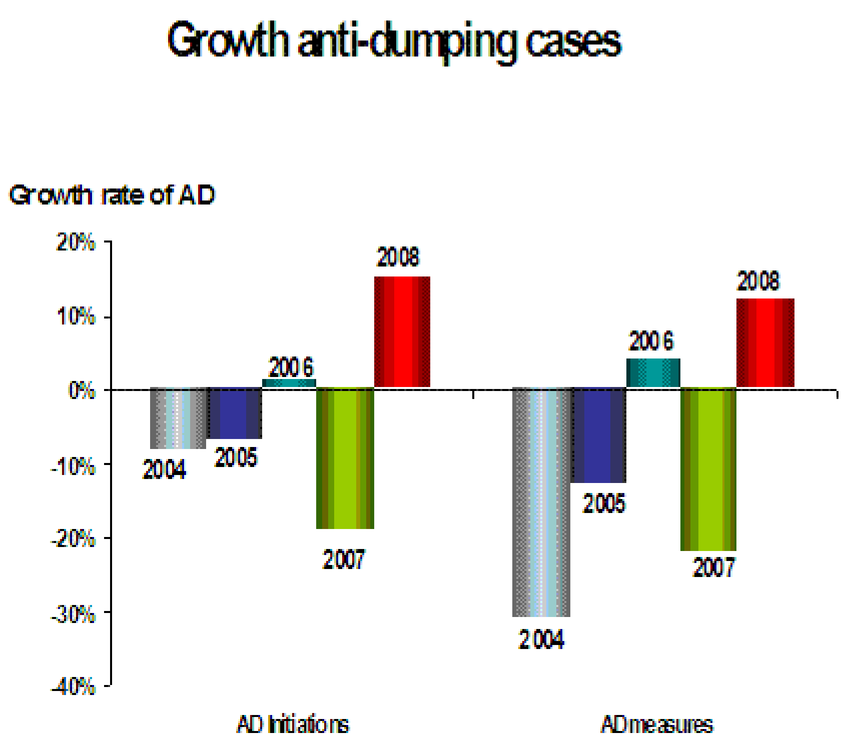
A Selected List of Measures

Difficult	Contentious	Most Controversial
Stimulus packages	Anti-dumping duties	Import quotas
Wage subsidies	Countervail duties	Customs and barriers
Packaging/labelling	Industrial Policy	Beggar-thy-neighbour tariff walls
Tech. licensing restr.	Currency Devaluation	Voluntary export restraints
Industry rescue $$	State Aids/subsidies	Export Bans
Food/health standards	Unilateral safeguard action	
Bailouts	Buy America	

Source: Drache 2009

Paul Krugman (2009a) tell us that when countries are faced with liquidity traps, currency crises, demand constraints, overextended consumers and overleveraged dud banks, the rules change dramatically and new often unorthodox rules are established. A little protectionism, in his carefully chosen words, is actually helpful. It encourages countries to apply the proper amount of stimulus to get the economy closer to full employment than might otherwise occur. Governments can support industries with financial and other state aids rather than force them to reorganize or close down as textbook theory instructs. They need to bend the rule of the Most Favoured Nation principle and limit market access; but this rule bending is legal and functionally important to national sovereignty as can be seen in Figure 5. What is significant is that of the use policy instruments providing domestic industries immediate relief from import surges, precipitous falls in demand and the collapse of global markets increased in 2008 as countries imposed duties on imports.

Figure 6



Source: WTO, Anti-dumping Database and Chad Bown, Global Antidumping Database, World Bank forthcoming 2009.

Significantly, the WTO has been quick to monitor the legalized protection that is part of its rule-based trading system. Trade theorists, such as Chad Bown (2009), argue that there is a cyclical dimension to state reliance on anti-dumping cases, see *Figure 6* "Anti-dumping cases, 2007-2008." It should surprise no one that surging unemployment and the near bankruptcy of mass production industries, such as auto and steel, have forced many countries in the global south to use anti-dumping strategies to buy time to ride out the global recession (Bown, 2009). Trade experts suggest that anti-dumping is functional and operates like an ad hoc industrial strategy for short-term goals. It allows states to give industries that are in short-run trouble state relief.

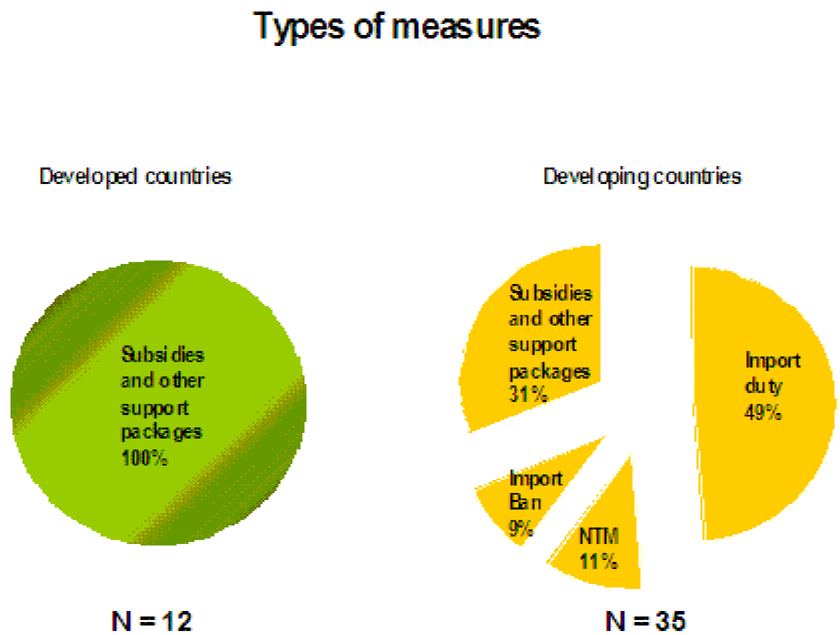
Global Protectionism: Still A Worrying Trend

In March 2009, the World Bank released an important quantitative assessment of trade protectionism, one of the few assessments compiled to date. The authors of the study are of the view that, so far, protectionism has been creeping and largely ad hoc; but they are uncertain whether it will stay that way. The 2010 Heritage House Index of Economic Freedom, which coincidentally covers the period of the worldwide recession, also examined incipient protectionist practices by government. The index captures government reliance on protectionist measures such as tariffs and other barriers. (Markheim and Miller, 2009). Remarkably, its ranking shows that worldwide average tariffs fell from 7.3 percent in 2009 to 6.8 percent in 2010 (Index of Economic Freedom 2009). With respect to non-tariff barriers, the one area in which a sharp rise might have been expected, barriers rose only 0.2 of a point from 11.7 in 2009 to a projected 11.9 in 2010.

The World Bank's assessment focused primarily on trade 'remedy' policy instruments such as anti-dumping, safeguards and countervailing duties – these are anti-subsidy policies implemented in response to domestic industry demands for protection. The immediate effect of these 'remedies' is an increase in the price of affected goods for consumers, so in periods of economic distress, these higher priced goods add to the burden of families and individuals (World Bank, 2009).

The World Bank, monitoring the list of trade and trade-related measures implemented since the beginning of the financial crisis, found 78 trade measures involving trade restrictions and the banning of imports in the name of health, safety or the environment. Of these, 66 were deemed to restrict trade at the expense of other countries. Significantly, thirty percent of the measures were dropped, important evidence that countries are adopting contingent kinds of protectionist measures to deal with the short-term collapse of global markets. Tariff increases, one of the best indicators of a rise in protectionism, comprise about one-third of recent trade restrictive practices. Rich countries have relied on subsidies and poor countries have used duties to restrict imports. One measure puts the total number of tariff increases at less than .05 percent of global exports (See Figures 7).

Figure 7 Rich countries use subsidies, poor countries use duties



Source: World Bank staff, List of Trade-related Measures, February 2009. Excludes anti-dumping cases.

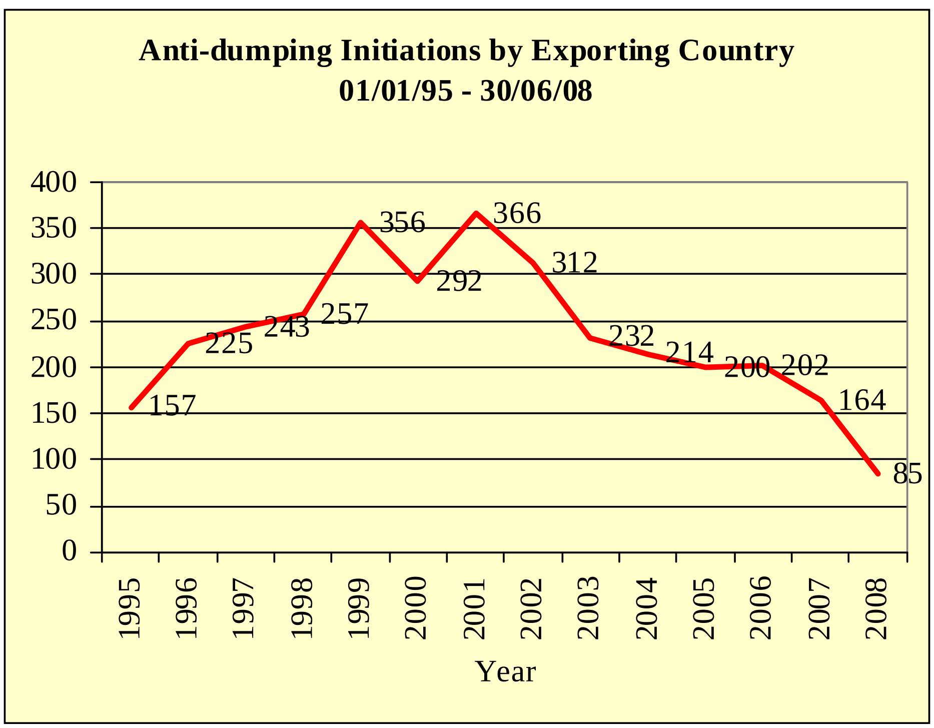
Since October 2008, the actual number of states pursuing protectionist measures is small by any measure. For instance, China banned Belgian chocolate, India excluded Chinese toys, and the United States congress has strengthened “Buy American” provisions. The U.S. energy secretary has stated he would like to impose tariffs on Chinese goods if Beijing does not reduce greenhouse emissions, but so far he has not acted on the threat.

China is at the centre of many of the most important trade disputes not only with the United States but also with many other countries. According to Simon Lester (2009) an international trade expert, of the most recent eleven WTO cases filed, seven have involved China -- in two of them China is a complainant and in five a respondent over tires, chickens, steel pipes and cars. The quantitative impact of these practices is small measured against global trade flows; however, their symbolic importance has attracted worldwide attention to the dangers of increasing trade tensions between China and the United States.

Legalized Protectionism: A Functional Defence

Rising China-US trade tensions is not an isolated example of the new genre of trade conflicts. Many experts consider anti-dumping to be a covert form of industrial policy as it offers stressed industries short-term relief from compeititive imports (See figure 8: Anti-Dumping Initiations by Exporting Country). The European Union, China, and the United States have used anti-dumping strategies to protect their low value products such as steel, paper and cement (Beattle, 2009).

Figure 8



Source Drache (2009)

Manufacturers who want to get an edge on the competition drop export prices on goods in order to increase market share by means of aggressive pricing strategies. When this occurs, states have the right to impose border restrictions on goods that are sold below the cost of production. More than two thousand antidumping notifications were reported to the WTO from 1995 to the beginning of 2005; by 2009, reports of antidumping passed the three thousand mark. Approximately 5 per cent of these went to the panel process, a fact that benefits the most powerful traders (Drache and Froese 2007).

The real issue behind the use of these trade measures is the changing geography of power, not only unfair trade practices per se. The different conception of the role of the state for developmental ends is at the centre of these disputes. Developing countries in the global south are relying on anti-dumping measures as sanctioned by the WTO to an unparalleled degree. They are beginning to use the system against leading exporters in the global north (Narlikar 2006). India was the most active country using this measure of trade with anti-dumping measures accounting for almost thirty percent of all the new initiations. Still in January 2009, Pascal Lamy, Director-General of the WTO, found there was “limited evidence” of any trend to restrict trade. In a second report released in April 2009, member states could not agree whether there had been “significant slippage” towards more lethal forms of protectionism (*Bridges Weekly*, 2009).

The Braudellian Turn: Some Lessons Learned

The lessons learned from an examination of these new state practices present a complex picture of global demand management strategies despite sharply contrasting institutional cultures. Analytically it is useful to identify some of these big picture themes of globalization after neoliberalism. The most important for the short-term are:

- States have acquired new interest in increasing policy autonomy and expansionary macro-economic policies nationally and in international bodies like the WTO. The focus on stability strategies marks a new phase in rethinking the trade-offs between equity and efficiency goals and the now contested objectives of market fundamentalism. India and Brazil have taken leadership roles and the old club model where the few decided for the many has given way to strategic coalitions of southern countries where the many negotiate and decide for the many. The new way of conducting the WTO business of negotiations has challenged the policy agenda of trade multilateralism to an unprecedented degree.
- Scaling up investment will pay long-term dividends for countries that use these tools wisely and prudently to develop their own policy space. Whatever the perceived distortions to trade are at the present time, the stimuli packages of taxpayer dollars have proven to be a surprisingly effective counterbalance to the turmoil in the world trading order.
- With world trade volumes wiping out the last four years of trade growth in less than half a year, globalization and neoliberalism are presently engaged in a messy divorce where new rules and practices are needed. Markets depend on confidence, the quality of the rules and the ability to deliver a higher standard of living -- all now in short supply. The coming global financial reforms to banking practices, derivative funds

and commercial-investment of near banks has acquired a momentum of its own in Washington and Brussels. Addressing the legacy costs of Hayek's seamless, perfectly equilibrated theory of markets, risks to overshadow the long awaited commitment to the millennium development goals.

- The current global crisis is not like the one of the 1930s when mountain-sized trade barriers brought the world trading system to its knees (Bhagwati, 1989). Strikingly, no country wants a global trade war -- not China, the United States or the Eurozone despite the new role of the state to broaden and deepen the management of national policy space. Governments always had an array of protectionist policy instruments available and have recently rediscovered both their legality and functionality. It is important to underline that legalized protectionism has been a structural element of the free trade system operating as a kind of liberal safety net for the trading order. In the global crisis, states have made extensive use of many of these policy instruments but no protectionist surge has been evident. [8]

The flushing of the system has other significant long-term impacts. Fernand Braudel, the great French historian, stressed the critical notion of the *longue durée* to grasp the contrary dynamics in times of deep structural change economically, culturally and, most important, socially.[9] The explosion of demand management and the expansion of policy space across the world is a phenomenon of historic proportion. It is important to see the

[8] Only 0.4 percent of imports were hit by new G20 restrictions according to the latest G20 2010 study commissioned by the G20 governments and the WTO(Beattie, 2010).

[9] For a contemporary examination of systemic change and the ways deep changes in the production of knowledge change our received wisdom about state and society see Jeremy Rifkin's latest book, *The Empathic Civilisation: The Race to Global Consciousness in a World in Crisis,* Politiy Press 2010.

current global crisis of demand management through a Braudellian lens. In 2002, *The Economist* published perhaps the most important table of the past twenty years. It was a graph that showed the global south led by China, India, Brazil and Russia overtaking the global north's share of global production. In this single table, *The Economist* captured the global shift that has already redefined the power relations between the North and the South.

Three immediate policy-directed conclusions flow from this Braudellian conjuncture. First, the 'rise of the rest' is redefining the system of trade multilateralism and bringing new challenges and conflicts. In many parts of the world, complex problem-solving has increasingly devolved to the regional level. This makes any co-ordinated response to the global crisis from the international community of nations increasingly complicated and hard to do. Co-operative action to achieve strong and sustainable growth has been slow and with G20 momentum flagging to find global consensus, the risk of future crises remains. National strategies, however effective in the short-run, are not enough. 'Controlled bruising', a form of national interest arbitrage between China and the United State, will continue to limit the fall out from rising trade tensions and force MNCs to adopt new strategies. Global business increasingly will look to national governments to support their drive for market access. The worry is that, in the word of Dominique Strauss-Kahan, "the need to find global solutions will be lost" (March 31, 2010).

Secondly, for a more balanced world economy to emerge from the chaos of the collapse of global financial regulatory order, public authority has to be more conservative than financial markets. The re-regulation of the financial architecture of global capitalism is still in its early days but remains the critical policy issue for governments as they look to reform the global architecture of internatonal financial markets. The most important message from these panics and regulatory failures is that strengthening domestic policy space and the need for autonomy, not template economic policy of a Washington Consensus kind, is now the priority. Banks need to keep more reserves, more regulation is needed to shed light on excessive-risk taking, banks will have to share the cost of future bailouts and the big bonuses paid to chief executive officiers have to be capped. France, Germany, UK, US, Japan and Hong Kong have already adopted new regulatory measures to avoid another global financial crisis but still there is no agreement between the US and European regulators. Financial reform has proceeded much more slowly in India, China and other jurisdictions.

The rise of the rest with their vast populations and enormous income inequality brings with it a new demand for more not less structural change for developmental ends. As we have seen in the cases of Germany, the United States, Brazil and China in the Great Recession of 2008-9, a strong GDP performance and high levels of consumer demand is the best way to limit system disturbance in times of crisis. Loose policy co-ordination beween the Euro-zone, the United States and China has been effective in the short-term but still not capable of sustaining balanced global growth. National strategies have been effective but not sufficient. The need to find global solutions remains a priority.

Finally the state is no longer missing in action but there is no co-ordinated response to the the extraordinary collapse of the housing investment bubble. The US recovery continues to be fragile and unemployment is stuck unacceptably in the double digit range. In 2010, Ben Bernancke warned that the US economy was still months away from any monetary policy shift. The much-needed extension of employment and other social benefits to millions of US workers continues to be critical to shoring up hesistant consumer demand and keeping interest rates at historic lows. The US recovery remains slow-paced and has forced experts to revise their expectations downwards. Labour markets and consumer spending continue to be weak. In 2010 Bernanke told the United States Congress that the Fed would continue to bring mortgage rates down and to buy Mortgage Backed Securities. His message was that there would be more need for fiscal consolidation and new regulatory reform initiatives for better oversight of systemtic risk, new rules for derivative trades, protection for consumers and the regulation of investment banks. For the next while governments will continue to favour a loose monetary policy to ensure a full economic recovery.

Global Policy Intervention: Scaling Up Across Borders

New state demand policies are nothing less than the product of system disturbance in times of crisis. Any premature exit strategy by governments to cut spending will have a large negative impact on mortgage rates, job creation, new hirings, and house prices. Winding down emergency programs 'would have significant impact on banks capacity to lend' and extend credit to firms and banks warned the International Finance Market Monitoring Group representing the world's biggest financial institutions (Brathwaite, 2010). Boosting growth and not fiscal consolidation is critical to strengthening the bond between citizens and government. Governments have begun to rebalance freedom and security, a no mean achievement at a time of global markets and economic integration.

For instance, in late November 2008, French President Nicolas Sarkozy announced a new thirty billion euros investment fund to protect France's strategic industrial assets from the credit crunch and foreign takeover; this was a strategic decision. His rationale could have easily come from any contemporary political leader: "The day we stop building trains, aircraft, cars, ships what is left of the French economy? Memories. I will not turn France into a reserve for tourists." Behind this rhetoric, there is something quite visible – a growing anxiety about joblessness and mass unemployment as a global reality. Unemployment has spiked in the United Kingdom and Spain; the numbers are also grim in Korea and Japan. Canada has already lost 400,000 industries jobs and the United States 10 million. China's labour market problems are on a scale unimaginable to a western economy. It is reported that over 20 million workers have been sent back to their villages. Still countries have to deliver on their commitments. National strategies have to have a global counterpart to ensure that fiscal, monetary and trade policies around the world add up and support strong and sutainable growth.

Fundamental changes in the world economy like the ones we have been describing require policy makers to accept the fact that governance requires a new agenda of global policy co-operation. The idea climate is more open, innovative and forward looking today than any time in the recent past. The priority is to make poverty eradication, sustainable development and climate change at the centre of the global policy agenda and this is no mean task as people everywhere try to come to terms with the Great Repression of 2008/9. For the moment the global crisis has had the untended consequences of the development agenda being shoved to the global public policy back-burner.

Still, addressing the structural weaknesses that led to the crisis has driven home a basic lesson that enhancing security is no longer a purely economic goal. New mechanisms to link macro economic policy to the micro side of economic policy are called for, but still are not in place. State rescue policies and legalized protectionism are, to say the least, an odd couple. At a time of system crisis they have delivered many positive benefits as financial markets collapsed and capitalism found itself on its hindfoot. These kinds of extraordinary measures direct our attention to the more fundamental requirement that global governance co-ordination must begin by reinforcing national policy space and scaling up co-operation across national boundaries. More innovative and effective forms of state intervention are essential in the transition.

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