Fed up with protectionism
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The current-account deficit is benign, says Alan Greenspan, but protectionism is dangerous. America’s garment makers do not agree. Its European creditors may be having second thoughts too

THE United States spends over $500 billion more each year than it produces. It gets away with this vast current-account deficit by selling American IOUs to foreigners. Many, including the International Monetary Fund, wonder how long this arrangement can continue and fear what will happen when it stops. But Alan Greenspan, chairman of the Federal Reserve, America's central bank, thinks the deficit is relatively harmless. At a conference on Thursday November 20th, he argued that borrowing from foreigners is easier than ever before thanks to the greater openness, transparency and unity of the world's capital markets.

But not everyone in Washington agrees. Manufacturers and their champions in Congress blame the trade deficit on an overvalued dollar that makes American exports uncompetitive on world markets. In response, the Bush administration has attended to both the cause and the symptoms of their complaint. It addressed the dollar's overvaluation in Dubai in September, when it invited the finance ministers of the G7 group of rich nations to sign a communiqué declaring that exchange rates should be left to the markets. Last year, it gave America's ailing steel manufacturers some more direct support by slapping tariffs on imports of steel. Now, it is turning its attention to textiles.

On November 18th, Grant Aldonas, under-secretary at the Department of Commerce, announced new import quotas on Chinese dressing gowns, knitwear and bras, capping their growth next year to just 7.5%. Mr Aldonas invoked a clause in China’s treaty of accession to the World Trade Organisation, which allows America to constrain import surges that threaten to disrupt domestic markets. The bra-buying public, benefiting from cheap Chinese imports, may not have noticed any market disruption. But America's textile firms, suffering from plant closures and job losses, would disagree. Now, the Commerce Department has shown that it is willing to use every device at its disposal to ward off the menace of cheap dressing gowns.

Mr Greenspan seems more concerned by the menace of protectionism. Long a champion of free and unfettered markets, he rounded off his speech on Thursday with an uncharacteristically rousing call to arms. "It is imperative," he declared, "that creeping protectionism be thwarted and reversed."

The quotas announced on Tuesday were in themselves only a small creep forward for protectionism. They cover only a few products, although the limits they impose will pinch tightly:
China’s exports of cotton bras to America, for example, grew by nearly 32% in the first nine months of this year, according to the American Manufacturing Trade Action Coalition. The symbolism of this protectionist gesture is probably of more consequence. It shows that America is willing to shield its textile workers from foreign competition even after the mesh of quotas that currently trammel the global textile industry is undone next year. This prospect alone is enough to weigh on the plans, expectations and share prices of Asia’s light manufacturers. The gesture is also weighing on fraught Sino-American trade relations. The day after the quotas were announced, China cancelled a trade mission to the United States to buy American cotton, wheat and soyabean. It also seized the occasion to announce that it is considering retaliatory measures against America’s illegal steel tariffs.

Chinese exports of textiles may be surging. But of greater significance to America's deficit are signs that European exports of capital may be starting to ebb. According to figures released on November 18th, foreigners poured just $4.2 billion (net) into American stocks, bonds and notes in September compared with over $50 billion the month before. America has not seen such a sharp turnaround in capital flows since the terrorist attacks of September 11th, 2001. The volte-face was most striking among European investors. Over the first eight months of this year, according to Morgan Stanley, Europeans made net purchases of American assets averaging around $28 billion per month. In September, they stopped buying and started selling, offloading a net $403m.

The news that America was trying to repel imports and failing to attract capital took a heavy toll on the dollar. On November 19th, the greenback fell to a three-year low against the yen and an all-time low against the euro. It soon rebounded a little, as the Bank of Japan conspicuously failed to deny rumours that it would intervene to support the dollar. But the Japanese central bank cannot prop up the dollar single-handedly. Of all the American securities held abroad, nearly half are in European hands, according to Morgan Stanley. If Europeans start selling (or even stop accumulating) these holdings, the Japanese authorities will struggle to fill the breach.

On their own, however, September’s figures are only a portent, not a proof, that the world is starting to lose its appetite for American assets. Monthly figures on capital flows are always quite volatile. September’s numbers may also reflect an initial over-reaction to the G7’s Dubai communiqué, released towards the end of that month. Investors may soon return to the fold now that the American economy is so clearly outstripping its rivals in Europe and Japan.

As Mr Greenspan said on Thursday, it is hard to know when a country’s flow of deficits and its stock of foreign debts become unsustainable. And when they do, it is hard to know whether they will unwind gently or abruptly. He himself suggested that, provided markets for goods and capital remain open, flexible and unfettered, market forces will be enough to "defuse" the deficit "incrementally". But not everyone in Washington seems as willing to leave the markets to their own devices. Some seem to think Mr Greenspan’s “incrementalism” needs a jolt from a bit of protectionism.