
23 Containing the economic nationalist virus through global coordination

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Economic nationalism is an opportunistic infection, seizing its moment now when the global economy is already weakened by the COVID-19 pandemic. This is partly inherent to the situation. Scared people and their politicians try to look after those closest to them, and hoard everything – medical equipment and pharmaceuticals, dollar liquidity, local markets, opportunities for exports, even aid to poorer countries. They want to keep it all for themselves and judge their friends’ worthiness of sharing with on an ever-rising standard. This is also partly the result of policy agendas being advanced by governments with autarkic autocratic sympathies, as emblematised by US President Donald Trump and his advisors, but also seen to varying degrees in Brazil, Hungary, India, the Philippines, Poland, and the UK (de Bolle and Zettelmeyer 2019). These ideologues see their moment in the current crisis, much like their nationalist forebears tried to seize the moment in the depression and disorder of the 1920s and 1930s.

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The economic nationalist policies of today are no more deserving of victory than the fascist regimes of a century ago. While fear-based hoarding on a national basis is human and understandable, it is counter-productive and costly. Both public health and macroeconomics demonstrated long ago that if every national government, let alone every household, tries to self-insure in a panic, the outcome makes everyone worse off. On the economic side, demand collapses, as do asset prices; liquidity and credit disappear; and shortages of critical components, skilled labour, and supplies of, yes,

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food and medicine emerge. Over time, those countries which try to be self-sufficient across the board and decoupled from the global economy just will end up suffering more from lack of diversified sourcing and unavoidable local shocks, though this harsh reality gets obscured in the current crisis.

Economic nationalism is not deserving of victory

Protectionist self-isolating policy regimes, of the sort advocated by the nationalists in Brasilia, Delhi, Washington and elsewhere, also lead to arbitrary exercise of political favouritism and punishment in the economic sphere, country by country, business by business. This not only corrupts and oppresses, but such regimes drive trend investment and productivity downwards even in the absence of a pandemic. These regimes raise the risk of global conflict and exploitation of smaller nations (Posen 2018). Stopping these opportunistic infections from becoming chronic conditions of our economies, after the plague has subsided, is critical to our lasting economic recovery.

International economic policy coordination, however, has an uphill road to navigate beyond the political fears and scapegoating fanned by COVID-19. The Trump administration's trade wars of choice have undermined working relationships between US and other governments; migration disputes among G20 members, including intra-EU, have further created distrust; growing suspicions of Chinese ambitions and practices have limited resources as well as the ability to make decisions in the IMF, World Bank, and WTO; lasting feelings of disappointment in technocratic and collaborative solutions to the financial crisis of 2008-2012 have been played upon by the same nationalist politicians to weaken policymaking capacity (visible diplomatic failure and disorder are their desired outcomes).

The irony, and actually the good news, is that the G20 economic policy coordination need not be all that ambitious in order to make a substantial positive impact. Many economic nationalists attack 'globalism' or international cooperation as harbouring aspirations for world government. During the last crisis, however, cooperation succeeded primarily by preventing opportunistic infections from beggar-thy-neighbour actions, even though the primary lifting of demand and financial restructuring had to be done by domestic governments on their own.

In several key policy areas, there is a useful agenda building on experience which should be advocated, and which importantly in no way conflicts with public health measures or increases expenditures. Such a collaborative agenda would at the margin also encourage governments to behave in more constructive and timely manner by ruling out some bad options. It is important, though, that the long-term goals of such

collaborations be behavioural norms for governments, cast in negative or deterrence terms, and as specific limited deals between governments. Attempts to connect across visibly distinct issue areas or to emphasise governance processes – let alone to use this moment to expand international organisations – are likely to backfire in our current era. Again, such ambition is fortunately not necessary in order to be effective in contributing to economic response to the crisis.

Monetary policy should stop panics in fixed-income and jointly raise the inflation target

Monetary policy has to take a backseat to fiscal policy on the macroeconomic stabilisation front in this crisis. The capacity for and impact of monetary easing were already limited in our secular stagnation, low-interest-rate environment whatever the nature of the next recession (ASSA 2020). Monetary policy is particularly ill-suited to respond to the COVID-19 pandemic, given its aspects of sudden stop in provision of labour services and key real activities – not financial flows – and other supply shocks. To the degree that central banks can prevent deflationary expectations from setting in, and real interest rates from rising, that of course would be helpful, but there again fiscal expansion has the most important role. What monetary policy measures should emphasise is stopping financial panics in fixed-income and credit (not equity) markets, where it can make a material difference and has effectively unlimited ammunition to do so. The Federal Reserve’s announcement regarding the Treasury repo market is a good example of this kind of measure.

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The best that can be done internationally on the monetary policy front is to increase the credibility of commitments to reflation, and to avoiding any premature or inadvertent tightening of policy. No one should kid themselves about the effectiveness of forward guidance as a boost to inflation expectations let alone nominal outcomes today (Posen (2012)). But central banks make recurrent mistakes of tightening prematurely, as the Bank of Japan did in 2000, the ECB did in 2011, and the Fed did in 2018. No central bank should be party to exporting deflation to other economies. So the major central banks should come together in raising their long-run inflation targets – jointly, and not in mealy-mouthed fashion of 2% on average over some period of catch up (Posen (2019)). If anything will raise medium-term inflation expectations independent of a recovery in the real economy, it would be a joint inflation target increase. It certainly

can do no harm. And if such a joint action proves insufficient to increase long-run nominal interest rates and inflation expectations, then we will truly know it is the real side of the economy, not expectations of policy, which drive inflation. Then the secular stagnation arguments for aggressive fiscal policy become even more compelling.

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Currency policy follows naturally as a place for international coordination, and, of course has been the channel for some of the worst beggar-thy-neighbour actions in economic history. In an under-appreciated success, the G7, China, and other large G20 members have adhered since 2012 to an agreement not to manipulate currencies against each other, unfounded claims in the most recent US Treasury report notwithstanding (Gagnon (2020)). This agreement should be reaffirmed publicly by the relevant economies. In fact, the agreement could be extended to more explicitly rule out all but joint foreign exchange intervention for as long as the pandemic lasts, with an implication that exchange rates between the dollar, yuan, yen and euro – and perhaps other haven currencies (NOK, GBP, CHF) – will be stabilised around current levels. Since all major economies are being affected by the pandemic nearly simultaneously, almost all have little room to move interest rates, all should be pushing macro policy in the same expansionary direction, and since the room for even early recovering economies to expand imports is limited, there is no good reason for significant swings of bilateral rates at this time of crisis. For those who believe in measures of currency under- and over-valuation, the degree of either among the G20 and haven currencies is at relative historic lows as of recent assessments (Steil and Della 2020, US Treasury 2020: 18), so the status quo levels are not in themselves a problem.

Financial stability policy is a place where central banks can make a difference, especially in collaboration with fiscal authorities, but there is an important cross-border dimension as well. The fundamental economic challenge is to bridge the financing and employment for the particularly harshly hit sectors – tourism, entertainment and hospitality, in person retail and services, and some forms of transport. With a few exceptions like airlines and hotel management chains, these sectors are predominantly composed of small and medium-sized enterprises, with part-time, gig, informal, or other workforces short on

sick leave.² Rolling over of outstanding loans to those SMEs, as well as providing trade and factoring credit when demand collapses, will be extremely high impact. There are many ways to do this, including those just announced in the UK and in the euro area. At its core, some amount of enforced rollover of loans tied to availability of liquidity and forbearance by bank supervisors for credit to the worst affected sectors is necessary.

Bank supervisors should agree to mutual allowance of rollovers and avoid national ringfencing

The international cooperative aspect comes in again in preventing counter-productive nationalist policies in this area. Even after 2008-12, a substantial share of small business credit is provided by foreign headquartered banks for most jurisdictions, and loans still are repackaged and resold (if not in the illiquid, opaque securitisations of the mid-2000s). The bank supervisors should agree to mutual allowance of rollovers, done in a transparent manner, to smaller companies in the affected sectors. Otherwise, there is the risk that supervisors will tell lenders to pull credit home to their local markets. Even if it were to be a wash on net in terms of how much gets pulled back between any two economies, the gross flows and interruption of credit availability – since small borrowers cannot easily switch lenders or survive even a short-period without credit today – would be devastating. And of course this would not be a net wash, with some economies – including in, but not restricted to, the developing world – seeing withdrawals of liquidity. This risk also argues for international information sharing on the net exposure of financial systems.

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Another aspect of global financial stability is the availability of dollar liquidity in times of panic. During the Global Financial Crisis, the extension of swap lines by the Federal Reserve to other economies providing loans (fully repaid!) of dollars to their financial institutions was a major piece of putting a floor under the situation (Bernanke (2016). The swap lines proved to be a lightning rod for criticism of the Federal Reserve

² Large companies with collateral (real estate, airplanes, landing slots, drilling rights) and which had the opportunity to accumulate cash reserves in recent years should not be given these rollovers of loans and forbearance. They will be able to benefit directly from declines in interest rates and will have access to market-based refinancing or debt for equity swaps, in a way that SMEs cannot. If fiscal authorities wish to bailout these companies, as the German and US administrations have indicated they will do, that is the direct transparent way to do it – but I would advise against doing so.

in the US Congress, completely unjustified, but politically potent nonetheless. The announcement by the Federal Reserve and five other central banks of “**Coordinated Central Bank Action to Enhance the Provision of US Dollar Liquidity**” before markets opened on Monday, 16 March 2020 was absolutely the right thing to do. The economic nationalists in the Trump administration might nonetheless try to employ the utilisation of dollar swap lines in their efforts to gain allies in attacking the Fed. There is no easy way around this challenge, so it needs to be tackled head on – without those swap lines in the background, the financial panic seen over the last week could go from a contained side show to a major driver of economic decline. One avenue is to have the European and Chiang Mai Initiative swap lines get pre-emptively activated and built up (and pressure the US to see this as a challenge to the dominance of the dollar if they fail to back the coordinated move). Officials who remain close to the Trump administration, Congressional Republicans and other governments (Australia, Brazil, Japan, the UK, and Taiwan come to mind as possibilities) need to make the case for the importance of these dollar swap lines to US global interests – and that the only financial risk to American households comes from the world economy not having these, not from their operation.

Tit-for-tat retaliation and fearful hoarding

Trade policy is getting grimmer by the moment. The tit-for-tat retaliations in the climate of fearful hoarding are escalating. We have gone from India to the EU restricting exports of pharmaceuticals and medical equipment; the US is pursuing autarkic solutions to substitute domestic production for imports, even when imports are available or can be licensed for production and offer superior performance (as with COVID-19 test kits). Allies of 70 years, Germany and the US are reportedly fighting over an American cross-border acquisition of a German biotech firm, because the Trump administration is casting it as a way to get a vaccine exclusively for the US (DW News 2020).

Some well-intentioned idealists proposed cutting tariffs as part of a G20 response to add to fiscal stimulus and business confidence just a week or two ago. We will now be fortunate if we can simply stop the endogenous escalation of trade war, both in scale and scope (imagine if we go from households hoarding toilet paper in the US to nation-states hoarding food supplies). Even if it is the rational short-sighted reflex reaction to others' behaviour, this kind of uber-protectionism makes even the largest economies more vulnerable to the next turn what needs the pandemic generates, and hammers the availability to the poor both at home and particularly in developing economies, through cutting supply and raising prices. That in turn will further extend the spread and persistence of the pandemic and of literal biological opportunistic infections.

The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) member states, the EU, and China should come together and agree to a moratorium on tariffs between each other going forward.³ Implicit would be the threat of future tariff increases and trade diversion for those countries which do not join. In the sensitive area of medical equipment and drug supplies, these governments should come up with a joint reporting mechanism on the availability of supplies and production facilities. These measures could be accompanied by commitments to expanded production with clear mutual agreements to export to each other, and to developing countries – an instance of tit-for-tat and managed trade in the right direction to arrest the escalation of trade war. The US government seems to only respond on trade these days to exclusion from market openings which disadvantage it, but caves rather quickly when these are presented. We can hope this convinces American officials that it is in their interest to join in, at least by pressuring American businesses and by showing clearly better results for citizens than attempting to go it alone. These governments, and any who join them, should further suspend trade negotiations of any kind with the US, India, and other large economies which refuse to agree to the tariff moratorium. As I warned in Brussels in January 2017, Trump’s trade policies would mean that China and the EU would at some point have to smack the US government upside the head – the pandemic makes that imperative (Posen 2017).

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Limit beggar-thy-neighbour spirals which would sicken us all further

This agenda for international economic policy cooperation in response to the COVID-19 pandemic is not going to be an easy sell. On the economics, however, and on the deliberate modesty of working the problem (rather than trying to defend, let alone extend, current international institutions), it should have a clear path on its merits. We should not give up on the power of concerted action because it has peer pressure going for it. Already, the governing coalition in Germany has done a useful about-face towards constructive fiscal stimulus, the Conservative government in the

³ As importantly tracked and documented by Evenett (2020). There are of course a host of non-tariff barriers to trade which have been rising since the global financial crisis, and which have spiked in response to the COVID19 epidemic. Of course, to the degree that these governments can include in their moratorium these kinds of harmful measures as well as tariffs that should be done. Tariffs here is used as shorthand.

UK is turning its public health policy towards current epidemic control, and the Xi government in China has turned relatively transparent in its health reporting and begun exporting medical supplies and aid. Not only are there no atheists in a foxhole, there are no isolationists either. For all the failures of policy coordination in the 2008-12 crisis, actual and perceived, the fact remains that such efforts limited the beggar-thy-neighbour spirals which would have made the main problem worse. We can stand up to economic nationalism and prevent opportunists from taking advantage of a time of weakness to sicken us all further.

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