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Does monetary protectionism lead to trade protectionism?

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BEHIND today's hand-wringing over currency wars is the fear that it's one small step from currency intervention and capital controls to traditional, noxious protectionism: tariffs, quotas, subsidies, etc. For example, Gerald O'Driscoll at the Cato Institute writes:

> *"The Fed's announced purchase is an exercise in monetary protectionism. It has already produced countermeasures in terms of capital controls by Brazil and perhaps others. It may lead to trade protectionist countermeasures. Monetary protectionism breeds trade protectionism and risks a global meltdown in trade as occurred in the 1930s, which paved the way for World War II."*

And Alan Greenspan obliquely makes the same point (http://www.ft.com/cms/s/0/68801b02-ed03-11df-9912-00144feab49a.html#axzz14uxVBwuU) today in the *Financial Times*.

But is it true? Does monetary protectionism breed traditional protectionism? I could argue the opposite. If monetary protectionism softens the pain felt by the trade sector, it weakens demands for the traditional variety. When America succeeded in devaluing the dollar against the yuan in 2005, it stopped the momentum of anti-China trade bills in Congress. QE, which may or may not be monetary protectionism (I don't think it is (http://www.economist.com/node/21012698)), seems to make traditional protection even less likely, as Barry Eichengreen and Doug Irwin argued eloquently (http://www.project-syndicate.org/commentary/eichengreen23/English) back in October:

> *"In the 1930's, the countries that raised their tariffs and tightened their quotas the most were those with the least ability to manage their exchange rates—namely, countries that remained on the gold standard… In a desperate effort to do something—anything—to defend their economies, they turned to protectionism, imposing "exchange-rate dumping" duties, and import quotas to offset the loss of competitiveness caused by their own increasingly overvalued currencies…*
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> *Today, the United States is in the position of the gold-standard countries in the 1930s. It can't unilaterally adjust the level of the dollar against the Chinese renminbi. Employment growth continues to disappoint, and fears of deflation will not go away… The villain of the piece [is] the US Federal Reserve Board, which has been reluctant to use all the tools at its disposal to vanquish deflation and jump-start employment growth. Doing so would help to relieve the pressure in Congress to blame someone, anyone—in this case China—for America's jobless recovery."*

I asked Tom Gallagher, a regular contributor to our "Economics by invitation (http://www.economist.com/economics/by-invitation) " series. His reply:

> “ *Some government intervention can be (in political-economic terms) the necessary cost to allow market forces to work more broadly. That was the argument for trade adjustment assistance and escape-clause import relief. Without those Congress wouldn't have gone along with free-trade agreements. The same argument could apply to capital controls now. We shouldn’t really call capital controls protectionism (if we keep that as a loaded word for bad policy) if capital controls are done to prevent bubbles. They are simply part of the central bank/IMF/World Bank new consensus that some regulatory action is probably needed to prevent bubbles. Emerging markets I think have thought this for some time. If QE means a dollar-based carry trade for some time, then countries like Brazil should discourage outside capital from creating asset bubbles.*
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> *After reading your blog post (http://www.economist.com/node/21012698) I wondered if you could distinguish by motive. If an EM imposes capital controls to deal with asset bubbles, that’s probably a good thing. If it does so to preserve an undervalued currency, that’s bad, but if the currency is appreciating maybe capital controls can serve that safety valve purpose mentioned above. I suspect in the wake of QE we’ll be seeing more capital controls, it will spook markets a bit and give editors more fodder for “currency wars” headlines, but it will be a war with few casualties.* ”

The real test, of course, is if those countries now experiencing appreciating currencies resist resorting to traditional protectionism, and that will depend partly on how well their economies perform. Even if they do succumb, though, it seems more likely that it will be in spite of, not because of, having already taken monetary steps.