

The Temptation for Protectionism and American Trade Policy

Robert Carbaugh and Tyler Prante

The financial crisis that began in 2007 and gained momentum in 2008 shoved the world economy into a severe economic slump that some have called the Great Recession. The crisis originated in the United States housing market and quickly spread throughout the economies of the US, Canada and Europe. Soon these countries were importing fewer goods produced by emerging countries and the crisis became global. International trade collapsed at a pace unseen since the Great Depression of the 1930s. What accounted for the rapid decline in trade?

First, exports and imports tend to move in the same direction as gross domestic product (GDP). As the GDPs of countries decline during a recession, so do exports and imports. Moreover, trade flows tend to be more volatile than the overall economy: when an economy contracts by a given amount, trade flows decrease by an even larger proportion. Why are exports and imports more erratic than the overall economy? Part of the reason is that trade is biased towards the volatile goods sector of an economy instead of services, which tend to be more stable over the business cycle. For example, trade in durable goods and other postponable purchases (such as electronic products and autos), which comprise a disproportionately large share of trade, collapsed most sharply during the Great Recession (Wynne & Kersting 2009).



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The drying up of trade finance appears to be another factor that has contributed to the decrease in international trade during the Great Recession. Trade finance includes loans, insurance policies and guarantees that are linked to international transactions and made by banks, private insurers and governments. As the economic crisis intensified in 2008, there was a flight to safety by banks, firms and investors who wished to reduce their exposure to activities considered to be relatively risky. The result was that the US, Germany and Japan realised record decreases in trade credit liabilities in 2008. This meant that exporting firms faced reluctant cus-

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tomers who were restrained by the decrease in trade credit.

Another factor that contributed to the decrease in global trade was the breakout of protectionism – that is, the use of tariffs and non-tariff barriers to restrict imports and investment. As the financial crisis spread to the real economy, governments responded by raising trade barriers

to protect domestic industries. Although the recent use of protectionist barriers has not come close to matching those barriers that were imposed during the Great Depression, there are similarities between the trade policies implemented during these two crises.

In light of the recent global financial downturn and the escalation of protectionism, there has been increasing pressure for governments to respond with protectionist policies of their own. When Barack Obama became President of the US, he inherited a rapidly declining economy and pressure by members of Congress to protect the jobs of American workers by imposing trade barriers.

The purpose of this paper is to examine the nature of protectionism that has occurred during the Great Recession of 2007–2009 and its aftermath. It focuses on the recent protectionist policies of the US and cites four examples. It also discusses the protectionist policies that occurred during the Great Depression, and applies lessons from this experience to the current situation.

Protectionist lessons from the Great Depression

During the Great Depression, governments erected tariffs in an attempt to direct spending to goods produced at home rather than abroad, thus stimulating their economies. One reason for the use of tariffs was that countries lacked other economic tools that could be used to increase aggregate demand, such as expansionary fiscal policy, which was neither well understood nor generally accepted during this era. Also, monetary policy was being used to decrease aggregate demand rather than stimulate economies. The Federal Reserve began raising interest rates in the late 1920s so as to halt an overheated stock market, which resulted in decreased investment and aggregate demand. The use of contractionary monetary policy spread globally as other countries followed suit due to their commitment to the gold standard. Under this system, participating countries agreed to maintain fixed exchange rates. Countries could not decrease interest rates when this was needed to combat unemployment because this action would result in their currencies depreciating below their fixed exchange values (O'Rourke 2009). Simply put, without monetary policy or fiscal policy to increase aggregate demand, countries resorted to tariffs as a means of economic stimulus.

The protectionist movement was first initiated by the US, which implemented the Smoot-Hawley Tariff Act in 1930. This measure increased US average tariffs to 53% on about 20,000 imported goods. To prevent the US from gaining competitiveness at their expense, countries not participating in the gold standard devalued their currencies. Those countries that remained on the gold standard, and thus maintaining fixed exchange rates, were more inclined to levy retaliatory tariffs. For example, Switzerland imposed tariffs on watches and shoes, Canada enacted tariffs on timber and logs, and Italy levied tariffs on olives and hats. Within two years after the Smoot-Hawley Tariff Act, US exports decreased by about two-thirds, as did the exports of many other countries. The main effect of the protectionism was to destroy trade and the benefits of comparative advantage. Economists are in virtually universal agreement that the adoption of restrictive trade policies intensified the severity of the Great Depression (Eichengreen & Irwin 2009).

The fixed-exchange-rate problems that were encountered by countries on the gold standard in the 1930s are similar to those that peg their currencies to the dollar or euro today. A contemporary example is Ecuador,

whose currency is dollarised. With no currency of its own, just US dollars, Ecuador loses its monetary policy as a means to stabilise its economy. Indeed, it may even be the objective of dollarisation to eliminate the independence of the fiscal authority, leaving no macroeconomic tools. In 2009, Ecuador imposed tariff increases on 630 products, affecting 23% of its volume of imports. Tariffs were also increased on 369 product lines and quota restrictions levied on 271 others for a period of one year. These protectionist barriers covered products ranging from shoes and cars to processed foods, sunglasses and mobile phones, and many other goods that can be produced in Ecuador. Given its lack of other policy tools, Ecuador insisted that its import restrictions were justified to reverse its widening current account deficit. In defence of its policy, Ecuador cited articles of the World Trade Organization (WTO), which permit developing countries to levy temporary import restrictions to combat a substantial decrease in its monetary reserves (Krugman 2009).

The message of the Great Depression for the 2000s would appear to be to avoid using protectionism to stimulate economies, but nevertheless stimulate (according to Keynesian economists). But how? Monetary stimulus is generally regarded as a first line of defence against economic downturn. Although monetary stimulus may benefit the home country by providing faster economic growth, it has a negative impact on its trading partners. Because monetary stimulus results in lower interest rates, there is a tendency for the home country to realise net capital outflows and a depreciation of its currency. Therefore, monetary stimulus in the home country results in incentive for its trading partners to respond with protectionist policies.

Fiscal stimulus is another option available for today's policymakers. When fiscal stimulus is initiated by the home country, it provides benefits for its trading partners as well. Faster economic growth at home results in imports increasing from abroad, while the upward pressure on world interest rates that crowds out investment at home and abroad is insignificant if considerable economic slack exists in the home country. However, it is possible that the home country's interest rate might increase as the result of the increased demand for money caused by the fiscal stimulus – for example, an increase in government spending. But a higher interest rate tends to induce net capital inflows, which cause the home country's currency to appreciate, and this results in an increase in imports. When a country enacts fiscal stimulus, its trading partners can export more to it, and thus they have no incentive to initiate protectionist policies.

Therefore, the home country is concerned about the benefits that are provided to its free-riding trading partners. Moreover, fiscal stimulus is not costless for the home country because it results in public debt that will have to be serviced by future generations of its people. However, the country's free-riding trading partners do not bear this cost.

Broken trade promises

The severe shocks experienced by the global economy in 2007–2008 nearly led to its collapse. In November 2008, the G20 leaders met at the Summit on Financial Markets and the World Economy to formulate a strategy to restore global growth and achieve the necessary reforms in the world's financial systems. The leaders declared that they would be guided by a shared belief that market principles, open trade and investment regimes, and effectively regulated financial markets foster the dynamism, innovation and entrepreneurship that are essential for economic growth and poverty reduction.

Moreover, the G20 leaders underscored the importance of rejecting protectionism and not turning inwards in times of economic uncertainty, as occurred during the Great Depression. The leaders pledged that they would refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing new measures to stimulate exports that are inconsistent with the rules of the WTO. Also, they would strive to reach agreement on the modalities that led to a successful conclusion to the WTO's Doha Round of multilateral trade negotiations (Council on Foreign Relations 2008). This pledge was reiterated by the G20 leaders when they met in September 2009.

In June 2010, the G20 leaders met in Toronto, Canada, to assess the fragile global economic recovery. They reaffirmed the importance that open markets have in supporting growth and job creation. Thus, the G20 leaders renewed for a further three years (until the end of 2013) their commitment to refrain from raising or imposing new barriers to investment and trade in

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Table 1: Number of protectionist measures imposed on target country, November 2008–June 2010

Target country	Number of protectionist measures
China	282
European Union (27 nations)	266
United States	213
Germany	204
France	188
United Kingdom	181
Italy	175
Belgium	170
Japan	168
Netherlands	163

Source: Global Trade Alert, *Unequal Compliance: The Sixth GTA Report*, Table 2.4, June 2010, available at www.globaltradealert.org

Table 2: Protectionist measures used to discriminate against foreign commercial interests, November 2008–June 2010

Protectionist measure	% of total
Trade remedy measure (anti-dumping duty, countervailing duty, safeguards)	49
Tariff measure	10
Investment measure	7
Government procurement	5
Local content requirement	4
Government bailout/aid	3
Other	22

Source: Global Trade Alert, *Unequal Compliance: The Sixth GTA Report*, Figure 2.3, June 2010, available at www.globaltradealert.org

goods and services. Meanwhile, President Obama stressed the need to keep economic stimulus measures in place to prevent a global slowdown. However, European leaders affirmed their intentions to move towards more conservative fiscal policies as the region grapples with an ongoing debt crisis.

In spite of the no-protectionist pledges of the G20 leaders, they have faced great temptations to adopt beggar-thy-neighbour trade policies to

protect domestic jobs as their economies weakened. Since the advent of the global economic contraction in 2008, numerous restrictive trade policies have been implemented by G20 nations, as summarised in Table 1. Table 2 summarises the relative importance of these protectionist measures; the most widely used ones have included bailout/state aid policies, import tariffs, trade defence measures (antidumping duties, countervailing duties and safeguard measures) and public procurement/buy national policies. Almost every nation and most product categories have been affected by another's beggar-thy-neighbour policy. The biggest targets of restrictive trade measures have included China, the US and Germany. The countries that appear to have inflicted the most harm on others include Russia, Germany, India and Indonesia. Despite the recent pledges of the G20 nations to maintain open markets, India has increased tariffs and levied other barriers on imported steel goods. Ecuador increased tariffs by 5–20% on 940 products, the Indonesian government has required its employees to buy only domestic products, and Argentina has imposed restrictions on imports of shoes, televisions, auto parts and textiles.

Despite all the publicity about policies to foster 'green' industries, innovation and future growth prospects of the economy, most of the protectionist measures have affected sectors such as agriculture and smokestack, lower-productivity manufacturing. Although the forms of protectionism used now and in the 1930s differ, and while the extent of current protectionism is far less than that of the 1930s, only the most casual observer could ignore the damage being done to international trade and its possible contribution to economic recovery (Global Trade Alert 2009). Also analysts note that, as long as unemployment remains high, there will be pressure to keep protectionist trade measures in place.

Concerning the US, the Obama administration has implemented several measures to support jobs in weakened industries including automobiles, tyres and steel, as addressed in the following sections of this paper.

The US imposes tariffs on Chinese tyres

As a condition for China's entering the WTO in 2001, it agreed that other nations could clamp down on surges of imports from China without having to prove unfair trade practices. This special safeguard lasts until 2013. The concession became real when China increased its shipments of tyres

for automobiles and light trucks to the US by 215% during 2004–2008. Four American tyre plants were closed and about 4,500 tyre production jobs were lost during that period, according to the United Steelworkers (USW) union.

In response to a complaint by the USW, the US imposed a tariff in 2009, in addition to the existing tariff, for a three-year period, on imports of tyres from China. The tariff was applied to low-price tyres, roughly \$50 to \$60 apiece, which constitute the bulk of the tyres China exports to the US. The amount of the additional tariff was set at 35% in the first year, 30% in the second year and 25% in the third year. The move would cut off about 17% of all tyres sold in the US. President Obama justified the tariff policy by stating that the US was simply enforcing the rule the Chinese had accepted. However, critics maintained that Obama was pandering to blue-collar workers and union leaders who were needed to support his legislative agenda regarding healthcare and other issues.

This tariff is an example of how political pressure can influence trade policy. During Obama's presidential campaign, he committed to protecting American jobs, many of which have moved to China and left employment holes in American manufacturing industries. The tariff signalled Obama's desire to keep his word. The USW hailed the decision by declaring that it was the right thing to do for beleaguered American tyre workers. However, officials in China's government stated that this decision sent the wrong signal to the world. Not only was it a grave act of protectionism, but it violated the rules of the WTO and contradicted open-market commitments that the US government made at the G20 financial summit in 2009.

According to the Obama administration, the tariffs would significantly reduce tyre imports from China and boost US industry sales and prices, resulting in increased profitability. This profitability would result in the preservation of jobs and the creation of new ones, as well as encourage investment. Also, the tariff would have little or no impact on the US production of automobiles and light trucks because tyres account for a very small share of the total cost of those products. Moreover, tyres account for a relatively small share of the annual cost of owning and operating an automobile or light truck.

However, the story is more complicated. The USW petition for the tariff increase was not supported by American tyre companies because they

had already abandoned making low-cost tyres in the US. Tyre company officials declared that it was not profitable to produce inexpensive tyres in domestic plants in view of competition from foreign companies. Most American tyre companies – such as Goodyear Tire and Rubber Co., and Cooper Tire and Rubber Co. – manufacture low-cost tyres in China that they sell in the US. Any other American tyre manufacturer that wanted to get involved in the low-end business would have to revamp factory lines to produce such tyres – a costly and complicated practice that would require considerable time. Moreover, as Chinese tyre exports to the US were blocked by the tariff, low-wage manufacturers in other countries such as Brazil and Indonesia began to increase (Ikenson 2009b).

In January 2010, China filed a complaint with the WTO, contending that American import tariffs on its tyres violated WTO rules. This trade case may take years to resolve, but could result in the WTO's authorising retaliatory sanctions being placed against the US.

US fiscal stimulus and Buy American legislation

As the US government moved towards enacting its \$787 billion fiscal stimulus legislation during the recession of 2007–2009, debate emerged over whether government-funded projects should use only US-made materials. According to proponents of Buy American legislation, not one dollar of stimulus expenditures should be spent on foreign goods; instead, tax payers' dollars should be used to buy US-made goods and thus support the jobs of Americans.

Proponents of the Buy American legislation noted that the US has funded proportionally more fiscal stimulus than other countries. Also, US fiscal stimulus provides spillover benefits to other countries. As the US economy grows because of the stimulus, so do its imports from other countries. Hence, these countries are free riders. They obtain the economic benefits of the US fiscal stimulus without bearing the cost of incurring government debt that will have to be borne by future generations of their citizens. Therefore, proponents argue that it is reasonable that some Buy American provisions be included in the fiscal stimulus legislation.

The initial fiscal stimulus bill sponsored by the House of Representatives stipulated that none of the funds made available by the bill could be used for infrastructure projects unless all the iron and steel used in a project is

produced in the US. The Senate version went even further, mandating that all manufactured goods used in construction projects come from US producers. This legislation was strongly favoured by US labour unions and companies such as US Steel Corp.

Although President Barack Obama supported Buy American legislation during his presidential campaign in 2008, his enthusiasm had weakened by 2009. The initial foreign reaction to possible Buy American legislation was outrage. The European Union, for example, warned that passage of the legislation would result in the US violating past trade agreements and intensifying the possibility of a trade war that could plunge the world into depression. Also, US exporting companies such as Caterpillar argued that foreign retaliation would greatly reduce their sales abroad: Caterpillar noted that, in 2009, 60% of its revenue was from foreign sales.

In response to these concerns, Obama came out against Buy American provisions that signalled blatant protectionism. He ended up signing a fiscal stimulus bill that included a watered-down version of the Buy American provisions contained in the House and Senate stimulus bills. For example, federal agencies can waive Buy American preferences if they inflate the cost of a construction project by more than 25% or are deemed to be against the public interest. Also, Buy American preferences are waived if they violate past trade agreements such as the North American Free Trade Agreement (NAFTA) reached by the US, Canada and Mexico. This means that NAFTA protects the ability of firms in Canada and Mexico to bid on US government contracts even though their products do not embody steel made in America. However, city and state (municipal) governments in the US are not obligated to honour the trade agreements of the federal government: they have been able to enact Buy American preferences that exclude firms in Canada, Mexico and other countries from bidding on municipal construction contracts for schools, water treatment plants and the like.

Many nations expressed unhappiness about Buy American legislation. For example, China and other developing countries, which did not have free trade agreements with the US, complained that Buy American legislation was used to shut out their products from the additional spending that the US government was making to counter its recession. Moreover, Canadian producers resented being prevented from bidding on municipal contracts in the US and thus pressured their municipal governments to

exclude US bidders from their contracts. Indeed, officials in Washington were scrambling to avoid an all-out trade war.

Auto maker subsidies and the World Trade Organization

Turmoil in financial markets and the ensuing global economic downturn brought substantial financial stress to auto makers in 2008–2009. The economic reach of the auto industry in the US is broad, affecting auto workers, auto suppliers, stock and bondholders, dealers and certain states. The ‘Detroit Three’ (Ford, General Motors and Chrysler) appealed to the US government for financial assistance as the recession gripped the US, noting that if they collapsed, there would be a costly domino effect through the US economy and abroad in terms of falling income and rising unemployment. In other words, these firms maintained that they were ‘too big to fail’.

The US government considered several methods of assisting the Detroit Three, including outright loans for GM and Chrysler, a ‘cash for clunkers’ programme to encourage the purchase of newer vehicles, a tax credit for new purchases, and the bailout of auto parts firms. In December 2008, the government allocated \$36 billion for the purpose of making bridge loans to Chrysler and GM. The initial loans consisted of \$4 billion to Chrysler and \$13.4 billion to GM, and they required both auto makers to submit restructuring plans in 2009 if they were to receive additional assistance. Despite these loans, these two firms went into bankruptcy in 2009.

Turbulence in the auto industry was not unique to the US. As auto sales decreased throughout the world, other countries implemented their own assistance programmes. For example, France provided up to \$7.7 billion to its failing auto makers in the form of loans, and it also established a cash for clunkers scheme. In the United Kingdom, ailing auto companies received \$3.2 billion in governmental loan guarantees.

Do these loans and loan guarantees constitute illegal subsidies according to rules of the WTO? According to WTO rules, for government assistance to be illegal it must meet several criteria. First, a financial contribution must be made by a government to a particular firm, not to a wide spectrum of firms. Also,

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it must provide the firm an advantage that would not occur under normal market conditions. Finally, the subsidy must cause serious injury, or threat of serious injury, to imports from foreign firms.

Analysts generally maintained that the auto bailouts in the US and other countries largely adhered to the WTO's definition of illegal subsidies. Then why were these subsidies not contested? A key reason is that because virtually all of the major auto-exporting countries enacted some level of assistance to help their ailing auto producers, it would be hard for one country to file a case against another without inviting retaliation. Therefore, it was unlikely that WTO cases would arise because of auto subsidy programmes. Nevertheless, sceptics worried that if a major industry, such as the autos, is not subject to the rules of the WTO, the ability of the WTO to maintain open markets based on comparative advantage could be greatly weakened (Brunel & Hufbauer 2009).

Obama says no to Mexican cargo trucks

As another example of US protectionism, consider the conflict taking place between the US and Mexico with respect to trucking. Reasonable arguments can be made by both free traders, who desire the efficiency of a deregulated trucking system, and social activists who are concerned about highway safety.

For decades, the safety of the North American trucking system has been of concern to Americans and Canadians. The US and Canada have laws limiting the number of consecutive hours a trucker can be on the road; truck drivers are tested for drug or alcohol use, and trucks are inspected for safety requirements. In contrast, Mexico has no roadside inspection programme or drug testing for drivers. It does not require logbooks or have weighing stations for trucks. It doesn't have a requirement for labelling of hazardous or toxic cargo, or a system to verify drivers' licences.

According to NAFTA, the US, Mexico and Canada agreed to open their roads to each other's rigs. In 1995, however, President Bill Clinton imposed restrictions on Mexican trucks, confining them to stateside areas within 20 miles of the Mexican border. Mexican goods travelling further than this arbitrary zone had to be loaded on to American trucks, a practice that pleased the US Teamsters (truckers) union. Moreover, in 2002, the US government introduced 22 additional safety requirements that Mexican trucks

would have to meet – a measure that was discriminatory as these requirements were not applied to US and Canadian carriers operating in the US.

In response to these measures, a NAFTA arbitration panel ruled that the US was in violation of its treaty obligations. The result was an agreement in 2007 that established a pilot programme that allowed a limited number of Mexican carriers into the US under rigid safety regulations. After 18 months, the programme provided evidence that Mexican carriers were as safe as their US and Canadian counterparts, and that transportation cost savings provided benefits for American consumers. That was bad news for the Teamsters union.

In 2009, President Barack Obama signed a bill that prohibited funds from being used to continue the two-year-old pilot programme that allowed some Mexican trucks to operate in the US. Pressure for the legislation came directly from the Teamsters, who complained that foreign truckers don't meet US safety standards. Mexico retaliated by releasing a list of 89 US products, worth \$2.4 billion in trade, that would face new tariffs of 10–45%. The tariffs were designed to hit as many US states as possible. Among the states hit hardest by Mexico's tariffs were California, Oregon and Washington, which exported a variety of agricultural products to Mexico. With the cost of imported American products higher, Mexican consumers switched to products from Latin America, Europe and Canada. Clearly, American agricultural producers paid a high price for the protectionism granted the Teamsters union. At the time of writing (July 2010), it remains to be seen how the trucking dispute will be resolved.

Is protectionism under control?

Despite the severity of the global financial crisis and its widespread effect on economies around the world, by 2010 it appeared that the G20 governments were increasingly resisting pressures to establish restrictions on trade and investment. According to the WTO, protectionism still remains a risk as unemployment remains high in many countries, despite the global economic recovery, but it has so far not caused the serious damage that many feared. Simply put, the global trading system has so far held up relatively well to the stresses of the economic crisis, according to the WTO. However, some independent economists are not as optimistic as

the WTO, as seen in the data presented in Table 1, which was compiled by Global Trade Alert.

Although the recent economic crisis could have triggered an even greater increase in protectionist measures, there are several reasons that explain why this has not occurred. First, multilateral institutions such as the WTO provide transparency and ensure an awareness of the adverse effects of protectionism as well as establish expectations of the types of policies considered responsible. Also, responses of governments to adopt fiscal and monetary stimulus programmes and prop up the financial sector helped moderate the crisis and thus decreased the demand for protectionism. Moreover, some 99% of import tariffs are currently expressed in percentage-of-value (*ad valorem*) terms, which means that falling import prices result in decreasing tariff payments. This contrasts with the 1930s, when many tariffs were in specific (fixed dollar amount) terms – when the prices of imported goods decreased, the tariff as a percentage of value increased (Henn & McDonald 2010).

Although there has been less usage of protectionism than initially feared by many, pressures still exist. Given the tendency for trade to grow more quickly than overall economic activity, as economies rebound and imports return towards their historic market share the demand for protectionism may increase. Also, when fiscal and monetary stimulus are withdrawn as economies recover, as currently is occurring in Europe, affected firms and workers may lobby for trade protection. It remains to be seen how these possibilities will play out in 2011 and beyond.

Conclusions

During 2008–2009, governments attempted to stimulate the financial and real sectors of their economies, reviving debate over the effectiveness of alternative economic policies. For example, the Obama economic stimulus programme put many people back to work in government-financed jobs and also supported the dwindling finances of state and local governments. However, this programme is thought by some to be unsustainable because it requires unprecedented amounts of borrowing and monetary stimulus that cannot continue indefinitely. By 2010, European nations were cutting back on public spending and increasing taxes to cope with massive budget

deficits; European nations do not want to be burdened with the financial and social problems that Greece has encountered as a deficit nation.

As an alternative to fiscal stimulus, some governments have attempted to protect their firms and workers by implementing restrictive trade barriers such as tariffs, while others have nurtured industries considered to be ‘national champions’ by providing them with subsidies. Yet most economists note that trade barriers increase the costs of production, which undermines economic growth (Ikenson 2009a).

As for President Obama, the record of his two years in office suggests that he is neither a committed free trader nor a hardcore protectionist. In 2009, he suggested that Congress should refrain from using language in the economic stimulus bill that might incite a trade war, and Congress responded by omitting the bill’s most blatant protectionist provisions. However, Obama did sign stimulus legislation that included Buy American provisions. He also approved the imposition of tariffs on imports of Chinese tyres, agreed to providing subsidies to domestic auto companies, and said no to Mexican cargo trucks entering the US.

Although many countries have yielded to the temptation of protectionism during the recent economic downturn, the risk that it would escalate to the heights of the Great Depression does not appear to be large. During the 1930s, there were no global rules, no sources of remedying trade disputes between nations, and no widely recognised restraints to unilateral actions by governments. Also, there were few organised constituencies that lobbied against increases in tariffs. The result was a trade war that resulted in global trade decreasing by about two-thirds during the period 1929–1934. However, the proliferation of global production, investment and joint ventures has blurred the distinction between ‘us and them’ in the 2000s. Global competition now involves supply chains that manufacture and transport goods made with parts and labour from many countries. When governments enact trade restrictions, they discourage foreign investment and lessen the attractiveness of their countries as locations for research, production or assembly operations in the supply chain. Therefore, the most effective supply chains tend to be those with the fewer restrictions, including trade barriers. Moreover, today’s world has international rules that work reasonably well promoting freer trade, such as the WTO, the EU and NAFTA. Simply put, influential systems of trade rules and the awareness that a global economy based on openness is

necessary for success provide support for the view that protectionist escalation will dwindle as economies rebound from their downturns.

It is enticing to assert that the G20 should pledge to refrain from all new acts of protectionism as nations recover from the Great Recession. However, such an idealistic approach is no more credible than telling people to stop eating desserts at Christmas. Rather than preaching complete abstinence, the G20 should adopt a more pragmatic approach which ensures that the rules-based trading system of the WTO survives. Instead of trying to open markets further, emphasis should be placed on keeping protectionism temporary and limited rather than becoming a permanent feature of the global economy, so that international trade can help the world recover from the Great Recession. The scale of the current economic downturn and the likelihood of a sluggish recovery suggest the need for ongoing vigilance against protectionist policies.

For the US, recovering from the Great Recession will necessitate that American-produced goods are internationally competitive and that external accounts (e.g. trade balance) remain approximately in balance. A reduction in the US trade deficit from its unsustainable levels in recent years would significantly promote long-term growth by contributing to new jobs, higher incomes and profits, and investment. Unless action is introduced to foster more balanced trade and decreased external deficits within an environment of declining barriers to trade, there is a possibility that resurging protectionism could reverse the gains of the past four to five decades.

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