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## **World Trade and Trade Policy:**

## **New Impetus for Liberalization or Drift to Protectionism?**

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*By Fredrik Erixon*

*Director, European Centre for International Political Economy (ECIPE), a world-economy think tank based in Brussels*

## Introduction

The global economic crisis has spawned fears of rising protectionism. Fears are particularly about a repeat of tit-for-tat protectionism in the 1930s. Spiraling protectionism then helped to turn a financial crisis into a decade-long depression, and governments had to spend a few decades negotiating in the GATT and other international organizations to undo the protectionism imposed during the mid-war period.

Yet these fears have not yet materialized. According to the World Trade Organisation and its recent survey of protectionist measures in the wake of the economic crisis, there is not much evidence of a sharp rush to protectionism.<sup>1</sup> Only about a handful of countries increased tariffs during 2008 (Argentina, Brazil, Ecuador, India, Indonesia, Russia, and Turkey)<sup>2</sup>, and it was only a limited number of goods which were subject to increased tariff protection.<sup>3</sup> None of these measures pose systemic threats to the world economy or to the integrity of the world trading system.

Nor are there reasons to believe a malign scenario of spiraling tariff protectionism to be an imminent threat. Certainly, some other countries will increase tariffs to ease conditions for companies suffering from contracting demand. But such tariff hikes are not likely to trigger retaliatory actions, or to cover goods that are significantly traded. There are two restraining factors.

First, countries have bound their tariffs in WTO agreements and understand they will be taken to dispute settlement if they raise tariffs above these limits. A number of emerging countries with significant tariff water – the difference between the bound levels and the applied levels – can raise tariffs without violating WTO commitments. Some emerging markets have already made use of the room for WTO compliant tariff hikes; others will likely do so as the effects of the crisis on output and employment grow worse. Table 1 indicates in what countries that may happen. However, WTO authorized tariff hikes also pose problems. Many emerging markets have made strong calls in the current Doha Round of trade negotiations to reduce applied tariff and subsidy levels in rich countries' agricultural sector in exchange for a reduction of the tariff water in emerging countries. Increases in the applied tariff levels would thus dilute the negotiating position for emerging countries.

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<sup>1</sup> World Trade Organisation, 2009, "Lamy: 'We must remain extremely vigilant'". News item, February 9, 2009, Accessible on WTO website: [http://www.wto.org/english/news\\_e/news09\\_e/tpr\\_09feb09\\_e.htm](http://www.wto.org/english/news_e/news09_e/tpr_09feb09_e.htm)

<sup>2</sup> Trade remedies like antidumping are not accounted for as such measures are targeted against specific countries/exporters.

<sup>3</sup> Ecuador, however, has imposed tariffs on 900 items.

**Table 1.** Tariff water in emerging markets

	Tariffs on manufactured imports			
	Average tariff (%)	bound	Average tariff (%)	applied Tariff Water Ratio
China	9.14		8.96	1.02
India	34.94		16.44	2.13
Mexico	34.91		13.33	2.62
Brazil	30.79		12.63	2.44
Turkey	17.03		4.69	3.63
Indonesia	35.55		6.75	5.27
Saudi Arabia	10.50		4.81	2.18
South Africa	15.72		7.85	2.00
Thailand	25.55		8.17	3.13
Argentina	31.84		12.57	2.53

*Source: WTO Country Profiles*

Second, countries with a significant participation in world trade cannot raise tariffs on a grander scale without damaging the competitiveness of their home firms. A significant portion of all trade today is trade in parts and components, or input goods, and companies have fragmented their supply-chains to such an extent it is difficult to trace the origin or nationality of a particular good. Advanced economies and emerging markets are densely integrated through such production networks. Import is needed in order to export, and new tariffs on input goods will adversely affect profitability and output higher up in the value-added chain.

Yet these two constraining factors do not backstop all forms of protectionism. WTO agreements are more powerful against tariff hikes than other forms of protectionism, e.g. non-tariff barriers and state aid to companies. Patterns of supply-chain fragmentation limit the temporary mercantilistic value of a tariff increase, but they do not have the same effect on trade-distorting subsidies to domestic firms. Non-tariff protectionism is often more damaging than tariffs. Tariffs are quantified and companies can calculate their margins and profitability of trade. Non-tariff measures are often opaque and foreign firms have difficulties in assessing the cost such measures impose on existing or potential trade. The uncertainties are bigger.

It is this form of protectionism – creeping rather than spiraling protectionism – that governments now succumb to amidst the economic crisis. It builds on protectionist trends underway long before the crisis hit in September last year. Efforts by governments today to limit protectionism, and the damage of it, should focus on this trend of creeping protectionism.

### **Creeping protectionism**

Current protectionist trends are similar to protectionism in the 1970s and 1980s. In the 1970s, oil-price hikes and other shocks triggered inward-looking, mercantilist policies, not least in Europe and the United States. Immediate policy responses were not massively protectionist: there was no equivalent of the Smoot-Hawley tariff. But escalating domestic interventions exacerbated economic stress and prolonged stagnation. Not least, they spawned protectionist pressures. Industry after industry, coddled by government subsidies at home, sought protection from foreign competition. The result was the “new protectionism” of the 1970s and 1980s.

Then, as now, manufacturers of gas-guzzling cars in America faced bankruptcy. The U.S. Congress bailed out Chrysler in 1979. By then the British government had already bailed out Rolls Royce and British Leyland, and Renault was saved by French taxpayers shortly after President Carter signed the Chrysler bailout. Several other sectors (wood and timber, energy and minerals, railways, airlines, shipbuilding) received government subsidies in the 1970s. Many companies were nationalized.

Policies like “voluntary export restraints,” “orderly marketing arrangements” and other mostly nontariff barriers were deployed to “manage trade.” The sectors that received subsidies at home also got protected from foreign competition. Through the 1980s, American car manufacturers were protected by VERs that restricted the number of Japanese cars exported to the U.S. Europe negotiated a similar agreement with Japan in 1983. To further restrict Japanese exports, some European governments imposed “local-content requirements” on the cars produced in Europe by companies like Nissan and Toyota. Many other sectors, like semiconductors and videocassette recorders, were also protected by VERs or similar measures. The French government even demanded that Japanese VCR imports enter France via Poitiers, a town hundreds of miles from the nearest port.

Many references to trade-distorting subsidies, increased non-tariff barriers, and other creeping protectionism in the 1970s crises could be made. Similarly, in a few years time we could produce an equally extensive analysis of measures government undertook in 2008-2010. The process has already begun.

Governments around the world have bailed out domestic banks and automotive industries. We are not even at the end of the beginning; more subsidies will be

handed to ailing auto manufacturers and other sector are lining up for direct government support. State-aid rules in the EU have been relaxed and certainly enabled suspicious state aid to go through the Commission's examination. The air is thick with governments' nods-and-winks to banks to lend at home, not abroad, and to car companies to ensure that their subsidies are spent on production and employment at home, not abroad. One hidden part of the US bailout of its banks is a restriction on firms to apply for H-1B visas. Other countries have not gone as far as to impose new restrictions on labour migration, but political leaders have echoed calls for "British-jobs-for-British-workers"-style views.

"Buy America" provisions in government procurement have been attached to the US fiscal stimulus package. Other governments, as in Spain and Sweden, have encouraged people to buy nationally produced goods. Government procurement has also been a favoured measure to support domestic manufacturers in Asian countries that are not member of the Government Procurement Agreement in the WTO. Chinese provinces and Indonesia, for example, have singled out domestic steel mills as favoured subjects. Several Chinese provinces have gone much further; in Hunan the local government introduced in January directions to government offices to buy passenger vehicles and raw materials, including medicines, made or sourced in the province. Non-tariff barriers have also increased in some sectors – from Belgian chocolate and Dutch eggs (China) over toys (India) to auto parts and TVs (Argentina). Apart from new sectoral NTBs, Indonesia has also limited the number of import entries.

Creeping protectionism was surfacing before the crisis begun and involved other policies than those mentioned above. Antidumping actions have been on the march again for some time. Global antidumping took a big jump in the first half of 2008, and estimates show the increase continued in the second half.<sup>4</sup> "Standards protectionism" has proliferated – in agriculture and manufacturing – and increasing talk of carbon-based tariffs have magnified protectionist threats dressed up as environmental policy. "China-bashing" is getting worse, with accusations of "unfair trade" linked to "currency manipulation" and bilateral trade deficits. Calls for corrective measures against China are likely to increase as the new US administration has officially labeled China as a currency manipulator. Investment restrictions have increased, and the number of unfavourable laws to cross-border investment has increased in the last years. Countries as diverse as China and France have singled out strategic sectors and national champions to be protected from the embrace of globalization. Protectionist tendencies can be seen everywhere in the energy sector.

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<sup>4</sup> See Elisa Gamberoni & Richard Newfarmer (2009) "Trade protection: incipient but worrisome trends" VoxEU March 4, 2009, <http://www.voxeu.org/index.php?q=node/3183>

## Co-ordinated actions to backstop protectionism

There is a strong need for a coordinated approach to prevent current protectionist trends to escalate into tit-for-tat protectionism a la the 1930s. It is important to finish the Doha Round, but an agreement from the round will have a limited effect on emerging protectionism. Measures applied today are not well-regulated in the WTO hemisphere; a finished Doha Round would not change this. Other co-ordinate actions are needed, and the first chance for global leaders to offer meaningful resistance to protectionism comes at the G20 meeting in London in early April. What should the G20 do?

- Avoid sweeping, shallow and non-committing pledges to fight protectionism. At the G20 summit in Washington, DC in November last year, members agreed to avoid protectionist measures for a year and to instruct their trade ministers to agree on Doha-round modalities before the end of 2008. It took only a few days before tariffs had been increased by a G20 member, and at least 25 percent of the membership has increased tariff since November. At least two thirds of the membership has imposed measures that clearly are protectionist, even if they are not forbidden by any WTO agreement. Making pledges you are likely to dishonor is a good way of undermining the entire legitimacy of the G20.
- Acknowledge the real protectionist threats. Governments today are fighting the wrong enemy. They argue for a battle against a 1930s style scenario of spiraling tariffs while such a development is highly unlikely. This Maginot line of anti-protectionism is morally admirable, but it prevents governments from fighting actual protectionism or protectionist threats. Similarly, governments need to acknowledge that current expansion of fiscal spending – regardless its merits as counter-cyclical policy – is a potential source of escalating protectionism. We have already seen this in fiscal stimulus and bailout packages in the US and Europe. A broader observation could also be made: protectionism tends to increase at times of rapid expansion of governments. Serious attention needs now to be given to avoid stimulus packages becoming a route of protectionism. Keynes turned to protectionism and self-sufficiency policies in the 1930s, partly as a consequence of his support for government activism and deficit-finances demand management. This Keynesian pitfall becomes ever more threatening as governments increase their spending to fight the recession.
- Establish a “ceasefire agreement” on key protectionist measures: tariffs, trade-distorting state aid, and buy-national policies. Other measures would ideally be part of a ceasefire agreement, too, but it is not political feasible to cover, for example, increased use of anti-dumping measures. The important task now is

to sort out the really bad apples – those who can trigger tit-for-tat developments.

- Task a smaller group of countries – e.g. China, the EU, Japan and the United States – to propose to the next G20 summit guidelines on how to prevent protectionist threats to materialize and progress multilateral agreements that strengthen disciplines on the favoured tools of protectionism. Cooperation is needed, but the G20, let alone the WTO, is too unwieldy to allow for clear proposals and leadership from the big countries to emerge from summits or unprepared plenary sessions.