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A Return to the 1970s?
Trade, Protectionism and Globalisation since the Crisis

In a new paper, Fredrik Erixon and Razeen Sally survey the trade-policy development since the start of the economic crisis. The crisis, and governments' responses to the crisis, did not precipitate a descent into 1930s-style protectionism. But "creeping protectionism" is increasing, and the crisis has reinforced trends visible before the start of the crisis. New patterns of protectionism, argue Erixon and Sally, are similar to developments in the 1970s and 1980s rather than the 1930s. Domestic "crisis interventions", especially in capital and product markets, and the return of Big Government, will spill over to external policy, with more defensive trade policies as a consequence.

Two thousand and nine was a crisis year for international trade, which suffered its steepest decline since the 1930s. Protectionism returned, reversing an almost three-decade trend of trade liberalisation. But, contrary to expectations, it has not returned with a vengeance, rather creeping to the surface in subtle ways.

It is fashionable to make comparisons between the recent crisis and that of the 1930s. This is appropriate in one sense. Then, a financial crash metastasised into the Great Depression. It also sparked massive government intervention, starting with intrusive and protectionist financial regulations. That caused global finance to fragment into national enclaves. The recent crisis, given its financial origins, has led to a bigger fall in output than in other post-1945 recessions. Recovery will probably take longer. And there is the danger that over-regulation of financial markets will cause global finance to fragment once again.

But in one other important respect the comparison with the 1930s is highly misleading. Then, tit-for-tat trade protection rapidly followed the Wall Street Crash, and the world splintered into warring trade blocs. This has not happened today, and it is unlikely to happen anytime soon. As the paper demonstrates, crisis-related protectionism today is remarkably restrained. Multilateral trade rules, international policy cooperation and market-led globalisation provide defences against a headlong descent into 1930s-style protectionism.

Rather the appropriate comparison is with the 1970s. Then, a series of shocks (notably the collapse of the Bretton Woods system and oil-price hikes) ended a long boom and triggered more government intervention. New labour-market and capital-market regulations were introduced. Subsidies were sprayed at vulnerable sectors. There were fiscal-stimulus packages. Governments slapped on price-and-wage controls to combat inflation. These measures exacerbated initial crises and prolonged stagnation. But they also spawned protectionism. Industry after industry, coddled by government support at home, demanded protection from foreign competition. The result was the "new protectionism" and "managed trade" of the 1970s and 1980s, covering up to 40 percent of world trade in the late 1980s.

Worryingly, the global economic crisis has triggered a big shift in ideas and policies against free markets and in favour of government interventionism. Pro-market reforms had slowed down around the world before the crisis broke, and there was rising skepticism of the liberalisation-and-globalisation policies associated with the Washington Consensus. But the crisis marked the close of a thirty-year chapter of freer markets and more limits on government intervention. A new chapter of bigger government has opened.

So far, government interventions have been more evident in domestic economic policy than in trade policy. Domestic "crisis interventions" are bunched in two key areas: huge bailouts and associated subsidies, especially but not confined to financial services; and fiscal stimulus packages, usually combined with loose and unorthodox monetary policies. The former is concentrated in the West; the latter spread across the OECD and developing countries.

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