PROTECTIONISM

U.S. must resist instinct to circle the wagons

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FEBRUARY 2, 2009

U.S. Senator Reed Smoot was a prominent leader of the Mormon faith born in Salt Lake City, Utah. Senator Willis C. Hawley had been an Oregon educator and economics teacher. Together, this unlikely pair sponsored the notorious trade-restricting legislation in 1930 that paved the way for the collapse of global trade, a key factor in the Great Depression.

Could global trade be facing a modern version of Smoot-Hawley, with new protectionist measures replacing the blunt instrument of higher tariffs? Until recently, the idea seemed far-fetched.

World leaders who met in Washington in November at the G20 agreed that raising barriers to trade would only exacerbate the global financial crisis. Yet, as the global economic crisis worsens and governments try to protect jobs at home by limiting competition from abroad, fears are growing of a new breakout of beggar-the-neighbour protectionism.

In Britain, hundreds of oil refinery and power plant workers went on a wildcat strike last week to protest plans by a refinery's French owners to use foreign labour on a construction contract. In Spain, where unemployment has soared, the government is paying foreign workers to go home so they will not compete with Spaniards for scarce jobs.

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Over the past week, officials from Egypt, India, Costa Rica and Indonesia all complained that their exports were facing new barriers abroad.

Fears of a new protectionism reached a peak last week when the U.S. Congress moved to protect the U.S. steel industry. Passing President Barack Obama's $819-billion (U.S.) stimulus package, the House of Representatives tacked on a rider requiring infrastructure projects to "Buy American."

The provision, which sparked immediate concern among U.S. trade partners, including Canada, is now being reviewed by the Obama administration to see if it contravenes international rules.

U.S. trade rivals are also complaining about Washington's move to bail out its troubled auto industry. Those measures "quite frankly, constitute protectionism," German Chancellor Angela Merkel said last week.

"Many of the big economies are turning inward as they cope with their domestic slumps," said Cornell University trade scholar Eswar Prasad. "Policy makers are very narrowly focused on getting their economies growing again. That could lead to real tension if countries think others are taking advantage of them."

Back in 1930, countries responded quickly to the new U.S. tariff wall. Even before Smoot-Hawley became law, imposing high tariffs on thousands of imported products, Canada responded with duties of its own on a range of important U.S. exports. Two years later, the Ottawa agreements brought Canada and other parts of the old British empire together in protective trade pacts, at the expense of the United States.

Most experts don't see a return to those combative days, when competing tariffs helped cause a two-thirds fall in global trade volumes. All-out trade wars are less likely today because the World Trade Organization and nation-to-nation trade deals such as the North American free-trade agreement provide legal channels for working through trade disputes.

Instead, the main worry is about a kind of creeping protectionism, in which countries subtly limit competition with subsidies, bailouts and other measures to protect domestic industries. Those measures distort trade and discriminate against foreign rivals, "but in the real world, it's hard to imagine things being played out otherwise," said Roy Culpeper, president and chief executive officer of the North-South Institute in Ottawa. "Governments are going to look after their own first with the scarce dollars they have going into deficit situations, and think about trade implications, if at all, only after that."

Scholars Frederik Erixon and Razeen Sally of the European Centre for International Political Economy foresee a spiral of tit-for-tat trade measures. "If one country subsidizes, others follow; if one sector gets subsidized, others will demand like treatment," they wrote in a recent opinion piece in The Wall Street Journal. "That will in turn lead to a clamour for other forms of protection against foreign competition, such as anti-dumping and safeguard duties, export subsidies and discriminatory product standards."

Richard Baldwin, who teaches international economics at the Graduate Institute in Geneva, says that in a nightmare scenario, a much worse form of protectionism could be set off if, for example, China were to devalue its currency to keep its exports to the United States priced low, undercutting hard-hit U.S. producers.

"China devalues to avoid social unrest from unemployed manufacturing workers, and the rest of East Asia follows suit to avoid losing competitiveness. The U.S. Congress already has some highly protectionist bills in front of it with respect to China, and they might well pass them. One would hope [Mr.] Obama would veto them, but who knows. If U.S. unemployment keeps rising, more Americans lose their homes, elderly their life savings. ... Things could become very ugly, and blaming the foreigners is a classic."

On the plus side, world leaders seem to understand the lessons of Smoot-Hawley and the danger that rising protectionism could choke off economic recovery. Japanese Prime Minister Taro Aso has announced that a new aid program for Asian countries will have a precondition: Countries that accept aid money must not restrict trade. "We will resolutely fight all protectionism," he said.

Trade ministers meeting on the sidelines of the World Economic Forum in Davos, Switzerland, on the weekend agreed to place the "highest priority" on concluding the long-stalled Doha round of world trade talks. If successful, that would lower trade barriers significantly around the world.

But with domestic workers and companies crying out for help, world leaders will find it harder and harder to resist the siren call of economic nationalism that lured senators Smoot and Hawley - and helped send the world economy onto the rocks.

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