Box 1

THE RISKS OF PROTECTIONISM

Since the intensification of the global financial crisis in September 2008, the sharp contraction in global trade has been a key factor propagating the economic downturn across borders, making it a truly global phenomenon.[1] At the same time, protectionist pressures have been rising worldwide, as signalled by policy statements and opinion polls, as well as by recent developments in multilateral, regional and bilateral trade negotiations.[2] Meanwhile anecdotal evidence of discrimination against foreign suppliers of goods and services has also been emerging. Against this background, this box discusses recent features of protectionism and the adverse implications for competitiveness, economic activity and welfare.

Gauging the full extent of recent protectionist initiatives is far from easy. Relevant data become available with considerable delay and many forms of non-tariff barriers or complex forms of protection are very difficult to identify and quantify. Often statistics on the use of contingent protection, including safeguard measures, anti-dumping and countervailing duties, are used as an early indicator of trade protectionism. However, according to the World Trade Organization, significant gaps exist in the empirical evidence on contingent protection, making it difficult to gather general trends from these data.[3]

Hence, the assessment of protectionist trends necessarily needs to rely on indirect evidence. Econometric analysis by the World Trade Organization suggests that the frequency of anti-dumping actions, countervailing duties and safeguards seems to be linked to the business cycle, with some statistical evidence of an increase in global anti-dumping activity during macroeconomic downturns. Global Trade Alert, a monitoring initiative coordinated by the CEPR, has identified 87 new measures – proposed or implemented since November 2008 by as many as 52 countries – that discriminate against foreign commercial parties. Over the same period, according to Global Trade Alert, only three trade-enhancing measures have been implemented.

Of the protectionist measures recently announced or implemented, only a few were aimed at increasing tariffs. Thus far, they do not appear to have triggered large-scale retaliatory responses. The complex web of multilateral, regional and bilateral trade agreements may have prevented this. Indeed, most tariff increases have been carried out by countries that are less integrated in the international trading system. In addition, the current dominance of international production chains may have reduced firms' demand for protection in the form of tariff increases and quantitative restrictions, as these would risk disrupting the functioning of their international production networks.[4]

More salient protectionist tendencies have been associated with the massive government stimulus packages, bail outs and subsidies, which recurrently feature provisions that effectively favour domestic parties and harm foreign exporters, investors and workers. Gamberoni

1 See Box 1 entitled "The recent sharp contraction in world trade from a historical perspective" in the March 2009 issue of the Monthly Bulletin as well as Box 10 entitled "The downturn in euro area trade" in the June 2009 issue of the Monthly Bulletin.
2 For an overview, see the article entitled "Assessing global trends in protectionism" in the February 2009 issue of the Monthly Bulletin.
3 World Trade Organization (2009), "World Trade Report 2009: Trade policy commitments and contingency measures".
4 See Baldwin, R. and S. Evenett (2009), "The collapse of global trade, murky protectionism, and the crisis: Recommendations for the G20" at http://www.voxeu.org/index.php?q=node/3199.

and Newfarmer (2009) indicate that, shortly after the commitment made by G20 leaders on 15 November 2008 to refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing export-stimulating measures inconsistent with obligations in the context of the World Trade Organization, 17 out of these 20 nations have actually announced protectionist measures.[5] Accordingly, 67 new restrictions other than tariffs and quotas have been implemented since November 2008, according to Global Trade Alert.

The consequences of a rise in protectionism can be severe. To start with, increased protectionism generates a large variety of market distortions, leading to substantial medium and long-run costs, in particular for the implementing countries. Subsidies to domestic industries – including direct state aid, guaranties and bail outs – artificially push down the costs for local firms, while tariffs or anti-dumping and countervailing duties artificially push up the cost of imported goods and services. Simulations, based on the framework used in Ottaviano, Taglioni and di Mauro (2009)[6], show that such measures preserve domestic production capacities only in the short run but obstruct an efficient reallocation of resources, thereby implying longer-term costs in terms of efficiency of production and international competitiveness. The above framework shows, in addition, that protectionism reduces welfare, by curbing product variety on the domestic market and strengthening firms' market power at the expense of consumers. The simulations of the impact of a rise in trade protectionism on competitiveness indicate that all countries would lose from such initiatives, but that the expected losses would be larger for the implementing countries, in particular if they are relatively small, open or specialised in sectors facing high international competition. Moreover, a different model simulation based on the multi-country version of the New Area-Wide Model[7] shows that if countries were to implement protectionist measures systematically, the impact on global welfare and on the recovery process would be sizeable. A unilateral 5 percentage points increase in import tariffs by a large economy may lower world GDP growth by up to 1 percentage point over four years and the adverse impact would be amplified if all countries were to impose tariff restrictions at the same time.

In conclusion, the risk of a resurgence of protectionism in the aftermath of the financial crisis should not be neglected. A sluggish global recovery and rising unemployment may increasingly tempt governments to adopt restrictive trade policy measures, which could lead to a retaliatory spiral of ever harsher trade restrictions and tensions. A resurgence of trade protectionism would not only significantly impair the global recovery process by further hampering trade flows and global demand but it would also reduce the global growth potential in the long run. Given the disruptive implications for the world economy, any protectionist tendencies should be strongly discouraged.

5 See Gamberoni, E. and R. Newfarmer (2009), "Trade Protection: Incipient but Worrisome Trends", 2 March 2009 at http://www.voxeu.org/index.php?q=node/3183.
6 See Ottaviano, G., D. Taglioni and F. di Mauro (2009), "The Euro and the Competitiveness of European firms", Economic Policy, January 2009, Vol. 57, pp. 5-53.
7 See Jacquinot and Straub (2008), "Globalisation and the Euro Area: Simulation Based Analysis Using the New Area-Wide Model", ECB Working Paper No. 907.