

## Trade Protection: Incipient but Worrisome Trends

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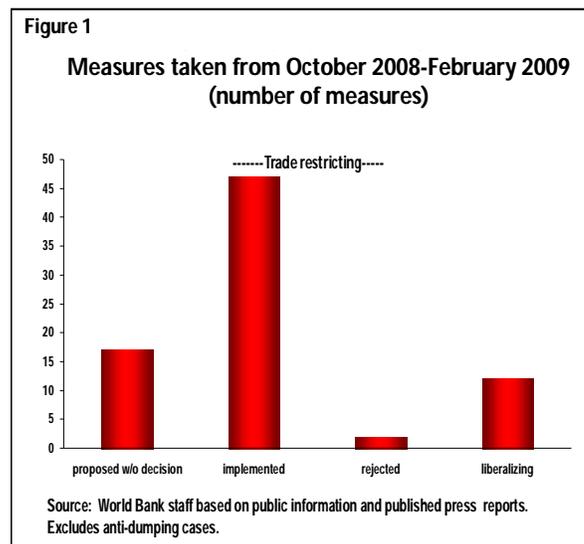
With the global economy teetering on the abyss of severe recession, political pressures demanding protection from import competition to protect employment are surfacing with increasing intensity around the world. However, if there is one lesson from the experience of the 1930s that is suddenly relevant, it is that raising trade barriers merely compounds recessionary forces – and risks pushing the economy into prolonged contraction.

For this reason, G-20 leaders signed a pledge on November 15, 2008, to avoid protectionist measures. However, since then, several countries, including 17 of the G-20, have implemented 47 measures whose effect is to restrict trade at the expense of other countries. While the trend is of concern, to date these measures have probably had only marginal effects on trade. The sharp contractions in trade volumes evident in recent months are a consequence not of protection, but of the global recession and financial feedbacks through skyrocketing costs of a shrunken pool of trade finance. Nonetheless, the trend in protection is up and the full effects recession have not yet been felt. Trends are a source of concern and worthy of constant monitoring.

### Several countries have adopted new protectionist measures...

Since the beginning of the financial crisis, officials have proposed and/or implemented roughly 78 trade measures, according to the World Bank's monitoring list of trade and trade-related measures.<sup>1</sup> Of these, 66 involved trade restrictions, and 47 trade-restricting measures eventually took effect (Figure 1). The trade effects of these measures are difficult to evaluate because of the prevalence of non-tariff border measures, subsidies and contingent

### Trade restrictions are numerous...



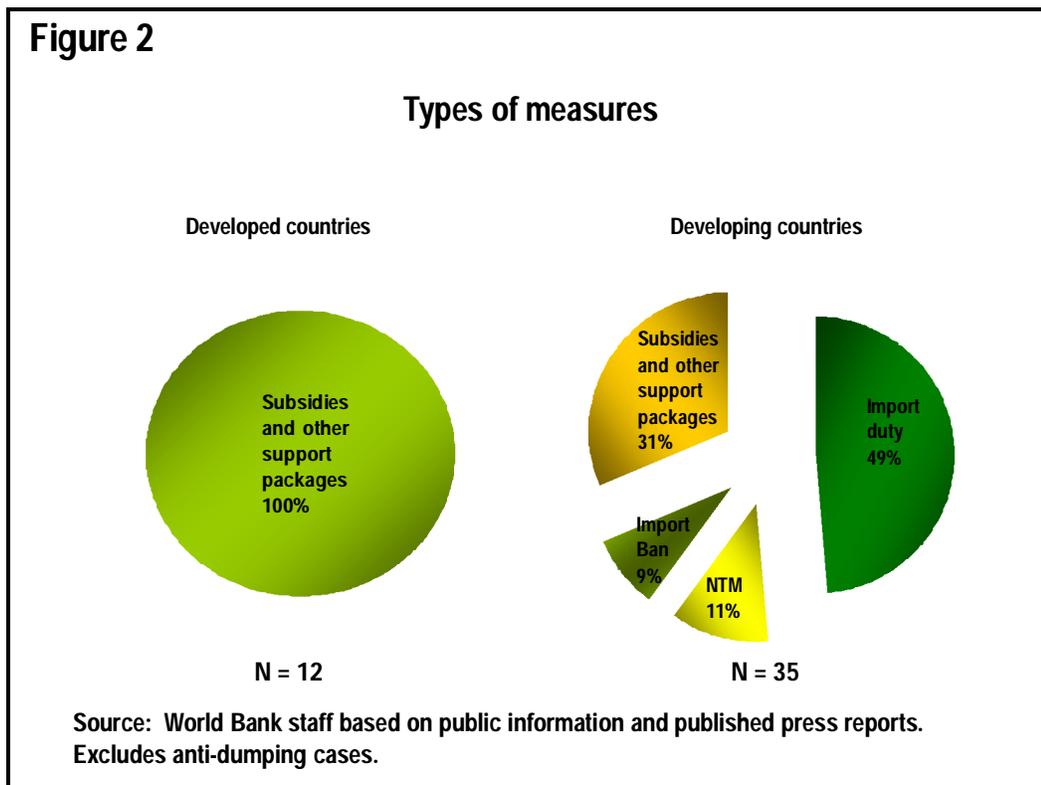
protection – a task that nevertheless remains to be done. Although the effects of these measures so far are probably minor relative to size of unaffected markets, they are of considerable importance for particular exporters shut out of protected markets.

Tariff increases comprise only about a third of these actions and a half for developing countries (Figure 2). For example, Russia raised tariffs on used autos, and Ecuador raised tariffs on more than 600 items. Non-tariff measures include such policies as Argentina’s imposition of non-automatic licensing requirements on auto parts, textiles, TVs, toys, shoes, and leather goods, or Indonesia’s requirement that five categories of goods (including garments,

Export subsidies are particularly egregious because they contravene the draft Doha modalities. The EU announced new export subsidies on butter, cheese, and milk powder. Less obviously, both China and India have increased the rebate on the duty drawback system for exporters, and, although the subsidy component is a matter of discussion, the timing of these measures raises questions.

Subsidies proposed for the auto industry have proliferated and total some \$48 billion worldwide, mostly (\$42.7 billion) in high-income countries. In addition to the US direct subsidy of \$17.4 billion to its three national companies, Canada, France, Germany, United Kingdom,

**Rich countries subsidize... Poor countries use barriers**



footwear, toys, electronics, food and beverages) would be permitted in only five ports and airports. In some countries, tightening standards have slowed import entry, including, for example, China’s import ban on Irish pork as well as rejection of some Belgian chocolate, Italian brandy, British sauce, Dutch eggs and Spanish dairy products; and India’s ban on Chinese toys.

China, Argentina, Brazil, Sweden and Italy have also provided direct or indirect subsidies – not including Australia’s support to its car dealers and South Korea’s and Portugal’s support to their component suppliers. To the extent that the industry is laden with excess capacity, these subsidies impede exit and delay adjustment. Even worse, subsidies may be linked to requirements that companies to

preserve domestic employment, even at the cost of shutting more efficient plants abroad in developing countries. (In the case of the European Union, state aids may not be conditional on the location of supported economic activities or employment). To prevent this, governments may react to the policies of neighbors – so, for example, Canada has matched the subsidies the US gave Detroit auto makers to ensure that Canadian plants of American producers would remain open.

A remarkable trend emerging from these actions is the reliance of developed countries on subsidies rather than border barriers, while developing countries have deployed all forms of protection (Figure 2). This undoubtedly is testimony to the superior financial strength of public budgets in developed countries. However, once economic pressures to stimulate economies are replaced with inevitable needs to reduce deficits, this pattern may portend equally severe pressures to wall off trade competition.

### **Anti-dumping cases are on the increase...**

These numbers do not include antidumping measures. After a period of slowdown, the number of antidumping cases (both investigations initiated and imposition of duties) surged in 2008, especially in the second semester (Figures 3 and 4). Compared to 2007, antidumping initiations grew by 15 percent and findings with imposition of duties grew by 22 percent. Developing countries accounted for the majority of initiations, though developed countries accounted for the greatest number of duty impositions. India was the most active, accounting for 29 percent of total initiations. In December alone, India initiated anti-dumping investigations involving both hot- and cold- rolled stainless steel products, affecting 19 countries. In addition to Japan, three developing countries -- China, South Africa, and Thailand – were the target in both investigations. The US and EU were the two countries that most frequently imposed duties. For example, the

EU in December 2008 imposed duties on preserved fruits from China as well as on imports of welded tubes and pipes of iron or non-alloy steel from Belarus, China and Russia.

### **Trends in agriculture, finance and labor movement deserve watching...**

Protection to agriculture may not require new measures because existing laws automatically provide increases in subsidies with declines in agricultural prices. Many programs – in the EU, US, Japan, South Korea, to name a few – entail price supports, so when commodity prices fall, direct payments to producers increase. For example, we estimate that US overall trade distorting subsidies of about \$8.1 billion in 2008 are likely to rise to \$9.9 billion in 2009 if current price projections materialize.<sup>2</sup> Trade distorting subsidies push the global burden of adjustment onto commodity producers in Africa, Asia, and Latin America where governments do not have resources to match subsidies of the wealthier countries.

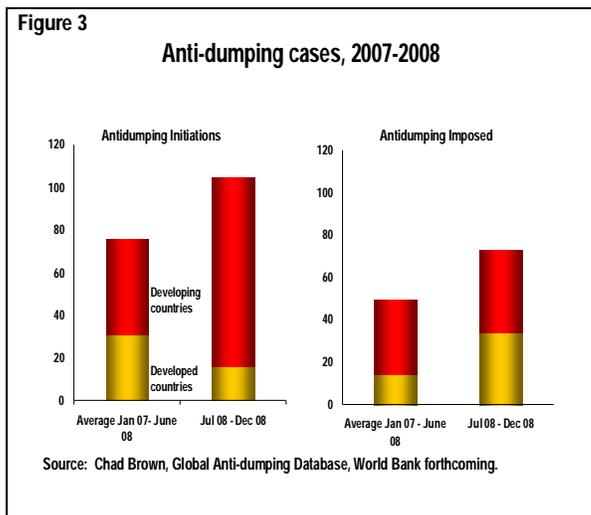
These measures also ignore the protectionist bias in the financial sector. While serving the urgent public purpose of reestablishing financial stability, virtually all nations have focused their financial subsidies on domestically owned banks rather than subsidiaries of foreign banks (perhaps a consequence of relative size more than national protection).

Workers in some countries, most prominently in the EU have campaigned for increased restrictions on foreign labor. In the United Kingdom, for example, the dispute over the use of Portuguese and Italian contractors in oil refining at a time of surging unemployment led workers to strike in protest at the end of January, and triggered several sympathy protests across Britain. Workers complained that foreign companies were overlooking skilled British workers. In January Malaysia banned the hiring of foreign workers in factories, stores and restaurants to protect its citizens from mass unemployment

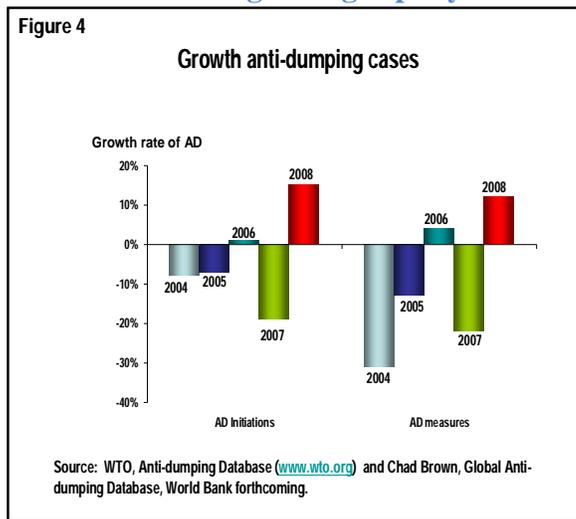
amid the global economic downturn. To their credit, the Swiss voted in a referendum in early February to accept EU labor rules, including foreign labor from newly acceded countries.

existing legislation and would imply no new restriction on federal purchases.<sup>5</sup> It would still mean that government purchases of iron, steel and other manufactures from China, India, and Russia, among others, would be subject to the provisions.

### Anti-dumping cases are up...



### ...and growing rapidly



### Buy America generates a storm...

In late January, the US House of Representatives passed a stimulus bill that would provide a 25 percent competitive margin for US iron and steel for all expenditures under the bill. Several governments, including Canada and the EU, and well known economists<sup>3</sup> objected forcefully to the provisions. With the administration weighing in, the Senate version, while expanding the coverage of the provision to all manufactured goods, added a stipulation that the provision “be applied in a manner consistent with United State obligations under international agreements” (Sec. 1604 (d)). This apparently exempts the 27 EU member states and the 12 other countries that have signed the WTO Agreement on Government Procurement and the countries with Free Trade Agreements.<sup>4</sup>

These countries collectively supply about 25 percent of US iron and steel imports. According to USTR and private lawyers, this seemingly small change puts the new stimulus legislation into conformity with

### ...but trade integration and stronger rules have thus far muted protectionism.

Several factors have clearly muted protectionist pressures, and distinguish this global downturn from the pressures of the 1930s. Countries are far more interdependent through supply chains, imported inputs, and even services. Export interests are far more powerful than before relative to pure import-competing industries. Producers for the domestic market are more reliant on imported inputs; and production chains link global markets through a web of trade in parts and components. The simple average of trade-to-GDP is today 96 percent compared to 55 percent in 1970 – and parts and components trade, an indicator of supply chains, has more than doubled as a proportion of total trade. Successive GATT/WTO agreements have provided much greater legal stability of trading relations. Because of this quite different political economy today, a few proposed

restrictions have been rejected or not enacted. In Brazil, for example, the bureaucracy attempted to impose widespread licensing arrangements and import controls reminiscent of the 1970s, only to provoke a response of outrage from the private sector that led to immediate reversal. Similarly, the more egregious forms of the Buy America provision appear to have been circumvented. Moreover, about 10 of the 77 proposed and implemented changes in trade policies involved steps toward greater liberalization, mostly related to free trade agreements.

Also, most countries have flexible exchange rates, and, as capital has sought safety in US Treasuries, nominal exchange rates against the US dollar have plummeted. This shift in relative prices domestically has given import-competing interests considerable protection. The floating rate regimes have arguably preempted a wave of competitive devaluations like the one that disrupted markets in the 1930s. For the handful of countries intervening in exchange rate markets, it generally has been to prevent further depreciations – such as Argentina and Russia. China has apparently ceased accumulating reserves since October, and the nominal rate has stabilized after a two year and 20 percent appreciation.

### **Forceful leadership can help.**

The cost of inaction on the Doha Agenda is rising. To date most countries have not yet raised tariffs to bound levels or taken full advantage of headroom on agricultural subsidies, however, as the recession deepens, many countries may well do so. It is a safe bet that the lower bindings and caps on agricultural subsidies contained in the draft texts that would have kept many markets open that will not be able to do so by the end of 2009. This underscores the importance of pushing forward with a rapid conclusion of the Doha round.

The recent decision by the WTO membership on February 9, 2009, in the Trade Policy Review Body will, in the

meantime, contribute to regular multilateral surveillance of the world trading system.<sup>6</sup>

The G-20, for its part, could adopt additional measures that would strengthen the fragile consensus against further protectionism. It could, for example:

- Commit to greater transparency by agreeing to provide quarterly reports on new trade restrictions, industrial and agricultural subsidies to the WTO, together with an mandatory analysis of the trade restriction on employment (since this would create new room for technical analysis and political discussion in- countries themselves).
- Agree to promote the use of standard safeguard provisions in lieu of anti-dumping laws.
- Agree to accelerate progress on technical issues still separating negotiators on the Doha round, including producing new working texts on the special safeguards mechanism, sectoral negotiations and cotton.
- Advocate greater Aid for Trade for low-income countries.
- And decide to endorse voluntary implementation of the trade facilitation provisions, not as an “early harvest”, but in a non-binding fashion linked to overall trade facilitation reforms design to lower trading costs.

### **Further Reading.**

Baldwin, Richard and Simon Evenett (ed) What world leaders should do to halt the spread of protectionism: 17 Essays November 2008 Vox <http://www.voxeu.org/index.php?q=node/2993>

Hufbauer and Schott “Buy American: Bad for Jobs, Worse for Reputation” Policy Brief Washington: Peterson Institution

for International Economics February 2009.

WTO Staff, “Report to the TPRB from the Director-General on the Financial and Economic Crisis and Trade-Related Developments” February 9, 2009.

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<sup>1</sup> The list of proposed, enacted and/or rejected trade measures is taken from news accounts, official reports, and other sources; virtually all measures are taken from two sources and where possible receive confirmation with country staff; nonetheless, numbers here are subject to a small margin of error as government policies at times are opaque and subject to change, even reversal. This list does not include “automatic” increases in agricultural protection, contingent protection (e.g., antidumping), WTO-sanctioned measures to retaliate against trading partners that have not complied with the findings of a WTO dispute settlement panel and financial sector subsidies (discussed in subsequent sections). More important, this discussion does not attempt to quantify the trade effect of any particular event and thereby attach some weight to each action – though obviously some actions have far greater impact in closing markets than others. It is important to note that it is difficult to distinguish the trade policy measures that are taken in response to the current crisis from measures that might have been taken anyway.

<sup>2</sup> This is based on the methodology of Will Martin and David LaBorde.

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<sup>3</sup> These have included economists of diverse persuasion, such as Gary Hufbauer and Jeff Schott, Douglas Irwin, Glen Hubbard, and Joseph Stiglitz, among others. See also Hufbauer and Schott “Buy American: Bad for Jobs, Worse for Reputation” Policy Brief Washington: Peterson Institution for International Economics February 2009.

<sup>4</sup> Most US FTAs have provisions similar to Art. 9.2(1) (General Principles--National Treatment and Non-Discrimination) of the US-Chile FTA, which provides that: “With respect to any measure governing procurement covered by this Chapter, each Party shall accord to the goods and services of the other Party, and to the suppliers of such goods and services of the other Party, treatment no less favorable than the most favorable treatment the Party accords to its own goods, services and suppliers.” The original version of the US bill would have violated this provision.

<sup>5</sup> Hufbauer contends that one legal interpretation could asserted some new restrictions, if minor, for those states that have not acceded to NAFTA; this could be clarified at signing if necessary.

<sup>6</sup> The first monitoring paper was discussed on February 9, 2009, titled “Report to the TPRB from the Director-General on the Financial and Economic Crisis and Trade-Related Developments”.