

Protectionism in a Globalized Economy: Beggar Thy Neighbour is Beggar Thyself

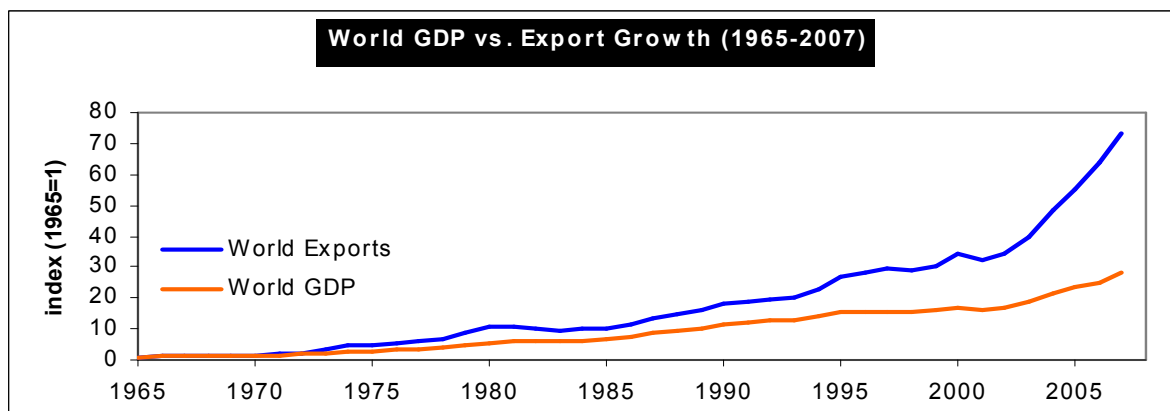
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Protectionist policies during the Great Depression were called “beggar thy neighbour” as they sought to shift shrinking demand away from imports in favour of domestic goods. In practice, policies like the Smoot-Hawley Tariff Act of 1930 led to a retaliatory cycle that helped to aggravate the depression. The current global economic crisis along with protectionist murmurs around the world have raised fears of a new wave of trade protectionism. The costs of these policies is even greater now than it was in 1930: the world economy is more deeply integrated through trade and investment linkages, and imports are much more likely to be inputs in the production processes of domestic industries as part of global value chains (GVCs). New trade barriers would have the unintended consequence of increasing costs for already struggling domestic industries.

The cost of protectionism has risen

Protectionism deepened the Great Depression: higher trade barriers have been estimated to have reduced real trade by 19 percent¹ (real trade fell by over 30 percent in combination with other factors, and nominal trade fell by almost two-thirds). A repeat of this policy failure would be even more damaging now. World merchandise exports are now equivalent to 25 percent of world GDP², and Figure 1 shows the dramatic increase in trade relative to the world economy, with much of recent growth attributable to the trade in intermediate products. The integrated nature of world trade is underlined by the speed of the contraction in the value of world trade (Figure 2), which is partly the result of a multiplier effect created by increased intermediate products trade. Global Insight predicts the value of world trade will plunge 28 percent from its peak in 2008 by mid-2009, and the WTO predicts a 9 percent drop in volumes in 2009 - a dismal situation that would only be amplified by trade protectionism.

Figure 1

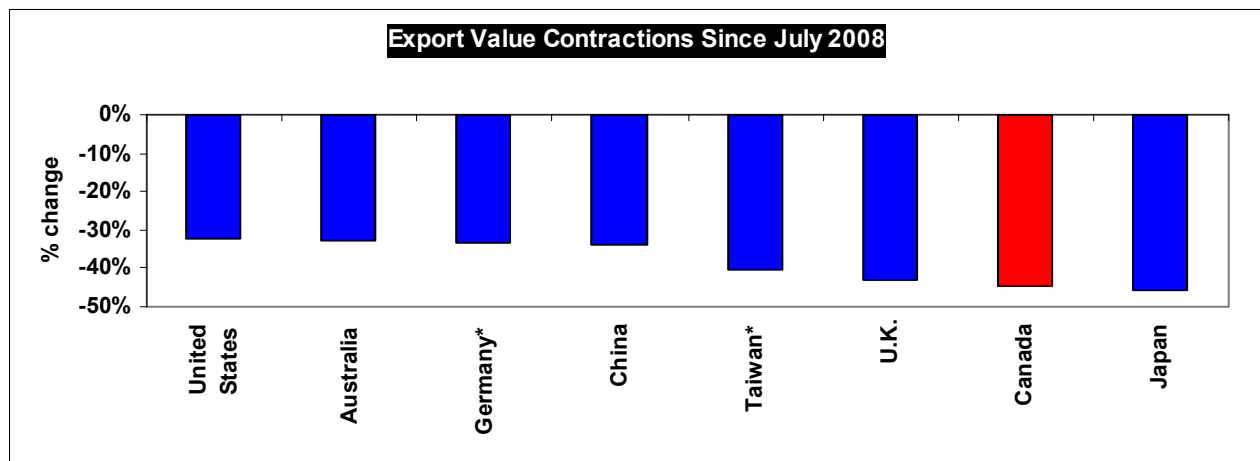


Source: Office of the Chief Economist. Data: World Development Indicators, World Trade Organization

¹ Madsen, Jakob, 'Trade Barriers and the Collapse of World Trade in the Great Depression'.

² Based on IMF trade and GDP data for 2007..

Figure 2



Source: Country statistical agencies up to January 2009, except for Germany and Taiwan (December 2008). Note that Canada's large value contraction is partially the result of the steep decline in commodity prices since the peaks of 2008.

To date there have been few new overt trade restrictions³, but there has been a wave of nationalist policies including the encouragement of domestic lending over international, industrial subsidies, and calls to bring offshored production home. During the Depression, non-tariff barriers were responsible for almost one-third of the decline in world trade attributable to protectionism⁴, and now they may pose an even more serious threat to the economic recovery.

In North America many sectors are integrated at the firm and industry level, and the global competitiveness of these firms is contingent on an integrated continental market. U.S. intermediate product imports grew at more than twice the speed of domestic inputs between 1995 and 2005 - 147 percent versus 65 percent⁵. This is partly the result of Canada's role as a U.S. supplier increasing in importance after the Canada-US FTA and NAFTA - our intermediate goods exports in North America are estimated to have risen 115 percent during the 1990s by the Conference Board of Canada⁶, with 60 percent of Canada's top 25 merchandise exports being intermediate (a value of \$200B if extrapolated to total exports).

Although capturing only one type of value chain trade, it is worth noting that 30.3 percent of Canada-U.S. trade is intra-firm. Most Canada-U.S. intra-firm trade is led by U.S. firms: three-quarters of Canada to U.S. intra-firm exports originate from the affiliate of a U.S. company back to its parent, and 94.4 percent of Canada-U.S. intra-firm imports are from U.S. parents. Trade barriers would thus primarily disrupt the internal value chains of U.S. firms, raising their costs of production while they face shrinking markets, thereby disproportionately hurting U.S. companies. Many value chain products also cross the Canada-U.S. border more than once, so the added costs of trade barriers could be multiplied at each stage of production.

Given the higher costs of protectionist policies, economic recovery strategies should take into account the importance of value chain trade. Canada has set an example with the unilateral elimination of import tariffs on a wide range of machinery and equipment in Budget 2009, reflecting that open trade not only helps our trade partners, but enhances the competitiveness of our industries.

³Recent Trade Developments Associated with the Financial Crisis", WTO Feb 9 2009

⁴Madsen, Jakob, 'Trade Barriers and the Collapse of World Trade in the Great Depression'.

⁵Calculations based on OECD harmonized Input Output tables

⁶Canada's Engagement in Regional and Global Supply Chains, May 2008.

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