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Trade Protectionism and Worldwide Economic Contraction

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> "I almost went down on my knees to beg [President] Herbert Hoover to veto the asinine Hawley-Smoot Tariff."... "That Act intensified nationalism all over the world." Thomas Lamont, banker and economic adviser, June 1930
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> "Now is a time where we have to be very careful about any signals of protectionism." President Barack Obama, February 19, 2009
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> "From the purely economic point of view nothing speaks against free trade and everything against protectionism." Ludwig von Mises (1881-1973), Austrian economist

When the economy is booming, foreign borrowings and imports of goods and services from other countries are most welcome. They allow for more spending without inflation and they raise living standards. It is a version of having your cake and eating it too. In an economic downturn, however, the political reflex of populist politicians is to turn protectionist and to become economic isolationists by raising trade barriers. In such an environment, foreign competition becomes a convenient scapegoat for the crisis, even though the causes of such crisis are most often purely domestic in nature.

Regarding trade, the Obama administration seems to have adopted the "good cop, bad cop" routine, extolling the virtues of free trade in presidential speeches while letting Congress pass protectionist measures in series. The fear here is a repetition of the 1930s when American politicians rushed to pass the infamous Smoot-Hawley Tariff act of 1930 that triggered an international trade war and which accelerated the worldwide economic downturn. World trade plummeted into a spiral downward and domestic production for exports contracted everywhere. Normal trade links were disrupted and intricate inter-country production arrangements were dismantled.

Indeed, in a misguided attempt to fight the economic downturn, governments all over the world rushed to adopt self-destructive "beggar-thy-neighbor" policies, in a futile attempt to devalue each other's currencies and to reduce their imports in retaliation, forgetting that one country's imports are the other country's exports. The consequence was that from 1929 to 1933, the value of world trade contracted by two-thirds, going from \$5.3 billion to \$1.8 billion.

The world economy went down with world trade and every country was worst off as a consequence. A severe recession was then turned into a worldwide economic depression.

This is because trade protectionism in the modern world is the equivalent of “cutting off your nose to spite your face” and its main consequences are to spread poverty and economic dislocations.

Some seventy years later, the same mistakes risk being repeated. Most modern economies are interrelated and if politicians begin to unravel such an economic integration, the consequences may be even worst than in the 1930s, because economic integration is much more advanced and prevalent than it was then.

World trade is already contracting due to the current global financial crisis, a decline in commercial bank trade credits and a drop in private investments. According to the World Bank’s projections, total world trade in goods and services this year is expected to fall 6.1 percent. The decline will particularly hurt large export-led economies such as Mexico, Germany and Japan.

The issue of protectionism is also particularly important for Canada, the U.S.’s most important trade partner. The United States and Canada not only share this continent, but they also have a mutually beneficial trading relationship that has been enhanced with the signing of the Canada-U.S. Free Trade Agreement on October 12, 1987. This treaty was enlarged in 1994 to include Mexico with the implementation of the North American Free Trade Agreement (NAFTA). As a consequence, there are no tariffs on most goods that pass between Canada and the United States.

In 2008, Canada’s trade with the United States accounted for about 76 percent of its total international exports and 63 percent of its imports, while U.S. exports to Canada represented about 20 percent of total American exports. A lot of American jobs are tied to American exports to Canada. In fact, Canada is the leading export market for 36 of the 50 U.S. States and Canada is a larger market for U.S. goods than all 27 countries of the European Community combined.

Moreover, Canada is the single largest exporter of total petroleum to the United States, supplying the U.S. with more than 2.5 million barrels per day. What is more, this oil supply is guaranteed under Nafta. There is also an important and growing cross-border trade of electricity between Canada and the United States that links the two economies.

This does not mean, however, that trade frictions between Canada and the United States do not exist. Sometimes politicians behave as if the trade agreement between the two countries did not exist. A case in point is the routine inclusion of “buy American” provisions in spending bills voted by the U.S. Congress, which can be considered overt protectionist trade-distorting measures and contrary to the spirit and the letter of the free trade agreement.

If the lessons of the past have been learned, governments should resist the temptation to export their economic problems abroad and should work instead to stimulate their economies without resorting to protectionist measures. What is needed now is to avoid sending the world economy into a self-reinforcing contraction that would hurt everyone.

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