The Takeaway

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Avoiding the Mistakes of the Past:

Rejecting Protectionism and Embracing the Global Economy

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The "Great Recession" of 2008 was the greatest global financial crisis since the Great Depression. It led to the bankrupting of businesses, caused credit markets to dry up, imploded the housing market, and led to a near collapse of global trade. The plunge in trade that occurred between the second quarter of 2008 and the third quarter of 2009 was the steepest fall of world trade in recorded history.[1]

Nowhere was this drop in trade more pronounced than in the United States, where the trade-to-GDP ratio fell by a larger percentage than in any previous recession, including the Great Depression.[2] As Figure 1 shows, during the Great Recession, the U.S. trade-to-GDP ratio declined by more than twenty percent in a single year.

In response to the Great Depression, the U.S. passed the U.S. Tariff Act of 1930. As a

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WHAT'S THE TAKEAWAY?

Free trade agreements, and membership in the WTO, kept the U.S. from engaging in protectionism after the Great Recession.

The proposed Trans Pacific Partnership would be the largest trade agreement since the NAFTA, accounting for nearly 40% of all global trade.

By embracing the global economy through initiatives like NAFTA and the TPP, the U.S. can foster increased job growth and economic prosperity for its own citizens, and for individuals around the globe.

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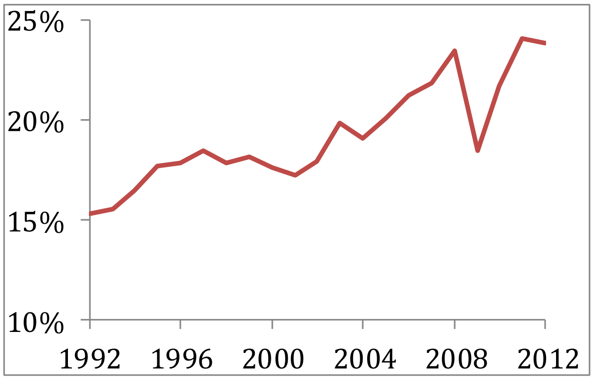
Figure 1: U.S. Trade as a Percentage of GDP



Source: World Bank. (2014). Merchandise trade (% of GDP). Data retrieved April 16, 2014, from World DataBank: World Development Indicators database.

result, nearly 900 American import duties were increased, limiting Americans' access to cheaper foreign goods and triggering retaliation from our trading partners. For this reason, the Act has been blamed as a contributing factor in extending the length and severity of the Great Depression. Thankfully, policymakers in the U.S. followed a different course of action following the Great Recession than they did in the aftermath of the Great Depression. Why was this?

THE WORLD TRADE OR ANIZATION

Institutional explanations for the lack of large-scale protectionism have largely centered on the role that the World Trade Organization (WTO) plays in governing international trade. The WTO, established in 1995 and made up of 159 countries, works to increase global trade, acting as an avenue where nations can negotiate trade agreements and settle trade disputes with one another.[3]

As a significant member in this organization, the United States was greatly inhibited from engaging in protectionism as a response to the Great Recession. This can be attributed to the discipline imposed by WTO rules, which are particularly binding for developed nations and serve to constrain the ability of governments to increase protectionism. When WTO nations agree to open their markets to one another, they "bind" themselves together by instituting ceilings on customs tariff rates. Developing countries often tax imports at rates lower than the "bound" agreement to increase their nation's access to cheap foreign products. However, in developed nations, like the United States, the actual tariff rates nearly always match the "bound" rates. After these "bound" rates have been set, a nation can only change its rates through costly renegotiations with its trading partners, likely requiring some form of compensation to engender agreement on new terms.[4]

INTERNATIONAL CAPITAL LOWS

In addition to WTO restrictions, economic incentives, such as international capital flows for cheap labor and products, can wield a strong influence in constraining protectionism. The flow of international capital leads to offices and factories being situated around the world, thus entangling the economies. This global footprint provides a strong disincentive to protectionism, particularly if those facilities are part of the global supply chain that buys and sells across borders. To remain the least-cost producer at any stage in the supply chain means keeping protectionism at bay by remaining engaged in global trade.[5] Protectionism through tariffs would increase the costs of inputs in a producing country and make that nation's producers less competitive globally.

Trade across the global market essentially creates a zero-sum game, whereby the demand for cheap inputs by domestic firms around the globe exerts countervailing pressure against protectionism. Simply put, domestic and international businesses and consumers have come to rely on the cheap products made available through international trade. As long as the U.S. economy continues to rely upon and benefit from free trade, protectionist responses to economic crises will not only be impractical, but harmful as well. Recognizing this fact, the U.S. continues to push for closer integration in international trade by pursuing free trade agreements with other nations.

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PURSUIN FURTHER INTEGRATION

The United States is currently working on a far-reaching trade agreement with twelve other nations, the Trans-Pacific Partnership (TPP). The TPP is a proposed free trade agreement between the United States, Canada, Mexico, Australia, Brunei, Chile, Malaysia, New Zealand, Peru, Singapore, Vietnam, and Japan. South Korea may soon become involved in the Partnership as well. Together, TPP countries make up roughly 40 percent of the world's GDP and 26 percent of total global trade.[8] In an attempt to move away from what some have seen as a preoccupation with the Middle East, the Obama administration has stated a desire to pivot its geopolitical priorities toward Asia. The TPP would form the economic centerpiece of this strategy, with many of the Partnership's provisions seemingly constructed to exclude China specifically.

The TPP has been likened to the North American Free Trade Agreement (NAFTA), enacted in 1994 between the U.S., Canada, and Mexico. Some make the comparison to NAFTA derisively, accusing the NAFTA of harmful effects such as facilitating the elimination of U.S. jobs. However, according to the U.S. Chamber of Commerce, nearly 5 million U.S. jobs exist as a direct result of the increased trade with Canada and Mexico created through NAFTA.[6] The NAFTA now constitutes the world's largest free trade area, linking 450 million people producing $17 trillion worth of goods and services annually.[7]

While the Obama administration seeks support for the TPP within Congress, some policymakers in the U.S. have continued to embrace a form of neo-protectionism, seemingly afraid of what they perceive to be negative consequences of the Partnership. These opponents believe that the TPP will harm American workers by causing jobs to be offshored to countries with lower environmental standards or labor costs. This argument may have some merit; however, the net benefits of the Partnership would far outweigh the negatives. According to the Office of the United States Trade Representative, roughly four million U.S. jobs are already supported through trade of goods and services with TPP countries. Implementation of the TPP would generate an additional $77 billion in real income benefits for the U.S. as a whole.[9] Unfortunately, politically powerful sub-groups, like labor unions and consumer or environmental protection advocates, continue to work toward stalling a trade agreement that would benefit the vast majority of United States citizens.

Free trade in general, and the TPP in particular, can provide many net benefits by increasing access to cheaper products for both businesses and individuals alike. The new global economy, powered by the proliferation of global supply chains, increased trade agreements, decreased trade barriers, and an increased number of foreign-based facilities, works as a powerful disincentive to protectionism. By rejecting protectionism, and further embracing this new economy through initiatives like the TPP, the U.S. has the opportunity to increase job growth and economic prosperity for individuals both domestically, and abroad.

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