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Risk of de-globalisation

This article is part of a series of Special Reports that discuss the downside risks to the global economic outlook. In this piece, we take a closer look at the risk of de-globalisation.

Protectionism is back!

As we warned in our Quarterly Report in June 2009, the first chapter of a study on what not to do in times of economic crisis would read 'Protectionism'. Back then, we were afraid it would rear its ugly head and although more urgent economic problems have emerged, we would be wrong to think of protectionism as a past threat.

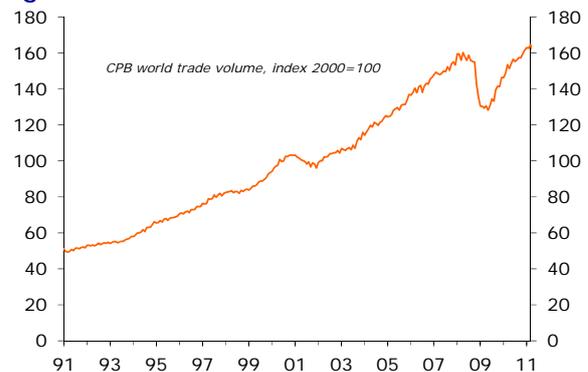
It's politics stupid

As we are seeing the 'comprehensive solutions' to the eurozone debt crisis and the US debt ceiling being discussed, economic considerations have taken a back seat to the political ones. Over the past two centuries, protectionism came back each time economies encountered difficulties. The World Trade Organization (WTO) mentions the depression of 1870 resulting in a standstill of the expansion of bilateral trade agreements. The most famous episodes of protectionism, of course, came in the wake of the 1930s Great Depression. According to most analysts, protectionism only exacerbated and prolonged the crisis. Some even blame protectionism for World War II. This may have already been predicted by French economist and legislator Frederic Bastiat (1801 – 1850) when he stated: *"When goods don't cross borders, armies will."*

Politicians remain open to the idea of protectionism for two main reasons. First, they generally have an inclination to remain in power. In order to do so, they must appease the public. The public wants jobs and economic prosperity and will give their votes to those who they think will best serve their interests. Generally speaking, people are very conservative.

They feel supported in a familiar environment, economically and culturally. In this sense, people want to keep their job, even if, on a global scale it is highly uncompetitive. Culturally, the historical (national) background, and religious affiliations become increasingly important. This has already resulted in several European political parties promoting nationalism over the European ideal. These parties tell the population that by shielding the economy from foreign influences, people will be able to keep their jobs and pensions. And they are probably right, in the short-term.

Figure 1: World trade



Source: CPB

In all fairness, the second political argument we look at makes sense: if everybody else is protectionist, why should we maintain open borders? This is where the international economic community embodied in the WTO, comes into play. The WTO is trying to set the rules for free international trade. This would reduce the opportunities for rent seeking countries that want to allow a non-competitive industry to profit from import restrictions while profiting from free trade in the rest of the world. However, the WTO can only uphold the laws that are currently in play, and try to facilitate discussions that would lead to an increase in borderless trade. Although the actual fears of increasing protectionism surfaced only in the first half of 2009, signs of an increasingly difficult environment for free trade were already

on the wall. Successive rounds of negotiations in the past decades have failed to improve the overall situation. The current crisis is only leading to more protectionist initiatives by countries and politicians that seek reward in promising the people (short-term) stability. This, in turn, will lead to more protectionist measures from the other countries. If this vicious circle were to gain traction, the overall economic effect would be devastating.

What would happen if we stop trading?

Trade brings welfare. David Ricardo showed in the early 19th century the advantages of free trade to all countries. All countries have a comparative advantage over other countries in the production of at least one type of tradable good. If all those countries were able to put that advantage into effect, they would export the products that are produced at the lowest relative cost, and use those exports to import the products for which they are at a comparative disadvantage. This means that if we allow our trading partner to export more to us, we actually benefit from their increased income because they will spend it on our exports. Free trade results in more efficiency, more and cheaper consumption, and more growth.

Therefore, if we stop trading, we lose (economic) welfare, and lots of it. If we look at the difference between the extreme examples of free trade and no trade whatsoever, the only winners are local producers of imported goods. These will no longer have to compete with more price efficient international producers. Local consumers lose, having to pay more for locally produced goods, and exporters of goods lose too, as access to the international market in which they were competitive, is lost. All-in-all, the overall result is less production of goods, and higher prices for those goods.¹

¹ Some would say that this will at least result in a smaller ecological footprint of production, this is not necessarily true. Closed borders will result in best practices applied in single countries only, not across the globe.

Box 1: What is going right? Putting on an optimists hat

The general idea of free trade providing benefits to the local population is widely accepted. Therefore, even in these times of increased navel-gazing, countries are still looking at opportunities to broaden the scope for their export products, and are at times even providing preferential access to import goods in return. Preferential Trade Agreements (PTA) have become more and more popular over the years. According to the WTO, these accords have been concluded since the 1950s, and moved to about 70 PTAs in total in 1990. After that, the number of PTAs moved up quickly to close to 300 by 2010. Part of these PTAs are multilateral agreements including the EU in Europe, NAFTA in Canada, Mexico and the US, and Mercosur in South America. However, Free Trade Agreements (FTA) account for more than 75% of the PTAs concluded.

Although economic theory suggests that a PTA leads to welfare losses in non-participating countries, it is a step forward from having protectionism. Furthermore, it opens the minds of these non-participating countries to the idea of free trade, as being left out will become difficult to explain to the electorate. Putting on our rosy spectacles, all countries (of the WTO countries, only Mongolia is not a member of any PTA) will enter into one or more PTAs. As these bodies grow, and the basic mindset for having preferential trade with other countries is there, trade agreements between various trading blocs come into play. This will bring us closer and closer to real international free trade.

This economic theory is almost self-explanatory. Almost. Factory workers losing their jobs because of overseas producers conquering their domestic markets, however, will still feel that they are losing out because of free trade. Especially when combined with protectionist measures taken abroad this fuels the expectation of local action against (allegedly) unfair foreign competition.

Why the fuss? No-one has sealed off borders

We are not the only ones worrying about increasing protectionism. The WTO and Global Trade Alert (GTA, a report made by the Centre for Economic Policy Research) are seeing an increase in the number trade related measures. The WTO has been looking at the restrictive measures since October 2008. In the period until October 2011, the WTO counted 674 restricting or potentially restricting measures, of which 19% have since been eliminated. It estimates that over 2% of international trade is currently affected by anti-trade policies, and that this number is also on the rise.

Table 1: The worst offenders

Rank	Measures imposed	Number tariff lines	Number of sectors affected	Number of trading partners affected
1	EU27 (242)	Vietnam (927)	Algeria (62)	China (195)
2	Russia (112)	Venezuela (786)	EU27 (58)	EU27 (181)
3	Argentina (111)	Kazakhstan (729)	China (47)	Argentina (175)
4	UK (59)	China (698)	Nigeria (45)	Germany (161)
5	Germany (58)	Nigeria (599)	Kazakhstan (43)	India (154)
6	India (56)	EU27 (550)	Germany (42)	UK (154)
7	China (55)	Algeria (476)	US (42)	Belgium (153)
8	France (51)	Russia (439)	Ghana (41)	Finland (153)
9	Brazil (49)	Argentina (429)	Indonesia (40)	Indonesia (151)
10	Italy (47)	Indonesia (388)	Russia (40)	France (150)

Source: CEPR

The GTA is even more depressed in its tone. It claims that trade tensions are mounting in the second half of 2011. It refers to the number of protectionist measures reaching the amounts we saw in 2009, when the previous bout of anti-trade policies were taken. As the number of measures to improve free trade has declined, the level of protectionism is increasing. Also, large trading nations have taken across the board measures such as local content requirements and government procurement preferences (Buy American, Argentinian, Australian, etc. but then obligated for the government). Moreover, the increase in tensions among the world's leading nations concerning trade disputes (even unrelated to the currency war²) is evident.

² Brazilian Finance Minister Guido Mantega raised

GTA claims that since July of this year, the protectionist measures have outnumbered liberalising measures by 3-to-1. When challenging the protective measures of other countries, countries are now also looking at the stimulus packages that were laid out in the wake of the 2008 crisis to support the local economy. In effect, most governments have discriminated between foreign and local companies when moving in to help a sector. Also, export subsidies, R&D subsidies and so on, have been enhancing the position of the local companies vis-à-vis foreign competitors. So what both the WTO and GTA mention is an increase in official litigation brought against other countries targeting just those policies. Of course, there is something strange about claiming that an increase in litigation for more free trade will hurt the free trade cause. But take the following into consideration: a second round of economic mayhem appears just around the corner, putting pressure on governments to – again – ‘save’ (national) businesses, banks and jobs. This will lead to governments on the one hand desperately trying to protect their local industries, but on the other hand challenging the same practices by other countries. The hypocrisy embedded in this reality makes for a challenging future for free trade. Really promoting free trade will not work in an environment where countries are only concerned with their own short-term welfare.

Bottom line:

It is high time for consensus-seeking politics. Local politics appear to be dominated by local issues concerning short-term economic fortune, and a search for cultural homogeneity. This may result in an increasingly hostile political environment, where efforts to look for joint goals is frowned upon. Most notable examples: the US political deadlock and the response

alarm about the Currency War in September 2010, stating that countries around the world were engaging in competitive devaluation to support their export sector.

within eurozone and EU to existential threats. On a global scale, after the initial exchange of fire started with the currency wars, nations are increasingly moving towards total economic warfare. It is not too late to head off the storm. Should policy makers in Europe finally be able to work together in order to get the economic house in order, that may send a strong signal to the rest of the world that co-operation by far outweighs navel-gazing.

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