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## 7. Protectionism and the crisis

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Since 1945, the world economy has experienced unprecedented growth. That growth was fuelled in significant part by the great liberalization of trade in goods and services, and by capital flows. Virtually all analysts and economic historians regard the reduction of policy trade barriers (tariffs, quantitative restrictions on trade, and other impediments to trade) and of transport and communications costs as having been essential in spurring growth. Countries such as Korea, China and India have been able to make huge gains in living standards and the economic well being of their peoples relying in significant part on the international market. And the industrial countries themselves have sharply reduced trade barriers. While there is still some protection, in most countries it is quantitatively smaller and significantly less protective than 60 years ago.

The crisis has naturally raised concerns in many countries about present and potential losses in employment and incomes. One of the responses has been to call for protection, or direct support, of domestic industries. As understandable as these calls are, responding to them would not increase employment and incomes, and, globally would reduce it. Worse yet, additional protection now would undercut progress made to date and seriously threaten to diminish, if not destroy, growth prospects going forward.

If one or more systemically important countries increase protection – of the traditional tariff-and-quota variety, of targeted support for individual industries, of programs encouraging or requiring purchases of domestically produced goods, or other industry-specific measures – in response to the crisis, other countries will find political pressures to do the same thing irresistible and will retaliate.

Even without taking into account the protectionist reactions on the part of other countries, however, the protection-imposing country or countries would gain very little, if anything, and that only for a very short time. The protectionist measures would have reduced the exports of other countries, thus reducing their incomes and their imports. To the extent that their imports did not fall sufficiently to offset their own reduced receipts, the exchange rate would adjust. The result would be reduced demand for imports from the systemic country. At best, then, the result of increased protection would be reduced employment in export industries which would offset any increase in employment in the protected, import-competing industry. Meanwhile, import-competing goods would have higher prices which would reduce domestic consumption.

But with protectionist responses, which would almost surely follow, the result would be even worse. Incomes would fall in the affected countries whose exports were confronting increased protection, but in addition, their retaliation would reduce export demand in the systemically important country or countries. One result would be higher prices of import-competing goods in both countries, reducing the quanti-

ties of the goods demanded. And it is evident that the level of employment in exporting industries in both countries would fall further.

Those responses guarantee that in anything but the extremely short run, increased protection would lower income and employment in the world economy, as it did in the 1930s. While not all countries are systemically important, enough "small" countries responding to heightened protection in big ones would together have a big effect.

This "negative sum game" is already evident today. American support for the auto industry has already led to plans for similar types of support in a number of other auto producing countries. Since the auto industry has excess capacity, most of the support will result in maintaining that capacity, rather than improving the prospects for the industry in the short or the longer term by letting the industry shed uneconomic units and move to a healthier long run position.

Even worse, however, is the fact that protection is much harder to remove than it is to impose. It has taken over fifty years to bring it down to present levels, and there is still hope that the conclusion of the Doha Round would reduce protection still further, to the advantage of all. But increased protection during the crisis would be hard to remove; when growth does resume, the problem of dismantling protectionist measures would arise and constitute a challenge. The heightened levels of protection would diminish the growth prospects of all countries, but those most badly hurt would be the low-income countries that have not yet shifted to open trade policies; their prospects, even if they did shift, would be greatly reduced. Even emerging market countries would find their growth prospects sadly reduced.

The temptation to adopt protectionist measures is strong in many countries. The G20 can significantly reduce that pressure by forswearing protectionist measures. Such an announcement would have a significant effect, especially if it were accompanied by a rollback of the measures adopted since the November meeting.

It is clearly highly desirable to find ways to increase employment and reduce the impact of the crisis on workers everywhere. But attempting to use any form of protection as an instrument to that end would have very little short run payoff, would result in reduced worldwide employment very quickly, and make growth prospects when recovery does come that much more difficult. The crisis is harmful enough without retrogressing on the progress the world has made in increasing real incomes and reducing poverty in the past sixty years. A trade war, with heightened protection, would intensify the downward spiral, not mitigate it.

The crisis is imposing high economic costs throughout the globe. It would be tragic if protectionist measures, intended to mitigate some of the difficulties, were adopted and intensified our difficulties.

## About the author

*Anne Krueger is Professor of Economics at Johns Hopkins University, having been first deputy managing director of the IMF (2001 – 2006). Before serving at the Fund, she was Herald L. and Caroline L. Ritch Professor in Humanities and Sciences and founding director of the Center for Research on Economic Development and Policy Reform at Stanford University and a Hoover Institution senior fellow. She has also been World Bank vice president for economics and research and President of the American Economic Association.*