

The Global Response to the 2008 Economic Crisis: A Return to Smoot-Hawley?

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In September of 2008 the housing bubble in the United States popped. The resulting weak financial institutions and the poor economic outlook for the coming months led to a decline in producer and consumer confidence as the crisis spread across the world and countries all over entered into a recession. Since then unemployment has begun to increase. The US alone lost 2 million jobs in the first three months of 2009.¹ This increase in unemployment has led to a rise in calls for protectionism and nationalism reducing the amount of international trade. Since the crisis began, newspapers have been publishing articles with titles such as “Smoot-Hawley’s ghost stirs into life again”² showing that there is a popular sentiment that this financial crisis will be reminiscent of that of the 1930s and the Great Depression. This paper will examine the rise in protectionism that has occurred since the 2008 financial crisis. Specifically, it will compare the financial crisis of 2008 and increase in global trade barriers with that of the 1930s in an attempt to make a prediction about the coming months and years for international trade. If the article titles are correct, and the world is returning to the levels of protection seen in the 1930s after the implementation of the Smoot-Hawley then this

¹ "Drop in New Filings Suggests Jobless Claims Hit Peak." *Wall Street Journal* 07 May 2009 Web.8 May 2009.

² "Smoot-Hawley’s ghost stirs into life again ." *Business Day* 21 Apr 2009 Web.7 May 2009.

current recession could last for years to come pushing the US, and the rest of the world, into a depression.

The decline in producer and consumer confidence and the resulting trade barriers have led the WTO to predict a 9% decline in global trade.³ However, this prediction is considerably less than that of the OECD, which predicts that international trade will decline by 13.2%. If the OECD prediction is correct, it would be the biggest decline in international trade since WWII.⁴ These data points show how much of an effect the crisis is having on the world but it is important to look at what is behind this decline. There are two factors that could contribute to this decline: a decrease in world production and an increase in protectionist measures. However, it is possible that these two factors could play off of each other as well. If the trade barriers continue to increase, world production will decrease as well because producers will have to pay higher amounts to export their goods. If the cost of production combined with the cost to export to consumers exceeds the possible profit, then producers will be less inclined to produce and sell their goods. The rising trade barriers could be what will keep the world in its current recession for the next few years.

The types of trade barrier measures being put in place today are different than the typical tariffs that were popular tools of protection in the past. WTO Director General, Pascal Lamy on April 1, 2009 described the current form of trade barriers as “low intensity protectionism” and warned WTO members against their use⁵. Another term

³ "WTO sees 9% global trade decline in 2009 as recession strikes," *2009 Press Release* 23 Mar 2009. World Trade Organization. Web.2 Apr 2009.

⁴ "OECD: 'International Trade in Freefall'," *Bridges Weekly Trade News Digest* 1 Apr 2009. International Center for Trade and Sustainable Development. Web.4 Apr 2009.

⁵ Sano. Hideyuki. "Japan eyes stimulus; earnings, trade flows worry," *Reuters UK* 8 Apr 2009. Web.9 Apr 2009.

being used to describe the types of protectionist measures was coined by Simon Evenett, a Professor of International Trade and Economic Development and director of the Swiss Institute for International Economics, is “Murky Protectionism”. Murky protectionism is described as discriminatory trade measures that have been hidden inside government initiatives and, on the outside, appear as perfectly reasonable goals.⁶ An example of this could be the U.S. stimulus package that on the outside is simply an attempt to boost the US economy. Other nations around the world are implementing stimulus packages as well, so it seems reasonable, however the two “Buy American” provisions of the \$800 billion US stimulus require the procurement of US steel, iron, and other manufacturing goods⁷ thus acting as a trade barrier to foreign producers of steel, iron, etc. The US is not the only nation using, or attempting to use murky protectionism. The initial stimulus package in France had a heavy support for their domestic car industry. Their plan would provide 6.5 billion euro in aid to French carmakers. However, the initial bailout, drafted in the early part of 2009, stated that any company receiving state aid should promise not to close its factories in France and it is feared among other members that this could lead to the closure of French-owned factories in other member states. France is not the only EU member supporting its car industry; it is joined by Germany, Italy, Spain, Sweden and the UK.⁸ However, the detail that says car producers must keep French factories open was against the EU rules of free movement of companies and serves as a trade barrier to keep production inside France. This provision has since been removed yet it serves to

⁶ Evenett. Simon. "The Global Economic Crisis, Murky Protectionism, and Developing Countries," *The GEG Blog* 20 Mar 2009. The Global Economic Governance Program. Web.12 Apr 2009. <<http://www.globaleconomicgovernance.org/blog/about/>>.

⁷ "Tariffs, Subsidies, etc. in the Economic Crisis," *Boston.com* 26 Mar 2009. The Associated Press. Web.7 Apr 2009. <<http://www.boston.com/>>.

⁸ "French auto bail-out plan raises EU protectionism fears," *Euractiv* 10 Feb 2009. Web.1 Apr 2009.

show that tariffs are no longer the most popular form of protectionism. Even though most countries would be able to raise their tariffs, because their applied rate is below their maximum WTO commitments, few tariffs have arisen. Instead the types of protectionist measures are tighter licensing requirements, import bans, and anti dumping measures. Wealthier countries, as illustrated above, have also been able to include discriminatory measures in their fiscal stimulus bills by protecting their national industries. This puts developing countries at an increasing disadvantage because their cost of exporting to those wealthier countries will increase and they are also not able to retaliate with their own stimuli because they cannot afford it.

Tariffs are losing popularity to this murky form of protectionism for a reason. Over the last few decades, countries all over the world have been entering into international agreements with the purpose of limiting tariffs. Globalization has also played a role in this as well. The growth and expansion of global supply chains have integrated national economies together now more than ever. This type and intensity of integration had never been seen before historically. The increased integration of global supply chains has led to vertical specialization. Vertical specialization is when manufacturers in one country rely on imported goods from other countries as inputs for their products.⁹ This has made it harder for governments when imposing tariffs because they could be hurting their domestic producers. Increased tariffs could make them less competitive by having them absorb the cost of the tariff for those imports they rely on for the production of their goods. Due to this vertical specialization and the increasingly entwined global supply chains, governments are faced with finding new ways to

⁹ "The Nuts and Bolts come Apart," *The Economist* 26 Mar 2009. Web. 7 Apr 2009.

implement protectionist measures. US car manufacturers seem to have found a way around this. They no longer lobby for direct protectionism, such as a tariff, because then foreign firms producing their cars in the US would also benefit. Instead they prefer direct subsidies to their firms. Globalization has led to the increased integration of economies making it harder for countries to protect their domestic markets outright.

Countries all over the world have begun to use these new forms of protectionism. In the top 20 worst offenders implementing protectionist measures, the total number of increased barriers to trade is 1,649 while only 186 barriers have been reduced. This is affecting a total amount of US\$ 10,530 in billions worth of imports.¹⁰ The top five worst offenders, in terms of the amount, not value, of trade barriers put into place is United States, China, Brazil, European Union, and India affecting 39% of the global trade value of 2007.¹¹ The most likely targeted sectors are food and live animals, chemicals and related products, machinery and transport equipment, and manufactured goods.¹² The European Union, for example, has reintroduced export subsidies on butter, cheese, and milk powder thus protecting their food industry¹³ while countries such as the US, China, India, and Mexico have put protectionist measures into place against manufactured goods.¹⁴ The most popular types of barriers being put into place are, technical barriers such as labeling requirements, antidumping measures, sanitary and phytosanitary measures, tariff levels, and countervailing measures. The US has put sanitary measures

¹⁰ "Analyzing Global Trade Barriers: Q108-Q109." *Grail Research*. Monitor Group. Apr 2009. Pg. 15

¹¹ Grail Research, 16

¹² Grail Research, 18

¹³ "The nuts and bolts come apart"

¹⁴ "Tariffs, subsidies, etc."

into place by banning Chinese poultry as a result of food safety concern.¹⁵ India has been the biggest initiator of anti-dumping action¹⁶ by placing antidumping measures on items such as yarn from China, Thailand, and Vietnam.¹⁷ The EU has also been a large proponent of anti dumping measures by placing anti dumping duties on iron and steel fasteners from China, plastic sacks and bags from China and Thailand, types of iron and steel from China and Moldova, and biodiesel from the US.¹⁸ It is clear that the amount of trade barriers is increasing and affecting a large sum of international trade. However, as research by Grail Research shows, “Trade barriers are growing, but no faster than they were a year ago”.¹⁹ But even still they are having a large impact.

Since the start of the financial crisis in 2008 government leaders have been calling for countries to beware of increasing protectionism, though not much has been done in terms of actually decreasing said protectionist measures. Many country leaders are meeting and vowing to each other to avoid protectionist measures however these countries are among the worst offenders such as the EU and the US.²⁰ Also many international organizations, such as the WTO, are warning against the rise in trade barriers and insisting upon countries that they do not implement such measures. On April 2, 2009, the G20 met and agreed to a US\$ 250 billion package to support global trade over the next two years²¹, however it is unclear where this money will come from. The main source of the new cash that the G20 promised to create was to be US\$ 250 billion

¹⁵ “Tariffs, subsidies, etc.”

¹⁶ “The nuts and bolts come apart”

¹⁷ “Tariffs, subsidies, etc.”

¹⁸ “Tariffs, subsidies, etc.”

¹⁹ Grail Research, 4

²⁰ “EU commits to help U.S. stem economic crisis,” *MSNBC* 5 Apr 2009. Associated Press. Web.6 Apr 2009. <<http://www.msnbc.msn.com/id/30056110/>>.

²¹ Desai. Sumeet . “G20 agrees \$250 billion trade financing deal,” *Reuters UK* 2 Apr 2009. Web.12 Apr 2009.

world of special drawing rights. Special drawing rights are the IMF's unit of account that if used would add to global liquidity by boosting the amount of money in countries reserves thereby making money more available.²² The EU and the US have also vowed to work together in order to stem this economic crisis however, they have conflicting views of how to deal with it. US officials are hoping that the EU will spend more money to stimulate their economy saying that their stimulus attempts are not sufficient enough and that more money is needed. However, EU officials claim that they are doing enough to stimulate their economy and that tougher financial rules are needed to solve the problems that caused the crisis.²³ It is important for the US and EU to work together to solve the financial crisis because once financial institutions are stabilized and strengthened, people will have more faith in their economy reviving producer and consumer confidence and hopefully leading to the decline of trade barriers.

Economists today have conflicting views about what to do about the current economic crisis. Many economists argue that the most important thing world leaders can do is to pledge and carry out, a quick completion of the Doha round talks. The completion of the talks, which began in 2000 and recently collapsed in the summer of 2008²⁴, are important because it would reduce tariff ceiling placing a tighter limit on a country's ability to increase tariffs. And although barriers today are less likely to be seen in the form of a tariff, they are still being used. The completion of the round would also ban export subsidies on agriculture. Export subsidies on food and agriculture have been widely used by governments in order to protect their domestic producers as prices

²² "Banking on the fund," *The Economist* 8 Apr 2009. Web. 12 Apr 2009.

²³ "EU Commits to help US Stem Economic Crisis"

²⁴ "Doha Development Agenda: Negotiations, implementation and development." *World Trade Organization*. 8 May 2009 <http://www.wto.org/english/tratop_e/dda_e/dda_e.htm>.

decline.²⁵ This is something frequently done by the European Union, for example the support of the dairy sector mentioned earlier in this paper. Most importantly however, is that the completion of the Doha Round would signal a clear commitment of all members to creating a system of open trade. Unfortunately though, not all economists agree. Some find that the goals of the Doha round are too ambitious. The ambitious goals would make it impossible to come to an agreement given the current weak state of the economy. Also they believe that the lowering of tariff ceilings would not be able to curb the new types of ‘murky’ protectionism that is being put into the place such as the Buy American Act.²⁶ Other experts believe that the window of opportunity for global action is about to close. It has been theorized that other world members were waiting for the Obama administration to reveal the stimulus package in order to assess how open to free trade President Obama would be. However, now that the US, under the new administration, is by far one of the worst offenders implementing the highest quantity and value of trade barriers economist fear that other members see the door on free trade closing and will subsequently begin to increase their trade barriers.²⁷ It is for this reason that people worry that the world will once again enter the barrier levels of the Great Depression. As one country begins to implement barriers to trade, others retaliate igniting a trade war.

As mentioned previously, many news articles and blogs are adopting a doomsday attitude saying that the world is returning to they days of Smoot-Hawley. However it is important to understand the history of the tariff. The Smoot-Hawley tariff, which came

²⁵ “The nuts and bolts come apart”

²⁶ “The nuts and bolts come apart”

²⁷ Grail Research, 7

into effect June 14, 1930, increased tariff levels for goods coming into the US to unprecedented levels. Although it was implemented after the crash of the stock market and during the beginning of the Great Depression, the tariff was not initially a reaction to the depression. The tariff was being discussed during the late 1920s while the US was experiencing a strong economy. At first it was meant to deal with agriculture and to protect domestic farms, however, after it log rolled through Congress additional commodities were added and received protectionism as well.²⁸ These increased tariffs led the world to retaliate against the US and their restrictive barriers leading to the collapse of world trade helping to elongate the depression. It is clear why people would attempt to find linkage between the current crisis and the depression of the 30s. The crash of the US housing bubble led the financial crisis to spread all over the world, much like the stock market crash of 1929. Also, the US stimulus package with the Buy American stipulations is direct protection of certain US industries and could be considered reminiscent of the Smoot-Hawley tariff. However, as discussed earlier in this paper, globalization had led to the increased integration of world markets and has made it harder for countries to impose tariffs on others without hurting their domestic markets. Therefore, it is not likely that the crisis of today will result inn tariffs of highly restrictive levels like those seen in the 30s. Most countries are continuing to respect trade laws and although they are increasing tariffs and barriers, they are doing so within WTO limits. However, some experts say that each trade barrier implemented today has a much stronger effect than it would have had if it were implemented in the 1930s. The Grail

²⁸ Taussig, F.W.. *The Tariff History of the United States*. 8th. New York: GP Putnam's Son, 1931. Print.

Research report calls this “more power in the punch”.²⁹ And they labeled the Buy American act as the poster child for the amount of force a trade barrier could have on the world. It is no longer necessarily the amount of trade barriers being implemented that matters. What is more important today is the depth and extent of goods that a measure can affect.

The WTO has been quoted saying that the world will not enter “an imminent descent into high-intensity protectionism” such as that of the 30s due to the trade treaties countries have entered into and the caps on possible import tariffs.³⁰ The increased globalization is likely to keep the world trading system from spiraling into a collapse. Some experts believe that the world learned from the last global depression and has since committed to free trade. It is understood now that all nations can benefit from free trade and that protectionism can do more harm to a domestic economy than help. World leaders tend to echo this idea. Gordon Brown said, “We will reject protectionist tendencies. We will monitor those countries and name and shame is necessary countries that are not following free trade practices, and we will work to underpin the trading system of the world with additional resources”.³¹ This statement was issued prior to the G20 meeting. President Obama also prior to the G20 meeting was quoted saying, “I think everybody understands the history of the Great Depression. So far at least, were seeing some movement to contain protectionist sentiments in these various domestic markets, but we have to build on that and [make] sure that there are sufficient credit lines

²⁹ Grail Research, 5

³⁰ Miller. John Lewis. "WTO Details Rising Protectionism, Pushes Countries to Reverse Course," *Wall Street Journal* 26 Mar 2009. Web. 5 Apr 2009.

³¹ Grail Research, 5

for trade”³². It is clear with these statements that they are committed to free trade; however, their actions show otherwise. It is necessary for them to act on their statements to ensure the future trading system.

Globalization has ensured that, for now, the world will not be slipping into a system of trade wars and increasing protectionist measures. With any sort of financial collapse it is expected that governments will try to protect their domestic producers and markets. However, vertical specialization is making it harder for countries to implement trade barriers without hurting themselves. This is positive because it will keep countries from implementing strict regulations against imports. However, the domino theory applies here in the sense that if one country, for example the US, leads the way in implementing high trade barriers, others will need to retaliate and protect their domestic markets as well. It is for this reason why now, more than ever, it is increasingly important for officials of the US and EU, who represent the largest trade partnership, to carry through on their statements and lower their barriers to trade and order to compel others to do the same. Also talks of the WTO Doha round should be reinitiated in order to show the world's commitment to free trade. And especially important is to make sure that the money promised at the G20 talks is put into the system. This could help countries by putting more money into their systems and creating more liquidity. However, it is safe to say that the world is not reverting back to the times of Smoot-Hawley.

³² Grail Research, 5

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