

ANALYSIS-Trade-induced recession possible without protectionism

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By Jonathan Lynn

GENEVA, Feb 15 (Reuters) - Conventional wisdom says that protectionism, raising barriers to imports or promoting exports at the expense of your competitors, can make recession worse.

But the collapse in trade volumes, deepening recession in export-sensitive economies, is happening with only a hint of emerging protectionist measures.

Some economists argue globalisation, in the sense of the increasing integration of different countries in the world economy, is the cause, acting as a transmission belt from one suffering economy to the next.

"With globalisation, the world can suffer the central cost of protectionism -- a deep fall in trade - without passing any new laws or regulations," Robert Shapiro, head of progressive think tank NDN's globalisation initiative, said in a blog.

The effect is particularly marked with small economies, rich or poor, as the domestic market accounts for a relatively larger part of the economy in big countries.

GREAT DEPRESSION

For policy-makers, the classic example of the damage done by protectionism is the Smoot-Hawley Tariff Act of 1930, which raised U.S. import duties after the 1929 Wall Street Crash to protect American farmers and other American jobs.

Other countries responded by shutting out U.S. goods, world trade crashed and the result was the 1930s Great Depression.

U.S. imports from Europe fell to \$390 million in 1932 from \$1.33 billion in 1929, while exports to Europe fell to \$784 million from \$2.34 billion. World trade shrank by two thirds between 1929 and 1934. By 1933, U.S. unemployment was 25 percent, up from 7.8 percent in 1930.

Many fear the same thing could happen today, through tariff increases or other measures to discourage imports, or bailout packages to save ailing industries, using government subsidies.

World leaders have vowed not to raise trade barriers, including at a G7 summit in Rome at the weekend [ID:nLE523133].

A number of measures suggest protectionism has been unleashed -- the "Buy American" provisions in the U.S. stimulus package, export subsidies for dairy produce resumed by the European Union, a French package for ailing carmakers.

But a report last month by World Trade Organisation Director -General Pascal Lamy found "limited evidence" of trade measures such as tariff increases since the financial crisis exploded in September, although it warned against the potential danger of industrial aid packages in rich countries. [ID:nL9417721]

DIZZY DECLINE

How then to explain the sudden decline in trade?

Exports in Germany, the world's biggest exporter, fell 3.7 percent in December after a record 10.8 percent drop in November, contributing to the biggest fall in industrial output in Europe's biggest economy since German reunification in 1990.

The government expects German GDP to fall 2.25 percent this year, the worst performance since World War Two. [ID:nL9582808]

Japan's export-driven economy suffered a record 35 percent fall in exports in December, while imports slumped, signalling sinking domestic demand [ID:NT343750]. According to a Reuters poll, Japan's economy shrank 3.1 percent in the last quarter of 2008, its fastest pace since 1974. [ID:nT178054]

U.S. exports and imports fell for the fifth month in December, while China's exports dropped 17.5 percent in January and its imports plunged 43.1 percent. [ID:nN11359044]

The International Monetary Fund, predicting the world economy will stagnate this year overall, forecasts world export volumes will contract 2.8 percent.

"The crux of it is that as the share of what the world produces that's traded across borders rises -- 18 percent of worldwide GDP was traded in 1990, compared to 30 percent in 2006 -- a serious recession in a few large places moves quickly around the world, driving down global trade," said Shapiro of NDN, a former undersecretary in the U.S. Commerce Department.

In other words weak demand in one country increasingly affects others because they are more dependent on exports.

Figures from the World Bank's World Development Indicators database tell the story. In 2005, the last year for which figures are widely available, exports accounted for 81 percent of Ireland's GDP, up from 46 percent in 1980. For Thailand, a mid-range developing economy, they rose to 73 from 24 percent. In the Netherlands, a trading power for centuries, they rose to 70 percent from 53 percent.

In Germany, a much bigger economy, exports were only 41 percent of GDP in 2005 -- still up from 20 percent in 1980. Brazil, China and India all have relatively small exports shares in their economy, but still much bigger than 25 years earlier.

In Japan the share then and now is about 14 percent, having slipped to 9 or 10 percent in the 1990s.

One of the nations with the smallest export share in its economy is the United States. Exports accounted for only 11 percent of GDP in 2005 and 10 percent in 1980, perhaps explaining why some Americans are willing to risk retaliatory action through protectionist measures of their own.

Still, that represents an increase from 1929 when exports were only 5 percent of GDP. (NDN's globalisation blog is at: ndnblog.org/node/3533) (Editing by Janet Lawrence)