

Free Trade and Protection in the Economic Crisis

To try to cope with the unemployment effects of the economic crisis, national governments have agreed to coordinate “stimulus packages”, to aid their domestic economies, and to pull the world economy out of a growing recession. These packages involve increased levels of government spending and/or tax reductions, with the intent of promoting increased spending on goods and services. This spending, it is hoped by the stimulus package designers, will lead to maintained or increased demand for goods and services, the sales of which will improve the economic health of the private and public sectors, and enable them to pay their workforces.

As the stimulus packages move through approval processes, provisions can be “tacked onto” these spending bills, restricting how the funds can be applied. “Buy domestic” provisions are currently receiving a lot of public attention. In addition, complementary “lend domestic” provisions, it has recently been argued in the public debate, should be applied to bank and non-bank lending.

Restricting government spending (and financial sector lending) to domestic sectors has led to criticisms that this is a return to “beggar-thy-neighbour” policies, which made the Great Depression of the 1930’s longer, and deeper. Traditional “battle lines” between “protection” versus “free trade” are being re-established. On the one hand, protection calls for buy (or lend) domestically, to stimulate domestic employment; whereas free trade calls for broader spending and lending policies, which would aid coordination of policies across countries.

The free trade position proposes an absence of all barriers to trade, in order to maximize global employment, and production of goods and services. Thus, even if one economy has greater absolute productivity in all areas of economic activity than another, if there are *relative* differences in productivity, it makes sense for the economies to specialize in areas where they have relative productivity advantages. The resulting production is then freely traded, to obtain the desired proportions of goods and services. Resources are then re-allocated to different uses over time, to take advantage of the optimal productivity conditions.

Re-allocation of resources due to differences in national productivity régimes takes no account of the dislocation which that re-allocation entails. For example, if one economy has a relatively less productive auto sector, but a relatively more productive textile sector, the efficient allocation of resources calls for resources to move from its auto sector to its textile sector.

However, it is usually very difficult for workers in one sector of an economy to migrate to another, hence the impetus to “protect” jobs in low-productivity sectors. Often, workers do not have skills which are immediately transferable across sectors, so the workers will experience periods of unemployment, as they re-train for available job

Appeared in the Lethbridge Herald, March 7, 2009

opportunities. This is not a trivial issue, but one which free trade proponents routinely ignore, thereby weakening the inherent common sense of the free trade position.

By ignoring the unemployment and dislocation implications of free trade, the human costs of unemployment become fertile ground for protectionist policies such as the imposition of tariffs, quotas and regulations. However, it is easy to see that these policies are particularly bad ideas which hurt consumers, who will end up paying higher prices for poorer products.

So long as proponents of free trade do not address the resource re-allocation issues associated with free trade, protectionist policies will attract support. In the current world economic context, the balance between relaxation or imposition of trade restrictions will play a significant role in how long the current recession will last. It is therefore important to address the resource re-allocation effects of free trade as part of the coherent policy development required to shorten the recession.

*Christopher J. Nicol, Ph.D.,
Professor of Economics, University of Lethbridge*

February 14, 2009