ECONOMIC NATIONALISM: TRANSATLANTIC RESPONSES TO THE FINANCIAL CRISIS IN COMPARATIVE PERSPECTIVE

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ABSTRACT

Garrett Workman: Economic Nationalism -
Transatlantic Responses to the Financial Crisis in Comparative Perspective
(Under the direction of Gary Marks)

As during financial crises of the past, the current economic recession has witnessed a dramatic increase in government intervention in the economy, coupled with a tremendous decrease in global trade flows. By examining the contemporary rise in economic nationalism as well as the political sources calling for protection in a historical context, this thesis highlights the potential dangers of closing borders to foreign goods and services. Through a comparative analysis of both the American and French responses to the financial crisis, this essay argues that while government intervention is frequently necessary and worthwhile, several protectionist actions included within stimulus packages have actually served to deepen the recession. Ultimately, this paper concludes that while the tendency towards protectionism demonstrated in recent months is discouraging, the world's trading system has fortunately not collapsed underneath the combined pressures of politics and economic nationalism.

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CHAPTER 1

INTRODUCTION

This thesis seeks to explore and explain the tendencies of the American and French governments to protect their domestic industries, ostensibly temporarily, to the detriment of their commitments to global trade liberalization and continued economic growth through openness to trade. France and the United States were chosen as case studies due to their standings as preeminent economic powers, and also because of their widely divergent state responses to the financial crisis. The level of government intervention in the United States has far exceeded the role of the French state rhetorically as well as in terms of stimulus dollars appropriated, both in real terms and per capita. Interestingly, this reaction is at odds with the national tradition both in largely *laissez-faire* America and *dirigiste* France.

First, the current economic crisis is placed in a comparative perspective with the many informative historical parallels that can be drawn with respect to the Great Depression. Through a demonstration of the disastrous effects of protectionism during the 1930s, the fears of modern economists are more easily justified. An analysis of legislation and political responses to the financial crisis which began in late 2007 including the controversial "Buy American" provisions of the American Recovery and Reinvestment Act of 2009 as well as French protectionist rhetoric in recent months will then serve as an introduction to the reemerging issue of economic nationalism.

Additionally, this essay will attempt to rationalize the varying responses taken by the French and American governments to the financial crisis through a study of the specific groups and economic interests calling for trade protection in each case. With governments expending ever-larger sums of public money attempting to mitigate the effects of the recession, an analysis of the effectiveness of these stimulus packages is both informative and necessary.

CHAPTER 2

HISTORICAL BACKGROUND

Back in October of 1929, the world bore witness to what is widely considered the worst stock market crash in the history of market capitalism. Over the course of about a week, the New York Stock Exchange lost over a quarter of its value, sending the industrialized world into the worst economic crisis in history—the Great Depression. One of the principal causes of this panic on Wall Street was the rumor that then-President Hoover would not veto the extremely protectionist Hawley-Smoot Tariff Act that Congress was considering at the time. Understanding the consequences of closing the nation's borders to trade better than any Congressman ever could, the stock brokers were thrown into a frenzy in an attempt to sell their shares before their values plummeted any further. Quickly, the economic crisis spread beyond the shores of the United States, creating a climate across the entire globe where citizens were suddenly thrown into unemployment and demanding protections from their governments. As the interdependent world economies were suddenly closing themselves off from each other, the crisis worsened and the world was soon entangled in the deadliest war in human history.

Signed into law by President Hoover in June 1930, the Hawley-Smoot Tariff Act increased duties on imports into the United States by a factor of up to 52% on average. In an attempt to protect and aid American industry, as well as prevent a further decrease

in global product values, the U.S. Congress passed this law in an ill-fated attempt to stem the downward tide of the global economy. However, international trade represented a very small percentage of the American economy in 1930, and any increase in tariffs would ultimately have an extremely limited effect in stimulating the economy. However, the retaliatory measures that the rest of the world inevitably enacted in response eventually combined to make the situation infinitely worse. Suddenly, the Americans stopped investing their capital abroad because of the stock market crashes, and the new Tariff act ensured that the American economy was also essentially off-limits to the exported goods from other nation-states. Foreign governments could only ratify tariff increases of their own to attempt to make up the loss of income: "*Privés à la fois du débouché et des crédits américains, les pays qui ne disposent pas de réserves de change ou qui sont endettés ne peuvent financier leur déficit commercial et doivent à leur tour fermer leur marché*" (Bénichi 2008 : 113). In a vain attempt to shelter the United States from the outside world, the government had unknowingly started a protectionist wave of trade barriers which combined to create the worst ever collapse of capitalism.

Similarly, the failure of the world's governments to coordinate and take corrective economic actions together ensured that the Great Depression would last several years longer than the natural progression of capitalism would have otherwise dictated. Despite the tremendous decline in the German GDP, for example, many nations continued to demand their financial reparations from the Treaty of Versailles. Some states intervened heavily in the economy—nationalizing countless banks and creating the wide-ranging systems of social protection that we recognize today as the foundations of the modern welfare state. Other more liberal decision-makers blamed exactly these Keynesian

interventions in the economy for extending the recession. Despite the fact that the Great Depression had wide-ranging impacts across the globe, paradoxically globalization seemed to stop as international trade slowed to a crawl and the world's governments failed to cooperate and coordinate their corrective responses.

Following the conclusion of World War II, the Allied leaders eventually understood that their protectionist legislation had created an economic environment that had inevitably led to a war for resources. Therefore the GATT (the predecessor to today's World Trade Organization) was created with the simple task of mutually lowering tariff barriers to global commerce (Teulon 2008: 66). Leading European nations as well as the political leaders of the United States, Canada, and others were well aware that the financial struggles of Italy and Germany had led to the rise of Nazism and fascism, as well as the fact that Japanese resource dependency led directly to the bombings of Pearl Harbor. Therefore, the international organizations created at the Bretton Woods Conference were charged with ensuring that the nations of the world would never again be able to close themselves off from one another. Theoretically, collective actions taken by the world's developed nations would help to mitigate the negative consequences of future economic crises.

Unfortunately, human experience dictates that those who fail to study and learn from the mistakes of history are doomed to repeat them. Though the current financial crisis came about far less suddenly than Black Thursday and the subsequent stock market crashes, many of the same economic indicators should have led us to believe that a recession was imminent. Similar to the rampant financial speculation of the "Roaring Twenties", the construction and housing industries were operating at unsustainable levels

on both sides of the Atlantic. Additionally, many governments continue to run massive levels of public debt in order to supply extraordinary spending levels on such things as national defense and social security programs. Consumers themselves also shoulder much of the blame for their accrual of unmanageable levels of debt, financed in large part by banks and investors willing to take on increasingly risky applications.

Exactly the wrong response to this current financial and credit crisis, however, would be to repeat the gross historical error of closing off national markets to foreign goods. The percentage of the American and European Union economies which are directly dependent on foreign direct investment as well as the sale of exported goods have never ceased to increase since the conclusion of World War II. Therefore, a protectionist response to the current recession would in fact have exponentially more disastrous results than the already horrendous consequences of Hawley-Smoot and the retaliatory measures it provoked during the 1930s.

Interestingly, global leaders have once again taken a wide range of different approaches to dealing with the present financial crisis, often at striking odds with the political history of their respective countries. For example, despite the *dirigiste* traditions of heavy-handed interventions in the French economy, it is readily apparent that the French government has reacted with considerably more fiscal restraint in the face of today's economic conditions. Meanwhile, the American government has clearly taken a leading role in responding to the financial crisis through President Obama's massive stimulus package, the nationalization of several banks and notable corporations including General Motors, and the expansion of government involvement into new economic sectors. In both the French and American cases, foreign governments have often

justifiably complained about conditions imposed by states and their stimulus packages that force government funds to be spent on domestic goods and services. If the example and historical suffering of the Great Depression has not already taught us about the dangers of shutting nations off from one another, this worrying trend towards so-called economic nationalism risks to once again throw the world economy deeper into recession.

CHAPTER 3

ECONOMIC NATIONALISM – DEFINING THE ISSUE

Before investigating the protectionist nature of many national responses to the financial crisis, it is first necessary to define the concept of economic nationalism, and to explain the inherent risks and consequences of protectionism. While not a particularly easy term to define, economic nationalism certainly goes against the idea of free and fair competition that is at the heart of the European Union's competition policy and its endeavor to achieve a fully integrated single market. "*Le concept est contraire à l'idée de concurrence libre et non faussée prônée, notamment, par la Commission européenne. On peut l'analyser comme l'intention de la part du consommateur, d'entreprises ou d'États, de favoriser les entreprises et les productions au sein de leur nation*" (Euractiv.com – "Le patriotisme économique envahit-il l'Europe ?" 2008). Nationalistic preferences are also against at least the rhetoric of U.S. economic policy, which has for decades emphasized the role and the ability of the free market to adjust and regulate itself. Essentially, economic nationalism boils down to the preferential treatment given to domestic producers and corporations by governments and local consumers. Through their purchasing practices and via subsidies favoring so-called "national champions," governments distort markets in favor of their own national industries—much to the chagrin of economists and analysts promoting free and open international trade.

Especially during times of crisis, it becomes easy to politicize economic strife and justify government investment and preference for domestic corporations in an effort to keep investments local and retain key jobs (and therefore votes). The problem is that today, the economy is more globalized than many local and national politicians would like to admit. It becomes incredibly difficult to reasonably and economically defend stopping trade and government transfers at national borders in a world where truly national production and consumption has certainly slowed and practically ceased to exist. Even back in 2005, Frédéric Lemaître, an economic analyst at *Le Monde* noted that,

> *Dans une économie mondialisée, il serait logique que le rôle [de protection des entreprises] soit défini au niveau mondial. Ce n'est pas le cas. Seul le commerce fait l'objet des règles internationales et toute aide publique peut être désavouée au nom de la sacro-sainte concurrence. Faute d'une véritable entente internationale sur ce sujet, le patriotisme économique risque de tourner à une véritable guerre économique.* (Lemaître 2005)

While not necessarily sparking international trade wars, national protectionist actions have the potential for inciting retaliatory measures to be taken across the world, much as seen during the height of the Great Depression. Despite any logic that global economic governance in terms of the protection of jobs and key strategic industries might have, all too often national politics intervene. Particularly during an economic recession in which voters and citizens are especially vulnerable—and therefore increasingly likely to support government intervention—protectionist interests often win the political debate between the free market and preferential treatments for domestic producers.

Of course, it would be incorrect to state that the state has no role in the economy, or that the markets are in fact fully capable of self-regulation. There are indeed many situations in which protectionist measures, when taken in reasonable limits and for determined periods of time, are incredibly efficient ways of stimulating the economy of a

given state. As during the Great Depression, the current financial crisis necessitated the involvement of the U.S. government to prevent large banks from filing for bankruptcy. Clearly, in times of economic recession, loans are needed to trigger investment and reinvigorate consumer spending. Thus, without the role of government money supporting the troubled banks, the problem could have become even worse. Another typical example of justifiable economic nationalism lies within the realm of national defense. In such a strategic and vital sector, it would make little sense to outsource jobs and technologies to potential global competitors (Euractiv.com – "Le patriotisme économique envahit-il l'Europe?" 2008). Many economists and government spokesmen have also used just this sort of argument to justify government subsidies both in the U.S. and the European Union to benefit Boeing and Airbus, for example.

Still, the world must tread carefully when deciding which national industries are truly vital and therefore worthy of defense from the open world market. Certainly, politicians are feeling the pressures from their constituencies to ensure that their now-limited tax revenues are spent and reinvested at home. Yet, governments must also ensure that their borders remain open to international trade and investment, or else the real risks of retaliation might resurface and trigger an even greater economic downturn. "The argument [in favor of economic nationalism] that protectionism will not get very far—is dangerously complacent. True everybody sensible scoffs at Reed Smoot and Willis Hawley, the lawmakers who in 1930 exacerbated the Depression by raising American tariffs. But reasonable people opposed them at the time, and failed to stop them: 1,028 economists petitioned against their bill" (*The Economist* – "The Return of Economic Nationalism" 2009). Once governments start passing legislation which creates

powerful constituencies in their favor, such as the defense of a large local corporation, it becomes easy to justify further interventions. The problems arise when foreign trade partners start defending their own local industries as well, all to the detriment of world consumers who are suddenly subjected to higher commodity prices. States love to pick out certain industries and proclaim these national champions as worthy of defense and government investment during economic booms and busts. However, economic realities dictate that state subsidies to financially insolvent companies eventually run out and the world economy is worse off after the inevitable retaliation takes place.

Clearly, policies promoting national protection are having an effect on the international marketplace. For the first time in decades, globalization appears to be slowing, and trade in goods and services across international borders is falling both in terms of product value and sheer quantity of commodities. World Bank statistics strikingly demonstrate the historic drop-off in trade values since the start of the financial crisis: "Monthly US imports and exports of goods declined by about *one-third* (emphasis in original) in value terms from peaks of $195 bn and $121 bn, respectively in July 2008, to $122 bn and $85 bn respectively, in February 2009" (Borchert and Mattoo 2009: 4). Additionally, due to the difficult economic climate, foreign direct investment on behalf of both private companies as well as governments has plummeted (*The Economist* – "The Return of Economic Nationalism" 2009). Not since the oil shocks of the 1970s have global trade levels retreated, yet last year, global trade receded from its all-time high due to the political pressures across the developed world to protect domestic industries: "In 2008, world trade declined for the first time since 1982. And, despite their pledges, seventeen G-20 members have adopted significant trade restrictions" (Patrick 2009).

While gathered for the G-20 meetings in London earlier this year, each of the heads of state signed a promise not to erect barriers to trade, however their actions have belied their words.

One needs to look no further than the World Trade Organization's own internal statistics to realize the extent of the damage caused by the financial crisis upon global trade flows. On March 25th, WTO analysts predicted that: "The collapse in global demand brought on by the biggest economic downturn in decades will drive exports down by roughly 9% in volume terms in 2009, the biggest such contraction since the Second World War" ("WTO sees 9% global trade decline in 2009as recession strikes" 2009). Things look certain to get worse before they get better, as global output growth in terms of world GDP shrank from 3.5% in 2007 to 1.7% in 2008. Economic growth is actually expected to turn negative on a global scale in 2009, by a factor of between 1 and 2%. Unfortunately, by closing their markets off from the outside world, political leaders across the globe are perhaps exacerbating an already dismal economic situation.

Despite their claims to understand the key role played by trade in generating an economic recovery, the vast majority of major industrialized economic powers have instituted some forms of protectionism in response to the crisis. Using France and the United States as case studies, an analysis of the political pressures for protectionism, as well as the governments' respective responses, combine to highlight the negative impact of the politicization of trade policy on the world's economy.

CHAPTER 4

THE AMERICAN CASE

Protectionist Responses to the Crisis – "Buy American" and Intervention

Regardless of the factors which ignited the crisis, what matters going forward is how governments react, especially the U.S. government acting as the world's preeminent economic power. Predictably, as is the case during any sizeable economic recession, interest groups clamoring for domestic protection and economic nationalism have been active politically and are making an impact in Washington. Most notably, during negotiations in both the House of Representatives and the Senate, the Democrat-controlled Congress added stipulations in the administration's massive economic stimulus package requiring money to be spent on infrastructure projects to be spent on American-produced goods and services. According to the version of the federal economic stimulus plan signed into law by President Obama: "None of the funds appropriated or otherwise made available by this Act may be used for a project … unless all of the iron, steel, and manufactured goods used in the project are produced in the United States" (American Recovery and Reinvestment Act 2009 §1605 (a)). Very few exceptions to this requirement—including the lack of suitable American-made goods, as well as a stipulation that if the purchase of American products will increase the price of a project by at least 25%—are listed as suitable excuses for the purchase of imported commodities. Only after the press got a hold of the final versions of the proposed

legislation and foreign powers began pressing the United States to repeal this clearly protectionist and trade-distorting requirement to "buy American" did Congress add the last-minute stipulation that the requirements to use American products be applied only: "in a manner consistent with United States obligations under international agreements" (American Recovery and Reinvestment Act 2009 §1605 (d)). One finds it difficult to imagine, however, a scenario in which the federal government pursues legal action against any state or local agency failing to comply with American obligations under bilateral and World Trade Organization trade laws. Moreover, it is highly unlikely that the state and local authorities applying for and spending the stimulus money have an adequate knowledge of specific requirements of international trade agreements which the United States are bound by.

In the short term, the requirement to invest the vast amount of stimulus money on American goods and construction work may seem like a politically advantageous decision taken by the administration. However, President Obama signed a resolution at the recent G20 meetings in London against giving into the temptations of protectionism and economic nationalism in recognition of free trade's positive influence on the global economy. His signature of the stimulus package which still includes protectionist provisions promoting the sale and use of solely American steel and manufactured goods seems to indicate a break of that promise. Before signing the stimulus package into law, he even came out publicly against the "Buy American" provisions that the House and Senate had added to the bill (*The Economist* – "The Return of Economic Nationalism"). While the opposition of the administration did convince the conference committee version of the bill to add in the condition that American international trade obligations are

to be met, the clearly nationalistic legislation is sure to inspire retaliatory measures among U.S. trading partners.

Where then, did the pressure for the Buy American provisions come from? Principally, pressures from American manufacturing lobbies, including the powerful United Steelworkers Union—which conveniently happens to be strongly based in politically significant parts of Michigan, Pennsylvania and Ohio—argued forcefully for their inclusion into the stimulus package. Along with other labor unions, the steelworkers were strong advocates for Obama's presidential candidacy during the 2008 elections, and thus their opinions count on Capitol Hill. During the Congressional negotiations, the steel and iron workers' representatives claimed that the only way to ensure that the money spent on stimulating the economy effectively was to essentially give American producers a 25% price cushion in manufactured goods (*The Washington Post* – "Buy American Rider Sparks Trade Debate" 2009). This is far from the first time that the U.S. steel industry has agitated for protection. Memorably, in 2002, President Bush unilaterally raised American steel tariffs in order to win support for the trade promotion authority ("fast track" negotiation responsibility) necessary to jumpstart Doha Round trade talks. The approval of Congress to give in to these protectionist pressures certainly seems politically useful in times of economic recession, and it certainly would have been difficult for any serious political debate in opposition to such a patriotic term as "Buy American" to have succeeded.

However, the results of the stimulus spending restrictions have been mixed, at best, in terms of protecting and creating jobs in the United States. Since the global economy has become increasingly interconnected, it is difficult for companies competing

for federal stimulus dollars to ensure that the industrial products being used in stimulus construction projects are truly of American origin. Companies based in the U.S., as well as foreign companies with American affiliates are all scrambling to find sources of American products so that they too can be eligible for government funding. As the *New York Times* stated on June 3, "Foreign and domestic companies that employ hundreds of workers in this country cannot bid for government projects because they cannot guarantee the American provenance of all the steel, iron, and manufactured goods in their supply chain, as the provision requires. Others are scrambling to figure out whether American-made alternatives exist to replace their foreign inputs" (*New York Times* – "The Peril of 'Buy American' 2009). Paradoxically, American companies, as well as American employees working for foreign firms are being harmed in both the short and long term by the necessity imposed by Washington to buy American products.

In fact, if any jobs at all are created by the provisions included in the stimulus package, their numbers are far outweighed by the costs of both foreign retaliatory measures, as well as the impossibility of procuring enough American goods to complete the many infrastructural projects. In an analysis performed by the Peterson Institute of International Economics, the Buy American provisions of the stimulus could create or protect approximately 9000 American jobs. However, in a labor market of over 140 million workers, 9000 appears to be little more than a mathematical error, rather than any sort of significant political or strategic gain (Hufbauer and Schott 2009: 1). Contrastingly, the number of American jobs that are strictly tied to foreign government procurement spending is well over 650,000 (*New York Times* – "The Peril of 'Buy American'" 2009). Imagine the consequences on the U.S. job market if and when

America's trade partners enact the inevitable retaliatory measures which would limit their own spending to exclude American manufactured goods. Specifically, the United States is at considerable risk to retaliation from countries such as Argentina, Brazil, India, and China whose tariffs against American goods are well below their WTO-mandated levels. Additionally, these states are also not signatories of the WTO's Government Procurement Agreement that obliges the United States, Canada, the EU and others to include each other's goods in government spending projects. Any temporary job increases based on a swell in demand for U.S. iron, steel, and other goods will soon by far outweighed by the prospective negative impacts the legislation will have on the openness of U.S. export markets.

Fortunately for the American worker and economy, a prominent effort by local and provincial governments in Canada has delayed its October 5, 2009 deadline on excluding American products from Canada's own stimulus package spending (*CBC News – Canada* "Buy American Exemption Deal in the Works" 2009). This is due to the ongoing talks between Washington and Ottawa to exempt one another from their limits on imports bought using stimulus money. As our largest trading partner, the Canadian reaction to the Buy American program is an important one, as clearly the trade relationship with our neighbors to the North is one that needs to be maintained and expanded rather than contracted.

Even worse than the potential loss of American jobs in retaliation for the Buy American provisions, are the potential negative effects of the passage of these protectionist measures on the reputation of the United States. While it is completely normal and politically salient to focus primarily on domestic constituencies during times

of economic crisis, the U.S. stands to lose much of its credibility as a global trade actor as a result of its protectionism during the current financial disaster. Suddenly, the US will seem completely hypocritical when imploring other nations to open their borders to American goods and services, as it simultaneously shuts the door on the entry of foreign products into government projects: "In a stroke, the United States would forfeit the moral high ground when it comes to slowing the protectionist juggernaut that now threatens the world economy. Enacting Buy American requirements would open the door for countries worldwide to walk away from their trade obligations" (Hufbauer and Schott 2009: 7). Representatives from the European Commission, China, Canada, and other governments have all responded that they will not take the Buy America provisions lightly, and are likely to revisit their own commitments to both free trade generally as well as to American imports more specifically. Suddenly the world might be again subjected to a wave of protectionism such as what followed the passage of the Smoot-Hawley Tariff Act in the 1930s. Since the economic stimulus package represents one of the first major policy proposals and achievements of the new Obama administration, it is imperative that the President shows leadership in promoting free trade, rather than leading the world down the dangerous path of economic nationalism.

Of course, the requirements listed in the financial stimulus package that firms buy and use American goods with the federal money are far from the only changes Washington has made in its efforts to solve the country's economic difficulties. The massive amounts of government spending included in the package have raised the amount of government spending as a percentage of GDP (28.1%) to levels not seen since World War II. Included in the over $787 billion American Recovery and Reinvestment

act, are provisions which favor certain sectors of the American economy—including banks and the automotive industry—in order to restart economic growth. Since state intervention in the economy has arisen to such a degree so quickly, companies are hurriedly investing more and more money into lobbying to ensure they receive any possible economic benefits from the newly activist federal government. "The massive intervention has shifted the way companies do business in a host of ways—not all of them intended by the government. Increasingly, companies big and small are competing on the basis of their ability to tap government money" (*The Wall Street Journal* – "U.S. Government intervention pits 'gets' against 'get-nots'" 2009). Evidently, the funds appropriated to these prioritized sectors are going to American firms with powerful lobbying capabilities, thus handicapping the ability of foreign affiliates, as well as smaller American companies, to comparably benefit from the state's investments.

While an active role in directing economic recovery can be expected to minimize the immediate damage caused by the financial crisis, over the long-term, a heavy-handed state will diminish prospects for growth. Administration heavyweights including Federal Reserve Chairman Ben Bernanke as well as President Obama himself have all attempted to assuage the fears of economists and business leaders that the state's sizeable role will linger after the crisis has been averted. Yet, industry representatives have failed to see how the state can quickly remove itself from the many commitments it has made in response to the recession. As a recent *Wall Street Journal* poll found: "only 16% [of economists] believed the federal government would be able to meet its goal of ending rescue programs without fundamentally altering the competitive landscape of the private sector" (*The Wall Street Journal* – "U.S. Government intervention pits 'gets' against 'get-

nots'" 2009). Many of these same economists expressed their fear that extending the state's role in the economy could have serious negative repercussions by sustaining unprofitable corporations selected for government aid, as well as burdening future generations with spiraling national debt and inflation. By acting to specifically protect certain strategic domestic industries, the government has intervened to such a degree not seen since the end of the Great Depression. Ultimately, the country's ability to fully recover after the crisis is over will be hampered if the state fails to keep its promise of dramatically reducing its role in the economy.

A Case Study in Nationalist Protectionism - the Automotive Industry

Along with the housing market, perhaps the hardest hit sector of the global economy has been the automotive industry. Without a lot of expendable income, fewer and fewer people are able to afford to invest in a new car, and thus the industry has been hammered by the current financial crisis. Unfortunately, the timing could not have been worse for Detroit's "Big Three" auto manufacturers: General Motors, Ford, and Chrysler, who were already struggling to remain afloat under increasing competition from foreign automakers on the American market. Judged to be an essential piece of the American economy, and as being "too big to fail" both culturally and politically, Washington has stepped in to either bailout the companies financially or directly run them operationally.

Perhaps the most directly protectionist and trade-distorting measure taken thus far by the federal government has been the decision to let GM fall into Chapter 11 bankruptcy and to then take over a 60% share in the corporation. While the company had been open to international competition, it had seen its market share both in the United States and on the global market continue to diminish as it stubbornly refused to produce

economical and environmentally-friendly cars, preferring instead to continue to produce mostly Sport Utility Vehicles and trucks. Yet despite the failure of General Motors to adapt to the desires of the modern auto buyer, Washington decided that the nationalization of the industrial giant was necessary to bolster confidence in the troubled American economy, as well as to ensure the employment of hundreds of thousands of manufactured workers across the politically-sensitive Midwest.

During bankruptcy proceedings on May 1, 2009, the United States raised its investment share in GM to $50 billion to assume a majority stake in the corporation, and giving the federal government unprecedented control of one of the nation's largest manufacturers. According to President Obama, the purchase of General Motors was necessary, "for the simple and compelling reason that their survival and the success of our overall economy depends on it" (quoted in *Washington Post* – "U.S. Bets Billions on GM's Resurgence" 2009). However, the increased government involvement in the automotive industry is in fact being criticized across the political spectrum in the United States. While Congressional Republicans question the underlying principles of intervention and the handpicking of specific companies and industries to bail out, even Obama's own Democratic Party is angry over the fact that despite being under government control, the bailouts will require massive job cuts in efforts to restore GM's competitiveness. Current plans stipulate that GM will be forced to close down 17 of its 44 plants, and also will be firing over 25,000 American workers in an effort to regain profitability. Massive government investment coupled with massive employment reductions should not sound appealing to any reasonable politician. In essence, all of the

problems of Buy American provisions are resurfacing yet again with the auto industry bailout.

While announcing the government's restructuring plans for Chrysler and General Motors, President Obama implored to U.S. consumers that, "If you are considering buying a car, I hope that it will be an American car" (quoted in *Wall Street Journal* – "What is an 'American' Car?" 2009). As was the case with supposedly "American" steel, iron and manufactured goods prioritized in the financial stimulus package, it is difficult to determine what exactly makes a car American. Is a vehicle American if it is produced by a corporation whose headquarters is on American soil, or should a car instead be considered American if it is actually produced using American goods in the United States?

Administration officials continue to emphasize that if German and Japanese auto manufacturers can continue to make profits even given current global economic recession, American firms should be able to adapt as well. This simply is not necessarily true thanks to the logic of comparative advantage. U.S. manufacturers may simply not be capable or well suited to producing every kind of good, and that fact is not necessarily bad for the economic well being of the United States. As Matthew Slaughter of the Council on Foreign Relations and Council of Economic Advisors put it:

> The broad goal of American economic policy should be to help all companies operating in the U.S. create and maintain good jobs at good wages. Translating this goal into sound public policy means rethinking recent [Presidential] sound bites, however. It means that the U.S. is not going to be great at everything. It means that U.S.-based companies need to be expanding abroad. And it means that some of the best companies in America are foreign-owned insourcing companies. (quoted in *Wall Street Journal* – "What is an 'American' Car?" 2009)

Essentially, US economic policy should not pick and choose specific companies to bail out based primarily on which country they happen to call home. Every year, foreign

automakers, to give just one example, continue to expand their presence in the United States and employ millions of American workers in competitively-waged positions. By virtue of its purchase of General Motors, amongst countless other protectionist responses to the current economic situation, the United States has gone against its traditional free-trade *laissez-faire* economic traditions, and opened the floodgates for other world economic powers to follow suit.

Recent Developments

In an effort to jumpstart the economy to the benefit of the struggling automotive industry, as well as to reduce car emissions by improving gas mileage, the U.S. government initiated the Car Allowance Rebate System better known as "Cash for Clunkers" in the summer of 2009. Essentially the program sought to renew customer spending on automobiles by providing a voucher for $3500-4500 towards the purchase of a new vehicle with significantly higher fuel economy than the vehicle being traded in. Customers received a reduced price when purchasing a vehicle, and automotive dealers were later compensated by the federal government for the difference. Proving incredibly popular, the initial budget of $1 billion turned out to be wholly inadequate to keep pace with demand. Eventually, the government extended the promotion and added an additional $2 billion appropriation. Ironically, despite the limited fiscal costs involved with the Cash for Clunkers program, the customer spending it provoked has had an exponentially larger effect on the recovery of the American economy.

Trade experts have been impressed with the program's odd characterization as one of the few government subsidies that has had the *de facto* effect of actually promoting imports over domestic goods. "The program doesn't advertise that 'we will

pay you $4,500 if you trade in your domestic gas-guzzler and buy a fuel-efficient foreign one.' But in practice that appears to be the result" (Alford 2009). Over 70% of the trade-ins were domestic models, while almost 60% of the new purchases were foreign cars.

That the Cash for Clunkers program had no restrictions whatsoever on the origins of the vehicles being traded in or purchased cannot be understated. Actually, among the top ten cars sold under the program, eight were import models. This can be seen as a victory for not only the Japanese automakers, but also their strategies to increase production in the United States. Further complicating the question of determining what exactly makes an American car is the fact that the two most popular cars sold are designed in Japan and made in America: the Toyota Corolla and the Honda Civic. All told, almost 700,000 vehicles were traded in and sold under the auspices of Cash for Clunkers. According to the U.S. Department of Transportation these summer auto sales will provide a direct economic boost of 0.3-0.4% to the American economy. (U.S. Department of Transportation Press Release – August 2009). Additionally, both foreign and domestic automakers are expected to increase their production of new vehicles in order to replenish depleted inventories, which the government claims will save or create over 40,000 jobs during the latter half of 2009. During a year of protectionist posturing, the Cash for Clunkers programs seems to have been an effective measure of government intervention that actually promoted international trade.

On the other end of the spectrum however, President Obama's decision to apply tariffs against the import of Chinese tires in late September has proven that the world has not yet escaped the threat of economic nationalism during this recession. Prompting a swift reaction by the Chinese, the episode has proven that even a small trade dispute

between the world's two largest economies has the potential to seriously retard global economic recovery.

When analyzing the specifics of the Chinese tire issue, it is important to understand the particular legislation that President Obama was acting upon when enacting this tariff. During China's bid to join the World Trade Organization in 2001, the Chinese faced significant political opposition, particularly in the United States Congress. As such, the so-called China-safeguard provisions allow the President to impose tariff barriers against Chinese imports if recommended to do so by the International Trade Commission. Recognizing the dangers implicit in taking such actions against the world's second largest economy which happens to be a particularly important trading partner, President Bush declined to raise ITC-recommended tariffs four times during his presidency. However, when the United Steelworkers accused the Chinese of flooding the American market with tires below their market value, the International Trade Commission recommended a 55% tariff increase—and President Obama agreed to levy the import duty at the rate of 35%. While the Chinese are aware of the legality of President Obama's actions, they are nonetheless justifiably incensed at the President's decision: "The Chinese know the decision is a matter of presidential discretion, unlike the antidumping and countervailing duty laws, which are on statutory autopilot and don't require the president's attention. Accordingly, the tire restrictions are the edict of the American president, and thus carry more profound meaning for the Chinese" (Ikeson 2009). The decision to apply these tariffs came directly from the White House, under heavy pressure from the labor unions that make up a significant part of his political base.

There are essentially two ways of looking at the issue. Either the tire issue is vastly overblown because bilateral trade in tires makes up an infinitesimally small percentage of American-Chinese exchanges, or the tire issue is only the tip of the iceberg since President Obama has sent a dangerously protectionist message with his first highly-publicized trade decision. One argument on behalf of *The Economist* and others who are predicting that this is only the beginning is the fact that the Chinese safeguard provisions allow all other WTO members to apply matching tariffs once any other member has imposed them—whether or not their own economies have been affected (Bown 2009). However, the larger issue at play is the precedent set by President Obama in agreeing to impose these tariffs. Now that the Steelworkers have successfully gotten tire tariffs passed, dozens of other industries and labor unions are currently waiting for their hearing at the International Trade Commission hoping the President will protect them as well.

Defenders of President Obama's decision, on the contrary, rightfully claim that a minor protectionist measure is often sacrificed for the ultimate goal of trade liberalization. For example, in 2002, President Bush initiated highly-controversial steel tariffs that were clearly illegal under the United States' WTO obligations as a political favor to constituencies in West Virginia and Pennsylvania. This happened to coincide with Congress' consideration with the proposed Free Trade Area of the Americas as well as the President's proposed Trade Promotion Authority which would strip much of the legislature's ability to influence the President's trade agreements. Ultimately the WTO struck down the tariffs as illegal, and Bush won his negotiation authority by a single vote in the House of Representatives. Writing for *The New Republic*, Noam Scheiber concludes that President Obama is making a similar concession to an important

constituency and fulfilling a campaign promise to ensure that America's trading partners obey the rules of international trade in defense of both American business and labor interests (Scheiber 2009). Especially since the goods in question are of such economic insignificance, and given the legality of the tire tariffs under rules China agreed to when negotiating its entry into the WTO, therefore, perhaps the issue has been overanalyzed and overstated after all.

CHAPTER 5

ACROSS THE ATLANTIC- THE FRENCH CASE

Motivations and Justifications for Protection

Though further removed from the initial wave of economic downturn associated with the current financial crisis both in terms of distance and severity, the consequences of the global recession were eventually felt across the ocean in France as well. While France has been spared the worst of the crisis as evidenced by the housing and construction collapses in Spain and Great Britain, as well as the enormous contraction of the German economy which is extraordinarily dependent on exports, Paris was still forced to react given the size and breadth of this financial catastrophe. As across the rest of the world, the actions of the French government would directly impact not only their own domestic economy, but also the ability of the rest of the globalized marketplace to regain its confidence and rebound quickly.

In the unique position of the European Union Council presidency in the latter half of 2008, President Nicolas Sarkozy and his government were well placed to lead a coordinated European response to the financial crisis emanating from the United States. Clearly, in view of the single market that links together European Union member-states, and fiscal rules and regulations directed by the European Central Bank which guide the Euro-zone countries, the EU economies are linked together more closely than any other collection of sovereign states in the world. One of the first collective European actions

was the call for the extenuating circumstances to exceptionally reprieve the member-states of their obligations under the Growth and Stability Pact. Notably, during a conference of the four European G8 members, the heads of state requested the requirement that each European state not be allowed to assume a national debt of greater than 3% of its GDP be temporarily ignored (*France 2* – "Pas de plan de relance européen 2008). President Sarkozy took the lead in calling on the European Commission and Central Bank to realize that the crisis required intensive action on the part of the nation-states, and that restoring economic growth requires flexibility in European directives. Recognizing that a common EU reaction to the financial crisis would be infinitely more effective, President Sarkozy and his European allies attempted to present a common front at the many EU and international summits related to the recession in the wake of the financial crisis.

At the same time, however, the leaders of the European Union states were unable to agree on specific collective responses, preferring instead to retain control over stimulus packages at the national level. Especially given the strongly-held position of German Chancellor Angela Merkel in favor of tailoring specific economic packages to national circumstances, Sarkozy faced a difficult task of unifying the EU behind a common position. While Merkel was insistent on the fact that national plans should not be detrimental to European cooperation or international competition laws, her desire to keep stimulus money within her own borders was clear, "*Angela Merkel a souhaité pour sa part que les initiatives des pays membres de l'UE en faveur de leurs systèmes financiers respectifs ne soient pas mises en œuvre au détriment de leurs partenaires. Elle a ajouté que 'chaque pays doit prendre ses responsabilités au niveau national' concernant la*

crise financière" (*France 2* – "Pas de plan de relance européen 2008"). While recognizing the necessity of reinvesting in the marketplace, specifically in national banks, to restore investor confidence and the availability of liquidity, ultimately the Europeans were unable to reach an accord on the supranational level to coordinate their respective plans.

In the absence of an overarching collective response, the French government took it upon itself to restore faith in a worsening economy which combined steadily decreasing industrial economic output with steadily climbing unemployment. While struggling to reach the same proportions as the American's $787 billion stimulus package, France's own €26 billion investment plan was specifically tailored to aid the most directly impacted sectors of the economy. Combining direct state aid to infrastructure projects including high-speed TGV trains and low-income housing projects, with rebate programs designed to increase consumer spending, France's economic bailout has been described by government officials as an investment in the future as well as a response to the present crisis. Specific measures include rebates towards buying newer environmentally-friendly vehicles, as well as tax incentives for research and the development of new green technologies (*Washington Post* – "France Plans $33 Billion in Economic Stimulus"). While contradicting his own campaign promises to limit government spending, President Sarkozy called upon the rest of the European Union member-states to invest in their own economies as well to prevent further economic slowdown. Emphasizing the temporary nature of the measures which are designed to stimulate immediate economic growth, Sarkozy noted that, "We do not have a choice. Doing nothing would cost us a lot more" (quoted in *Washington Post* – "France Plans $33 Billion in Economic Stimulus").

Clearly the lack of a response to a crisis of such magnitude would be unacceptable both economically as well as politically.

One specific aspect of the French economic rejuvenation package has received infinitely more attention than any other both within Europe and internationally for its nationalistic overtones and its potential to distort global trade—the government's plans to aid its own ailing automotive industry. In February, President Sarkozy announced plans to give both Peugeot-Citroën and Renault loans of up to €3 billion each in order to keep factories open and workers employed in France (*Euractiv.com* – "French auto bail-out plan raises EU protectionism fears"). Responding to a tremendous decline in both automotive production and sales in France as well as across Europe, Sarkozy and his government made the loans available in order to protect these icons of French manufacturing, much like the American intervention in favor of General Motors and Chrysler. Not only are these companies highly visible symbols of French economic prowess, they are also a highly unionized and active industry in French domestic politics. Given the dire situation facing the automotive industry, in addition to the aid given to their American competitors in Detroit, the government needed to act decisively.

However, the original French plan went one step further than the American bail-outs, as the loans were conditionally available only if the corporations pledged not to shutter any of their factories in France nor dismiss any French employees. Predictably, this caused an immediate outcry across Europe and indeed the world for its blatant protectionism. Heads of State from the Czech Republic to Sweden called out the French plan as going directly against founding EU principles of free and fair competition across the single market. Given that both Renault and Peugeot-Citroën operate several factories

and employ thousands of Eastern Europeans, fears were understandably raised by such leaders as Czech Prime Minister Mirek Topolánek that the loans would require the companies to fire lower-wage employees in their countries in order to keep their promises to retain French workers. In preparation for their own turn at the EU's rotating Council presidency, representatives of the Swedish government also heavily criticized the French automotive plan. Swedish Prime Minister Fredrik Reinfeldt said that he was "'very worried' about the growing tide of protectionist economic measures in Europe… [and] In a thinly-veiled criticism of France, Reinfeldt said 'If everyone seeks only to protect their own economy, then Europe will only become poorer and fall further behind in this economic crisis'" (quoted in *Euractiv.com* – "French auto bail-out plan raises EU protectionism fears"). An emergency meeting of EU leaders was called in February in order to combat this worrying trend towards protectionism. Finally, the European Commission assured the other member-states that it would ensure France fulfilled its responsibilities to abide by European competition regulations.

Ultimately, France was forced to back down from the most controversial aspects of its much maligned automotive bail-out plan in the face of such concerted opposition. Specifically, the conditionality clauses of the loan agreements to car manufacturers that would have required Renault and Peugeot-Citroën not to close any factories within France for the duration of the loan were removed. Thanks to the combined efforts of Commission completion officials and the well-publicized efforts of other European leaders to dissuade the emerging protectionist threat, Sarkozy's government ultimately backed down (*Euractiv.com* - "French U-Turn on car rescue plan"). Paris' change of heart was also welcomed by the European Union's Directorate General for Competition

which emphasized the fact that national recovery plans are to be discussed with the Commission and approved by Brussels before being implemented. While insisting that it would remain vigilant in its monitoring of France's implementation of the automaker loans, EU Competition Commissioner Neelie Kroes added that, "It's important for the commission to remove all ambiguity in this case, as Europe must avoid a return to protectionism and its negative consequences for employment in Europe" (quoted in *France 24* – "French auto bailout satisfies Brussels before summit"). With their economies integrated to such a degree, the members of the European Union simply cannot afford to react individually to this financial crisis. Worst of all are such outright examples of protectionism and economic nationalism as the (thankfully short-lived) French plan to set aside funds for its auto manufacturers only on the condition that their investments were to be spent and kept within the borders of France alone.

CHAPTER 6

CONCLUSIONS: REFLECTIONS AND FUTURE OUTLOOKS

As during economic crises of the past, many nations of both the developed and developing world are enacting dangerous protectionist measures that paradoxically harm prospects for economic recovery of their own economies, as well as globally. Consider the Buy American legislation signed in to law by President Obama for example. If companies can only compete for federal money by promising to invest in American products which are necessarily more expensive due to a finite resource supply, these companies inevitably must pass on their added costs to consumers. While a few thousand jobs may or may not be temporarily "saved", the entire economy bears these additional transaction costs. The enormous negative impact is only compounded after America's trading partners inevitably retaliate, effectively closing off the export market to American producers. Ideally, the world would be better served by coordinating its response to the current crisis—surely including temporary measures investing government funds in their local economies to boost investor confidence and restarting consumer spending. However, if nations begin closing their markets off from the rest of the global economy to which they are so inextricably tied, the world may yet again bear witness to a wave of protectionism turning the current economic recession into a depression.

While the world is better prepared to respond to the challenges posed by the rising influence of economic nationalism thanks to the framework of international agreements

and organizations which promote trade liberalization, governments should remain vigilant in the fight against protectionism. For example, the recent proclamations of the G-20 speaking out against protectionism would hold more sway if the signatory nations had not repeatedly broken their promises. Timing the release of their noteworthy report on the impact of the financial crisis to coincide with the recent G-20 Summit in Pittsburgh, the independent watchdog agency Global Trade Alert noted that the G-20 nations have proposed and enacted over 120 protectionist measures since their original pledge to fight protectionism last November (Evenett, Global Trade Alert 2009). In fact, not a single G-20 member state has resisted the political temptation to protect its local economy since the first convening of the G-20 in Washington last fall. International pressures to resist protectionism would clearly be more effective if they were enforced by these nations which collectively represent 85% of global commerce. Joint statements by political leaders at such high-profile meetings as the G-20 summit in London and European Union Council meetings are a start; however more must be done to avoid escalating protectionism.

In stark contrast to the world of the 1930s and the Great Depression, today's global economy has many rules-based institutional barriers in defense of the global trade system. Risks of protectionism again becoming the rule rather than the exception are therefore limited, but they are not absent. Despite the enormous benefits of free trade for consumers in the form of lower prices and wider commodity availability, it is a political reality that industry interests in favor of protectionism are infinitely better organized than these same consumers. These industries and their labor unions have been victorious in numerous political battles during the course of the current financial crisis, and left

unchecked, the damage to international trade done by these protectionist measures could well extenuate and worsen the economic downturn.

Though the chances of a nation-state actually removing itself from the World Trade Organization, NAFTA, EU, or any other international organization which encourages free trade, are essentially nonexistent, there are still many ways that member countries of these groups could enact barriers to trade while still fulfilling their membership requirements. A primary risk is that the major trading powers could raise their tariffs on imported goods from their current "applied" rates to much higher "bound" rates which would be completely in line with their obligations to the WTO. A striking example of this change includes the fact that India could increase its average tariff rate from 14% all the way up to 50%, and still be a member in good standing! Estimates by policy analysts judge that moves to bound tariff rates would decrease international trade flows by at least an additional 7.7% per year (Drezner 2009). Additionally, there is widespread evidence of the developed nations enacting ever-higher non-tariff barriers to trade in the forms of environmental regulations as well as stimulus requirements for domestic investment. Both of these moves have sparked a dramatic rise in the number of cases at the WTO's Dispute Settlement Body (Drezner 2009). However, even if member states are held to their obligations by the Geneva organization, the fact that cases generally last up to 18 months allows nations to enact temporary protectionist measures without penalty. So, again, the probability of a return to 1930's era protectionism is lessened thanks to the wide-ranging international framework protecting trade liberalization, however the chances of such a vicious cycle of economic nationalism are not zero.

In conclusion, political leaders will be held accountable for the results of this economic nationalism. While the current state of affairs is discouraging, it must be said that even during the best economic climates, the benefits of free trade are a hard sell politically. Public opinion polls in the United States, for example, have never demonstrated a clear majority in favor of free-trade agreements. As of April 2009, for example, only 44% of those polled thought such measures were good for the country, and over a third (35%) disagreed. Even these modest figures are actually a decided improvement over 2008, where a plurality actually viewed free trade negatively ("Support for Free Trade Recovers Despite Recession" 2009). President Clinton, for example, famously remarked that one of his biggest regrets as president was his inability to convince the American public of the advantages of globalization and international trade. This was during an unparalleled expansion of the American economy.

Especially during a recession, clauses stipulating that stimulus monies will go to domestic industries and will protect national workers over their foreign competitors are incredibly popular politically. Therefore, it must be said that the current level of protectionism has been far less than could be imagined. Tariffs against Chinese tires and proclamations defending French factory workers to the detriment of their Eastern European compatriots are more political posturing than actual rejections of trade liberalization. Ultimately, they are understandable during times of economic strife while citizens are seeking actions from their elected leaders in defense of their livelihoods. While not ideal and certainly counterproductive to the prospects of immediate economic recovery, policies of economic nationalism have largely been held in check both in principle and in practice during the crisis. Heads of states will have to continue to balance

these political pressures from domestic constituencies who desire protection against international demands for further liberalization. How they respond will ultimately decide their own political fates as well as determine the eventual outcome of the financial crisis.

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