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Trade and the Crisis: Protect or Recover

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Executive Summary

The pace of trade reforms waned from the mid-2000s as protectionist sentiment began to increase. With the onset of the global financial crisis, reform progress not only halted but began to reverse. As we show in this note, new trade restrictions have had—in the limited products they targeted—a strong negative impact on trade. The aggregate impact of new restrictions is modest, at about 0.25 percent of global trade, as most countries have resisted a widespread resort to protectionism. Looking ahead, however, in 2010 sustained high unemployment, uneven growth, and an unwinding of government stimulus measures suggest that protectionist pressures may rise.

Gaps in World Trade Organization (WTO) commitments leave ample scope to further restrict trade, so unless all countries vigorously resist protectionism this could threaten the economic recovery and drag down future growth. Continuing and further enhancing the monitoring of all protectionist measures and maintaining the high-level political awareness of the associated macroeconomic risks will help. But the surest way to avoid such a downside scenario is to tighten multilateral trade commitments by completing the WTO Doha Round. This can be viewed as a key part of the exit strategy from the global economic crisis.

I. Introduction and the "Great Trade Collapse"

1. **The trade contraction that followed the deepening financial crisis in 2008 was sudden and sharp, but by mid-2009 trade had started to recover.** Countries publicly undertook to resist widespread protectionist measures, which alongside supportive macroeconomic policies and the existence of multilateral trade rules helped to restrain protectionist sentiment in the crisis period. However, where new restrictive measures were put in place they did heavily impact trade in targeted product categories, a finding with important consequences for policy makers.

2. **The crisis-induced collapse of trade caught the attention of top-level policymakers.** On the heels of the Lehman Brothers collapse and its consequences for capital markets, the contraction in global trade was sharp and sudden. Global trade volumes fell 17.5 percent between September 2008 and January 2009 in an episode now termed the "Great Trade Collapse" (Figure 1).[1] In downturns, trade normally falls more sharply than industrial production or overall economic activity, but the extent of the Great Trade Collapse was surprising initially. It has been largely explained by three factors: compositional effects, global supply chains, and reduced availability of trade finance (Box 1). Not only was the collapse abrupt, it was also highly synchronized. In the months preceding September 2008 fewer than 5 percent of OECD countries had negative export growth, while in the subsequent months nearly all experienced an export fall of more than 10 percent (Araújo and Martins, 2009).

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[1] CPB Netherlands Bureau of Economic Policy Analysis (2010).