Paul Krugman - New York Times Blog

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The Protectionist Non-Surge

And now for something completely different. OK, at least somewhat different.

I've been remiss about posting class notes for WWS543, Trade Policy; I'll do an omnibus catch-up post soon. But the class goes on; this is the final week. And today I'm talking about protectionism in the Great Recession and after — which is mainly about the surprising absence of any major protectionist surge.

So why isn't 2008- playing like 1929-, at least on this front?

To the extent that we have a standard answer, it lies in the macroeconomic diagnosis of protectionism last time. Eichengreen and O'Rourke have showed, convincingly, that the main driver of protectionism in the 1930s was the lack of perceived alternatives to boost employment. Countries that stayed on the gold standard couldn't take any monetary or fiscal actions to reflate, so they turned to tariffs and import controls.

So were we saved from a repeat by the fact that we're in a world of fiat currencies and floating exchange rates? Not so fast.

You see, outside the euro area countries are free to use monetary policy — but monetary policy isn't very effective, because we're up against the zero lower bound. (You can argue that there's more scope for expansion than central banks have used, but anyway they haven't, so the perceived constraint is there). Countries are also free to use fiscal policy, but ReinhartRogoffBowlesSimpsonRehn have scared them into worrying about deficits instead. Overall, macroeconomic policy has ended up operating within constraints reminiscent of those imposed by the gold standard cult.

So why, exactly, aren't we seeing more protection? Why aren't politicians — even conservative politicians — looking at the situation and saying, hmm, a tariff won't increase the deficit, it won't involve debasing the currency, but it could clearly help create jobs?

One answer might be the "Smoot-Hawley caused the Depression" thing; this isn't true at all, but it might be serving the purpose of a noble lie.

Or maybe it's the structure of trade agreements. The countries that arguably could really, really use some protection right now are inside the European Union, so no go. Countries outside still know that any protection they impose will lead to big problems at the WTO; the United States has to know that a protectionist response would break up the whole world trading system we've spent almost 80 years building.

So here's a thought: maybe the secret of our protectionist non-surge isn't macroeconomics; it's institutions.