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New Protectionism and the European Union: A Theoretical Background with a Critical Overview of Current Developments

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I. Introduction

> *"Protectionism is a misnomer. The only people protected by tariffs, quotas and trade restrictions are those engaged in uneconomic and wasteful activity. Free trade is the only philosophy compatible with international peace and prosperity."* [1]
>
> Walter Block – Senior Economist, Fraser Institute (Canada)

This provocative opinion seems on the surface to be quite credible. It would be in line with the powerful, unmistakable trend towards trade liberalization witnessed in recent decades. In fact, nearly all countries in the world have discovered and exploited the benefits of free trade. Facilitated and driven by the globalization of the world economy and the increased interdependence between nations, the reduction of trade barriers has yielded significant gains in the welfare and prosperity of many nations. Consumers experience lower prices as foreign producers expand their exports to new markets. Indeed, one could argue that increasing economic integration has even correlated with a decline in armed conflict, at least in the West. Protectionism, the counterpart of free trade, seems outdated and is publicly admonished by politicians as if it were a remnant of a bygone era.

Yet despite current trends and public comments by politicians, protectionism is still widespread, both in obvious and less obvious forms. Even the strongest proponents of free trade, such as the European Union and the United States, impose protectionist measures that they have a hard time eliminating. What are some of the newer barriers to free trade, and how can the existence of protectionism be explained? This paper attempts to shed light on the matter by looking at economic theory and by examining present-day protectionist threats.

In the first part of the paper I lay the theoretical groundwork for my analysis by highlighting the economic benefits of free trade that have caused it to become so popular in the past century at the expense of protectionism, the other major policy option. I then examine the most popular instruments of protectionism. Drawing upon arguments in the political economy literature, I explain why protectionism remains so prevalent despite its welfare reducing effects.

In the second part of the paper, these theoretical insights are translated to the current situation of the European Union. The EU was created largely to promote trade and eliminate protectionism from within. Though the EU has greatly increased trade in the region and is seen as an emblem of trade liberalization, it is in reality far

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[1] http://www.isil.org/resources/lit/free-trade-protectionism.html

from perfection with regards to eliminating protectionism. I look at three contentious issues involving accusations of protectionism and how this important trading bloc has responded to them. This includes a look at its Common Agricultural Policy, protectionist impulses from within the EU itself, and the at times heated relationship with its most important trade partner, the United States. These problems show the challenges and dangers of protectionism, even in the current day.

I find that, despite all the progress made towards free trade, present day protectionist policies prevent much greater economic benefits from being realized. Yet, at the same time, these present-day obstacles are not enough to cast a shadow on the many positive developments made towards a barrier-free world in recent decades.

II. Free Trade vs. Protectionism

A. Trade Liberalization

From an economist's point of view, economic welfare can be increased through specialization. This is because specialization and free trade allows each country to produce those goods that it can produce more efficiently than another country can. According to free trade theories, a country should only produce goods for which it enjoys a comparative advantage. When factors of production and scarce resources are allocated in a Pareto-optimal manner with absolutely no trade barriers between countries, national and worldwide income and living standards are maximized. Or, to look at it in another way, economists Gould, Woodbridge, and Ruffin (GWR: 14) point out that through free trade, every person benefits from technological and geographical advantages that exist anywhere else in the world. As a by-product, specialization also promotes innovation because a country can lose its trade advantage if another country discovers and implements more efficient techniques (Krugman and Obstfeld: 289). While this simplified reference model for free trade is a good platform to strive at and to keep in mind while constructing public policy, it is far from reality for reasons I explain later.

These ideas about comparative advantage date back to David Ricardo (1817) and even earlier. However, the start of the modern free trade movement is generally viewed as beginning with the Generalized Agreement on Tariffs and Trade (GATT) in 1947. The creation of GATT was a response to the massive increase in protectionism during the Great Depression, propelled by the Smoot-Hawley Tariff Act of 1930. This now infamous legislation, passed by Congress in 1930, sent tariffs in the U.S. soaring to 59% in 1932 and provoked retaliation by foreign governments worldwide. Some observers even believe that it contributed to the deteriorating conditions of the Great Depression (Krugman-Obstfeld: 310). GATT quickly became an important forum for multilateral trade negotiations in the post-war period, helping to facilitate many rounds of important negotiations that led to a continuous reduction of trade barriers. In 1995, at the end of the Uruguay Round, GATT was succeeded by the more formal World Trade Organization (WTO). The WTO has taken up many functions of GATT and also has some additional functions such as settling trade disputes and conflicts.

B. Bucking the Trend: New and Traditional Protectionism

Protectionism can be defined as "a policy of protecting domestic industries against foreign competition by means of…restrictions or handicaps placed on the imports of foreign competitors." [2] Protectionist measures come in many forms – e.g. tariffs, import quotas, and bureaucratic obstacles, all of which distort international trade. It is important to distinguish these governmentally imposed restrictions from company-specific barriers, such as risk analyses of exporting or investing in a foreign country, or transport costs, which may flow into a company's decision-making process for or against doing business abroad. Discussion here is focused on external, governmentally imposed trade barriers.

Tariffs are taxes "levied on the traded commodity as it crosses a national boundary" (Salvatore: 235). They have long been the most important kind of trade restriction. While both import and export tariffs exist, import tariffs are more important because export tariffs have been eliminated in many industrial countries. As part of the GATT agreements since WWII, tariffs have been reduced sharply and according to Salvatore nowadays "average 5 % or less on industrial products" in the developed world (235). If the world market price for a commodity is lower than the price in a specific country, which is often the case in the absence of free trade, tariff barriers may force consumers to purchase from the domestic producer and pay higher prices for the commodity than they would otherwise. Income is thereby redistributed to a small group of domestic producers, yet the welfare gain experienced by those producers is more than offset by the losses to consumers and foreign producers. This explains why tariffs are inefficient and produce welfare losses.

[2] http://www.britannica.com/EBchecked/topic/479643/protectionism

Quantity restrictions, such as import quotas that limit or restrict the amount that a commodity is allowed to be imported, have also been popular measures to restrict trade. From a welfare perspective, the outcome is similar to that of a tariff. As the importing country does not get tariff revenue, this may make quantity restrictions more favourable to foreign producers that have a license to import. In practice, these advantages for importers may well disappear if they are forced to expend resources to obtain import licenses in the competitive market, which in and of itself induces negative rent-seeking behaviour (Krugman and Obstfeld: 291). Voluntary export restraints (VERs) are a variation of import quotas. However, in the case of VERs, foreign countries are forced to reduce their exports 'voluntarily' with the threat that higher trade restrictions will be imposed if the exports threaten a domestic industry (Salvatore: 276). Though banned by the Uruguay Round in 1999, VERs have been used in the past by the U.S., the EU, and other major players, for example, against Asia, and are almost as efficient as import quotas in limiting imports.

More common and relevant recently have been technical and administrative protectionist barriers - customs, safety, and health regulations, or indirect taxes (such as VAT or sales taxes), together often termed the 'new protectionism.' Anti-dumping duties and export-subsidies are also used in many countries. As the use of traditional tariff and quota measures have step-by-step been curtailed under WTO regulations, countries increasingly rely on these newer protectionist measures because their complexity and less-obvious nature make them more difficult to be recognized and controlled. For example, a country could argue that labelling requirements for food or technical requirements for cars are simply meant to protect the consumer and have nothing to do with protectionist motives. Although in some cases legitimate, administrative barriers are in other cases thinly veiled disguises for restricting imports, especially in sectors where the country or region may have a competitive disadvantage.

In addition, there are also convenient loopholes in WTO restrictions of traditional trade barriers for key sectors, such as agriculture, that countries take full advantage of (see: my discussion of EU CAP in Section IV B). For all of these reasons protectionism manages to keep its grip in spite of all the progress made in combating it during the last decades.

III. Theoretical Explanations for Protectionism

The idea that protectionist policies are associated with welfare losses is well documented – it has been pointed out for centuries by prominent economists such as Adam Smith and John Stuart Mills. For example, Mills observed in the 19th century that "trade barriers are chiefly injurious to the countries imposing them." [3] Why then does Protectionism still exist? Shouldn't the government just keep out of market intervention altogether and let free trade dictate everything? In examining these issues, it is important to keep in mind that, while protectionist measures may hurt the world economy as a whole, this does not preclude the possibility that specific groups and/or even nations may benefit from certain policies. And policies are oftentimes aimed at exactly that rather than maximizing universal welfare. In the first section I explain and judge the validity of economic arguments for trade barriers, while in the section that follows I outline the political economy components.

A. Beggar-Thy-Neighbor Policies

Paul Krugman (1987: 134) argues that free trade models neglect the importance of strategic trade policies, and importantly, the possibility that an 'optimal' tariff may exist that increases a country's welfare. Very large countries using tariffs can in certain cases force foreign producers to lower their prices. By importing goods more cheaply relative to the exports and by using the tariff as taxation, a country can improve its terms of trade and achieve a national welfare (NW) level higher than under free trade. As *Figure 1* on the next page shows, this holds true as long as the tariff imposed lies between t_0 and $t_{c.}$ The country should not impose a tariff that is too large; otherwise imports will decline to such an extent that the costs outweigh the benefits. For small countries, the optimal tariff approaches 0 because they cannot influence the world price for goods.

Furthermore, Krugman (135) argues that in the real world, sufficiently large economies of scale advantages in an industry can well lead to only one single company being profitable. Countries help their domestic companies obtain an advantage through subsidies or R&D which allow their companies to be the established one and earn 'excess returns' before foreign firms are ready, effectively

3 John Stuart Mill, *Essays on Some Unsettled Questions of Political Economy* (2nd ed., 1874; New York: Augustus M. Kelley, 1968), p. 38.

knocking out the competition. With their monopolistic position, countries can then demand optimal tariffs.

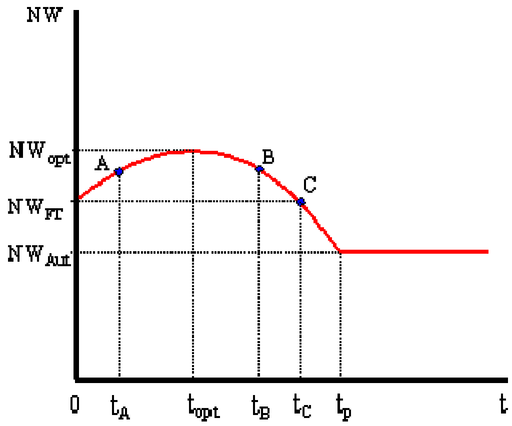

Figure 1 [4]

A different argument that promoters of protectionism use is known as the infant-industry argument (Salvatore: 287). The argument follows that a domestic industry might have a comparative advantage in production, but that it needs to be protected from foreign competition until it gains the necessary economies of scale to compete on a global scale. While in the short-term, the infant industry is at a competitive disadvantage and requires temporary protection, any costs are more than made up for by long-term productivity. Yet, economist Salvatore points out several qualifications. What kind of industry qualifies for protection? How does one decide when to remove the protectionism? In addition, it is difficult to predict whether the return in the mature industry will compensate for the higher prices consumers must pay for the good during its infancy period. Salvatore also argues that policy makers should focus on finding domestic solutions, such as a direct production subsidy, rather than change trade policy. While the infant-industry argument may be valid in certain cases (more likely in developing countries), it is in practice difficult to justify and implement.

One popular though fallacious argument for protectionism is that free trade leads to unemployment. According to the authors Gould, Woodbridge, and Ruffin (1993: 1), "the perception that liberalized trade contributes to unemployment has historically been a primary cause" of protectionism. Governments of high-wage countries attempt to prevent unemployment by protecting domestic industry and by safeguarding jobs that they fear would otherwise be replaced by cheap foreign labour. The casual observer may point out that it would otherwise be impossible to compete with low-wage countries. And in fact, this may go hand in hand with the

[4] http://internationalecon.com/Trade/Tch90/T90-9.php

line of argument that market failure exists and markets are not perfectly competitive, a key assumption in free trade models. Many countries do in fact have non-negligible levels of unemployment.

However, higher domestic productivity (better equipment, better trained workers, etc.) may more than compensate for the higher wages. And in fact, empirical evidence shows that it is the high wage countries that dominate world trade and that a trade-deficit does not automatically generate unemployment (GWR 1993: 14). In addition, the comparative advantage argument remains valid, as each country should perform best by specializing. High wage countries in capital intensive commodities, while cheap labour countries in labour-intensive commodities (Salvatore: 287). Therefore, it may even be desirable that unskilled-jobs be transferred abroad if foreign producers can use the labour more efficiently. Some economists also argue that "protection is an inappropriate and inefficient way to correct for domestic market failures," such as unemployment (Bhagwati: 2008). The natural process by which jobs shift from one industry to another can cause temporary unemployment however, an issue that politicians and special interests are keenly aware of.

There are other justifications for protectionism with weaker economic merit. These often involve distributional objectives, such as the protection of specific groups, or the protection of consumers by arguing that imports from other countries may not satisfy environmental and health requirements. Others point out the advantages of product diversification and self-sufficiency (long an argument for the large subsidies of EU farmers – see: section IV-B). While in certain cases product diversification may be desirable – such as when there is a threat of war, or concerns that others may impose 'optimal tariffs', they are difficult to harmonize with classical economic theory.

The usual consequence of most of these aforementioned protectionist policies is that, while certain groups or nations *may* experience a short-term gain in welfare, this comes at the expense of other domestic sectors (that aren't protected by the government), foreign countries and foreign producers. This is a so-called *beggar-thy-neighbour policy* (Salvatore 292). The welfare loss experienced by the rest of the world far exceeds any possible welfare gains of the imposing country, due to the reduced trade and specialization. As such, many beggar-thy-neighbour policies and strategic trade provoke retaliation by other countries. For example, other countries could impose countervailing duties to offset the tariff. Benefits are neutralized and in the end everyone stands worse off. A great lesson in history was the response to the Smoot-Hawley Tariff Act (See: Section II-A) that ended with higher protectionist measures everywhere.

B. The Political Economy of Protectionism

As I have shown, by increasing the price of commodities, trade protection generally benefits inefficient producers, hurts consumers, and leads to an overall welfare loss. Even a strategic trade policy that could benefit an individual country is unlikely to be a long-term success because of the threat of foreign retaliation. Yet, despite the progress that the world community has made toward free trade in the past century, governmental efforts to liberalize trade and open up markets are usually controversial and fiercely contested. The key to unraveling the mystery of protectionism is to understand that social welfare is only one component that influences public policies. Just as important is lobbying.

Helpful insights into the influence exerted by lobbyists can be found in the political economy literature. Trade restrictions are usually "advocated by those special groups in the nation that stand to benefit from such restrictions. (Salvatore: 235)" These self-interested groups, many of whom fear that competition from abroad will take away their business, include a wide array of actors ranging from industry-based coalitions of capital owners to industry associations and labour unions. Protectionist measures, just like all policy decisions, are the "endogenous outcome" of a complicated political process that involves not only welfare considerations, but the interests of voters and special interests (GWR 1991: 13).

According to the theories of Mancur Olson,[5] small and well-defined interest groups (that are better informed than consumers and politicians) have a large stake in policy outcomes. These groups "stand to gain a great deal (monetarily) from protection," (Salvatore: 239) and each member exerts a direct influence in the decision-making process. In this way, they have a better chance to succeed in their lobbying efforts than larger groups that are negatively affected by policy changes, such as domestic consumers or foreign producers. They have an incentive to lobby the government to adopt protectionist measures as long as the marginal benefit of doing so exceeds the marginal cost of the lobbying effort (GWR:13).

Economists Gould, Woodbridge and Ruffin (1991: 13) believe that the lobbying by domestic industries hold significant sway in policy formation as it

[5] See: "The Logic of Collective Action: public goods and the theory of groups," ,Mancur Olson, 1971

forces politicians to pay attention and consider their positions. Politicians and policy makers are just as self-interested as the special interests because they seek to win elections and maintain political power. Lobbyists can help politicians achieve their goals through campaign finance donations or by mobilizing their constituents if the politician vows to support their position. Interest groups can also influence politicians in office by providing (usually biased) reports and research that show to what extent their industry or livelihood could suffer if certain protectionist legislation does not get passed.

For the politician, it can be a worthwhile investment to enact policies lobbied for by a small interest group even if he or she knows that it comes at the expense of the general population. Consumers that could punish this behaviour in elections barely notice their welfare losses because they are spread out over the entire population. They may not even know its root cause due to the non-transparency of the political system, and can only with great effort be mobilized to organize and resist harmful policies. Political economy theorists argue that politicians are ultimately hostage to these interest groups.

To look at it in another way, trade policy is therefore determined by a "political contest" between the lobbying expenditures of the domestic industries that seek protectionism on the one hand and the consumers on the other (GWR: 13). All too often, an economically insensible result is obtained. The authors provide an example involving the U.S. sugar industry. The U.S. Federal Trade Commission estimated in 1984 that sugar producers increased profits by $783 million through import quotas and tariffs, yet this came at the expense of US consumers who had to pay $1.266 billion in higher prices. Even though the average consumer would lose $5 a year because of the policy, sugar producers got their way.

Thus, oftentimes trade policies are designed to appease to particular groups or redistribute income rather than maximize welfare and efficiency. This rent-seeking behaviour of organized interests is harmful to society in two respects: first, costs and resources devoted to the lobbyism itself are wasted, and second, consumers pay higher prices. The only winners are the lobbyists themselves and those dependent on them. Yet these theories by Olson and other economists help explain reality and how narrowly-minded interest groups can potentially control public policy.

IV. Protectionism and the EU

A. The Unique Nature of the EU and an Overview of RTAs

Regional trade agreements (RTAs) have blossomed in recent years. According to Shujiro Urata (2002: 23), not only is the number of RTAs increasing, but RTAs are getting bigger, more diverse, with increasing depth of cooperation between countries. This holds true even for countries not in close geographical proximity to one another, such as Singapore and New Zealand, and encompasses the participation of countries that have avoided getting heavily involved in RTAs in the past, like Japan.

This trend is driven not only by globalization but by a WTO policy that exempts countries participating in a RTA from the WTO 'Most Favoured Nation' clause. This is a clause that forbids any country from acting in a discriminatory nature against any other member of the organization. Increasing regionalism may also be a reflection of the difficulty of coordinating increasingly complex trade policies on a worldwide scale (Urata: 26). This is especially true recently with tariffs so low and less to be gained through further WTO trade rounds, which make major breakthroughs via global agreements more difficult. Environmental and labour issues that have become major obstacles in the WTO negotiations can be more effectively overcome bilaterally. At the same time, bilateral and multilateral trade agreements are preferable to unilateral measures, even if classical theory dictates that a country would benefit from unilateral action, because a country can demand concessions in return for its participation. Thus, agreements to liberalize trade between fewer countries are more promising.

While trade restrictions between member states of the most basic RTAs are removed completely, members still have the power to impose their own tariffs against countries outside of the group. An example of a RTA is NAFTA, formed by the U.S., Canada, and Mexico. Also popular are customs unions – for example Mercosur in South America. In a customs union, the entire bloc itself decides on common trade regulations towards non-members. The most advanced stage of cooperation involves unions with a common market in which there exists a free movement of factors of production between member countries. In the case of the European Union, some policies are even harmonized under supra-national control. This depth and scale of the EU is unprecedented and unparallel anywhere in the world. This makes the EU unique and an especially interesting area for a review of the effects of protectionist policies.

The European Union is in an interesting position in that, while protectionist barriers have in theory been eliminated between member states within the union (qualifications in section IV: C), significant protectionism is allowed against non-members. The trade relationships of the EU with the rest of the world are vast and complex, encompassing a network of agreements and partnerships that involve nearly all countries and regions of the world.

RTAs like the EU create three economic effects due to their unique nature (Urata: 2002). First, there is a trade creation effect – the "effect whereby trade is created between the members of a group by lifting the trade barriers between them. (27)" Producers export more to member countries and specialize more efficiently. There is also a trade diversion effect, whereby "after the establishment of an FTA, imports are diverted away from more efficient non-members toward members that may be less efficient. (27)" Increased trade with other member countries comes at the expense of trade with the foreign exporters they replace. This constitutes a suboptimal reallocation of resources and is considered a negative effect. Finally, there is the 'terms of trade' effect, as "the terms of trade of members are improved due to their increased influence over non-members as a result of the greater volume of trade between member nations. (27)" In reality this mainly holds true for more economically powerful unions like the EU. On sum, while a global, multilateral framework, such as those imposed by the WTO and trade rounds, are preferable, FTAs are generally better than no cooperation at all (except when the trade diversion effect is strong).

B. The EU and Agricultural Protectionism

The European Union is often viewed as a model in regional integration and in promoting trade around the world. Indeed, the EU has cut many trade barriers through bilateral agreements, grants poor countries privileged relationships, and through its creation significantly enhanced trade between member countries. In particular, the EU claims it has some of the lowest tariffs on industrial imports in the world, averaging about 4%.[6] Though the EU prides itself with its free trade policies, the EU in reality does still protect key industry sectors. The most notorious example of EU protectionism involves its contentious Common Agricultural Policy (CAP).

[6] http://europa.eu/pol/comm/index_en.htm

The CAP, with its roots stemming from the formation of the European community itself, is a farm policy that enacts trade barriers on agricultural goods from abroad while subsidizing domestic producers. In the past, the CAP even guaranteed minimum prices for European farmers that were far above the world price. In fact, although European producers have a major competitive disadvantage in agricultural production, subsidies and artificially higher prices often led to overproduction and major food surpluses (BBC: 20.11.2008). The only way the EU could sell these excess supplies on the world market was by means of subsidized exports. Export subsidies are technically illegal under the WTO, yet they are allowed in the agricultural sector thanks to lobbying by the U.S, EU and other developed countries (Krugman/Obstfeld: 311).

While domestic farmers benefit from higher income and job security, consumers ultimately lose because they must pay an artificially higher price for food as well as higher taxes to subsidize its production. The costs of higher food prices to consumers have been estimated at 50 billion a year, while money paid for the subsidies amount to 43 billion, a gigantic 45.4% of the EU budget in 2006 (BBC: 2008). Critical observers note the significant damage this may cause to foreign producers in developing countries because it denies them access to the EU market. According to the WTO, agricultural exports are "often the economic driving force" accounting for "over one-third of export earnings for almost 50 developing countries."[7] This is quite starting and ironic considering the many special EU relationships with poor countries that are focused on economic development.

Yet because farmers are a small and well organized group – only 5% of EU citizens work in agriculture, a sector that generates just 1.6% of total GDP (BBC: 2008), and other reasons mentioned in the political economy section of my paper, they consistently have success pushing through their interests. Farmers and defenders of CAP policies point to the fact that the funds lead to decreased reliance on imported food, promote self-sufficiency, and guarantee the survival and traditional appearance of rural communities. More than half of EU citizens live in rural areas (BBC: 2008). In addition, it is true that agricultural subsidies are hardly limited to Europe. If Europe were to remove its trade barriers without a countermove by other countries, the entire agricultural industry may be forced out of business. However, this is not enough to diffuse criticism of reckless CAP spending. After all,

[7] http://www.imf.org/external/pubs/ft/fandd/2004/12/pdf/picture.pdf

having comparatively inefficient producers find more productive work elsewhere may well be justified by classical economic theory anyway.

The CAP began to undergo major reforms in 2003, partly in response to the criticism and also in response to the ballooning budget and resentment by taxpayers and consumers. EU funds are supposed to flow into rural developmental aid, to diversify the rural economy, and make farms more productive and efficient while still preserving the traditional appearance of the countryside.[8] Payments in general are supposed to be decoupled from quantity of produce, with guaranteed prices being lowered and aid instead dependent on quality factors and conditions such as food safety, animal welfare, and environmentally friendly practices. The EU has drawn up a bold plan to eliminate all export subsidies by 2013 and to further reduce import duties, even if the latest talks at the Doha Round fail.[9] These are pretty big reform plans. Only time will tell whether they will be successful in making European farmers more competitive internationally and end the reliance on trade-distorting and welfare-reducing agricultural support. What is certain is that the debate over agricultural subsidies, both in the EU and in the rest of the world, is unlikely to end anytime soon.

C. The EU and Threats of Internal Protectionism

There are even issues involving protectionism within the union itself. That may seem difficult to imagine because the most common tariff and non-tariff barriers have long been eliminated. Indeed, plans were already underway to abolish customs barriers with the very creation of the European Community in 1957. In 1985, the EU published a White Paper with the aim to "abolish, within seven years, all physical, technical, and tax-related barriers to free movement within the Community" and to create a European market that balances the American market.[10] A few years later, these ideas were made official with the Single European Act. Yet despite much progress, this does not mean that member countries do not clandestinely practice protectionism in other ways to benefit local companies and industries, especially when it involves national pride or times of crisis.

The effects produced by the aftermath of the financial crisis of 2008 illustrate these dangers well, even in an area so economically integrated as the EU. In response to the crisis, the temptation of governments to pass bail-out bills by

[8] http://ec.europa.eu/agriculture/publi/capexplained/cap_en.pdf
[9] http://europa.eu/pol/agr/index_en.htm
[10] http://europa.eu/abc/12lessons/lesson_6/index_en.htm

themselves to protect important domestic companies was high and a European solution was lacking. Alone in Europe, exports and imports declined by 14.8% and 14.5% in 2009.[11] Although European leaders, such as Manual Barroso, warned the European community that trade barriers would only lead to a worsening of the crisis and a protectionist race to the bottom, nearly all European governments enacted protectionist measures.[12] For example, Sarkozy was sharply criticized for his remarks that French automobiles must be produced in France.

One particular poignant example of protectionist accusations was the attempted rescue of Opel by the German government in 2009. German unions and politicians feared that without a plan allowing an investor to rescue Opel from hard-hit GM, thousands of jobs were at risk at the four Opel sites in Germany. Welt-Online called the Opel-rescue plan in September, 2009, a „clear form of protectionism at the expense of its foreign neighbours" because of its emphasis is on saving German jobs (Eigendorf – 12.09.2009). The German government had offered €4.5 billion in taxpayer money to rescue the automobile manufacturer from GM. It was also an election year, which meant that German unions had a special influence over the politicians. This is an example of the interplay between politics and economics explained earlier in the paper. Accusations were so pronounced that an EU-Commissioner even warned Germany against "economic patriotism" and pledged to review whether non-commercial protectionist measures were involved with the Opel-rescue (Spiegel-Online: 15.09.2009). Even after GM decided against selling Opel, there were large concerns that EU countries were making competing bids to prevent GM from cutting jobs in their territory. The European Commission had to step in to thwart those attempts and prevent GM from letting member countries compete against each other (Die Welt: 24.11.2009).

Economic patriotism and national pride has not been an issue just in times of crisis, but has a longer history as well. For example, in 2006 France successfully prevented the Italian energy provider Enel from merging with the French provider Suez by fusing Suez with another French company (Spiegel Online: 03.03.2006), provoking anger in Italy and protectionist accusations.

In a recent study (2009), economists Natalie Chen and Dennis Novy found significant trade barriers in the EU, and that the "most substantial costs are technical barriers." The study found that, while costs associated with geography and

[11] http://www.wto.org/english/news_e/pres10_e/pr598_e.htm
[12] Warnings by European leaders: http://www.wsws.org/de/2009/feb2009/prot-f13.shtml

transportation explains 25% of the variation in trade integration, policy factors, including technical barriers, explain 7% of the variation, a finding that the authors believe is far from negligible.

D. EU-US Bilateral Relations and Tensions

U.S.-EU trade relations have global significance. Taken together, the U.S. and EU account for more than half of the world's GDP, and each depends on the other as an important trade and investment partner.[13] According to the European Commission, trade flows between the blocs average about €700 billion annually. When investments are added, "total commercial exchanges across the Atlantic amount to a staggering $4.4 trillion annually" and "14 million workers depend" on trans-Atlantic trade, as noted by EU Trade Commissioner Ashton last year (Palmer/Reuters – 27.11.2009).

Considering the interdependence of these two important trading blocs, one may ask why no free-trade pact exists between them. In fact, there has been discussion for years about creating a free trade pact, or at least coming closer to a barrier free marketplace between the EU and the U.S. This is a goal that has been set forth by the Transatlantic Economic Council (TEC), a bilateral forum created in 2007 to increase cooperation on trade policy and improve relations. Yet this goal is far from being realized because regulatory differences are still significant and harmonizing many of them remains illusive, due in no small part to the many special interests involved. The EU Commission's Vice President for Enterprise and Industry recently stated that even with a FTA, this root problem would not be cured (Palmer/Reuters – 27.10.2009). Indeed, divisive regulatory issues have continuously strained the trading relationship in recent years. While tariffs are fairly low, non-tariff, administrative barriers, especially those involving product safety, environment and labour policies, and agriculture, still loom large.

A current dispute between the US and the EU involves the US export of poultry to Europe. Europe has banned all imports from American producers of poultry since 1997 because the meat is processed with pathogen reduction treatments. American poultry exporters believe that the ban, supposedly in place due to health concerns, is completely unfounded and prevents them from entering the lucrative European market. Despite years of negotiations and continued evidence that the chemicals cause no negative health effects, EU agencies have continuously

[13] http://trade.ec.europa.eu/doclib/press/index.cfm?id=544

prevented efforts to lift the restrictions. Heavy lobbying by European agricultural interests has almost certainly played an important part. As a result, the US lodged a complaint with the WTO last year, and the WTO is currently reviewing the matter (USTR Press Release – 08.10.2009). This and other contentious issues, such as US export of genetically modified food to Europe, have repeatedly provoked sharp debate. I believe that it is quite possible that many of these unduly strict health regulations are simply disguised forms of protectionism.

Accusations of protectionism are also common in the aerospace industry. For example, France's Sarkozy and German's Merkel recently argued that the US was unfairly helping a domestic company in a dispute over the competitive bidding of a refuelling tanker contract.[14] The European leaders believe that the Pentagon changed its technical specifications for a new Air Force contract to favour the type of planes Boeing has over that of the competition. As a result of these changes, the two other competitors, including European Aeronautic Defence and Space Co, dropped out in the third round of bidding, leaving Boeing as the only bidder. Although the bidding deadline has since been prolonged and EADS is planning on making a solo-bid, this may simply be a way of staving off European pressure and creating artificial competition to Boeing. Such charges of protectionism in the aerospace industry, also seen in the dispute over EU subsidies of Airbus, have a long history.

Regulatory differences have significant opportunity costs. According to a recent study by the European Commission that analyzed the economic losses induced by non-tariff trade barriers between the EU and U.S., simply reducing all "actionable" regulatory differences would increase GDP in the EU by €122 billion per year and increase total exports by 2.1%.[15] The US, in turn, would experience gains of €41 billion per year in GDP and 6% in higher exports. If tariffs, subsidies and quotas were included, this total would undoubtedly be much higher.

V. Conclusion

The move toward free trade in the past century has led to unparalleled levels of economic growth and living standards in many countries around the world. Efforts in the past to improve welfare by inhibiting trade and competition– such as during the Great Depression, in the USSR, or through import substitution by

[14] http://www1.voanews.com/english/news/europe/Sarkozy-Expected-to-Decry-US-Protectionism-in-Upcoming-Visit-88969562.html

[15] Details of the Study: http://trade.ec.europa.eu/doclib/docs/2009/december/tradoc_145612.pdf

developing countries, have failed spectacularly. The present day plight of countries economically isolated (Korea, Cuba, etc) make clear the benefits associated with free trade. Yet even in the present day, the EU and nations across the world impose protectionist measures that are tremendously difficult to overcome and prevent the realization of much greater welfare gains. Thus, models of free trade that I presented at the beginning are too simplistic and do not accurately portray reality.

After a review of protectionist measures used in the past and present, with an emphasis on the threats posed by new forms of protectionism, I examined three present-day issues facing regional trading blocs such as Europe. In doing so, I hope to have shown that challenges to free trade and protectionism come in many forms.

Especially with the current financial crisis, protectionism has made somewhat of a comeback. In 2009, world trade contracted by 12.2%. Alone in Europe, exports and imports declined by 14.8% and 14.5% respectively.[16] That amounts to the largest decline since the Great Depression. According to a study by the World Bank, in the aftermath of the crisis the same G-20 leaders that pledged to avoid protectionist measures themselves implemented 47 measures to restrict trade.[17] Yet the same study added that these responses are still fairly "muted" protectionist measures and, due to many factors, not comparable with threats posed during the Great Depression. Export interests have become more important, countries are more interdependent, and due to global supply chains, domestic markets depend on imported goods. Furthermore, GATT/WTO and its agreements have added a level of stability to world trade that did not exist in the 1930s. For these reasons, it is unlikely that the crisis will constitute any long-term constraint on economic growth and free trade. Indeed, the fact that the crisis did not cause much heavier damage proves how entrenched and dependent the world is on free trade.

In all, despite a focus in the latter part of my paper reviewing the challenges of free trade in the present world, this should not overshadow these and other many positive developments since the 1930s. Cooperation is increasing amongst countries and trade barriers are continuously being lowered and removed. Though non-tariff trade barriers will remain contentious in the foreseeable future, one should not forget the tremendous tariff-decreases that have been negotiated and the many institutions created and agreements signed that have contributed to world trade.

[16] http://www.wto.org/english/news_e/pres10_e/pr598_e.htm

[17] http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,print:Y~isCURL:Y~contentMDK:22105847~pagePK:64257043~piPK:437376~theSitePK:4607,00.html

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