

# **Learn from the past: an implication from the United States protectionism**

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## **ISSUE**

The debate around free trade has been going on for centuries. More voices are embracing protectionism given the current economic downturns. Is free trade really the scapegoat to blame? Would the adoption of protectionist and interventionist policies save the economy? In this brief note, I will give recommendations along with empirical evidence.

## **BACKGROUND**

The United States realized significant gains from trade liberalization from the early 1940s till today. However, a rising voice is questioning the efficiency of free trade and demands a shift towards protectionism. It is commonly acknowledged that the distribution of trade benefits is uneven. Increases in imports and consumer surplus are associated with costly job loss in the manufacturing sector. A panel study suggested import-competing industries are responsible for approximately 40% of the overall manufacturing job losses from 1979 to 2001 in the United States. [[Kletzer \(2005\)](#)]

Job cuts in the United States between 1978 and 1990, where a spike of net imports was witnessed, were estimated to be 7.2% and 2.1% for the production and services sectors, respectively. The manufacturing sector, due to its less skill-demanding nature, disproportionally takes the expenses of globalization. Moreover, when trading with developing countries, low-skill workers in the manufacturing sector face the strongest challenge. This prevails a problem beyond the labour market, the increasing inequality between skilled and unskilled workers. They not only bear the risk of job losses but also face a wage cut. Workers are paid for their productivity, which is realized through the market equilibrium price. While consumers gain from the trade by paying less, on the other hand, the work productivities are valued less. [[Sachs and Shatz \(1994\)](#)]

It is notable that not all job and income losses are attributed to trade liberalization. Technology shift also plays an important role in the story, in its own channel to the losses. Unfortunately, this was not further discussed in the literature due to the lack of measurement precision. I do believe, the unknown is the biggest problem, as the next industrial revolution is likely to be in the high-skill worker sectors. Even now, more and more businesses are outsourcing their service providers to offshore teams. This

trend should be a wake-up call to the policymakers for comprehensive assistance. In the future, the cost of the trade nevertheless would also land on the skilled workers.

I will conclude this session by presenting the aftermath of the trade war in the United States. As many believe, protectionism and the high tariffs should be the solution. This is disproved by empirical evidence. In 2018 the United States launched a trade war by significantly raising the import tariffs. Just as the model shows in the latter session, this action always resulted in the trading partners' retaliation. The tariff indeed has an impact on the import and the export volume, but overall a loss occurred. The estimates demonstrated an annual loss of \$51 billion and the equivalent real income loss of \$7.2 billion. The main reason is the complete pass-through of tariffs to duty-inclusive price. [[Fajgelbaum et al. \(2019\)](#)]

## ASSESSMENT

Canada, despite being culturally and physically close to the United States, has a very different trade composition and demographics. The number one trading partner of Canada is the United States, and the main export and import are energy products. Thus, engaging in free trade is not going to be a big shock to the domestic manufacturing industries, as in the United States.

Now I will introduce a model as a piece of strong evidence for free trade. A comprehensive model proposed by Ralph Ossa suggested the optimal tariff average to be 62%, yet this is never feasible in the real-world setting. In the ideal world, an economic body can realize great welfare gains from setting the optimal tariffs, by imposing the cost on the trading partner. However, trading partners retaliated optimally in the real world. If taking into account the complete lobbying (eg. union strike against the tariffs), the adoption of protectionism reduces overall government welfare further, totalling -2.9%. On the other hand, tariffs with negotiation yield significant welfare gains, up to 3.6%.

Besides the model framework, a piece of empirical evidence recommends Canada's diversity in trade. A study on NAFTA finds that NAFTA improved trade with the other countries involved, but Canada's trade improved the least, less than 10% of Mexico's improvement. Although real wages went up, Canada's gains from NAFTA were mostly in increased trade. In fact, Canada's welfare actually went down due to NAFTA. Due to a drop in export prices, Canada saw a decrease of 0.11% in terms of trade. The effects were also concentrated in a few sectors, with some having larger aggregate effects. The diversity of sectors, their links to one another, and intermediate inputs are important variables for predicting the effects of tariffs. When welfare gains from NAFTA are subtracted, Canada received the largest benefits from world tariff reductions compared to other NAFTA countries. [[Caliendo and Parro \(2014\)](#)]

Right now, Canada is actively expanding the diversity in trade, like the Canada-Chile FTA and Canada-Korean FTA, I believe this aligns with the best interest of the Canadian economic outlook. Not to mention the fact that Canada is an immigrant country, the engagement in trade worldwide strengthens the tie between new Canadians and their motherland, in which potential social gains can be achieved. I recommend

that Canada should keep up with the trade diversity while the government should adjust assistance toward the disadvantaged groups from international trade. For one, trading realizes significant societal gain, but this cost should not be borne by the individual. For two, more and more Canadians, despite working as service providers are also at risk of job loss due to the current trend of service outsourcing (eg. offshore teams), no individual should be left behind either.

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