

Dialogue &co episode 4 (1/2) – The return of protectionism – Challenges and perspectives

VOICE-OVER

Welcome to Dialogue &co. In this episode and the next, both recorded on 7 February 2025, three speakers will try to provide some economic insight into a topic that is preoccupying much of the media and political debate: protectionism. With Donald Trump's frequent announcements on the campaign trail and since his inauguration, protectionism, and particularly its most conspicuous aspect – tariffs – has taken centre stage.

In this first episode, Hervé Le Bihan, Director of International Economics and Cooperation, and Antoine Berthou, Head of Division, International Macroeconomic Studies, answer questions from Lucile Rive, podcast production manager for the Banque de France. They place current US trade policy within the broader historical scope of the organisation of world trade. Enjoy the podcast.

LUCILE RIVES

Hello, Hervé Le Bihan.

HERVÉ LE BIHAN

Hello, Lucile.

LUCILE RIVES

Hello, Antoine Berthou.

ANTOINE BERTHOU

Hello.

LUCILE RIVES

Before we begin, given that the US administration's announcements are coming thick and fast, it's probably best to point out that these two episodes of Dialogue &co were recorded on 7 February 2025. And so, Hervé Le Bihan, what's the latest on President Trump's tariff announcements?

HERVÉ LE BIHAN

Well, to begin with, Lucile, we should make it clear that, as of today, 7 February 2025, there is still a great deal of uncertainty as to the measures that will in fact be applied. Because during the American presidential campaign, Trump as a candidate spoke about imposing tariffs of around 60% on China and 10% to 20% on other US trading partners. Then at the beginning of February, Trump as president issued executive orders directing the United States to impose tariffs of 25% – this time on Canada and Mexico – and 10% on China. The

main objective was to put pressure on the Mexican and Canadian governments with regard to drug trafficking and illegal immigration. Once Mexico and Canada had made concessions, the tariff measures were suspended and continue to remain so. But the risk of further tariff increases remains very much on the horizon and could probably have an impact on other US trading partners such as the European Union.

LUCILE RIVES

So Hervé, these are measures that target the United States' major trading partners. Are we witnessing a major shake-up of world trade?

HERVÉ LE BIHAN

That's a big question. It depends on the size of the shock. And it could be major. But let's come back to what tariffs actually are. They are a tax on imported products. Currently, they are at around 0% within North America. If tariffs rise to 25%, as Trump suggested, then, as an example, the price of a car built in Mexico and normally sold in the United States for USD 40,000 will rise to USD 50,000 unless other price determinants change, which we can discuss. So, we also have to take into account indirect costs, by which I mean the costs for companies that purchase intermediate inputs abroad, especially in a context where goods can cross the border several times. This would considerably increase production costs in the United States as well.

LUCILE RIVES

So it could be a major shock. Antoine Berthou, can placing this in a long historical perspective help us understand the extent to which free trade on a global scale is being called into question?

ANTOINE BERTHOU

Yes, it's true, we should try to approach it a little from this perspective. And what we're seeing today with this new US trade policy is a major change – at least in terms of what is being said – from the historical trend that we have seen over a long period of time, at least since the mid-19th century. What we do know is that since the 19th century, trade has been considerably simplified with the lowering of barriers to trade. And this lowering of trade barriers has taken several forms. On the one hand, customs duties have been reduced – what we call trade policy. And on the other hand, transport and communication costs have come down, leading to rapid progress in trade. An interesting example is the creation of the transatlantic telegraph cable in 1866, which meant that prices for traded goods could be fixed.

Now, if we're trying to assess trade policy and protectionism a little, we can use data published by the World Bank, which allows us to calculate a simple average of all tariffs on all imported products. This is known as the most favoured nation tariff, i.e. the tariffs that apply generally in the absence of a free trade agreement and without retaliatory measures, for example anti-dumping duties. This gives us an idea of the level of protection, and on that basis we find that tariffs in advanced economies are set on average at around 2% to 3%.

And this is particularly the case for the United States, the European Union and Japan. Again, we're speaking generally, without taking trade agreements into account.

The so-called most favoured nation tariffs – still in this general case – are higher among emerging economies. And protection remains particularly high, especially in the agricultural sector, thanks to tariffs and other non-tariff barriers, such as import quotas, for example. But considerable progress has been made in opening up economies. Let's take the example of India. In 1990, India imposed an average tariff of 80%, which is very high. Today, after a series of measures to liberalise trade and several economic crises, it is down to 14%. We see comparable progress in most emerging economies, while advanced economies opened up following the Second World War. Another example is China, which joined the World Trade Organization in 2001. And all these strides forward, all these measures to open up economies, have considerably facilitated global trade.

But free trade – bringing us back a little to the subject of our conversation today – is indeed being called into question. The effects it has on economies are disputed, particularly because of the way the gains are shared out.

LUCILE RIVES

So, Hervé, can you help set the scene historically for free trade, and tell us how economic theory explains how free trade has gradually taken hold since the mid-19th century?

HERVÉ LE BIHAN

Yes Lucile, there are benefits to free trade that result from the specialisation of economies. In fact, the idea that there are comparative advantages between countries and gains associated with specialisation and trade is a very old one. It was first put forward by the eminent economists Adam Smith and David Ricardo between the end of the 18th century and the beginning of the 19th century. Typically, specialisation occurs in sectors with so-called comparative advantages, that is, sectors of the economy that have a price advantage over their competitors. Specialisation of this kind makes production more efficient on a global scale and increases income and consumption worldwide. For example, global aeronautical production is highly concentrated in a few countries, including France and the United States. Not every country is going to manufacture aeroplanes because their production requires an entire ecosystem combining capital and very specific skills and expertise. And very few countries can bring together all the ideal conditions. The same applies to many cutting-edge industries such as biotechnologies, and also to more traditional, labour-intensive sectors, such as textiles and clothing, and sectors that exploit natural resources, such as agriculture or extraction.

As barriers to trade have come down, the organisation of production has become more complex. We have seen the development of what are known as international value chains. Producing mobile phones, cars, aeroplanes or wind turbines involves assembling large numbers of parts and components that may have been manufactured in several countries. Each value chain links a large network of companies connected through contractual relationships or integrated into large multinational groups. This organisation, which

benefits from relatively low costs in terms of communication, transport and customs duties, has led to significant productivity gains, improving the productive efficiency of our economies and thereby generating income on a macroeconomic scale. And this has increased consumer well-being globally.

LUCILE RIVES

Antoine, we've seen that free trade and the specialisation of economies generate gains at a macroeconomic level, on a global scale, but there are also downsides.

ANTOINE BERTHOU

Absolutely. There are winners and losers. On the losing side, we see clearly that specialisation is detrimental to certain sectors or companies that are the least productive – the least productive for the economy that is opening up. And in this respect, the change in the structure of production is not entirely due to international trade. Some industries have declined as a result of other factors, particularly technological progress. People often point to the examples of robotisation or changing consumer patterns. However, research carried out by economists also shows that competition from low-wage countries, particularly with China joining the WTO in 2001, has led to job losses in the exposed industries in countries such as the United States, but also in France and elsewhere in Europe.

But despite the jobs lost, it's important to remember that other jobs have been created in sectors where countries had comparative advantages. And these advantages are at the root of the macroeconomic gains that we mentioned earlier. But there are transition costs insofar as the skills required in the "winning" sector are not necessarily in line with the labour market's supply. This can therefore lead to the losers demanding greater protection, particularly in employment zones that have gone through drastic change in recent years.

LUCILE RIVES

And this scepticism about the effects of free trade, is that what we're seeing in the United States, Hervé Le Bihan?

HERVÉ LE BIHAN

Well, the objections to free trade are not unique to the United States, but across the Atlantic they found their way into trade policy with protectionist measures during Donald Trump's first term. And the Biden administration actually maintained and extended these measures, with a first wave of tariffs particularly targeting China between 2018 and 2020. So the average level of tariffs, which Antoine referred to earlier, has risen in the United States and is now at around 5%. Then, during his presidential campaign in 2024, Donald Trump promised to step up US protectionism massively with the aim of redressing the external imbalance, but also in order to obtain geopolitical concessions. If, ultimately, his proposals were applied, it would bring US tariffs back to the levels seen during the interwar period.

LUCILE RIVES

Antoine Berthou, you mentioned earlier that China joined the World Trade Organization.

Can you tell us what this organisation is? And when countries are part of it, are they still free to implement trade policy as they see fit?

ANTOINE BERTHOU

Well, there are a certain number of rules that regulate world trade – in goods and in services. Trade of goods and services between countries is governed by what is known as the GATT, which is a set of agreements signed in 1947, immediately after the Second World War. The GATT now falls under the responsibility of the World Trade Organization, the WTO, which was founded in 1995. The majority of countries have signed these agreements, which encompass not only the global trade in goods and services and intellectual property rights, but now also – and this is important in the digitalised economy that we live in – the digital trade in goods and services. The rules must be transparent and, in general, bar any form of discrimination. We were talking earlier about most favoured nation status; it's similar to that idea.

The WTO has a Dispute Settlement Body that deals with disagreements between members and may, in certain cases, authorise retaliatory measures. So there, this takes us away from the general idea of most favoured nation. For example, there are anti-dumping duties to compensate for practices that would mean that a competitor sells its products on the external market – its export markets – at prices lower than it charges on its domestic market. So this is the idea of discrimination that we find in the WTO rules. And these rules have a considerable impact on world trade. For example, academic studies have shown that when China joined the WTO in 2001, the increase in trade with the United States was not due to trade barriers coming down, because the barriers were already low. Instead, it was due to a reduction in the uncertainty surrounding the tariffs applied to Chinese exporters – previously these duties had to be voted through US Congress every year.

LUCILE RIVES

But in that case, why – despite the existence of this organisation – are we seeing an increase in protectionist measures?

ANTOINE BERTHOU

The role of the WTO is now less central than it was in the past, for two reasons. First, the issues have become far more complex and the major players in world trade such as the United States or the European Union are establishing trade relations through bilateral trade agreements. The EU-Mercosur agreement is a recent example, but the European Union has also signed a number of agreements with South Korea, Japan and a wide range of other partners. And these agreements allow them to set more ambitious objectives than those allowed by the WTO's world trade rules – more ambitious social and environmental standards, for example. Second, the WTO has been weakened by the appointment of judges to the dispute settlement Appellate Body being blocked. This prevents the WTO from arbitrating disputes.

Generally, world trade has been rocked in recent years by major shocks, some of which resulted from political decisions. Reference has been made to the increase in US tariffs

during Donald Trump's first term targeting a large number of imported products, starting with washing machines, solar panels and steel, and also a large number of partners in addition to China. The European Union was also targeted. More recently under Joe Biden, batteries and electric vehicles, particularly those imported from China, were targeted with new tariffs.

LUCILE RIVES

So, Antoine Berthou, world trade has been rocked in recent years, and it's not just because of decisions made in the United States.

ANTOINE BERTHOU

Absolutely. And in fact there are other examples beyond the United States of barriers to trade that have shaken the global economy a little. We can take the example of Brexit, which changed the rules on trade between the European Union and the United Kingdom. Or the international sanctions that targeted trade with Russia after its first incursions into Ukraine in 2014 and then of course since February 2022. Or China, which has often restricted exports of critical materials, targeting Japan in 2010, for example, and more recently, exports of gallium and germanium, which are widely used in industrial processes. And this all considerably weakens global value chains.

LUCILE RIVES

And these are the same value chains that have become more complex, making imposing tariffs even more punitive?

HERVÉ LE BIHAN

This is particularly the case in North America. Between Mexico, Canada and the United States, there is an entire value chain circuit, particularly in the automotive industry, as production, and not value added, is taxed.

LUCILE RIVES

But Hervé, shouldn't we protect those industries that are becoming less productive? And more generally, are there situations in which protectionism would appear to be justified?

HERVÉ LE BIHAN

For most economists, protecting industries that are in decline would cancel out the gains from opening up to trade. But, many economists agree that it can be worthwhile for a country to protect so-called infant industries to nurture their development. But the difficulty lies in identifying a nascent industry that has real development potential.

LUCILE RIVES

Thank you, Hervé Le Bihan.

HERVÉ LE BIHAN

Thank you, Lucile.

LUCILE RIVES

Thank you, Antoine Berthou.

ANTOINE BERTHOU

Thank you.

VOIX OFF

And thank you to all our listeners. In the next episode of Dialogue &co, Hervé Le Bihan and Antoine Berthou consider the economic consequences of US trade policy for the United States and also for France and the euro area. Don't forget to leave us your comments and stars on your podcast listening platforms. See you soon for the next episode of Dialogue &co.