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Economic Pessimism: No Excuse for Protectionism

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In his April 2 testimony before the Congressional Joint Economic Committee, Federal Reserve Chairman Ben Bernanke said that "it now appears likely that real gross domestic product will not grow much, if at all, over the first half of 2008 and could even contract slightly."[1] Adding to this guarded assessment of the U.S. economy, he cautioned that a recession is "a technical term"[2] determined by the Business Cycle Dating Committee of the National Bureau of Economic Research (NBER), which has not yet declared a recession.[3]

Indeed, 2008 began with intense speculation and predictions that the U.S. economy either is in or would slip into a deep recession. Worse, the ongoing economic pessimism has been further fueled by the exaggeratedly negative news and rhetoric that is typical in an election year.

In a time of economic uncertainty, responsible policymakers should be realistic rather than pessimistic about the future. Especially in this presidential election year, the challenge to Washington is not to get trapped in attempts at quick fixes of short-term problems at the risk of eroding the economic freedom that has been the backbone of America's prosperity. Congress must take a long-term view focused on strengthening economic fundamentals. Pessimism is not an excuse for burdensome regulation or protectionism.

What Is the State of the U.S. Economy? America's $13 trillion economy is certainly going through challenging times. After expanding for "the sixth consecutive year in 2007,"[4] economic activities recently have slowed due to major corrections in housing and financial markets. This is not pleasant, but it should be properly viewed as a normal and reasonable correction in the aftermath of an unprecedented economic boom.

In other words, the U.S. economy is going through the slowing part of a business cycle. This cycle is a key characteristic of our free-market system—the economic ebb and flow that defines dynamic entrepreneurship—as the growth rate fluctuates above and below its long-term trend. The cycle includes periods of relatively rapid growth of output and periods of relative stagnation or decline. True, an economic slowdown is not something anyone would welcome, but no country has yet perfected the art of perpetually high economic growth. Right now, the economy seems to be regrouping rather than advancing.

The generally accepted authority for determining when U.S. recessions begin and end is the Business Cycle Dating Committee of the NBER, a nonprofit group based in Cambridge, Massachusetts, that has 600 academic economists.[5] Interestingly, periods of recession seem to be getting shorter and more moderate in modern economic times. According to the NBER, which has not described the current eco-

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nomic situation as a recession, recessions have become shorter and less frequent. Since 1945, recessions have averaged just 10 months. The last two recessions were among the shortest and mildest on record; both the 1990–1991 and the 2001 recessions lasted just eight months.[6]

Throughout modern economic history, the multifaceted and dynamic U.S. economy has been on a path of continual change and adaptation owing to endogenous as well as exogenous factors, but trending always toward a higher and better state. Economist Joseph Schumpeter, the father of business cycles theory and "creative destruction," once elaborated, "It is by no means farfetched or paradoxical to say that 'progress' unstabilizes the economic world, or that it is by virtue of its mechanism a *cyclical process*."[7]

Still, no matter how "creative" the process is, the current slowdown is unpleasant and destabilizing for some economic activities. At the same time, however, the current slowdown is helping the market mechanism work to revalue inflated assets in the housing and financial markets on the basis of real economic fundamentals.

Pessimism Driving Protectionism: A Perilous Recipe for Our Economy. A key driver of our economic prosperity is a high level of flexibility and resilience founded on economic freedom. This has been continuously protected by keeping levels of regulation and government intervention low while emphasizing great transparency and strongly protected property rights.

Yet the truth is that economic freedom, like other freedoms, is always vulnerable. History tells us that this is never more so than when politicians are running for office and espouse populist rhetoric, playing to people's fears and calling for more government interventions that promise a quick fix to whatever is deemed faulty in a complex economy.

In 2008, voters deserve an honest debate about economic policies such as free trade, not populist bromides.[8] True, most voters are somewhat uneasy about the current economic slowdown. However, it may be a gross mistake to assume that they are comforted by alarmism and calls for more government action. According to a poll by Democracy Corps, more than 55 percent of 1,017 respondents agreed that "government makes it harder for people to get ahead in life."[9] The same study reveals that 54 percent of respondents perceived government as a "hindrance to economic growth."[10] Congress should not misjudge that, due to the current anxieties over economic slowdown, Americans would automatically support congressional actions for more direct government interventions.

More important, Congress should not use economic pessimism as an excuse for more protectionism. Some politicians argue that the benefits of

1. "Bernanke Sees Recession Risk," CNN Money.com, April 2, 2008, at *http://money.cnn.com/2008/04/02/news/economy/bernanke_testimony/index.htm?postversion=2008040210.*
2. Mark Felsenthal, "Bernanke: Recession Possible, Growth to Rebound," April 2, 2008, at *http://news.yahoo.com/s/nm/20080402/bs_nm/usa_fed_bernanke_dc.*
3. The NBER defines a recession as "a significant decline in economic activity spread across the economy, lasting more than a few months," and usually visible in measures such as gross domestic product, employment, incomes, and industrial production. For more information, see *The NBER's Recession Dating Procedure*, at *www.nber.org/cycles/recessions.html.*
4. *Economic Report of the President*, 2008, at *www.gpoaccess.gov/eop/index.html.*
5. Greg Ip, "What a Recession Could Mean to You," *The Wall Street* Journal, January 20, 2008, at *http://online.wsj.com/article/SB120078173684203245.html?mod=WSJBlog.*
6. *Ibid.*
7. "Schumpeter in His Own Words," *Economic Insights*, Federal Reserve Bank of Dallas, Vol. 6, No. 3, at *www.dallasfed.org/research/ei/ei0103.pdf.* Emphasis in original.
8. For more information, see Ambassador Terry Miller, "Trade Policy and Election Promises: Does the Rhetoric Match the Facts?" Heritage Foundation *Lecture* No. 1072, April 1, 2008, at *www.heritage.org/Research/TradeandForeignAid/hl1072.cfm.*
9. Al Quinlan, Michael Bocian, Stan Greenberg, and James Carville, *Getting the Public to Listen*, Democracy Corps, March 1, 2007, at *www.greenbergresearch.com/articles/1863/3330_Democracy_Corps_February_28_2007_Graphs.pdf.*
10. *Ibid.*

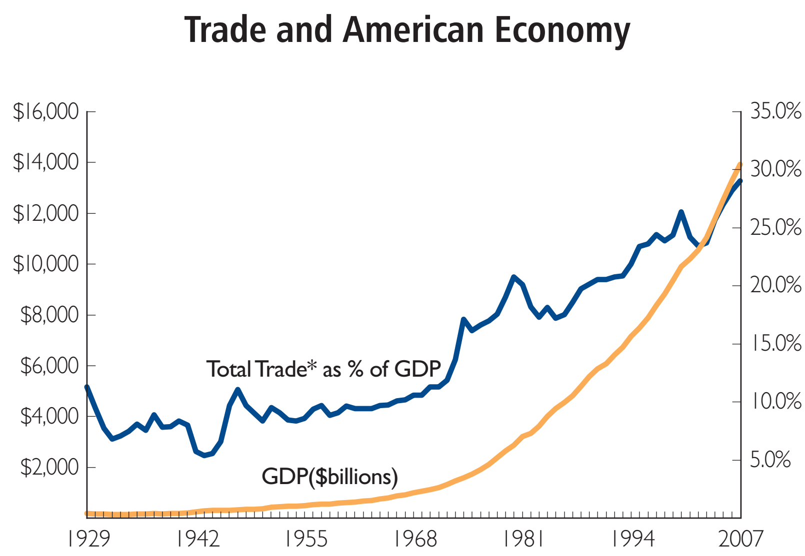
today's free trade system go unfairly and primarily to low-wage countries, which take jobs away from Americans. Such arguments are not supported by the facts. President Ronald Reagan once eloquently reminded Americans of this truth:

> A creative, competitive America is the answer to a changing world, not trade wars that would close doors, create greater barriers, and destroy millions of jobs. We should always remember: Protectionism is destructionism.[11]

America's economy, over the past few decades, has proved that openness coupled with flexibility makes the economic pie much bigger and that the benefits can be widely shared. Over the past 10 years, open trade has boosted job growth by more than 13 percent and has helped to raise U.S. GDP by nearly 40 percent.[12]

As Charts 1 and 2 demonstrate, trade has been the backbone of the U.S. economy, contributing almost 30 percent of GDP in 2007. The benefits go not only to workers and entrepreneurs in export industries, but also to consumers of imports. Free trade has delivered a greater choice of goods for people in all 50 states—everything from food and furniture to computers and cars—at lower prices. America is now the top exporter of services, consistently recording service trade surpluses since 1970. U.S. service industries account for more than 75 percent of U.S. private-sector GDP, creating 80.2 percent of U.S. private-sector employment.[13] Reflecting America's strength and flexibility, the service trade surplus has increased exponen-

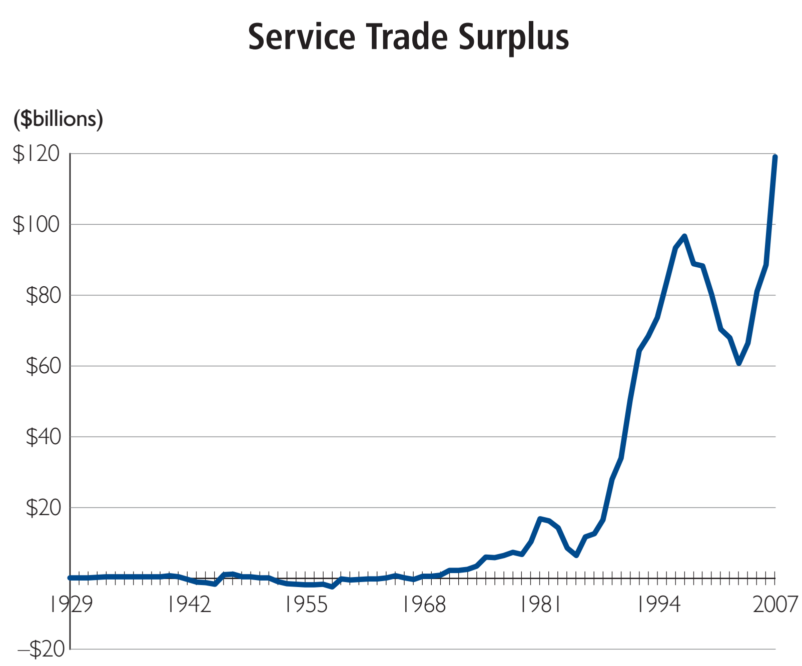
Chart 1 WM 1883



* Exports plus imports.

Source: National Accounts, Bureau of Economic Analysis, U.S.Department of Commerce, available at *http://bea.gov/national/nipaweb/index.asp.*

Chart 2 WM 1883



Source: National Accounts, Bureau of Economic Analysis, U.S.Department of Commerce, available at *http://bea.gov/national/nipaweb/index.asp* tially in recent decades and reached more than $100 billion in 2007, as Chart 2 indicates.

Unfortunately, this powerful force of dynamic economic expansion has been under growingly exaggerated doubts, suspected as being the root cause of every economic ill in recent years. But, according to a recent study conducted by the President's Council of Economic Advisers, no more than 3 percent of all job disruptions may stem from international trade, while 97 percent of job displacement is due to other factors such as productivity increases, new technologies, and innovation.[14]

Despite the fact that international trade, reinforced by the free trade agreements that have been implemented since 2001, has been one of the biggest drivers of economic growth,[15] Congress has all but shut down the trade agenda in recent months. But protectionist approaches or isolationism have been tried throughout history and have failed to create new and better jobs of the future. Protectionism might shelter old and outdated jobs, but it will not provide effective protection for those negatively affected by the business cycle or gains in productivity, or for those few whose jobs are lost to trade.

Conclusion. Without overreacting to the current economic slowdown, putting forward a long-term policy plan that strengthens economic fundamentals would calm fears among entrepreneurs and restore confidence. The temptation to fuel economic pessimism during an election year should be resisted, and the false virtues of protectionism should be rebuffed. As the economy goes through the downside of the current business cycle, Congress should remember that protectionism never protects. It is economic freedom that will promote new jobs and greater prosperity.

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11. Address by President Ronald Reagan before a Joint Session of Congress on the State of the Union, January 25, 1988, at *www.presidency.ucsb.edu/ws/index.php?pid=36035.*
12. Office of the United States Trade Representative, *The President's Trade Policy Agenda*, 2007, at *www.ustr.gov/assets/Document_Library/Reports_Publications/2007/2007_Trade_Policy_Agenda/asset_upload_file629_10624.pdf.*
13. U.S. Coalition of Service Industries, "Quick Facts," at *www.uscsi.org/Statistics/#facts.*
14. Office of the United States Trade Representative, *The President's Trade Policy Agenda*, 2008, at *www.ustr.gov/assets/Document_Library/Reports_Publications/2008/2008_Trade_Policy_Agenda/asset_upload_file490_14556.pdf.*
15. For more information, see James Roberts, "Want More Economic Stimulus? Pass the Pending Free Trade Agreements!" Heritage Foundation *WebMemo* No. 1830, February 27, 2008, at *www.heritage.org/Research/TradeandForeignAid/wm1830.cfm.*