Protectionism and the Business Cycle

by Alessandro Barattieri, Matteo Cacciatore and Fabio Ghironi

Discussion by: Fabrizio Perri
Minneapolis Fed

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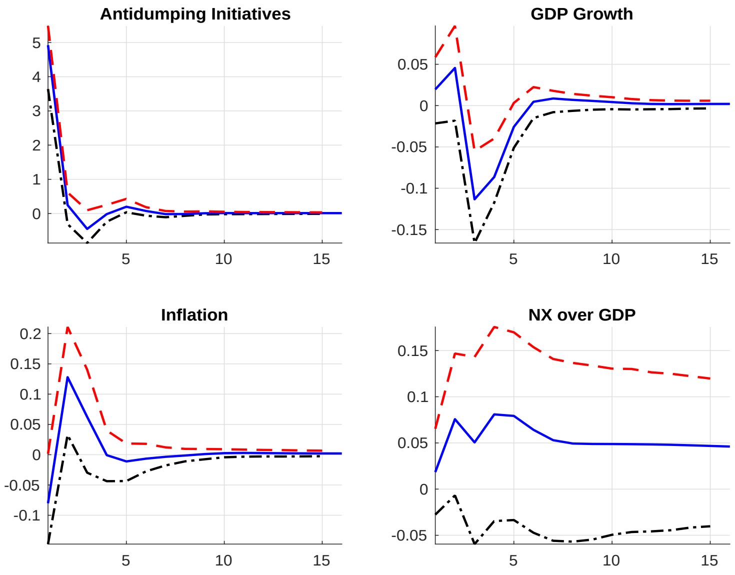
- Takeaway: increasing import tariff is a bad idea!

Outline

- On the empirics
- On the model
- Understating the case against protectionism?

On the empirics



Interpreting the size of the effect

- How is a increase in tariff measured?
- # of antidumping investigations initiated (some of which will lead to persistent and large increase in tariffs) on HS-6 product-country pair
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- A typical big item "940360 - Wooden Furniture For Other Use, from China" in 2015 is about 300 millions CD (No. 25 HS-6 import category from China)
- Estimate of value of shock to import taxed is about $300 * 5 = 1500$ millions CD, or 0.075% of GDP
- Estimated GDP impact is over 0.1%, implying large tariff multiplier for Canada, i.e. for every $ of import subject to tariff GDP falls by 1.25 $
- For Turkey (0.5% GDP decline, 1.5% inflation increase) potentially even larger!

Are these values plausible?

- Key VAR identifying assumption is that the increase in AD initiatives exogenous to economic activity.
- For an emerging market like Turkey this might be an issue
- Country enter a typical emerging market recession (i.e. long), sectors in crisis respond by soliciting AD initiatives, recession continues on
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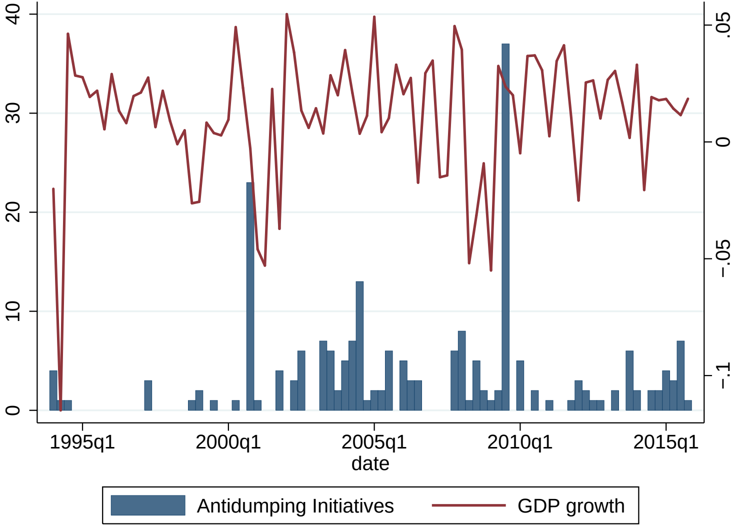
- VAR exercise might pick up part of the recession as "driven" by AD practices
- Suggestion: translate tariff shock into dollar values (also useful for quantitative comparison of data v/s model) and acknowledge that some of the estimated effects might be driven by reverse causation

AD initiatives and GDP growth in Turkey



- Spikes in AD initiatives towards the end of recessions

On the mechanics of the model

- Why taxing imports causes domestic GDP to fall?
- As price of imports increases, demand for (relatively substitutable) domestic varieties increase, domestic producers (albeit less efficient) should increase labor demand, leading to increase in domestic GDP
- Paper argues that two forces counteract this:
  - Interest rate response (hike in response to higher CPI) from the central bank
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- Permanent income fall main factor
- For this factor to affect GDP sticky wages essential (if wages not sticky lower demand causes a fall in wages but not in output)
- Suggestion: Highlight more the role of labor market friction

On additional cost from protectionism

- The paper limits its analysis to the case in which trading partner does not respond to tariff increase
- In reality an increase in tariff might trigger a tariff war, which might be have much bigger macro cost
- Perri Quadrini (2002) investigates whether the tariff war that followed the Great Depression could explain the poor performance of Italy in interwar years and conclude that a global tariff war (with labor market frictions) can generate drops in GDP exceeding 10%

Conclusion

- Excellent paper
- It makes a strong and well articulated case (both empirical and theoretical) that taxing imports has a detrimental effect on GDP