Book Reviews

Edited by Robert Herren

Trade Policy Disaster: Lessons from the 1930s. DOUGLAS A. IRWIN. Cambridge, MA: The MIT Press, 2012. Pp. xv, 195. $25.00.

Dartmouth economist Douglas Irwin is the among the foremost experts on the history of international trade. Beginning with his 1996 book, *Against the Tide: An Intellectual History of Free Trade*, Irwin has brought light to an area where there has been much darkness. In Paul Krugman's *Journal of Economic Literature* review of *Against the Tide*, he notes that the "… book is full of new insights and unexpected delights" - even for a prominent international trade economist such as himself. My sense is that Krugman, along with all trade economists, would have the same opinion of this book as it overturns conventional wisdom regarding the cause of Great Depression-era trade policy.

Originating with lectures delivered as part of the prestigious Ohlin Lectures at the Stockholm School of Economics, this book focuses on the the root causes of 1930s protectionist policies. While clearly a response to the Great Depression, the protectionist policies adopted during this period are often thought of as being the result of rent seeking by domestic producers. This is not the only possible cause, however, and Irwin's goal in this book is to identify more specifically the underlying cause. As he points out in the preface, our lack of understanding regarding the underlying causes of 1930s trade policy changes is problematic as that experience colors how economists expect similar downturns to proceed. Early commentaries by economists on so-called "Great Recession," for example, frequently expressed concern that the economic downturn would trigger a wave of protectionist policies. This did not occur, and Irwin suggests that a better understanding of the 1930s experience makes obvious why trade restrictions and exchange controls were unlikely policy responses to the "Great Recession".

To better understand the responses of individual countries to the Great Depression, Irwin first takes the reader through a brief history of the Great Depression in Chapter 1, focusing on the causes of the Great Depression and the timing of protectionist policies. He begins with the role of the gold standard in starting and transmitting the economic downturn. Irwin argues that the beginning of protectionist policies in

many countries was not in response to the United States passing the Smoot-Hawley Tariff Act in June of 1930 as is commonly argued. Instead the origin was the European financial crisis of 1931 that started in Austria and spread via banking systems weakened by deflation. (This is not to say that Smoot-Hawley was unimportant, just that it did not spark the subsequent trade war). The weak balance-of-payments position of Britain led investors to sell off pound-denominated assets, leading to a gold outflow from the Bank of England. Britain responded by going off the gold standard and floating the pound, which in turn caused other countries to respond with exchange controls (to protect their gold reserves) or tariffs and quotas (to protect domestic markets from cheap imports).

Irwin makes a strong case that the underlying cause of most protectionist trade policies during this period was the fixed exchange rate regime of the gold standard. Adherence to the gold standard was problematic because of the open economy trilemma, which states that open trade, independent monetary policy, and gold standard parity cannot be achieved simultaneously. For example, a country wanting to keep stable exchange rates can only have free trade by giving up control over domestic prices. Similarly, a country wanting stable exchange rates and stable internal prices can only do so through restrictions on trade. In good times, the trilemma was not problematic as countries happily gave up control over domestic monetary policy. Given post-1929 deflation, however, domestic price stability became preeminent, forcing policymakers to choose between the gold standard and free trade. Many countries chose the gold standard, which forced them to abandon free trade in order maintain domestic price stability.

The process by which countries tried to negotiate the trilemma is important to understanding why different countries chose different policies in response to the same economic pressures. After explaining in Chapter 1 how protectionist policies of the 1930s were often a policy response to deflationary pressures when adhering to the gold standard, Irwin devotes the remainder of the book to discussing different aspects and implications of the open economy trilemma and how it played out across a wide variety of countries. Chapter 2, in particular, is devoted to a detailed exploration of how different countries dealt with gold standard parity being incompatible with both independent monetary policy and free trade. What emerges from Irwin's discussion of the different country experiences is how much history explains the policy response. Countries

that had recently dealt with high inflation were more likely to stay on the gold standard in the belief that it would provide domestic price stability, which in turn made foreign exchange controls or import restrictions inevitable.

Chapter 3 is an empirical look at three issues related to the open economy trilemma. First, Irwin looks at the role of protectionism in explaining the 25 percent decline in world trade during this period. Using several different calculations he estimates that roughly half of the decline in world trade can be explained by higher trade barriers enacted as responses to the deflation of the Great Depression. Second, he finds evidence for a prediction of the open economy trilemma, namely that countries staying on the gold standard use trade restrictions more than countries abandoning it. Finally, he explores the larger macroeconomic consequences of each country's policy choices with respect to the open economy trilemma. Irwin convincingly shows that it mattered for economic recovery whether a country chose to abandon the gold standard, concluding that (p. 142), "trade restrictions proved to be a poor substitute for exchange rate and monetary policy changes as a means of promoting recovery."

In the fourth and final chapter, Irwin reinforces the point that the protectionism of the 1930s was the result of the inability to have fixed exchange rates and free trade in a deflationary environment. He wants scholars to focus less on protectionism and more on its underlying cause, the unwillingness to move away from fixed exchange rates. Irwin then concludes by speculating on why there has been so little protectionism in response to the Great Recession. While he gives many reasons, the most important is that fixed exchange rates are no longer considered to be a preeminent policy goal in a world of floating exchange rates.

I learned a lot from *Trade Policy Disaster*, which is not surprising considering that I am a public sector economist, not an international economist. Beyond exposure to the open economy trilemma, however, Irwin's careful scholarship convinced me I was giving too much weight to political economy concerns as being a driver of 1930s-era protectionism. In my opinion, any book that goes beyond providing information and instead changes opinions is well worth reading.

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