Protectionism: The Rising Tide
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Protectionism: The Rising Tide

After a number of false starts, there are now indications that a sustained, albeit anemic, economic recovery is in the works. This surge in activity is good news to the millions who fill the ranks of the unemployed, which now compose over 8 percent of the U.S. labor force. But the implications extend beyond the shores of the U.S. With imports comprising a full twelve percent of national income, a recovery in the U.S. and the other industrialized nations of the Organization for Economic Cooperation and Development (OECD), will expand the markets for the exports of the less developed countries (LDCs). As a result, these countries will be in a better position both with respect to growth, and their ability to meet their international debts.

All, however, is not well, for there are a number of developments that could stifle world recovery. One of the most critical variables is the threat of protectionism. In the depths of the recession last summer, there were murmurs of "unfair trade." It would have been surprising if, in the third year of a prolonged recession these murmurings had not been heard. Recessionary times have always been the breeding grounds of trade wars. That does not make them any less troubling. As Detroit was battered by low consumer demand, Japan's highly visible auto imports (which now hold 30 percent of the market) was a convenient focus of resentment. The American Midwest, long characterized as the world's granary, was also enduring one of its most serious trials since the Depression, as farm income plummeted, and farm failures rose to record levels. In this context, the European Community's (EC) unprecedented agricultural surpluses, and consequent exports, provided yet another scapegoat. While the recovery may well be on the way, there is no assurance that these pressures for protectionist measures will disappear. Indeed, there are a number of reasons to believe that they will persist indefinitely, although in a less virulent form.

For as the hot Washington summer wore on, the battle cry was heard— the cry for 'reciprocity.' Reciprocity in the past, under the framework of the General Agreement on Tariffs and Trade (GATT) meant that equal and proportional reductions in trade barriers would be the guiding principle in trade negotiations. In the new "get tough" lexicon, reciprocity involved *raising* trade barriers to promote free trade.

To understand this paradoxical stance, one must follow a particular line of reasoning. The U.S., reciprocity proponents argue, already has fairly open markets. As a consequence, the U.S. lacks sufficient leverage in negotiating increased access to foreign markets. New "temporary" barriers, or the threat thereof, are necessary to redress these imbalances. Such an approach, as reflected in the 1982 Danforth bill (S 2094) was not an extreme one on Capitol Hill. Some ideas floating around involved the concept of "approximately equal" flows as a criterion of "free but fair trade." Other movements in Washington included the domestic content bills of Congressman Ottinger (HR 5133) and Senator Ford (S 2300). These bills would have required that a certain proportion of imported automobiles be built with U.S.-manufactured parts.

On top of these initiatives, semi-official measures have been imposed. Under Congressional pressure, the Administration agreed to negotiate an extension, for a third year, of a voluntary restraint agreement (or VRA) with Japan to limit the number of autos that could be imported into the U.S. to 1.68 million units. Recently, Europe responded similarly to the influx of Japanese video cassette recorders, curtailing imports to 4.55 million units per year. The end result is that although there is some indeterminate and short term retention of employment in protected non-competitive industries, consumers will pay more for goods.

The question is to what extent protectionist pressures are responses to actual injury due to unfair trade practices, such as dumping (selling at below cost), as opposed to merely the self-interested calls for protection of inefficient industries. In assessing the phenomenon of increasing protectionism, a look at the numbers may be useful.

In 1981, the U.S. imported $40 billion worth of goods from Japan, and exported $22 billion. This imbalance in the merchandise accounts is a favorite topic of those crying "unfair trade." Such allegations are usually buttressed by charges that Japan, through its Ministry of International Trade and Industry (the infamous MITI), uses tax breaks to subsidize exports that in turn deprive Americans of their jobs. At the same time, it is charged, Japan maintains high and effective barriers to imports into their country, especially in fruits, beef, tobacco and in cases where government procurement is involved.

As is recognized in most academic circles, trade balances are a very questionable means of assessing the "fair trade" practices of a country. Focusing on the trade between two countries, the bilateral trade balance, to the exclusion of the overall trade balance is even more misleading. On this point, the U.S. overall trade balance was only SDR23.82 ($28) billion in deficit, in which case OPEC oil imports could bear equal "blame" for the problem. The more relevant figure is the trade in both goods and services, plus net dividends from U.S. investments overseas, in which case the U.S. (in 1981) came out with a surplus of $4.2 billion.

If one must look at bilateral trade balances, it is interesting to note that, proportionally, Japanese merchandise imports comprise 1.9 percent of GNP, while for the U.S., that same ratio is only 1.3 percent. Taking into estimation the trade in services, the bilateral current account also shows a more balanced picture: a net services surplus of between $1.9 and $3.4 billion (depending on whose figures are used).

This is where one document illustrates the hazards of accepting the "conventional wisdom," as promoted by reciprocity enthusiasts. The *Report of the Japan-United States Economic Relations Group* is a remarkably insightful work, which represents the views of the so-called "wisemen's group," established by then President Carter and the late Prime Minister Ohira. The *Report* concludes that:

> "The trade imbalance reflects structural differences

between the two countries and would exist even if there were perfect access to the Japanese market for American products, or if American economic policies were well managed. It reflects an efficient allocation of resources for the two countries."

The report finds other variables much more critical in explaining the current accounts imbalance. These factors include the higher savings rate in Japan (twice that of U.S. households) which promotes higher overseas investment flows, the exchange rate—where the U.S. dollar is overvalued—and energy costs. On the last point, the fact that Japan must import 99 percent of its petroleum needs probably has some ramifications for the Japanese propensity to export.

Overall, the impression that the Japanese market is hopelessly closed off is an outdated one, and runs counter to the opinions of many businessmen. A report of the U.S.-Japan Trade Study Group, performed by a private consulting firm, concluded that the U.S. has penetrated Japanese markets much more than is widely acknowledged. A great part of the failure to sell more is the lack of American business initiative in adapting to local conditions, as the Japanese have done in the United States and other markets. It is a shortcoming which has its roots in the size of the domestic market which, historically, has been sufficiently large for American industry. Only lately has this problem been recognized, and both the U.S. International Trade Commission and the Congress have been taking steps to facilitate private export initiatives.

Still, resentment is mounting, even while the Japanese have accelerated the removal of trade barriers, as agreed to in the Tokyo Round of the Multilateral Trade Negotiations (MTN) which took place from 1973-79. These concessions have gained only moderate prominence in the American press. And yet, the *Report* concludes that ". . . in terms of average tariff levels and quotas on manufactured products, Japan's market at the end of the phasing in of current tariff reductions in 1987 will be no more closed than that of the United States." While informal barriers such as a byzantine domestic distribution system and design (as opposed to performance criteria) constitute real impediments to trade, the problems they pose are also slowly being resolved. TheJapanese have established an Office of Trade Ombudsman, as well as specific consultative groups to deal with forestry, high-tech, beef and citrus products. The announcement last March of liberalization of 17 trade-related codes represents yet another instance of tangible progress.

Yet, a more typical attitude is expressed in the U.S. Trade Representative's (USTR) report issued last November. While accepting the recent liberalizing moves of the Japanese government, the report, entitled *Japanese Trade Barriers* paints a dark picture of the situation, replete with excessive agricultural quotas, government obstinacy, and a corporate system of business (and more specifically procurement) which does not parallel U.S. practices. In criticizing Japanese agricultural trade policies, the report makes no mention (and probably properly so) of U.S. Federal marketing orders, which constitute effective non-tariff barriers (NTBs) to trade through specific quality and quantity standards. Moreover, while USTR lauds the opening up of Japanese government procurement practices to foreign bidding (as in the case of the Nippon Telegraph and Telephone), it omits any comment on the biased procurement policies of the U.S. government embodied in the *Buy American Act*.

While much could be said about the case of Japan, resentment is by no means restricted to that country. Despite a $10.7 billion trade surplus with the European Community, a certain number of practices have raised the ire of several groups in this country. At the center of the maelstrom are industrial and agricultural export subsidies.

In agriculture, the EC's common agricultural policy (CAP) has consistently boosted output, even while high supports have translated into higher food costs in Europe. Since these agricultural products are so high-cost, they cannot be exported without a subsidy to make them competitive with, for instance, U.S. exports.

The failure to reach a substantive accord at the GATT ministerial meeting in November of 1982 only increased American willingness to retaliate against such policies. The U.S. recently announced the sale of 1 million metric tons of grain to Egypt, with supporting loans at two percent below market interest

Headed toward troubled waters

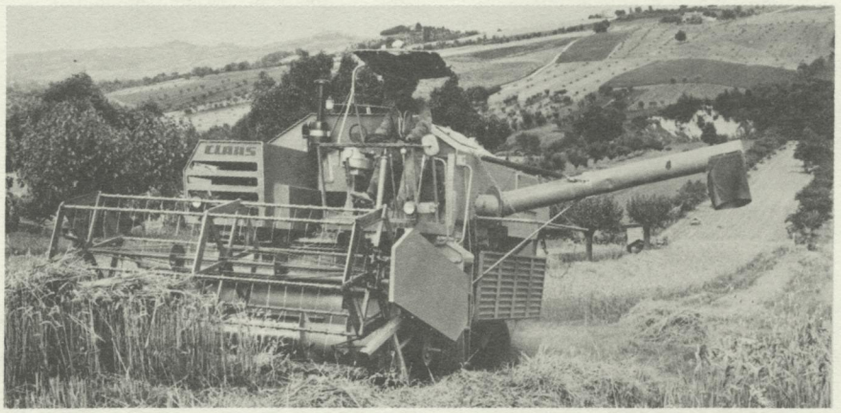
rates. The Reagan Administration openly declared this a warning shot over the EC bow, although on this issue, the U.S. is on thin ice. Public Law 480 ("Food for Peace") has mandated sales of surplus U.S. agricultural production below cost to LDCs for years.

On another front, with over a hundred complaints filed by steel companies against European imports, the U.S. International Trade Commission (US ITC) is also hard pressed to absolve the Europeans from guilt on "dumping." That is hard to absolve politically. The US ITC eventually agreed that there was injury, and the "trigger price" mechanism which had regulated imports of steel is now being replaced with a formal quota.

Unfortunately, such measures will probably help the domestic steel industry only marginally, and make less competitive on world markets the industrial users of steel—automobile manufacturers, shipbuilders and the like. Quotas such as those just imposed tend to promote imports of higher quality goods, such as specialty steel—exactly those areas in which the U.S. should be concentrating its competitive energies.

Frustration is also building over European subsidies for other exports, like commercial aircraft, and other big-ticket items. Last July, the members of the OECD agreed to keep export credit rates above 11 percent, and to limit other concessionary lending terms. As interest rates have fallen, the room for maneuvering has also shrunk, and there are allegations that some members, especially the French, are violating the agreement. All these have lent impetus to Congressional support for a "war chest" to fund export credits. Even old-time opponents of the Export-Import Bank (Ex-Im), like Congressman David Obey have joined the rolls of Ex-Im enthusiasts.

Subsidies can also exist in the form of lower tax rates on export income. A 1977 study by the National Planning Association found that the effective U.S. corporate tax rate on export income was 27.4 percent, while the French rate was 8.7 percent and the Japanese, 17.9 percent. In contrast, Germany's effective rate was 39.7 percent. In any event, these sort of figures have buttressed demands for action. In Congress, expansion of DISCs (Domestic International Sales Corporations), paper companies that provide tax exemption on a certain portion



of corporate income, was considered, even though a GATT council had ruled them illegal. Now, the Reagan Administration is proposing a modification of DISCs, which would make them legally acceptable to GATT, though it threatens to exacerbate the use of export subsidies even more.

Although Japan and Europe attract most of the unwelcome attention of U.S. policymakers, the LDCs also receive their share. It is true that the Multifiber Agreement (MFA) has been restricting textile markets, a major LDC export, since 1974. But recently, pressures to organize markets have increased—perhaps not so much in orderly marketing arrangements (OMAs), as much as in extra-GATT "voluntary" restraint agreements. Such agreements often have the implicit threat of a quota behind them, and raise prices to consumers just as effectively as a tariff or a quota. William Cline, an economist of the Washington based Institute for International Economics, estimates that up to one-third of the U.S. market is affected by such arrangements, which cover everything from footwear to televisions.

Most recently, the U.S., in its review of the Generalized System of Preferences (GSP), reduced the amount of goods that the LDCs could import into this country duty-free. Originally, $8.4 billion worth of goods from 140 LDCs were covered under this authority. Some measure of protectionist sentiments can be garnered from the Administration's admission that such cutbacks were made to head off even more severe demands for import restrictions when GSP authority comes up for Congressional renewal (in 1984).

The irony is that even as the U.S. and other Western nations are seeking to limit access to their markets, the U.S. is demanding that LDCs earn their way out of debt through exporting. And while the West is the largest market for LDC exports, the Third World is the outlet for one-third of U.S. exports. Unfortunately, if LDCs don't have the foreign exchange from exporting to the West, they certainly won't be able to import from the U.S. Since an estimated 4.8 million Americans rely on export-related jobs for their livelihood the dangers of the "beggar thy neighbor" policy that many nations are now following are obvious.

The trend for LDCs to export higher and higher level technology items ensures that the West will have to face a long period of adjustment, even after the recession of 1979—83. It is not only the U.S. and the EC which will have these problems. Newly industrialized countries (NICs) such as Korea also trouble Japan's low technology industries. Steel production is far below full capacity utilization there, but the media prefers to focus on the problems wreaked by "Japan, Inc.," on the West. The reality is that the development of the Third World means the inevitable decline of many older industries in all the OECD nations.

In this context, the quick fix, of the "countervailing tariff," "voluntary" restraints, and the like, will only mean higher prices for consumers in the short run, and greater distress in the long term. "Reciprocity" and Japan notwithstanding, protectionism will only prove a temporary, and costly, palliative for inefficient industries, in a world populated by NICs, MICs and ADCs.*

* MICs are middle-income countries, while ADCs are advanced developing countries. All of these represent LDCs with significant industrial sectors capable of producing medium—technology level goods such as steel and televisions. □