Protectionism—Not Worth It

By Nobuyoshi Namiki

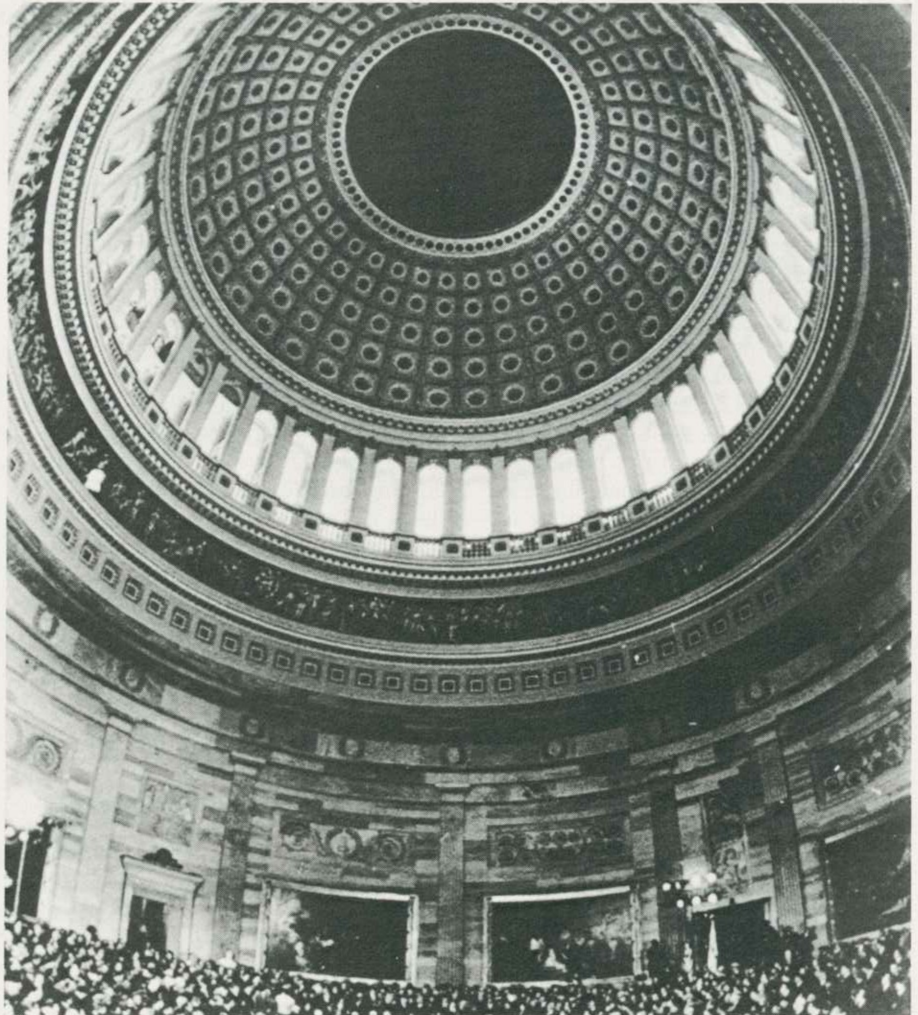
When the Great Panic shook the world half a century ago, John Maynard Keynes said that what Britain needed to do was to restrict imports and raise import tariffs, thereby protecting British industries and maintaining employment. This statement may sound strange in light of the so-called Keynesian economic theory which he was to develop later. Needless to say, around the same time he also advocated increased public spending for housing, roads, and railways.

History shows that the first of these led to the institution of preferential tariffs for British Commonwealth nations and to the division of the world economy into blocs, while the second became the cornerstone of Franklin D. Roosevelt's New Deal philosophy.

But even Keynes was influenced by the times. His primary concern was the interests of the United Kingdom alone, and he gave only secondary consideration to the possible adverse effects on the global economy of the measures he advocated. Today, half a century later, politicians, acting in the interests of their own constituencies, are drafting import restriction legislation out of transitory and short-term considerations. These politicians are making no attempt to weigh the effects of their shallow thinking on the world economy.

Although already in decline, Britain in the days of Keynes had international status far greater than today's United Kingdom. The United States today occupies a position of overwhelming strength in the international community, far surpassing that enjoyed by Britain in the days of Keynes. Countries in leadership positions, particularly the present United States, should not abuse their power for short-sighted, self-interested gain.

The following scenarios investigate the possible state of the world economy after U.S. import restrictions.



Protectionist moves rising in the U.S. Congress

Import surcharge or export surcharge

Proposed American congressional legislation to restrict imports falls into two broad categories: legislation to restrict imports of specific items, such as textiles, and legislation to limit imports in general by imposing a uniform 25 percent surcharge on all products from all countries.

The U.S. president would most likely veto legislation to restrict specific imports. Such laws would obviously violate GATT (General Agreement on Tariffs and Trade) and would erode American leadership in international economic policy-making. This in turn would postpone indefinitely the start of a new round of multilateral trade negotiations. Loss of leadership in international economic

Nobuyoshi Namiki, a director and the chief economist at the Japan Economic Research Center, is a leading expert on Japan's industrial structure. He is also an editorial writer for the Nihon Keizai Shimbun.

policy-making would weaken American authority and prestige in international politics.

Yet if the U.S. president were to veto a succession of import restriction bills passed by Congress, the protectionists might become irritated enough to introduce an across-the-board import surcharge; the surcharge currently being discussed is targeted primarily at Japan, but it is reported that three other nations are also on the blacklist. If the surcharge clearly discriminates against Japan, however, Japan could conceivably institute an export surcharge even while the U.S. president was taking action to veto the American measure.

Using the revenue from an export surcharge, Japan might establish an import subsidy fund or reduce income, investment, and housing taxes in order to stimulate domestic demand. A 5 percent surcharge on exports would mean more than ¥2 trillion ($10 billion) in additional revenue for the government. The imposition of a 10 percent surcharge would bring in ¥4.5 trillion.

It appears unlikely that the trade imbalance problem on the American side will be resolved simply by the dollar depreciation resulting from the coordinated intervention in foreign exchange markets agreed upon by the G-5 (finance ministers and central bank governors of five advanced countries) in September 1985. Even with such intervention it will take the U.S. trade imbalance two or three years to improve, and so the protectionist moves in the U.S. Congress are likely to continue.

Hopefully the trade imbalance will be cured by a combination of a Japanese export surcharge and import subsidies. If the revenue from a 10 percent export surcharge were channeled into an import subsidy fund, it would mean an effective 20 percent appreciation in the yen's exchange value vis-à-vis the dollar. If the surcharge revenue were used instead to cut taxes, it would substantially boost domestic demand.

But this is not the only, or even the most likely, possibility. Should the U.S. Congress stand fast on imposing a surcharge on imports, two other cases are also conceivable: In one, the U.S. would introduce a surcharge exclusively on imports from Japan. Or, the U.S. could impose a surcharge on imports from all advanced countries, and these countries would in turn take countermeasures.

It is unlikely that the U.S. would make developing countries the direct target of import restrictions. However, the repercussions of a trade war among advanced countries would devastate the developing world.

The finance ministers of five major Western industrial countries, known as the "Group of Five," met in New York September 22 to discuss coordination of monetary policy.

Import surcharge effects: Japan only?

Let us first consider a scenario in which the U.S. singles out Japan and imposes a 25 percent surcharge on imports from Japan.

According to a simulation analysis using the *Nihon Keizai Shimbun's* NEEDS (Nikkei Economic Electronic Databank Service) model, Japan's current account surplus in fiscal 1986 would decrease by $16.08 billion as compared with the base standard case, lowering economic growth by 2.1 percentage points. If the U.S. continued the surcharge, Japan's current account surplus in fiscal 1987 would decrease by $19.9 billion compared with the base level, lowering the country's economic growth rate by 3.0 percentage points. Continued imposition of a surcharge would almost halve Japan's current account surplus and pull down its economic growth rate from 2% in fiscal 1986 to 1% the following year.

The decrease in imports from Japan would also cause inflation in the U.S. and reduce U.S. exports to Japan. However, it is impossible to simulate this effect by itself, as a model capable of such analysis does not presently exist.

An econometric model generally uses only economic variables. However, an economy is itself a part of historical development, and is influenced by numerous variables other than the economic ones. Above all, the psychological factors which influence economic decision-making cannot be programmed into an econometric model, and this makes the reading of simulation results difficult. For instance, the NEEDS model predicts that Japan would suffer most from a U.S.-imposed surcharge, but in actual practice, the outcome would probably be quite different.

If the U.S. imposed a 25 percent surcharge on imports from Japan, the effect would be the same as if the yen's exchange rate, the base of calculation for Japanese exporters, went from ¥240 to the dollar to ¥192. In previous yen appreciation phases, the yen's value rose to ¥201 to the dollar in fiscal 1978, to ¥230 in fiscal 1979, and to ¥217 in fiscal 1980, for an average of ¥216. The difference between ¥192 and the average ¥216 is 11%, while the difference between ¥192 and ¥201 is only 4%. It is not beyond the ability of Japanese exporters to absorb these shifts, as the past record of Japan-U.S. trade has shown. Simulation with an econometric model is nothing more than a mechanical application of price elasticity.

Japanese exports to the U.S. would probably decrease, not because of pure profit considerations, but as a psychological reaction to the strong U.S. stance. The extent of the decrease, however, is likely to be less than the above simulation suggests.

Depending on the circumstances, Japanese exporters might raise their dollar-denominated export prices. The price elasticity of Japanese export goods is low. This means that, because Japanese goods have features which cannot be found in the products of other countries, export volume would not fall even if prices were raised slightly. In short, the U.S. aim of braking imports from Japan would not be achieved. Moreover, even assuming that Japanese products possessed no distinctive characteristics and

exports of them to the U.S. did drop, higher prices for Japanese goods in the U.S. would simply cause imports from other countries to increase. The U.S. would not in any way gain from imposing a surcharge on imports from Japan.

The above is a scenario of what would happen if the U.S. one-sidedly imposed a discriminatory surcharge on imports from Japan and Japan went meekly along with it. Japan, however, also has the option referred to earlier of responding with a surcharge on its own exports. The export surcharge would have to be imposed not only on exports to the U.S. but on exports to other countries, or else Japan would be left open to severe criticism from the EC and other countries.

An export surcharge of about 5% would not affect Japanese exports much. Indeed, Japan's annual current account surplus might increase by some $5 billion as a result of the so-called J-curve effect, even though the economic growth rate would drop about 0.2 percentage points. A rise in prices of American imports from Japan would send the prices of America's imports from other countries climbing, eventually touching off price hikes by domestic American companies as well. Inflation would be the certain result.

There are some in the U.S. who think their country should take advantage of its strength to impose an import surcharge. They might consider the possibility of Japan imposing an export surcharge on its own exports as a countermeasure. If the two measures are placed side by side, it is immediately evident that it is the proposed American move which is high-handed and one-sided and cannot win international approbation. Yet should Japan institute an export surcharge, America would gain nothing. Cool-headed theoretical thinking is essential to the high-stakes game of international economic policy-making.

Global protectionism: deadly

If protectionism swept the advanced as well as the developing countries, what kind of impact would it have on the world economy?

As should be evident already, I do not think for a moment that these dire forecasts are correct. No country other than the United States is willing to become the standard-bearer of protectionism. This is because other nations sense the crisis of protectionism engulfing the world.

The following is presented not as a possibility but as the worst conceivable scenario which must be prevented at all cost. The model used in this analysis is the global economy model developed by Japan's Economic Planning Agency. It was developed and refined from 1979 through 1983, and its first simulation results were announced in 1985. It is a quarterly model linking trade-related models developed for each of nine countries (Japan, U.S., West Germany, Britain, France, Italy, Canada, Australia, and South Korea) and six regions (Asia, Middle East, Latin America, Europe, socialist countries, and the rest of the world). This may well be the best model available today. However, because of the intrinsic limitations of such models, this one naturally is not without constraints. Therefore, the results of this simulation were simply used as a base for a composite model incorporating similar calculations from other sources and reflecting my own phenomenological approach. The basic case used was the five-year, medium-term forecast worked out by the Japan Economic Research Center.

The results are shown in the diagram. It assumes the major advanced countries adopting measures resulting in a 5 percent contraction of their imports. Unlike a bilateral case involving only Japan and the U.S., in a situation affecting all major countries each country need only impose light import restrictions because the overall trade contraction psychology will have strengthened. For instance, initial measures to cut imports by about 2% would actually result in a reduction of around 5% because of repercussion effects, and can be considered the equivalent of a case in which all countries simultaneously adopted an import surcharge of 5% or so.

This cutback in imports would deteriorate the economic environment in each country. It would reduce private equipment investment and household disposable income, slacken economic growth rates, and ultimately cause global trade to shrink. As is evident from the diagram, prices of primary products would be hit the hardest of all. This would deal a lethal blow to developing countries, which depend on exports of primary products for their survival. Some debtor nations would be forced into effective bankruptcy, further fanning confusion in the international financial market.

This scenario makes it clear that import restriction measures must be avoided at all cost. However, even without such measures, other problems still remain.

Japan should liberalize imports of all agricultural products, excepting only rice, and of all manufactured goods. In addition, it should abolish all tariffs. And even for rice, Japan should take medium- and long-range market-opening measures to gradually reduce the government protection currently extended to rice producers.

The United States, for its part, should try to reduce its huge budget deficit, bring down high interest rates, and moderate the dollar's excessive exchange rate. It should beef up its supply capacity, increase savings, and thus improve the trade imbalance. American corporations must change their management philosophy drastically and pay greater attention to improving labor-management relations. Together, all these measures would help pull Japan-U.S. relations through the current crisis and would spare the world economy the ruinous effects of protectionism. ●

Impact of Import Restrictions on the World Economy