

The Dangers of Local Protectionism

By Kimura Fukunari

Unclear Future of Japanese Trade Policy

While searching for a new direction, current Japanese trade policy has become a mixture of active liberalization and local protectionism. From the government's actions of the last three years to create a framework for multi-layered international trade policy, it is clear that it intends to link foreign trade policy with active domestic structural reform, through its efforts to achieve free trade agreements. As a beginning, a free trade agreement with Singapore is to be concluded within the year. Meanwhile, protectionist actions have also become obvious, including the recent provisional safeguard measures instituted for welsh onions, fresh *shi-itake* mushrooms and rushes used to weave *tatami* mats (*tatami-omote*).

These recent provisional safeguards are related to agricultural products, but the context is somewhat different from past agriculture protection which traditionally took the form of securing food safety, environmental protection and other multiple-purpose functions. These three safeguard products were originally only subject to 3% to 6% tariffs and were not included under the sheltering trade protection umbrella. But this has now developed into provisional measure implementation, in service to political demands from certain fairly narrow locales. This movement was initially interpreted as a rather obvious vote-winning tactic preceding the Upper House election, and was not even well received among officials at the Ministry of Agriculture, Forestry and Fisheries (MAFF). The background for this may also include the decline in leadership power of the senior members of parliament from the ruling party who manage agricultural policy, for better or for worse.

However, the Upper House election is over, and the tone of the debate involving safeguards has changed

somewhat. Since the mass media have reported extensively on safeguards, the good thing is that the general public has come to understand the nature of protectionism. On the other hand, however, there developed an atmosphere that anything would be allowed as long as it meets the regulations of the World Trade Organization (WTO), and more and more industries and companies would try to achieve second and third safeguard measures. Since the Ministry of Economy, Trade and Industry (METI), which is supposedly continuing to promote free trade, is also maintaining safeguard demands from industries within its jurisdiction, reasonable decisions cannot always be reached in inter-ministerial deliberations. While the protectionism movement may not be strengthening in Japan overall, a dangerous sign is the tendency for local protectionist demands to make it through the government. We need to take this opportunity to clearly reaffirm why free trade is so important.

The Trap of Protectionism

Various protectionist foreign trade policies have factors that would benefit the parties seeking protection. In fact,

because of this, it can come to be seen as a habit-forming activity much like a drug addiction.

To begin with, the expense incurred by trade protection is not readily noticeable. Although at first glance the cost of trade protection seems only to lie on the foreign producers and exporters, in fact the main effect is a rise in the domestic price of the commodity being protected. However, the price hike is very hard to recognize as it is spread among all of the consumers and producers in other industries who consume the product directly and indirectly.

Moreover, even if the cost of trade protection is properly understood, a mechanism of political economy goes into effect and the slight cost spread evenly to everyone in the country tends to be taken lightly. Then priority is given to the opinion of a small number of producers who reap big profits from protection. As illustrated in Figure 1, the political process for typical trade protection involves a small number of people who demand protection, while the large majority of people bear the cost of the protection. If decisions were simply made by national referendums, the trade protection policies would not

Figure 1

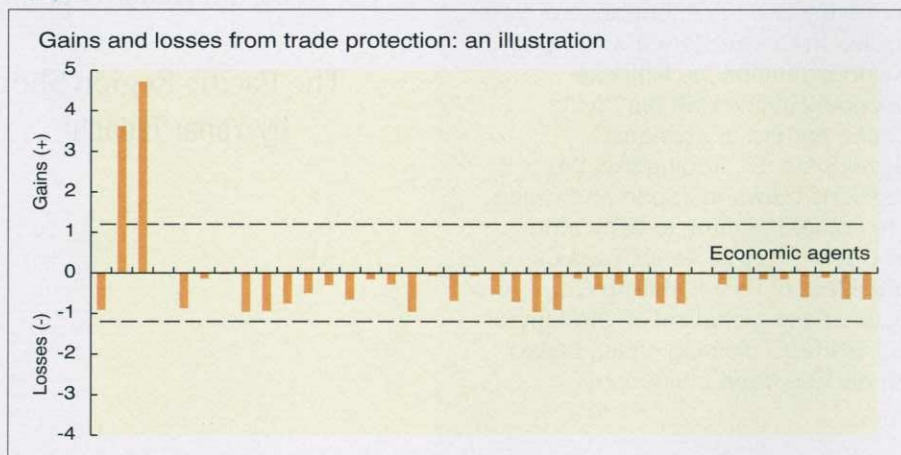


Figure 2

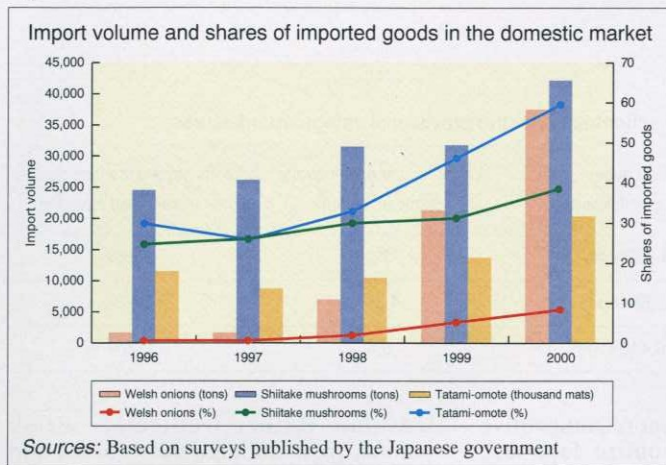
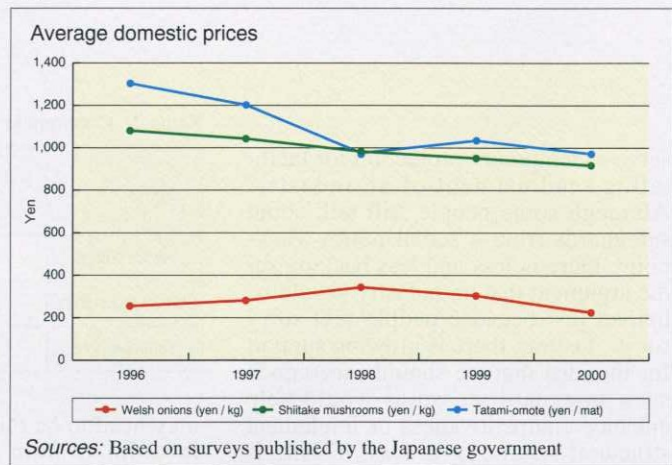


Figure 3



be adopted. However, in order to exert influence on a policy in the actual political process, a particular expense called a "voting cost" is necessary. If a voting cost of the size shown in Figure 1 is expended (expressed by the horizontal dotted lines drawn at 1.2 and at -1.2), only votes in favor of protection will be made, and the protection policy will end up being adopted. Thus, it often happens that the true national interest, which is thin and broadly based, is not reflected politically.

Whether a trade protection policy is really a suitable method for protecting a certain industry must also be taken into consideration. Theoretically in most cases, providing domestic producers with direct production subsidies rather than raising domestic prices overall with a trade barrier minimizes the loss to social public welfare. In the case of a production subsidy, since consumers can keep enjoying the low price corresponding to the international price, the burden of the protection policy is minimized. The reason that trade protection policies are still usually chosen is that, because the cost of protection cannot be easily seen, it is more politically feasible. If subsidies of millions or tens of millions of yen are distributed to each farmer as a production subsidy, naturally more people will think it is unfair. Although the consumer pays more for a trade protection policy than would be needed for a production subsidy, this usually goes unnoticed. Since trade protection policies meet with little political resistance, they can be seen as policies that take advantage of people's lack of knowledge.

When trade protection policies proliferate, not only is the efficiency of the market mechanism ruined, but the dynamism whereby economic structure

changes over time through competition is also lost. The sweet taste of honey, in this case maintaining the status quo, once enjoyed, is not easily forgotten. Trade protection policy should be strictly limited to cases in which a clear market failure exists and enough future profits to offset the expense of a protection policy can be expected, and should be enforced through public attention and monitoring.

The Debate over Safeguards

Since 1995, Japan has already implemented around 30 special safeguards based on the Uruguay Round Agreement on Agriculture. Compared with general safeguards, the requirements for special safeguards are less stringent, retaliatory actions are not permitted, and there are also no stipulations for compensatory measures. Although the duration of a special safeguard is a maximum of one year, there are no restrictions on its reintroduction, and many special safeguards are repeatedly renewed. When compared to the special safeguard, far more transparent information is provided for the current provisional safeguard measures based on general safeguards, and they become an object of discussion for the general public. This should be considered a positive thing.

The Japanese government has been continually emphasizing that it is adhering to WTO regulations, specifically Article XIX of the General Agreement on Tariffs and Trade 1994 and the Agreement on Safeguards, with regard to Japan's recent provisional measures for three agricultural products. However, some jurists are pointing out potential legal problems including the definition of domestic indus-

tries, proving a causal relationship between imports and alleged damage, and the interpretation of "like products." Figures 2 shows the volume of imports and the change in the domestic market share for the three recent safeguard products in the past five years, and figure 3 shows the change in the average domestic price, based on data released by the government. Although the volume of welsh onion imports has certainly increased rapidly, the domestic market share for imported welsh onions is still low, and the fall in the domestic price has not been remarkable. Although the volume of imports and the domestic market share for imported fresh shiitake mushrooms have certainly risen, the drop in the domestic price has been mild. The problem is that a deterioration of profits for domestic producers had already begun in 1996 and 1997 before the rapid increase in imports. As for tatami-omote, although the rise in the domestic market share of imported tatami-omote is remarkable, part of the cause is the declining trend in domestic production. The profit deterioration for domestic producers also began in 1996 and 1997. Although further detailed analysis is required, it seems questionable whether it can still be proved that serious injury has resulted from, or is likely to result from, the rapid increase in imports, even when taking into consideration various market factors other than the rapid increase in imports. In any case, let us wait for future government announcements regarding these issues, and instead review the recent debate from the viewpoint of economics by going back to the original purpose of safeguards.

It has become generally recognized that safeguard measures should only

Table 1 Changes in tariff schemes under the provisional safeguard measures

	Tariff quotas (year equivalent)	Tariffs up to the tariff quotas (same as before)	Tariffs beyond the tariff quotas (ad-valorem tariff equivalent)
Welsh onions	9,823 tons	3%	256%
Shiitake mushrooms	29,684 tons	4.3%	266%
Tatami-omote	18,440 tons	6%	106%

serve as temporary protection for facilitating readjustment of an industry. Although some people still talk about safeguards from a social policy viewpoint, there is less and less backing for the argument that an industry should be helped just because people feel sorry for it. Instead, there is growing support for the idea that we should ascertain if such safeguard measures would help enhance competitiveness or implement structural reform, or at least if there is the will to carry out structural reform in an industry seeking protection. This kind of trend should be welcomed in keeping with the original purpose of safeguards. Of course, in order to turn a provisional safeguard action into an unprovisional action, one of the necessary conditions according to the safeguard agreement is that it bears "evidence that the industry is adjusting," and the side seeking continuation of the safeguard cannot help but to emphasize this point.

However, the concept of evaluating the costs and the benefits of a safeguard for the entire national economy and then ascertaining whether to take an unprovisional action for the measure is still not widely accepted. We need to discuss more concretely who should bear the cost and who is going to be protected, and whether it will be a beneficial policy for the country. First of all, overseas producers and Japanese consumers bear the cost of a measure. In addition, in the case of the three recent safeguard products, the great majority of imports come from China, where Japanese companies are heavily involved in developing these import businesses. Therefore, companies that are succeeding in internationalizing production and supply must also bear the cost, while the safeguards protect domestic producers who have missed the wave of internationalization. In short, the foreign trade policy ends up burdening Japanese consumers and Chinese producers with all the costs required to balance the interests of those Japanese producers who did not catch the wave of internationalization with those Japanese who did. Do such policies really benefit the country overall?

Even though domestic producers who have fallen into the current predicament

may need to be made more competitive in order to help the entire Japanese economy, achieving this through safeguards results in major economic loss. A domestic production subsidy is a more beneficial policy if provided effectively. However, since there are strong criticisms of the traditional type of farm subsidy spending on the agricultural sector as well as its results in the past, this kind of measure is considered unwarrantable. This is how inefficient foreign trade policies are selected.

Indeed, the tariff rates based on provisional measures are high (refer to Table 1). Although it is unclear how the tariffs are calculated, they are usually at almost the same level as prohibitive tariffs. And even though the lower conventional tariff rate is to be applied if imports are below the tariff quota amount, which was defined based on the actual import results for 1997 to 1999, the quota level has been exceeded easily since imports began to increase in 2000. Moreover, since the level of the tariff quotas was also decided based on the actual exports in 1999 and earlier, the increase in imports from China in 2000 has not been accounted for, thus the higher customs duty immediately applies.

According to newspaper reports, in addition to safeguards, MAFF has a total of ¥40 billion in budgetary appropriation requests for measures to help vegetable producers. These are also policies that further increase the burden of general citizens. A clear explanation is needed from MAFF on what it really hopes to achieve with these measures.

Structural Reform and Popular Sentiment

Behind these recent provisional safeguard actions, there are the frustrated emotions of the domestic producers who missed the wave of international-

ization. Rather ironically, Welsh onions, fresh shiitake mushrooms and tatami-omote were not all first produced in China before being exported to Japan. It is said that today's cheap imports are a result of Japanese producers or their agents going to China and providing Chinese farmers with seeds, cultivation techniques and other assistance. The domestic producer who is losing out to competition from Chinese imports, while being overwhelmed with a feelings of powerlessness, may nurse feelings of moral loathing based on jealousy toward the people who freely transferred production expertise originally developed in Japan to a foreign country for their own profit. As a result, unfair labels such as "traitor" are sometimes used.

Needless to say, since the cultivation techniques in question are not patented, there are no legal issues regarding the use of this expertise for new forms of business, and there is no reason for criticism in the light of economic ethics. It has turned out that the productivity gap between China and Japan is so large that it is more profitable to employ the time-consuming trade method of encouraging overseas development with the purpose of importation. The producers and agents who perceived this advantage should rather deserve praise for their contribution to the overall welfare of society by succeeding in providing consumers with less expensive goods.

This is ultimately the kind of situation that calls for the abilities of politicians or bureaucrats. Inevitably there will be producers who end up being eliminated by the market mechanism during the process of industrial adjustment. When being petitioned by people who have been eliminated from the market, it is easy to say, "We will do something." However, when protection is applied on the company or industry

level, the natural speed of industrial adjustment is slowed, and the creativity of the people who initiate new trade opportunities is thwarted. There is no problem in setting up a social safety net for the entire society at a level that the citizens can agree upon, but not just for specific industry or company groups. However, policies that hinder industrial adjustment should be avoided to the greatest extent possible.

Costs for Japan's Economic Diplomacy

The target products of the recent provisional safeguards are very insignificant when compared to Japan's entire trade picture. However, there is a lot of public attention focused on Japan's safeguard actions both inside and outside Japan, and there is a danger that it could lead to a weaker position in economic diplomacy for Japan, which has been promoting freer trade all along.

Following the Japanese government's enactment of provisional safeguards on welsh onions, fresh shiitake mushrooms and tatami-omote on April 23, the Chinese government retaliated on June 22, by announcing that it would levy a uniform 100% special customs duty on Japanese-made automobiles, cellular and car telephones and air-conditioners, in addition to the existing import duties. The Japanese government is strongly protesting the measure by China, and is asking for withdrawal of the tariff. The amount of these exports from Japan to China is several times greater than the amount imported from China to Japan of the three products targeted by the recent provisional safeguards. Actual exports to China of cars and these other products have already been impeded, and the companies concerned are beginning to suffer.

The WTO rules recognize retaliatory actions by the exporting country suffering damage from a safeguard imposed by the importing country, based on certain conditions. As the Japanese government is insisting, the timing and method of the measure taken by China is not in keeping with WTO rules. However, as it is not yet a member, China cannot seek the usual dispute settlement system used by WTO member

nations, and it is unclear to what degree China will be the subject of international criticism for enacting the retaliatory action based on its own standards.

In a recent case, China temporarily stopped all imports of South Korean mobile phones and polyethylene when South Korea restricted garlic imports from China in June 2000. The real likelihood of China taking a retaliatory action to Japan's provisional safeguards was pointed out from the beginning. However, the Japanese government did not even make an effort to offer China some compensation, and was soundly rapped with a retaliatory action by that country. Moreover, China's retaliatory action was targeted on the most symbolic items among exports from Japan to China, that is, Japan's most internationally competitive manufactured products.

Even if Japan's series of measures are all in conformity with WTO rules, they did in fact inflict one-sided damage on China, and the logic of the Japanese government blaming the Chinese government does not seem very persuasive. There are many people inside and outside Japan who sense a protectionist motive somewhere behind these provisional safeguards, and at any rate, the measures do give the impression of a Japanese inclination toward protectionism. The impact on other industries, the danger of damaging Japan-China relations and the distrust created for Japan's economic diplomacy – these are costs that cannot be ignored. Once again, the costs and the benefits for Japan overall should be carefully considered, and we must return to our original debate on “national interest.”

The Argument for a Well-Balanced National Interest

Around the time when this paper is published, the discussion involving Japanese safeguards is reaching a climax. On Nov. 8, the 200-day period for the provisional measures on welsh onions, fresh shiitake mushrooms and tatami-omote will expire, and the Japanese government will be faced with the decision on whether to pursue this action. Also, before then, a determination now under review on whether

to pursue a textile safeguard for towels is scheduled for Oct. 15. Therefore, public attention will likely be focused not only on whether these policy decisions conform to WTO regulations, but whether the costs and benefits for the whole Japanese economy were evaluated properly, and whether the decisions were truly reached in the “national interest.”

The decision concerning safeguards on towels is especially important. First of all, in the case of towels, there is a clear contrast between the successful and unsuccessful companies within the industry according to their level of globalization, which is not the case for welsh onions, fresh shiitake mushrooms and tatami-omote, and the sides for and against the safeguards are clearly visible. People are watching to see whether the government will use foreign trade policy to intervene and balance the interests within the industry.

Secondly, the towel industry is under the jurisdiction of METI, and naturally lobbies for safeguards with that ministry. In spite of this, whether or not METI as the ministry in charge of international trade policy can make a judgment that will satisfy the people is also a big issue. Recently, there are increasing calls from international law and economics scholars for a governmental agency to manage trade policy in Japan, which, like the International Trade Commission in the United States, would be independent from the actual industries. The question has arisen whether trade policy can be left to METI, which is made up of departments handling individual industries. Although this writer holds the past activities of METI in high regard considering its policy of promoting free trade, it is now more important than ever before that the Ministry show its true worth. Let us hope sincerely that wise judgments are made. JTI

Kimura Fukunari is a Professor at the Faculty of Economics, Keio University. He specializes in the Theory of International Trade and Development Economics.