TRADE or WAR

PROTECTION – A REAL DANGER

THE PROSPECTS for recovery from the world recession depend more than anything else upon a revival of world trade. But it is the advocates of trade restrictions who now seem to dominate trade policy.

Their lobbying is so effective that even those politicians who are the most vociferous about the merits of competition in domestic affairs are silent or equivocal about trade liberalisation.

The change in influential opinion which has occurred over the past ten to fifteen years can now be seen as constituting a major threat to world prosperity.

A market economist surveying the scene in the late 1960s could have justified a certain feeling of complacency. The lessons of the protectionist 1930s seemed to have been learned, and although many trade restrictions remained, they were progressively being dismantled by international agreements epitomised by the Kennedy round of tariff cuts in the Sixties.

The pace of change may have been slow but at least it was in the right direction (see table).

Helped by greater openness, world trade was growing much faster than world output (by 7 per cent a year in the 25 years to 1973 compared with a 5 per cent a year growth of world production) and could be seen as an important contribution to economic growth.

Such barriers as remained were being overleaped by the setting up of overseas subsidiaries of what came to be known as 'multi-national corporations'. Capital and technology as well as goods and services were moving around the world with greater freedom than ever before.

As a major trading nation, Britain was an important beneficiary of these developments, but it lost its position as one of the world's largest exporters of manufactured goods.

In 1950 the U.K. and the U.S. each had about a one-quarter share in the value of world exports of manufacturers. By 1973, the U.K. share had fallen to 9½ per cent and the U.S. share to 16 per cent, while West Germany's share had grown from 7 per cent to 13 per cent and Japan's from 3 per cent to 13 per cent. Over the same period, there was a large increase in the proportion of U.K. imports accounted for by manufactured goods. Since 1973, the U.K. share of manufactured exports has remained about constant, but manufactured imports have continued to rise (the share of imported cars in total registrations rose from 14 per cent in 1970 to 57 per cent in 1980, to take a particularly dramatic example).

These developments brought about a change in the structure of the U.K. economy which came to be referred to as 'de-industrialisation'.

Manufacturing employment fell by over 3 million between 1966 and 1981 – a reduction of about one-third. In some industries, such as textiles and shipbuilding, this was the continuation of a long-established trend, but in many others, it was a decline from a peak occurring in the mid-1960s. Very few industries escaped. Some of this decline in employment was due to the recession and some of it was offset by an increase in employment outside manufacturing. But the remainder has contributed to the present high level of unemployment.

The fear of growing de-industralisation has been a major factor behind the growth of quantitative import restrictions which have occurred over the pat ten years.

By PAUL KNIGHT

In addition to the protection of the common E.E.C. external tariff, a wide range of U.K. imports are now subject to such restrictions. About one-third of all imports from Japan are covered by what are termed "voluntary restraint agreements" covering cars, pottery, cutlery, TV sets and hi-fi equipment. Over 95 per cent of imports of clothing and textiles from low-cost sources are subject to various forms of restraint. There are restrictions on footwear imports from Taiwan, South Korea and Eastern Europe. Inter-industry agreements cover a wide range of consumer electronic products from Singapore, South Korea and Taiwan.

The proportion of our trade which is covered by import restrictions other than tariffs rose from 0.2 per cent in 1974 to 17.4 per cent in 1980.[1]

THE U.K. has by no means been alone in imposing such restrictions, and trade restrictions of other types have been developed here and elsewhere. Bilateral (or barter) deals between governments have become an increasingly common feature of trade between the more regulated economies. Financial incentives have been used increasingly to induce multi-national companies to set up local factories to substitute for imports. And 'non-tariff barriers' created out of administrative regulations have become increasingly common.

These developments have drastically confined the scope for the normal conduct of international trade. It has been estimated[2] that a quarter of all trade in goods is now subject to quota or "voluntary restraint" arrangements, another quarter is conducted by barter, and a third quarter constitutes the internal transactions of multi-national companies.

The ideal of free trade, which had been widely envisaged as the ultimate goal in the 1960s, now seems so remote that the term itself has dropped out of use because it sounds too utopian to be considered by practical men.

Thus, in the course of a mere fifteen years, we have seen a change in the climate of (negotiated) trade liberalisation, to one in which the proliferation of trade restrictions is regarded as inevitable or even desirable.

How has this change come about?

The traditional fallacy of composition encapsulated in the phrase "what's good for General Motors is good for the United States" is partly responsible. But more sophisticated arguments have also played their part.

One such argument, which is framed in terms which are specific to the U.K., runs roughly as follows:[3]

> Suppose that a 1 per cent growth in U.K. incomes leads to a 2 per cent growth in U.K. imports, but a 1 per cent growth in world incomes leads to only 1 per cent growth in U.K. exports. Then – since imports cannot indefinitely grow faster than exports – the U.K. economy can only grow at a half of the rate of the rest of the world. Moreover, there will always be 'stop-go' budgetary action because governments will be forced by balance-of-payments crises to rein back upon the economy (eg by increasing taxation) whenever it tries to grow too fast.

A supporting argument is that the restrictions upon growth which this scenario implies puts U.K. manufacturers at a disadvantage compared with their overseas competitors by depriving them of the economies of large-scale production and making investment and innovation less rewarding. This aggravates the problem by making domestic firms less and less able to compete in international markets.

Effective Protection Rates, per cent:

	Before the Kennedy Round:	After the Kennedy Round:
U.K.	27.8	16.0
U.S.	20.0	11.6
E.E.C.	18.6	11.1
All developed countries	19.2	11.1

(Britain's entry into the E.E.C. was later to bring its effective protection rate more into line with other countries).

'Free trade serves the cause of world peace. When governments get too involved in trade, political disputes multiply. Peace is threatened'

PRESIDENT REAGAN

The Cambridge Economic Policy Group (CEPG) of the University of Cambridge Department of Applied Economics have demonstrated that, on past experience, the U.K.'s import and export relationships are indeed broadly as hypothesised above, and they have incorporated their findings in a forecasting model. Without import controls, this model forecasts an indefinite increase in unemployment to 5 millions and beyond.[4]

The CEPG theory has been criticised on several grounds,[5] some of them technical (e.g. that its statistical analysis is biased by the effects of adjustment to the Kennedy Round and E.E.C. membership) and some of them political (e.g. that retaliation would nullify the benefits of import controls). But its fundamental weakness lies deeper. It can be illustrated by the story of the Luton straw hat industry.

Luton, a town just north of London, was once a world centre of the straw hat industry. It contained a concentration of the necessary plant, machinery and people with the appropriate skills. For many years it was successful and prosperous; but the time came when straw hats went out of fashion. Factories closed, unemployment soared, and it did not occur to the government of the day to step in with tariffs or subsidies.

As demand for straw hats fell, however, the demand for other products was rising; in due course, Luton acquired the equipment, and its people acquired the skills, to supply them. Prosperity returned and unemployment subsided.

THIS (highly formalised) story of Luton is one of market change and industrial adaptation. Market change can take many forms. Sometimes it is abrupt, sometimes gradual; it is due sometimes to a change of taste, sometimes to the emergence of a well-placed competitor. And successful adaptation can also take a variety of forms. Sometimes it can be achieved by changes of technology or working practices, or by pay restraint. But often it can be achieved only by structural change, by the replacement of existing products by new ones, or possibly the replacement of existing firms or industries by new ones.

Economists are apt to assume that the only way in which an excess of supply over demand can be corrected is by a reduction in prices. In the simplified models which appear in text books, this may be true. But in the real world, structural change is an important mechanism of adjustment, especially in an economy which is strongly dependent upon international trade.

Structural change can be painful, however.

It takes time for obsolescent productive capacity to be replaced, and during that time, it can give rise to unemployment. If there is a concentration of declining industries in particular areas – as has been the case in Clydeside in Scotland, for example – serious local unemployment problems may arise.

Nationally, this is a problem of adaptation which is essentially transitional. But if the pace of adaptation lags persistently behind the pace of change, the resulting unemployment may persist or increase.

Viewed from the standpoint of a particular industry or a particular locality, the case for subsidies or protection to resist the effects of market changes can be extremely persuasive. And if those affected are sufficiently well-organised, they may exert considerable political pressure (think of the French farmers).

But from the standpoint of national economic policy, a sustained resistance to change would obviously be disastrous.

The idea of preserving the Luton straw hat industry over the years is, in retrospect, too ludicrous to be taken seriously. But the more sophisticated advocates of import controls argue that they need only be temporary – that firms would respond to an assumed domestic market by investing and modernising, and that this, together with the economies of scale, would restore their international competitiveness, rendering the controls unnecessary.

This is a paradoxical proposition, which amounts to claiming that the way to make industry competitive is to shield it from competition. There is no convincing evidence to support it. Its attraction seems to stem more from a mood of despair – "everything else has been tried" – than from any rational analysis. But the influence of the advocates of this counsel of despair, combined with that of special interest pressure groups, is on the increase.

Britain's trade unions and managements alike are pressing for more import controls.[6] The fact that such controls are likely to put upward pressure on the exchange rate, so that help to one sector of industry is paid for by damage to other sectors, seems to be lost on them.

Thus the threat to the world economy continues to grow. The restraining framework of GATT (the General Agreement on Tariffs and Trade) is crumbling as devices to avoid or evade its provisions become commonplace. GATT Ministers – faced with the choice of attempting to regulate, and thus condone, such evasions or of turning a blind eye – were never expected to do anything effective to stop the rot.

Unless public opinion is alerted to the danger, the governments of the free world may collectively kick the ball in their own goal, and thus fulfil Karl Marx's prophesy that capitalism contains the seeds of its own destruction.

BRITAIN'S WARNING

BRITAIN'S Trade Minister, Mr. Peter Rees, who led his country's delegation to November's Geneva meeting of G.A.T.T., the General Agreement on Tariffs and Trade, has issued this stark warning:

"It is crucial that we should defuse the political tensions which have been growing throughout the recession between the world's major trading powers.

"There can be little doubt that the liberal trading order has come closer to breakdown in recent months than at any time since the war.

"The tensions over the growing imbalance between Japan and virtually all her Western trading partners, and the increasing wrangling over agricultural surpluses, all threaten the kind of breakdown in trade relations which previous historical experience had seemed to make unthinkable."

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