Research Department
Federal Reserve
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FRB SF Weekly Letter

The New Protectionism

In 1979, the last major multilaterial agreement lowering barriers to international trade was signed in Tokyo, culminating a thirty-year effort under the aegis of the General Agreement on Tariffs and Trade (GATT) to promote freer trade among the world's nations. Now, scarcely five years later, multiplying protectionist pressures and actions pose perhaps the greatest post-war threat to the continued growth of international trade. Indeed, in the last eighteen months, the U.S. government, normally a leading advocate of free trade, has restricted imports of motorcycles and specialty steel, while extending previously existing barriers to textile and auto imports. Europe has moved to restrict its imports of autos and electronic equipment from Japan, and threatens to retaliate against our barriers to specialty steel by restricting its own imports of chemicals from the U.S. The situation could get worse as, for example, "domestic content" legislation that could effectively curtail most U.S. auto imports is widely favored in the U.S. Congress.

These developments have been dubbed the "new protectionism," although in its imposition of trade barriers to alleviate domestic problems it can hardly be called unprecedented. This *Letter* examines what is really novel about the new protectionism and the problems it may pose for the U.S. and the world economy.

Scope

Certainly, the new protectionism represents a significant increase in barriers to trade. The International Monetary Fund's staff has estimated that protectionist measures adopted by the world's nations in the last four years encompass products representing nearly 20 percent of world trade in manufactured goods and 33 percent of agricultural trade. Nearly 50 percent of all world trade is now estimated to be affected to some degree by trade barriers other than tariffs, compared to 40-45 percent a decade ago.

The new protectionism is also distinguished by its heavy and increasing reliance on such non-traditional barriers as "voluntary export restraints" (VER) and "orderly marketing arrangements." These generally amount to quotas on imports of a given product from one or more particular countries. For example, the U.S. VER on autos applies to Japan only. The discriminatory application of these measures, and their implementation outside the multilateral framework of GATT, represent a significant departure from such traditional barriers to trade as tariffs.

New also is the geographic source from which the new protectionism is emanating. Many of the new barriers have been imposed by the U.S. and European nations to combat imports from Japan and the newly industrialized countries (NICs) of Asia and Latin America. These moves have come as Japan and the NICs have gradually reduced their own barriers to imports—often at the urging of the U.S. and Europe, traditional defenders of free-trade principles.

The cost of this increased protectionism has probably been very substantial. For example, a study recently prepared by Wharton Econometrics suggests that our quotas on Japanese auto imports have raised the average price of a car sold in the U.S. by nearly one thousand dollars. With roughly seven million cars sold in the U.S. last year, that added up to a total cost to U.S. consumers of nearly $7 billion from this measure alone. Thus, whatever protection trade barriers afford, it does not come cheaply.

Reasons?

Protectionist measures have been engaged for a variety of reasons. Directed at Japan, they are often justified as a necessary response to that country's allegedly greater protectionism compared to other major industrial nations. While this may have been true some years ago, studies have shown

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that Japan is now no more restrictive overall toward imports than other major industrial nations, *including* the U.S. Indeed, Japan's average level of tariffs (5.9 percent) is currently lower than that of Europe and only slightly above that of the U.S. Admittedly, Japan is relatively restrictive of certain products, such as agricultural goods. However, the United States itself severely restricts imports of certain agricultural products, such as sugar and dairy products, while European barriers to agricultural imports (not to mention their subsidies of agricultural exports) generally are more stringent than those of either the U.S. or Japan.

Likewise, protectionist measures by the U.S. have sometimes been advocated as a way to reduce our large and growing trade deficit, itself sometimes blamed on protectionism abroad. But while barriers to imports reduce the volume of goods we buy from abroad, they may not improve our trade balance significantly. Import prices could well rise (as happened with our restrictions on Japanese autos) and leave the value of imports little changed. Furthermore, foreigners may reduce their purchases of our exports in response to our restrictions on imports of their goods. In any case, numerous studies indicate that it is the high value of the dollar, not barriers to our exports, that is largely responsible for our trade deficit.

A more basic source of protectionist pressure lies in the high unemployment in the United States and Europe in such historically key industries as autos and steel. Protectionist measures have aimed in large part at stemming the decline of these industries by giving them some relief from foreign competition. In part, these industries' woes reflect the worldwide recession of 1980- 1982. However, many of these sectors probably are facing secular declines that reflect in part a general shift in the output of developed countries from heavy industry toward services and higher technology manufactures. More important are the relatively high wage rates in the U.S. and Europe that put them at a competitive disadvantage in steel, autos, and other traditional industries against lower wage countries such as Japan and the NICs. Such shifts in comparative advantage are, of course, neither new nor confined to the West. Indeed, Japan finds itself increasingly challenged in steel and shipbuilding by Korea, Taiwan and other NICs.

New concepts

In the end, the most novel but problematic aspect of the new protectionism may prove to be the approaches to trade policy it has advanced. In particular, the notions of "bilateral reciprocity" and "industrial policy" are increasingly advocated as bases for trade negotiations even though they represent significant departures from the principles that underlie trade policy for most of the post-war era.

Bilateral reciprocity. Bilateral reciprocity entails restricting imports from a given country to the same degree that that country restricts one's exports to it. Thus, if Japan were more protectionist than Germany, we would place higher barriers on our imports from Japan than on our imports from Germany. By contrast, post-war trade agreements generally have been based upon the non-discriminatory "most-favored-nation" (MFN) principle. This means that a country's imports of a given commodity receive the same treatment regardless of where they come from. In applying the MFN principle in trade negotiations, nations have sought to balance their own trade concessions with those obtained from their partners as a group; they have, in effect, sought reciprocity on a multilateral basis.

In contrast, the rationale underlying bilateral reciprocity is that the benefits from trade liberalization should be reciprocal on a *bilateral* basis. Realistically, however, the gains from trade liberalization cannot be expected to balance bilaterally any more than one nation's trade balance with another can be expected to balance. Because of differences in industrial structure, country A

may stand to gain mainly from increased access to B's market, while B gains primarily from increased exports to C, and C from greater access to A. Only through a multilateral agreement, where A grants concessions mainly useful to B while benefitting mainly from C's concessions, are the potential gains likely to be great enough to induce all countries to incur the political and social costs of significant trade liberalization.

Economic efficiency considerations also argue for a non-discriminatory (MFN) principle in trade policy. For the world as a whole, the gains from freer trade come in large part from the shift of production of each commodity toward the most efficient, lowest cost, producer-nation. Bilateral reciprocity could have a perverse effect by shifting production *away* from lower cost producers, if these producers were deemed more protectionist than higher cost producers.

Industrial Policy. Industrial policies are government measures that affect a nation's trade indirectly by promoting domestic producers at the expense of foreign competitors. For example, it has been argued that the Japanese government's promotion of research into computer technology is an industrial policy that can discourage imports and promote exports even though it does not constitute any direct or explicit barrier to trade. Consequently, there have been several proposals to include industrial policies in trade negotiations (others have advocated that the U.S. government adopt its own industrial policy).

Admittedly, a government could, in principle, discourage imports (or encourage exports) of a given commodity simply by structuring domestic tax or other policies to foster domestic production of competing goods, or to discourage consumption of those goods. On this basis, virtually the entire array of government measures—tax structure, anti-trust laws, and science and regulatory policies—could be considered industrial policies.

Still, the very comprehensiveness of trade-related industrial policies is a major practical obstacle to their inclusion in actual negotiations. Government tax and regulatory policies are generally shaped by domestic considerations, such as equity and efficiency, that are apt to vary among nations. Governments are probably less willing to modify such policies—much less tailor them to conform to policies of others—to enjoy the gains from free trade alone. At the least, arriving at rules governing policies with only indirect impacts on trade is extremely difficult to achieve given the wide variety of policies involved. Any one, after all, can play the industrial policy game: foreigners, for example, could ask if low U.S. gasoline taxes (compared to those of other nations) constitute an industrial policy aimed at discouraging imports of small European and Japanese cars.

Protection?

Reflection on some "old" history may supply the best perspective to the new protectionism. In the early 1930s, the United States and other industrial nations sharply raised trade barriers to alleviate unemployment—but made the world depression much worse. The post-war GATT effort to lower trade barriers fostered the rapid growth of world trade, promoted the development of many poorer nations, and brought about a more efficient allocation of world resources. Policymakers must ponder whether, in view of these history lessons, the protection seemingly offered certain industries by the new trade barriers is worth the threat they pose to these longer-term gains.

Charles Pigott

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 4/18/84	Change from 4/11/84	Change from 12/28/83 Dollar	Change from 12/28/83 Percent Annualized
Loans, Leases and Investments[1] [2]	178,816	1,413	2,791	5.1
Loans and Leases[1] [6]	158,892	1,460	3,537	7.3
Commercial and Industrial	47,202	254	1,239	8.7
Real estate	59,682	131	783	4.3
Loans to Individuals	27,803	201	1,152	14.0
Leases	4,994	− 13	− 69	− 4.4
U.S. Treasury and Agency Securities[2]	12,228	− 36	− 279	− 7.2
Other Securities[2]	7,696	− 11	− 467	− 18.5
Total Deposits	188,075	−1,698	− 2,922	− 4.9
Demand Deposits	45,579	− 966	− 3,658	− 24.1
Demand Deposits Adjusted[3]	29,997	−1,152	− 1,334	− 13.8
Other Transaction Balances[4]	12,958	26	183	4.6
Total Non-Transaction Balances[6]	129,538	− 757	553	1.3
Money Market Deposit Accounts—Total	40,094	− 544	497	4.0
Time Deposits in Amounts of $100,000 or more	37,802	− 240	− 363	− 3.0
Other Liabilities for Borrowed Money[5]	19,015	1,041	− 3,992	− 56.3

Weekly Averages of Daily Figures	Week ended 4/09/84	Week ended 4/26/84
Reserve Position, All Reporting Banks		
Excess Reserves (+)/Deficiency (−)	273	188
Borrowings	53	44
Net free reserves (+)/Net borrowed(−)	220	144

1 Includes loss reserves, unearned income, excludes interbank loans
2 Excludes trading account securities
3 Excludes U.S. government and depository institution deposits and cash items
4 ATS, NOW, Super NOW and savings accounts with telephone transfers
5 Includes borrowing via FRB, TT&L notes, Fed Funds, RPs and other sources
6 Includes items not shown separately

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