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Can Import Controls Really be Helpful?

by Dr Günter Weinert, Hamburg *

In Great Britain wide circles have for some time reflected on the advantages of import restrictions as a means of increasing employment. The following article examines the validity of some major arguments brought forward in support of import curbs.

The danger was soon perceived: The sharp rise of oil prices in late 1973 and early 1974 was bound to cause huge current account deficits in the western industrial countries, and so it had to be feared that some of them, finding themselves in a tenuous external economic position, would resort to restrictions on foreign trade. The danger was soon banished however, or so at least it seemed. Since import restrictions were likely to provoke requital and, given the defective absorptive capacity of the OPEC countries, the inevitable trade deficits would show up largely in the industrial countries, the OECD countries arranged between themselves that they would refrain from protectionist intervention.

But if anybody on the strength of this agreement and the substantial reduction if not elimination of the current account deficits in all western industrial countries during 1975 believed that the danger of a relapse into protectionism had disappeared, he has been deceiving himself. For the improvement in the external position of the western industrial countries is primarily a consequence of the world-wide recession: The fall in production has caused the deficit countries' import volume to contract more sharply than their export volume while the terms of trade improved at the same time. Soaring unemployment was the obverse of the fall in production. In most countries it has risen to its highest level for over twenty years.

As the external economic difficulties „transposed“ themselves into an employment problem, curbs on imports were demanded with increasing insistence in various countries. While however in most countries a partial withdrawal from the attained degree of trade liberalisation is wanted only by a few groups with special interests and obvious motives, in Great Britain wide circles have for some considerable time reflected on the advantages of import restrictions as a means of increasing employment although it has long been taken for granted that a far-spread free trade is beneficial for the prosperity of all participating economies,

at least as far as western states in a broadly similar state of economic development are concerned.

These reflections cannot be brushed aside without putting forward special arguments, especially in the discussion in Great Britain, because the advocates of import curbs in the ranks of the British trade unions and political groups can refer to an expert opinion in their support: About a year ago the economists forming the Cambridge Economic Policy Group (CEPG) came out in favour of import controls when they presented a forecast of economic developments in Great Britain in 1975–1978. They reached their conclusion as a result of a comparison of three projections envisaging alternative economic strategies.

There was an acute reason for undertaking these medium-term projections: The CEPG study was concerned with the parameters set to economic policy in practice by the big balance of trade deficits resulting in particular from the sharp rise of oil prices in late 1973 and early 1974. With Great Britain's heavy international indebtedness in mind the authors arrived at the incontestably correct conclusion that the current account deficits must be substantially reduced over the medium term if the external value of sterling is not to deteriorate considerably. The prospect that Great Britain will from 1980 be a net exporter of oil gives the country a certain measure of credit-worthiness, and for this reason it would not be essential to eliminate the short-term deficits. It was thought that gradually diminishing shortfalls on current account – cutting the deficit by 1978 at least to something like two-thirds of the 1974 deficiency – could be financed "in the market", i.e. with funds derived chiefly from the OPEC countries. But this reduction to about £ 2.6 bn (at 1974 prices) would still entail great risks and, possibly, sooner or later necessitate a sharp adjustment.

The balance of trade, which shows a particularly large deficit, was regarded as the vantage-point for a lasting improvement, and successive sterling devaluations would be the method appropriate to

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a market economy system. They would have to be at least drastic enough to prevent a deterioration in costs relative to the international level and have to go hand in hand with a rather restrictive economic policy: The real growth of the gross domestic product would have to be kept down to 2.5 p.c. on average in 1976–1978, after zero growth in 1975. The model computations led the CEPG to the conclusion that under the assumed conditions the number of unemployed would rise well beyond the 1,000,000 mark by 1978, which would be equivalent to an unemployment rate of about 5 p.c. The rate would even rise to 6.5 p.c. if the current account were to be brought into full balance by this strategy.

The unwelcome negative effect on employment could be avoided by a more drastic devaluation. To reduce the unemployment rate to 2.5 p.c., this devaluation would have to bring the relative costs compared with other countries down by 15 p.c., and to reach this lower cost ratio, which would have to be maintained until 1978, the external value of sterling would have to be lowered by about 30 p.c. The repercussions on internal price and wage levels of such a movement of the exchange rate would require an even larger reduction of the sterling rate of exchange in 1976 in order to make sure of the “new” cost ratios. With this variant the economists expected the consumer prices to rise by a good 30 p.c. in 1975 and 1976. In the next two years they would again go up sharply, and in 1978 they would still rise by about 18 p.c.

The CEPG Proposal

The Cambridge economists considered the low employment level of the first variant and the high inflation rate of the second alternative both unacceptable. The same is obviously true of any of the combinations in between these two extreme solutions which would involve a lower level of employment than in the first variant and less severe inflation than in the second model. Last but not least, it must be borne in mind that foreign creditors still keep large accounts in Great Britain. If the risks of devaluation seem too great, they might withdraw their monies, which would greatly aggravate the external problems and hence the internal difficulties as well. The authors are therefore definitely in favour of the third variant: The desired improvement on current account could be achieved coincidentally with a gradual reduction of the unemployment rate to 2.5 p.c. by halving the average annual rate of increase of imports of industrial manufactures in the projection period (to 9 p.c. from the 18 p.c. annually recorded in 1969–1974), either through imposition of quotas or by surcharges.

Prices are expected to rise more slowly under this third projection than on the assumptions of the second variant, but there is much uncertainty on this score. The wages' behaviour will be crucial. If the wage-earners are content with small increases in real incomes, the updrift of consumer prices could slow from 16 p.c. last year to 4 p.c. in 1978. It could not be ruled out however that it would abate only slightly, from 20 p.c. in 1975 to 15 p.c. in 1978.

The authors of the study are of course well aware of the fundamental objections to the strategy they favour but dismiss the frequent claims that import restrictions involve dangers for the internal and external economy:

□ The “beggar-my-neighbour” argument is rejected on the ground that the alternative of a deflationary domestic production and demand trend as the result of a restrictive economic policy would ultimately have the same negative effects on employment abroad since the demand for imports would necessarily have to be reduced quite substantially;

□ The danger of retaliatory measures on the part of directly affected industrial countries is regarded as fairly slight because they would be the ones to lose most in an escalating trade war;

□ As for the view that the efficiency of British industry would be impaired by abatement of competition, exactly the opposite would be the case: The greater security of British industry would improve its productivity, especially because the propensity to invest would not, as was otherwise to be feared, evaporate.

These countercharges are however hardly adequate to dispose of the objections against import controls. The plea for the strategic variant of “safeguarding a high level of employment while lessening the external imbalance through import controls” merely shows that British economic policy is asked to take great risks. The fact that Great Britain in 1964–1966 unilaterally levied special duties on industrial manufactures, first at 15 p.c. and later, on international pressure, at “only” 10 p.c., without requital by its trading partners is hardly such as to strengthen the CEPG argument. The analogy applies to the measure itself but ignores entirely the fundamental differences in the economic situation in the world between the mid-sixties and the present time. Today — as distinct from the mid-sixties — the western industrial countries have undergone a severe recession. Production and employment levels are almost everywhere lower than they were three years ago. This is one of the reasons why, as already mentioned, the protectionist tendencies

have everywhere become more marked. This being so, the danger of retaliatory measures being taken is incomparably greater than it was ten years ago.

Objections not Refuted

It seems that the CEPG economists tend to underestimate this danger. With all due confidence in the rationality of the actions of individual national economic authorities it remains doubtful what reasoning is behind the countervailing measures of other governments. It could certainly differ materially from the CEPG's anticipations, for import restrictions do not only entail a shortfall in the demand reaching foreign suppliers but — at least relative — increases in prices as well, both by raising the foreign production costs in the areas concerned (owing to a further decline in capacity utilization) and "overpriced" imports from Great Britain (because the "requisite" degree of devaluation has been prevented). In the present situation import controls have, besides, the grave drawback of impairing the external economic situation of the partner countries more than would happen in "normal" periods: Because of the oil price explosion in late 1973 and early 1974 the western industrial countries as a group are in a deficitary external position. In the short term the absorptive capacity of the OPEC bloc still remains inadequate, which means that import controls in effect merely redistribute the deficits. Other countries which are also in deficit are unlikely to defer to such a redistribution without taking counter-measures.

The — probably excessive — trust in the rationality of the actions of economic authorities must cause even greater misgivings, the more so as the rationality of group behaviour has its limits. Governments will be caught in a vortex of protectionist interests if the internal economic problems, especially in the employment field, cannot be solved soon. Decisions with emotional undertones can lead to overwrought reactions, especially in politics.

It would be much less hazardous to initiate a search for possible solutions for the external difficulties in cooperation with important partner countries than to trust that the other countries concerned will refrain from restrictions. This applies especially to member countries in free trade areas such as Great Britain in the EC.

Whether the partner countries would really lose more than Great Britain if retaliatory measures were taken is also a moot point. This is a question which can be judged by various criteria, and these lead to quite different results.

The CEPG's attempt to dispel the objections by arguing that advantages will accrue at least to the

country which restricts its imports does not carry real conviction. The view that it is possible to ensure a high employment level independently in this way seems to spring from too insular an approach. Increased efficiency may well result from improved productivity through higher capacity utilization. But this is true only in the short term. Quite apart from the danger that the supplies for export may be cut too drastically, abatement of the competitive pressure from abroad could put a damper on the disposition to effect innovations and hence also investments in the medium term already, the more so if no time-limit is fixed for the import restrictions so that they "degenerate" into indirect subsistence subsidies.

Advantages — at least for Great Britain?

The economic development in the last two years in particular (the authors had knowledge only of the course of events in 1974 when they prepared their report) shows on the other hand how deceptive an isolated view of economic problems can be. If one concentrates on the connection between the employment level on the one hand and the external economic developments on the other, he tends to disregard the possibility that the economic policy may in practice, irrespective of this connection, be turned into a certain direction by unwelcome developments in the internal economy. This was Great Britain's lot in the past year and should be a warning to many other countries which are also toying with the idea of imposing curbs on imports.

In the first half of 1975 Great Britain was rocked by a "wages explosion": The wages shot up even more than in 1974 — and that when underemployment was already on the increase. In April the hourly wages were 31 p.c. and in July 34 p.c. higher than twelve months earlier, notwithstanding the "social contract" which provided that wage and salary increases were not to exceed the updrift of prices. The prices in consequence still escalated at a time when almost all other major industrial countries in the West were already scoring stabilization successes. In April 1975 British consumer prices were approximately 22 p.c. higher than a year earlier and in August about 27 p.c. — the highest year-on-year rise ever. Prices would hardly have risen more had the devaluation strategy been adopted.

The trend of money wages in Great Britain during the past two years has falsified the assumption concerning the function of wages in the CEPG's model computations. The authors had assumed that — as in the preceding years — wages would rise at rates of up to 5 percentage points in excess of the price updrift. The attitude to wages has

however changed considerably. The need to safeguard real incomes against expected price increases was used as an excuse for seeking substantial improvements in real incomes.

It was only because of the rapid rise in the unemployment figures, especially in the second quarter of 1975, and the anticipation that this trend would continue that a new "voluntary" incomes policy was accepted. Under the impact of the worst unemployment since the war the soaring wages were subjected to a de facto limit of 10 p.c. until September 1976. This guideline figure has so far been adhered to.

Conclusions

There are three main conclusions which should be drawn from the British experience. They concern the connection between the level of employment on the one hand and the trend of wages and prices on the other; the possible need for flexible priorities in regard to the aims of economic policy; and the danger of confusion about causal connections (the identification of external economic developments, instead of price movements, as the cause of internal difficulties).

□ It must be feared that a lower unemployment rate would reinforce the uptrend of wages and prices. This thesis certainly finds strong support in the attitude of the British miners who early in 1974 "abused" their greatly enhanced power after the oil price explosion to force through extremely large wage demands. There is thus a great danger that an increase in employment levels made possible by import restrictions will be reflected in big wage hoists and corresponding price rises. Abuse of the abatement by "dirigiste" means of competitive pressure for raising prices can of course conceivably also occur, but price advances could be thwarted more easily by price controls as operated in Great Britain at present than could excessive wage increases.

□ In the first four months of 1975 price increases sharply accelerated. The tightening of the fiscal brakes to which the Government resorted in the spring was a riposte to the very high ongoing inflation rate. As it threatened to escalate further, the Government was virtually forced to give the fight against inflation top priority. The CEPG considers price advances of over 25 p.c. to be intolerable, as does the Government. That is implied in its rejection of the second alternative. That the — largely home-made — upsurge of prices by about 24 p.c. compared with 1974 was in fact below the rate of about 30 p.c. to be anticipated for 1975 according to the CEPG projection 2 is probably due to the fact that the Government had in the first half of the year "already" adopted the brake device rejected under strategic alternative 1.

□ The decline of production and demand was only in part due to external factors, as has already been indicated. Not only did Great Britain not receive any stronger deflationary impulses from abroad than other countries, but its export trade did not fall off at all as sharply as the world trade did during the recession. The largely "home-made" downturn was the "price" which had to be paid for the long delay before action was taken against inflation.

Nevertheless, import restrictions were imposed at the turn of the year. Their minor extent, however, indicates that the British Government has assumed a sceptical attitude toward CEPG's arguments, the more so as from the outset severe pressure had been exerted on Britain by its most important trade partners to do without import restrictions. The fact that Great Britain did not totally refrain from restrictions is to be regarded as a concession to the trade unions that will facilitate the adherence to the present incomes policy in spite of the significant decline which the private households' disposable incomes, measured in real terms, have undergone meanwhile.

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