TIM CONGDON

**Contributions by Sir David Nicolson MEP
and
Cecil Parkinson MP**

Centre for Policy Studies

Against Import Controls

TIM CONGDON

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Foreword

The prolonged world-wide depression in which we are living is a symptom of profound economic, social and political change, presenting a challenge of survival and growth to us all.

It is perhaps understandable that in such times there should be those who seek to shield their industry from economic competition by advocating a policy of protectionism.

This advocacy must be resisted at all levels: by politicians, businessmen and other leaders of opinion. But it is particularly welcome that Tim Congdon has written a refutation based on an analysis and development of economic principles—a refutation at once forthright and meticulous in its answer to the protectionist case.

We, the politicians and businessmen, can play our part in this by: reversing recent trends towards heightened international trade disputes, by proposing positive industrial policies which extend beyond individual national boudaries—such as the Industry Policy proposals of the European Democratic Group in the European Parliament—and by setting in train positive measures to ensure that nations understand each other better—such as the newly formed American European Community Association, which aims to increase the understanding between the two great industrial blocs which are on either side of the North Atlantic. But it is easy to accuse us of being motivated by sectional or personal interests, of sacrificing real people and real jobs to an unrealistic ideal, or of simply not putting the interests of our own nation to the fore.

This essay shows clearly the fallacies of the economic justification of protectionism and uses the vivid examples of Chile and the Argentine to warn of the possible political and social effects of such economic measures. It is thus of concern to all of us that the arguments for free trade and greater international economic partnership, unpopular though they may be, are put as strongly and as frequently as we are able.

Sir David Nicolson
Member of the European Parliament

A Ministerial Commendation

The Tokyo Round of Multilateral Trade Negotiations to strengthen the rules of world trade, the GATT, took seven long years to complete and the results began to come into effect in January 1981. Most of the major industrialised countries of the world reaffirmed their belief in the open trading system and their determination to abide by the new rules. It has since become clear that the renegotiation of the rules was the easy part of the process and that their implementation is going to be very difficult.

The recession has given rise to economic problems in most developed countries. The search for scapegoats is on and the pressures for protectionism grow. At such times it is the voice of the producer which is loudest and all Governments have to recognise that well organised, well financed producer lobbies are now more active than they have been for may years offering false panaceas. A statement of commitment to the open trading system and a condemnation of general import controls is followed quickly by a demand for specific controls in certain areas. If producers had their way there would be so many specific controls that the difference between specific and general would effectively disappear.

Mr Congdon has chosen the most appropriate time to demonstrate the folly of a great deal of current thinking and to remind us that the commitment we made to implement the new rules for world trade and to observe them offers far and away the best prospect for dealing with the problems of the recession. The idea that we can protect our way out of trouble is fundamentally wrong-headed. Mr Congdon demonstrates this with great skill and conviction.

Cecil Parkinson MP
Minister of State
Department of Trade

Introduction

In the last thirty years several all-embracing solutions for Britain's economic weakness have been proposed, partially adopted and then dropped. Planning and devaluation were the two pet nostrums of the 1960s, each of which, before it was applied, was thought to have special curative properties. At present some entrepreneurs of economic opinion are campaigning for an idea which, both in the ambition of its objective and the style of its marketing, resembles these earlier pretences to a panacea. The idea is import control. Its most insistent salesmen are the staff of the Department of Applied Economics at Cambridge. They are supported, inevitably perhaps, by businessmen and trade unionists in industries subject to severe import competition. In February 1979 British Leyland ran a series of full-page newspaper advertisements proclaiming "The Battle for Britain"; one of the advertisements averred that British manufacturers were "fighting" for a "proper" market share and claimed that other countries "instinctively protect domestic markets by preferring to buy home-produced goods when they can".[1] Several politicians have become involved, with most import control advocates in the Labour Party. But grumbles about the government's allegedly too ideological commitment to free trade have also come from Conservative back-benchers. Positions on the "protection versus free trade" question do not mirror positions on the conventional left-right political spectrum.

It is not surprising that there should be a demand for import controls from such opinion-peddlers as business pressure groups, humdrum columnists and MPs self-consciously on the make. Protectionism is, almost by definition, a nationalistic sentiment since it rests on the premise that trade which crosses frontiers is in some way different from trade within frontiers. It has obvious attractions for any journalist or politician who wants to beat the patriotic drum. Protectionism appeals to the most unthinking of prejudices, that the group one belongs to deserves to be treated differently from others. The chauvinist strand is sometimes made obtrusive by resort to images of conflict and military metaphors. Thus, BL is said to be "fighting" for a market. More significant, since it came from one of the most thoughtful ministers in the last Labour government, was Edmund Dell's observation that international trade was "a war of all against all".[2] When he said this, Mr. Dell was Her Britannic Majesty's Secretary of State for Trade.

It is surprising, however, that a well-defined circle of academic economists, such as the Cambridge Economic Policy Group, should favour a move towards import restriction. The economic theory on this issue is extensive, rigorous, long-established and widely taught; it shows that free trade *is* best for the world economy.[3] There are some qualifications to the conclusion, but they are not fundamental and in only one or two rather unusual cases can it be demonstrated that the imposition of a tariff improves welfare. These arise when a large country is able to turn the terms of trade in its favour because the demand curves for its imports and exports are less than infinitely elastic. They hardly apply to Britain, because of its smallness, and certainly form no part of the protectionist argument as it has been presented so far. The stand taken by the CEPG is, therefore, difficult to explain and justify. Given the weighty scholarship of the intellectual case for free trade, some economists consider that the CEPG has forfeited respect by its uninhibited advocacy of import limitation. Occasionally members of the CEPG seem to recognise the professional disquiet aroused by their views and hide behind euphemisms to conciliate their critics. Professor Robert Neild, for instance, has written on "managed trade" which he equates with "organized free trade".[4]

All the same, the CEPG has performed a valuable public service in assembling a compendium of fallacies and distilling them into one readily accessible source—their sequence of annual *Economic Policy Reviews*. As it is easier to attack coherent error than diffuse complaint, the CEPG has excused believers in a liberal trade system from the need to answer the random grievances of miscellaneous business and trade union interests. Maurice Scott, with colleagues formerly at Nuffield College, Oxford, has countered the CEPG argument by doubting both the validity of the deductions drawn from its model and the legitimacy of its analytical framework.[5] Nevertheless, focus on the Cambridge case against free trade may not prove a successful polemical strategy. Such an exercise, being critical in character, must be negative in tone. What is needed is a positive restatement of the case for free trade accompanied by a straightforward account, not slowed down by technical exegesis of the CEPG model, of the damage import controls would cause. Indeed, it is possible that general academic disdain for protectionism has left a vacuum in the public debate, since university teachers do not improve their reputations by scribbling popular and topical pamphlets against mistakes and confusions which have been regarded as such for decades. The purpose of this essay is to help fill that vacuum.

This is not a review article on the massive international trade literature, nor is the text cluttered with diagrams and equations. The first chapter deliberately avoids complexity, by amplifying Adam Smith's insight that economic specialisation generates—and, indeed, is almost equivalent to—economic progress. It emerges that perhaps the most effective method for undermining the protectionist position is to push it to its logical extremes. The second chapter is a more conventional critique of import controls which emphasizes that the effects of new and increasing imports in one area in the economy are balanced by benefits elsewhere. The final chapter examines the tragic consequences of autarkic policies for the economies of Argentina and Chile, which were, at one time, among the most dynamic and outward-looking in the world. In view of the odium the two countries have incurred in recent years, not least because they have set about reversing such policies, this chapter may be the most controversial. It may also be the most instructive. It would be tragic if Britain, by gradually closing its economy to the outside world, were to end up in the same chaos as Chile in 1973 or Argentina in 1976.

This essay has been written in some haste and I have not sought extensive comments on the text. But I am grateful to Maurice Scott for some helpful remarks. Responsibility for errors and opinions rests entirely with the author.

I would also like to say a special word of thanks to Bibiana Tang, my secretary, for being so helpful and efficient in typing the essay.

Notes

(1) The advertisement appeared on p. 5 of *The Times* on 11 February 1980. It was criticised in T. G. Congdon 'Why buy British?' *The Spectator* 23 February 1980.

(2) E. Dell 'The politics of economic interdependence', Rita Hindley Memorial Lecture, London 12 February 1977. The quotation is from p. 265 of D. Lall 'The wistful mercantilism of Mr. Dell' *The World Economy,* June 1978.

(3) The classic demonstration, at the most sophisticated level of high-brow economic theory, is in P. A. Samuelson 'The gains from international trade once again' *Economic Journal* 1962, pp. 820-9. A much more accessible and comprehensive treatment is provided by W. M. Corden *Trade Policy and Economic Welfare* Oxford University Press 1974. A list of reasons for protection is given on pp. 412-4.

(4) R. R. Neild 'Managed trade between industrial countries' in R. Major (ed.) *Britain's Trade and Exchange-Rate Policy* Heinemann: London, pp. 5-23. The quotation is from p. 5. The juxtaposition of these two phrases in his paper is nevertheless rather odd since only shortly afterwards "management" is defined as "any action designed to cause a deviation from free trade".

(5) Their work is brought together in M. Fg. Scott et al *The Case against General Import Restrictions.* Trade Policy Research Centre: London 1980. See particularly chapter 3 on 'Flaws in the Cambridge Group's case for import restrictions'.

I. "That the Division of Labour is limited by the Extent of the Market'

i

The title of this chapter is not original. It is the same as that of chapter three in Adam Smith's *Welfare of Nations*, published in 1776. Smith's work was organized as an indictment of mercantilism, the system whereby eighteenth century governments regulated trade in order to strengthen the balance of payments. Although he broached in a number of passages the opportunity cost notion which lies behind the modern theory of comparative advantage, he did not have this theory in fully-fledged form. It is the most satisfactory demonstration of the virtues of free trade. Without this conceptual tool, he had to rely on a more direct and intuitive approach. The division of labour gave him the idea he needed.

Smith's starting point in his first chapter was casual empiricism. He asked his readers to observe how "the accommodation of the most common artificer or day-labourer in a civilized and thriving country" depended on the industry of people whose number "exceeds all computation". A woollen coat, for example, was the product of nine crafts, quite apart from the merchants and sailors involved in transporting raw materials and the finished article, and "the variety of labour . . . necessary . . . to produce the tools of the meanest of those workmen". In consequence, the living standard of "an industrious and frugal peasant" in an advanced European country exceeded "that of many an African king, the absolute master of the lives and liberties of ten thousand naked savages".[1]

The explanation was that the division of labour, so distinctive a feature of "a civilized and thriving country", led to great gains in productivity. Workers' dexterity improved the more times they carried out one operation; time was saved by not passing frequently from one sort of work to another; and the invention of machinery, by which labour was "facilitated and abridged", was more likely when the attention of men's minds was "directed towards a single object, than when it is dissipated among a great variety of

things". Smith's most celebrated example was the manufacture of pins. By himself, an unskilled worker could not make more than 20 pins a day; in collaboration with others, an experienced pin-maker could be responsible for 4,800 pins a day.[2]

If the division of labour was the key to greater productivity, on what principle did it rely? Clearly, the different stages of a production process depended on the sale of raw materials to a manufacturer and the sale of finished goods to middlemen. The middlemen, in turn, had to seek a market. In other words, "the propensity to truck, barter and exchange one thing for another" gave occasion to the division of labour. It was a short step from here to assert that "the division of labour is limited by the extent of the market". As Smith expressed it:

> When the market is very small, no person can have any encouragement to dedicate himself entirely to one employment, for want of the power to exchange all that surplus part of the produce of his own labour, which is over and above his own consumption, for such parts of the produce of other men's labour as he has occasion for.[3]

The logical chain was complete. Productivity gains—and so economic growth—depend on the division of labour; and the division of labour depends on the extent of the market. Specialization is therefore almost synonymous with economic advance. Any interference with "the trucking disposition" or any curtailment of the market "by extraordinary restraints" on trade, to use Smith's terms, hinders specialisation and checks "the progress of opulence". Although Smith digressed for several hundred pages in *The Wealth of Nations* before resuming his attack on the evils of the mercantilist system, the insights developed in the first three chapters were his sharpest critical weapons.

These insights remain basic to the case for free trade. Specialisation between individuals has been taken so far in industrial countries that the typical worker does not consume any part of his own production, but relies entirely on what he buys of other people's production. His 'trade' is equivalent to 100 per cent of his income. Indeed, there are many economic agents whose trade is greater than their income. A wholesaler or retailer obviously buys and sells goods worth several times the profit he can expect to earn. Most companies, whose income is strictly speaking only the dividends attributable to shareholders, have a turnover which is a multiple of those dividends. The same principle can be extended from individuals and companies to the regions of a country. The 'trade' of the average English county is more than 100 per cent of its gross domestic product. This may seem curious until it is noticed that its industries usually purchase materials and components from other counties, sell them in a semi-finished condition and buy them back again as finished goods. Because the value of the transactions in primary and intermediate goods exceeds actual 'value added', the ratio of trade to output is above one. In fact, there are some significant politically autonomous units where this is also the case; the city-states of Hong Kong and Singapore, neither of which has tariff or non-tariff barriers on its trade, are the best examples.

If an individual were to cut himself off from trade, he would immediately suffer a precipitous decline in living standards. There may be a deep, instinctive urge to return to the simple life of self-sufficient agriculture; the yearning was once exploited politically in this country when the ideal of labourers' small-holdings with "three acres and a cow" was advanced by Joseph Chamberlain and Jesse Collings in the 1880s; but there can be no doubt that by foregoing the complex economic interdependencies of a modern society an individual would be much poorer.[4] Equally, any county which erected obstacles to trade with other counties would lose the advantages of specialisation. Its industries would have to cater for smaller markets and provide a wider range of products, almost certainly at higher unit costs. At the level of nations, the same drawbacks apply. A country fully engaged in international exchange has access to the best and most sophisticated goods available. Because many local needs are met by imports, its industries do not have to supply solely the domestic market, but can look outwards to the world market as a whole.

So far the argument, following Smith, has laid stress on the efficiency gains, arising from economies of scale and experience, which accrue from the division of labour. Trade enables individuals, regions and countries to achieve increased output per head. In economic language, societies move to a higher 'production function'. But this is not the central theme of modern trade theory. Instead, it takes production functions and the resources of capital and labour able to exploit them (or factor endowments) as given. It proceeds to show how differences in factor endowments or consumption patterns between countries make trade worthwhile.

The underlying rationale is simple. A closed economy, with no international trade, establishes by the operation of supply and demand in various markets particular price ratios between goods. By opening itself up to commerce it becomes possible to trade at different price ratios, those existing in other countries. The price it can obtain for the goods which was relatively cheap within its own territory before trade is raised. It is profitable to specialise on making this goods, selling part of its production abroad and in return buying the goods which used to be relatively cheap in other countries' territory. International trade allows the economy to seek new and better

consumption opportunities even though its technology and resources are unchanged. In the words of David Ricardo in his 1817 *Principles of Political Economy and Taxation*, "No extension of trade will immediately increase the amount of value in a country [by which he meant the total labour input] although it will very powerfully contribute to increase the mass of commodities, and therefore the sum of enjoyments."[5] This can be translated into modern technical terms as saying that participation in trade does not 'immediately' increase national income, but it does increase consumers' and producers' surplus. Although not captured by national income accounts, consumers' and producers' surplus are the most analytically satisfactory measure of welfare.[6] (The word 'immediately' is important, as it suggests Ricardo did not want to deny the subsequent bonus from economies of scale and experience described by Smith.)

One deduction from this theory of specialisation is that a country with static output, by a rising ratio of trade to output, is experiencing a gain in welfare. Britain has not been far from this position in the last seven years. Gross domestic product per head rose by only 5·4 per cent between 1973 and 1979, while the ratio of exports to output climbed from 27·1 per cent to 32·5 per cent and of imports to output from 32·5 per cent to 35·0 per cent. Impressionistic evidence—in particular, of the benefits which many people have clearly derived from foreign-made cars and consumer durables—tends to confirm that economic progress is understated by the national income figures. Unfortunately, the degree of understatement cannot be easily quantified.[7]

The division of labour, made possible by trade, improves efficiency; specialisation according to comparative advantages, also made possible by trade, improves welfare. These two principles apply to trade between individuals, regions and nations. It is self-evident that individuals are worse off as Robinson Crusoes than as members of a sophisticated industrial society. It is fairly obvious that regions would lose out if they separated from the countries to which they belong. Why, then, should nations be any different? They bear the same relationship to the world as regions do to countries. Indeed, many politically distinct entities—such city-states as Hong Kong and Singapore again illustrate the point—are smaller than the regions of large nations. If there is free trade between regions, why should there not be free trade between countries? To quote Adam Smith once more, "Were all nations to follow the liberal system of free exportation and free importation, the different states into which a great continent was divided would so far resemble the different provinces of a great empire."[8] Interferences with trade, justified as they are solely by the fact that frontiers are in one place and not another, must reduce both efficiency and welfare.

ii

The protectionist lobby has placed heavy emphasis on the extent to which the domestic market is now being supplied with foreign goods. Import penetration is presumed to be a sign of economic weakness, a symptom of the inability of British industry to compete even within its own market. The newspaper advertisements sponsored by British Leyland reflect this attitude; above the caption, "The Battle for Britain", appeared a kitchen scene with tags such as "Portable Radios: Imported 96 per cent", "Mixers with Bowl: Imported 56 per cent" and so on. But we can now see that this whole caste of mind is a mistake. As long as imports are matched by exports and there is no payments imbalance, high import penetration ratios are equivalent to a high degree of trade specialisation; and the more deeply involved a country is in international commerce, the greater is its economic welfare.

Whether imports are matched by exports is, at first sight, solely an empirical question. (In the next chapter, however, I shall argue that a balance-of-payments 'problem' is a conceptual illusion). Fortunately, the evidence is abundant and clear. An official study published in 1977 showed, in the period from 1968 to 1977, "Over manufacturing as a whole the growth in import penetration seems to have been matched by an increase in the export sales ratio." The banausic details are that food manufacturing, chemicals and the soap and detergents industries had expelled imports and gained new export markets, while metal manufacturing, textiles and the car industry had lost ground. In the mechanical and electrical engineering industries increased import penetration and higher export sales ratios had been more or less level.[9] Relative export and import performance was disturbed in 1978 and 1979 by the appreciation of the pound and there is no doubt that it was sterling's movement which gave impetus to the import control campaign in 1980. But, again, taking a long time-span, the figures are reassuring. In the ten years from 1969 to 1979 import volume rose by 63 per cent—and export volume by 61·8 per cent.[10] Exports were by far the most vigorous component of demand, rising by an average 4·8 per cent a year, while gross domestic product went up only 1·9 per cent a year.

Import control advocates believe—wrongly—that imports can be stopped without damaging exports. If certain imports are prevented from entering Britain, the domestic demand for these goods will either be unsatisfied (in which case living standards plainly fall) or resources made available so that they can be produced in Britain. But where would such resources come from? Unless the supply of other goods destined for the home market is disrupted (again with direct effects on living standards) they must come from export-oriented industries. When labour and capital is bid away from the production of exports to the production of import-substitutes, gains from international specialisation are lost. Any restraint on imports is also a drag on exports. As import controls take effect industry becomes inward-looking, with enterprise becoming cramped and confined by the small local market.

The momentum that trade specialisation can give to an economy has been recognised in theories of 'export-led' or 'export-propelled growth'. They vary in formulation, but the most familiar theme is that business confidence is promoted by access to the larger markets made possible by export growth; in consequence, investment and 'technical dynamism' benefit. Kaldor has identified a more specific rationale in Verdoorn's law, a putative relationship between the rate of sales growth in manufacturing industry and the rate of productivity growth. There has undoubtedly been an association in the last thirty years between rapid export growth and more broadly-based economic expansion, at the level both of the world economy and of individual countries. But the reasons were explained very well by Adam Smith two centuries ago and it would be much more accurate to speak of 'specialisation-led' than 'export-led growth'. Exports have no unique or special attributes as an economy's adrenalin-pump. Why should companies respond differently to an order from abroad than an order from at home? Why should unions and management be more "technically dynamic" because they are selling in Dusseldorf rather than Leeds? The gains come because certain products and lines can, in a free trade situation, be supplied from abroad. It becomes possible to concentrate on exports instead, gaining the economies of scale and experience attributable to longer production runs. The doctrine of export-led growth is an emphatic validation of the case for free trade. It is ironic, therefore, that the two authorities on export-led growth in Britain, Kaldor and Beckermann, have now publicly espoused import controls.[11]

There are perhaps two explanations for this paradox. The first is the belief that a particular category of demand or output has particular growth-inducing properties and should be manipulated by the government. If it were true that exports and imports had the same economic repercussions as any other sales and purchases of goods, if all business transactions and activities were equally desirable, there would be no merit in official favours to certain sectors of the economy nor, indeed, in any deliberate government role. But this suggestion of government impotence is unpalatable to the interventionist mentality—and also to the policy advisers who have taken advantage of it. So Kaldor, Beckermann and their associates must forever be discriminating between exports and imports, industry and services, public sector and private sector, and so on, in order to justify their pet interferences. The second explanation is much cruder. It might be termed 'commodity imperialism'.[12] When British visitors to India or Australia in the nineteenth century saw the Union Jack on public buildings it gave them a thrill, a consciousness that their civilisation had spread and dominated. Equally, when they go to France or Spain for their holidays in the 1980s and fail to notice many British-made cars some may feel a loss of visibility and presence. Their national pride has been affronted. How much worse still if shops in Britain itself are stuffed with imported articles and garages with foreign cars; and the worst desecration is for that final refuge of a nation's way of life, the British kitchen, to be filled with "Portable Radios: Imported 96 per cent" and "Mixers with Bowl: Imported 56 per cent". The ideal of commodity imperialism is for Britain to be exporting everything it produces and either importing nothing or importing only goods of British design with British brand-names. This is patent absurdity. Quite apart from the cultural impoverishment of having only British things to buy, the excess of exports over imports would be a permanent denial of consumption. Despite this, commodity imperialism is not proposed as a conceptual frippery. Although no one may have openly stated his belief in it, it seems to be implicit in many utterances and sentiments of import control enthusiasts. It certainly accounts for the simultaneous advocacy of export-led growth and import restraint, a combination which a few seconds of clear-headed thought would show to be totally inconsistent.

iii

So far I have focused discussion on the advantages of free trade and the logical incoherence of some arguments levelled against it. It may reinforce the central theme of the last few pages—that commercial specialisation and economic advance are one and the same process—if we now consider the disadvantages of trade restriction.

It should be said straightaway that, despite the extensive public debate, few well-defined targets present themselves for critical examination. Numerous industry lobbies have called for import quotas on the products which concern them most directly, but the motive is always selfish and the analytical vindication usually feeble. Instead we must return to the Cambridge Economic Policy Group to find a clearly formulated protectionist strategy. For many years its annual *Economic Policy Review*, though enthusiastic about import controls in general, failed to provide a short, simple and precise statement of what import controls would actually entail. The usual approach was to demonstrate that, with a given growth objective, the balance of

payments would deteriorate intolerably if conventional policies were followed; devaluation and import restriction were then contrasted as possible remedies; and import restriction, measured relative to an external payments target, emerged as preferable. The content of the import restriction programme was left unspecified and opaque; nowhere was it said what tariffs, quotas or import deposit schemes would be needed to accomplish the desired degree of restriction. But in its 1980 *Economic Policy Review* the CEPG gave some numbers for the first time. Its projection of an "alternative economic strategy" was based on a 30 per cent tariff on finished manufactures, 20 per cent on semi-manufactures, 15 per cent for services and zero for food, oil and raw materials, imposed from the start of 1981.

In the paragraphs after this recommendation two arguments in favour of the alternative strategy were outlined. The first, in the tradition of previous *Economic Policy Reviews*, was that import controls would remove the balance-of-payments constraint on a reflationary demand stimulus and that reflation would be followed by improved utilisation of existing capacity; the second, advanced less explicitly, was that import restriction might enable British industry "to modernise more rapidly than in the past" and build up "a stronger productive base with which to face the 1990s".[13] The reflation argument generates a need for ever rising tariff rates because, according to New Cambridge, the trends responsible for Britain's secular balance-of-payments deterioration are cumulative and must be neutralised by ever stronger doses of protectionist medicine. Thus, the *Review* states that, "The results of very tentative calculations . . . are that by 1990 the highest tariff rate, that on finished manufactures, might have to reach 70 per cent to sustain growth of business output at 4 per cent a year." The difficulty is that there is no upper bound to the appropriate tariff level. If the underlying causes of payments imbalance have not been corrected, the CEPG recommendation for the 1990s might be tariffs of well over 100 per cent. It would be very helpful, therefore, if the second argument proved valid. Were tariffs to have a benign impact on the performance of British industry, permanent and, indeed, escalating tariffs would not be needed. Instead, once the refurbishment of the "productive base" had been completed, tariffs could be reduced or eliminated. The 1980s would be a protectionist interruption, a sort of industrial rest-cure, to a basically free and open economic policy.

But the second argument does not stand up. Suppose it were true that 30 per cent and 70 per cent tariffs on finished manufactured imports had favourable effects on the "productive base". Then, logically, 300 per cent and 700 per cent tariffs would be even more beneficial. Moreover, it would be rash to wait until 1990 before introducing them; they should be imposed straightaway. If the argument is right, there would be enormous and dramatic productivity gains to be achieved without further ado.

Is this credible? Common sense tells us that it cannot be. Tariffs of several hundred per cent would cocoon manufacturing industry from competition and almost certainly retard, rather than accelerate, modernisation. Even fervent advocates of import controls have not so far recommended that almost sheer tariff walls be brought in overnight. They have favoured 'moderate' tariffs and sometimes vacillated about whether tariffs or quotas, accompanied by auctions of import licences, would be best. The CEPG's long-standing reticence about the content of an import controls programme is, in this context, very understandable. Its members may realize that approval of a low tariff, because it will bring some advantages, leads inevitably to approval of a high tariff because it will bring even more. But that seems implausible. Hesitation about specifying, in exact numbers, the appropriate tariff arises from the insecure intellectual foundation of the protectionist case.

This sort of attack on protectionism—that when taken to extremes it becomes absurd—can be pressed in another direction. All import restriction proposals are in a sense artificial because they rely on the existence of nations and of frontiers between them. Tariffs are levied and quotas enforced when products pass frontiers. But nations and frontiers are not immutable; they could be changed readily if the political will were strong enough and the potential economic gain sufficiently attractive. The mutual economic relationships of regions differ from those of countries mainly because fewer hindrances are placed on the movement of products between them. As regions share the same government and law, the obstacles to commerce are less than those between nations. Supporters of import controls believe that countries become more prosperous by shutting themselves off from their neighbours and placing stricter barriers on trade. Their recipe for higher economic welfare should be quite general. Not only should countries impose higher tariffs on imports from other countries, but also regions should erect tariffs on imports from other regions. Indeed, the process should be widened. Cities, towns, villages, hamlets and even streets should have their own import control machinery, with customs officers, tariff schedules and, of course, presiding Economic Policy Groups to keep the public fully aware of the merits of trade restriction. In this way, industrial "modernisation" can be furthered, while the "productive bases" of the villages, hamlets and streets concerned are revitalised. If protectionism is the answer to Britain's economic problems, it must also be the path to greater affluence for Yorkshire, Cornwall and Norfolk. These counties should, in their own self-interest, unilaterally declare economic independence from the rest of the United

Kingdom and bring in tariffs of, well, whatever the right figure may be. The county councils would no doubt seek the advice of their respective Economic Policy Groups on whether "20 per cent for semi-manufactures, 30 per cent for finished manufactures, 15 per cent for services . . . and zero for food, oil and raw materials" were really suitable.

This may sound like a flight of the imagination, an extravagant caricature, which need not be taken seriously. But it is seriously intended. The purpose of the exercise is to emphasise that protectionism is just another form of nationalism and that, like all nationalist sentiments, it is as legitimate as the concept of the 'nation' with which it deals. There is no doubt that many people are loyal to Britain in a way that they are not loyal to the neighbourhood where they live. But this does not explain why the economic relations of regions within a country should be behaviourally different from those of countries between themselves. Protectionism suggests that political fragmentation and disintegration are the keys to economic advance. In his splendid anti-imperialist satire, *The Napoleon of Notting Hill,* Chesterton hinted almost eighty years ago that it was as sensible to be patriotic about Battersea and West Hampstead as about the British Empire. The logical culmination of the nationalistic trends then current was the Great Army of South Kensington, the Battle of the Lamps in Portobello Road and the Empire of Notting Hill. Equally, the logical culmination of protectionism is internecine tariff wars between English counties.[14]

Once nationalism is allowed into the discussion, the rational base for economic assessment is, of course, eroded. The assumption of paramount consumer sovereignty may no longer be applicable. Instead of individual utility being the motivation for economic action, a more complicated welfare function—in which collective enjoyment plays a role—has to be maximised. It has been suggested that electorates obtain satisfaction from two sources—private consumption; and "collective consumption of goods and services provided through the government at the cost of sacrifices of private consumption". In the electoral conflict "competition among parties will tend to carry the allocation of the economy's productive resources between private and collective consumption to the point where the marginal return of satisfaction per unit of resources expended is the same in the two uses."[15] In such a world, the virtues of free trade are heavily qualified because "satisfaction", as appraised by politicians, may encompass such non-economic objectives as self-sufficiency and the psychic kick from overseeing certain industrial activities. Self-sufficiency is, almost by definition, incompatible with free trade; and the development of particular industries for reasons of national vanity may require tariff or quota protection. These non-economic goals are often explicable in terms of commodity imperialism. Self-sufficiency naturally implies that foreign goods are not visible in the country where one lives and, if the sight of only indigenous products is itself a benefit, the country is better-off. The industries which the commodity imperialist favours tend to have a number of common characteristics. They are technologically advanced; they are associated with 'big-ness', being able to exploit significant economics of scale; and they can plausibly attach the epithets of 'strategic' and 'indispensable', two terms which make most sense if there are military applications. A country with such industries should be able to boast about its technological sophistication, its commitment to world-scale industries and its defensive strength.

Regrettably, all this bravura has its costs. The biggest and most obvious is that making a wide variety of products to achieve self-sufficiency and making various special products to flatter national pride absorb labour and capital from other activities, including those in which a country has its comparative advantage. Since the outcome is not to be judged by purely economic criteria, it may seem unnecessary to take this discussion further. But the interesting point is how readily protectionists appeal to non-economic arguments, often without being conscious of what they are doing.

The most conspicuous examples are in developing countries where large sums are invested in prestige projects, such as steel mills and car factories. These are invariably unprofitable and have to be insulated from foreign competition by high tariffs if they are to survive. But the same mentality lies behind the present anxiety about 'de-industrialization' in Britain. Members of the CEPG have been active not only in supporting a programme of import controls, but also in expressing alarm about the contraction of manufacturing output and employment. Indeed, the tariff structure they have proposed—with the highest rate being on finished manufactured imports—reflects their solicitude for industry. The obsession with finished industrial products is consonant with the thought-habits of commodity imperialism. The raw materials and components which go into products 'in the shop windows' are hidden from the final consumer; he is conscious only of the brand name and the country in which the last stages of fabrication took place; nationalistic excitement is felt from seeing finished articles from one's own country, rather than from abroad, even if most of the constituents of the product are imported. The wish for visibility to the final consumer may in part account for the competition between governments to bribe multinational enterprises into locating car assembly plants, shipbuilding yards and other late fabrication manufacturing units within their borders. Protectionists who worry about the growth of finished manufactured imports and de-

industrialisation are thinking on precisely the same lines. It should be unnecessary to note that the whole approach is based on a delusion. Anyone who regards a product as British when 80 per cent of its value was added abroad and only the last 20 per cent in this country is a bit silly.

Although the case developed so far against import controls has been primarily economic there is a more fundamental philosophical objection; they are an infringement of personal freedom. Economic transactions between the citizens of any one country suffer from many government interferences, but in principle the same legal system is applicable to all. However, when tariffs or quotas are in force, transactions with individuals in another country are subject to different rules purely and simply because those individuals belong to another political unit. There may be no ethnic or even geographical logic in this. An Englishman in Britain may buy something from an American company with a Birmingham office without paying a tariff, but if he buys the same product from the American subsidiary of a British company he does have to pay a tariff. A factory in California has a market nearby in Mexico, but tariff barriers encourage its management to seek sales outlets elsewhere in the USA, even though some markets, such as those in New York or New England, are thousands of miles away. The existence of national frontiers and trade barriers causes economic actors to behave contrary to their own free choice and against what Adam Smith termed the "natural and most advantageous distribution of stock".[16] From a libertarian standpoint, there is no justification for treating individuals in different nations in different ways. Frontiers and nations are merely political accidents. As Chesterton wrote of Cecil Rhodes, "who thought that the only thing of the future was the British Empire", protectionists look at the world as if

> there would be a gulf between those who were of the Empire and those who were not, between the Chinaman in Hong-Kong and the Chinaman outside, between the Spaniard on the Rock of Gibraltar and the Spaniard off it, similar to the gulf between man and the lower animals.[17]

Nothing except national prejudice warrants such discrimination. If free trade is permitted between the citizens of a country, it should be permitted between the citizens of different countries.

By interfering with the freedom of trade across frontiers, the state is able to exert powerful influence over the distribution of income within frontiers. It is indisputable that a tariff, however much it harms the public at large, is of benefit to the domestic industry concerned. There is even a celebrated result, known as the Stolper-Samuelson theorem, that in a two-factor, two-product world the opening of an economy to trade reduces the absolute real income of the factor of production which was relatively scarce under autarky. As its authors recognise, it follows that there may be "a grain of truth in the pauper labour type of argument for protection".[18] But society as a whole does not gain from protection and it should be possible for those groups which gain from free trade to compensate more than fully those groups which lose. More realistically, when it becomes known that the state is susceptible to pressure from particular interest groups and indulges in mercantilist policies to alter income distribution between them, those groups have been given an incentive to lobby politicians for protectionist favours. Professor Alan Peacock has commented on how private businessmen now face a "motivation distortion" because profit-maximisation has "increasingly less to do with satisfying the needs of current and potential final customers". Instead, "an enormous amount of time and effort" has to be devoted to adjusting production to government wishes. This distortion is over and above that caused to the production "mix" from socially-motivated resource misallocation and inappropriate relative prices.[19]

The damage can increase exponentially. A protectionist structure, once it is in being, creates its own growth momentum. Politicians, aided and abetted by the bureaucracy, improve their lot by multiplying tariffs, quotas and trade regulations. It increases their work-load and enhances the need for ever increasing numbers of administrators, customs officials, lawyers and so on. As such 'work' is socially futile, import controls impoverish a nation by switching people away from gainful employment. Moreover, those who remain in productive activities suffer from motivation distortion. They find that it is more worthwhile trying to win preferential treatment from politicians than upgrading their technology or intensifying sales campaigns. It is particularly galling for a manufacturer, who has worked hard to improve his product and raise his profits, to see a rival obtain an equal or larger profits boost from the political gift of a new tariff, import licence or whatever. The injustice of this process stems from the purely private nature of the benefit being awarded to the lobbyist. Society as a whole is probably worse-off because a particular regulation or control has been introduced. The discrepancy between social and private costs and benefits creates opportunities for corruption, exaggerating the distortion of incentives and the economy's inability to respond to authentic price signals. There are techniques by which market forces fight back. The three most common in external trade are smuggling, under-invoicing and the misclassification of goods away from high-duty into low-duty categories. In the case of developing countries with severe tariff barriers, these attempts at evasion are costly to prevent. The island states of Indonesia and the Philippines, close to the free ports of Kong Kong and Singapore, have found smuggling a serious and

intractable problem.[20]

But, if market forces cannot be pent up, it is distasteful and unhealthy that they must seek illegal forms of release. Indeed, the general characteristics of a society adopting protectionism are that the legitimate economy succumbs to the 'black' economy and that both types of activity are replaced by political methods of gaining economic rewards. Politics is essentially unproductive; a politician gives to one group by taking away from another; he cannot increase output, only redistribute it. The economy therefore increasingly resembles a zero-sum game and benefits go, not to the productive and thrifty members of a society, but to the most noisy, violent and selfish. It becomes an assumption of thought that nothing can be done by individuals, but anything and everything can be done by the state. The ultimate outcome of protectionism is social disintegration and collapse. This may sound far-fetched, but there are today usually a handful of developing countries on the verge of a catastrophe of this kind. Almost invariably, their international trade is subject to a medley of tariff or other trade-restricting devices and their foreign payments are hindered by exchange controls of Byzantine complexity. As we shall see in chapter III, even quite sophisticated countries, such as Chile and Argentina, can fall apart after years of inward-looking, autarkic policies. It is naive to think that social collapse could not happen in Britain if a mistaken 'alternative economic strategy' were pursued. Perhaps the most important warning given by extreme instances of protectionist folly is that the intrusive government role erodes political freedom and attempts to restore economic sanity have necessitated military dictatorship.

It is recognised in public debate that the introduction of extensive and systematic import controls would have damaging consequences. Happily, the policy has so far gained only limited official favour. But in analysing the question of why protectionism should command the support it does and whether protectionist sentiment is likely to grow in future, the nationalistic element in the import controls propaganda is crucial.

Britain's history is a handicap to the free trade cause. In part this is because the relative freedom of trade in the past hundred years has been accompanied by economic decline compared to other countries. But perhaps more serious are assumptions engendered by former economic dominance. Until thirty years ago Britain was a great power, with its political prestige enhanced by its eminent industrial position. It had a stake in making almost every important industrial product. Although in some areas, such as shipbuilding and textile machinery, its market share was much higher than its nearest rival's, the range and consistent quality of output was truly impressive. The memory of this comparatively recent omnicompetence is inimical to free trade. Free trade leads to specialisation and, for a country whose economic growth is slower than others and which is therefore becoming relatively 'smaller', that must be associated with its exit from several industries. Which industries have to contract will depend, as do all issues of resource allocation, on comparative advantage and not on the length of their craft traditions or the nostalgic regret their closure may cause. It is understandable that declining industries should object to the workings of market forces and appeal to Britain's past industrial heyday as justification for defensive import controls. The knowledge that Britain was once involved in such a wide spread of industrial activities strengthens these appeals. Many people believe that, if Britain manufactured a particular product thirty years ago, it can and should do so today. The great diversity of industry in the past suggests that self-reliance, rather than specialisation, is a viable and sensible policy now. Professor Johnson has attributed the varying strength of protectionism in different countries to their "generalised preference" for industrial production and their comparative advantage in it. There should always be at least one country, the so-called "strongest industrial country", in such a position that the universal adoption of free trade would increase its industrial exports more than its industrial imports. The weak countries want trade restriction instead.[21] On this analysis Britain, where there is a definite favouritism for industrial production, but which nevertheless is certainly not the foremost industrial nation, should see vigorous protectionist campaigning.

The connection between economic strength and a political disposition towards free trade, and between economic weakness and protectionism, was endorsed by Edmund Dell, as Secretary of State for Trade, in his 1977 Rita Hindley Memorial Lecture. In his view, commercial negotiations are conducted on the mercantilist principle of whatever is most in a nation's interest. This does not preclude free trade. In fact, "the typical mercantilist response" is "free trade where you are strong; nationalism where you are weak". A few other quotations from the same lecture expose the thought-habits behind these statements. The essential point is that Dell interpreted a nation's interests as being its "influence in the world", not its economic welfare. In his words, "Our first priority must be our strength, not our consumption". From the viewpoint of a politician, who has to represent his country at international meetings, that is fair enough. But whether the welfare losses to him, supposedly consequent on the pursuit of an open economic policy, outweigh the welfare gains to the community at large is doubtful; and whether politicians' self-esteem should form any part at all in the calculation of a nation's well-being is perhaps even more so.[22]

The candid nationalism of Dell's remarks is rare. Normally import control

advocates are furtive and apologetic about their nationalistic inclinations. However, it is understandable that a politician should be mercantilist on trade questions. As I argued earlier, politics is essentially a zero-sum game, from which some groups benefit only at the expense of others. Politicians may be excused regarding other types of activity, including economic, as having the same character. It follows from this line of thought that Britain's 'success' in international commerce may be equated with the failure of other countries; that trade does not give gains all round, but rather provides opportunities for competition; and that its outcome may be interpreted in terms of 'winners' and 'losers'. According to Dell, who considered the balance of payments a valid benchmark of attainment, "international trade is a kind of war in which it is better to win than to lose . . . You win by having a surplus and you lose by having a deficit". Moreover, to quote him again, ". . . the operations of the market are not inevitably in the interest of every nation participating in international trade. Those nations which are most competitive and energetic will thrive at the expense of their less vigorous competitors".[23]

The whole approach is mistaken. International trade is not a zero-sum game. Indeed, it is a fallacy of composition to imagine that it can be. Any individual act of exchange must, if freely undertaken, be to the advantage of both parties. If it were not, one or the other party would refuse to participate. Trade between nations involves thousands of such acts of exchanges. If each one individually confers benefits, they must do so collectively. The one way to escape this logic is to claim that certain parties in international trade are coerced into it, but this makes little sense when the subjects of the discussion are sovereign nation-states.

Several ideas are responsible, therefore, for protectionist attitudes: the belief, a legacy of the past, that Britain is capable of being a world-leader in many industries; the belief that industrial production, in particular the production of finished manufactures, is of itself a Good Thing; the belief that the government should decide on the distribution of income between different economic sectors; and the belief that trade, like politics, is a zero-sum game. All these beliefs are virulent in Britain at present and it seems inevitable that the protectionist case will continue to be advanced forcefully in the media. Their impact on public opinion will be compounded by the perception of Britain's relative economic weakness and its gradual retreat in world markets.

The irony is that the smaller an economy is in relation to others, the more it benefits from free trade. This principle is a corollary of the Smithian argument that specialisation and economic progress are one and the same thing. If the world were united under one government continents would specialise in different kinds of production and there would be the welfare and efficiency gains described earlier in the chapter. If the world were divided into two some specialisation benefits would be foregone, but they would probably not be serious because all the important fuels and raw materials, and favourable climatic environments, would be found in both halves. But suppose the world were split into a thousand independent political units and all were forbidden to trade with each other. The loss of specialisation benefits would be massive. It follows that a large country, such as the USA, which accounts for about a quarter of world production, would suffer much less damage from a move towards protectionism than a small country like Britain. There is an obvious common sense appeal in this. One would, after all, expect Hong Kong to experience a bigger drop in living standards than China if commercial relations between the two were severed. Or, again, if Somerset stopped trading with England, Somerset would lose more than England.

The relationship of Britain to the world economy is not dissimilar to that of a county to Britain. Britain has not much more than 1 per cent of the world's population and it produces about 3·5 per cent of world output. Income levels in the developing countries are likely, over a period of decades, to catch up with those in the developed, including Britain. As a result, Britain's output share will come to correspond more closely to its population share. A reasonable expectation is that in, say, thirty or forty years' time it will account for no more than 1·5 per cent of world output.

Clearly, Britain must specialise. Pessimists about the economic outlook, who tend to be import control advocates and jeremiahs about de-industrialisation, may ask in what activities specialisation will occur. Britain's decline in recent decades seems so comprehensive that they cannot envisage any sector with the capacity to withstand foreign competition. But, even if it were true that Britain had an absolute disadvantage in every industry, there must by definition be some industries where it has a comparative advantage.[24] In those it will specialise, unless impeded by government intervention or commercial protectionism.

Perhaps the best example for Britain to follow is provided by the two Asian city-states of Hong Kong and Singapore which have already made several appearances in this chapter as the heroes of the free trade philosophy. Both have populations which are miniscule in relation to their neighbours', but their role in world trade and finance is much greater. Their *per capita* incomes are also many times higher. These achievements reflect their governments' commitment to absolute free trade and the consequent specialisation on a quite limited range of products. In particular, they both act as entrepot and service centres for the bigger economies around them. Although it is perhaps unwise to make the conjecture, Britain's comparative advantage

today probably lies in the same activities that have made Hong Kong and Singapore so prosperous—communications, tourism, financial services, various forms of consultancy (legal and accounting work, computer software, engineering and technical consultancy), commodity trading and so on.[25] Any artificial attempt to retard de-industrialisation by erecting high (and probably rising) tariff barriers against manufactured imports would therefore be contrary to Britain's long-term interests. It would hinder this country from specialising in those areas where it excels. The 'alternative economic strategy' would not only deprive consumers of foreign products which they want and have freely chosen, but would also stop production moving into the most advantageous sectors. It is sad to think that, more than two hundred years after Adam Smith demonstrated that free trade, specialisation and economic growth are inextricably connected, there should still be vocal supporters of isolationist economic policies.

It may be a fantasy, but could one suggest that the role Britain might play in the world economy could resemble the role Hong Kong plays to China's economy? Hong Kong has a mere 0·5 per cent of China's population and it will not be long before Britain has about the same proportion of the world's. If this is Britain's future, the policy government should be considering is not a unilateral move towards protectionism, but the unilateral adoption of free trade.

Notes

(1) A. Smith *An Inquiry into the Nature and Causes of the Wealth of Nations* (eds. R. H. Campbell and A. S. Skinner) vol. 1 Oxford University Press 1976, pp. 22-24.

(2) A. Smith *ibid* pp. 14-15.

(3) A. Smith *ibid* p. 31.

(4) Significantly, Chamberlain later advocated the abandonment of free trade and split the Conservative Party in 1903 by his call for "tariff reform". It was the same caste of mind which could welcome a return to primitive rustic bliss. Kaldor, who has helped inspire the Cambridge Economic Policy Group, has written nostalgically about Chamberlain as a precursor of today's protectionist lobby. See his remarks on p. 22 of F. Blackaby (ed.) *De-industrialisation* Heinemann: London 1979.

(5) D. Ricardo *On the Principles of Political Economy and Taxation* (ed. R. M. Hartwell) Penguin: Harmondsworth 1971, p. 147.

(6) See the Appendix for a simple diagram explaining Ricardo's point and the notion of consumers' surplus.

(7) But see R. Batchelor and P. Minford 'Import controls and devaluation as medium-term policies', pp. 44-72, in H. Corbet et al *On How to Cope with Britain's Trade Position* Trade Policy Research Centre: London 1977, for an

interesting attempt to measure the loss of consumers' surplus potentially due to import controls.

(8) A. Smith *op cit* vol. 2, p. 242.

(9) J. D. Wells and J. C. Imber 'The home and export performance of United Kingdom industries', pp. 78-89, *Economic Trends* H.M.S.O.: London August 1977.

(10) These figures are slightly misleading, since exports were depressed and imports boosted in 1979 by two major strikes, the lorry-drivers' in January and the engineers' in September and October.

(11) Kaldor's position is well-known. For Beckermann on export-propelled growth, see W. Beckermann 'Projecting europe's growth' *Economic Journal* 1962. An attempt at formalisation is on pp. 379-80 of R. M. Stern *The Balance of Payments Theory and Economic Policy* Macmillan: London 1973. For Beckermann on import controls, see W. Beckermann 'A plan to rescue the economy' *New Statesman* 2 February 1979.

(12) The echo to Marx's "commodity fetishism" is self-conscious.

(13) University of Cambridge Department of Applied Economics *Cambridge Economic Policy Review* Gower: Farnborough 1980, p. 15. Other estimates of required protection, referring to the balance-of-payments obectives of earlier *Economic Policy Reviews,* are higher. M.Fg. Scott 'The Cambridge Economic Policy Group's case for import restriction', p. 32, in M.Fg. Scott and the Hon. W. A. H. Godley *The Arguments For and Against Protection* Bank of England papers for panel of academic consultants 1980, suggests that a 50 per cent tariff on imported tariffs would be needed by 1985 and 100 per cent by 1990 to achieve Cambridge objectives.

(14) We remarked in the introduction on the ease with which protectionists lapsed into military metaphors. Perhaps the habit is not altogether accidental.

(15) H. G. Johnson 'An economic theory of protectionism, tariff bargaining and the formation of customs unions' *Journal of Political Economy* 1965, reprinted on pp. 99-142 of P. Robson (ed.) *International Economic Integration* Penguin: Harmondsworth 1972. The quotation is from p. 102.

(16) A. Smith *ibid* vol. 2, p. 630. Smith was condemning the monopolisation of the American trade on the grounds that the "stock" (i.e. the resources) devoted to this "distant employment" was a diversion from "near" employments.

(17) G. K. Chesterton *The Napoleon of Notting Hill* John Lane: London 1904, p. 16. The classic exposition of the contingent character of the nation state is the third chapter, 'On the character of a modern European state', of M. Oakeshott *On Human Conduct* Oxford University Press 1975. R. G. Collingwood had the same perception when he criticised the idea of a "plan of nature", in which a particular political unit is the agent, as something formed in advance of its own execution. Thus, "We use phrases like the conquest of the Mediterranean world by Rome; but actually what we mean by Rome is only this or that Roman, and what we mean by the conquest of the Mediterranean is only the sum of this and that individual piece of warfare or administration which these men carried out." (R. G. Collingwood *The Idea of History* Oxford University Press 1946, p. 95).

(18) W. F. Stolper and P. A. Samuelson 'Protection and real wages'. *Review of Economic Studies* 1941, reprinted in pp. 245-68 of J. Bhagwati (ed.) *International Trade* Penguin: Harmondsworth 1969. The qotation is from p. 267. The authors continued that, "We are anxious to point out that even in the two factor case our argument provides no political ammunition for the protectionist . . . [I]t is always possible to bribe the suffering factor by subsidy or other redistributive devices so as to leave all factors better off as a result of trade."

(19) A. Peacock *The Credibility of Liberal Economics* Institute of Economic Affairs: London 1977, pp. 10-12.

(20) W. M. Corden *Trade Policy and Economic Welfare* Oxford University Press 1974, pp. 67-70.

(21) H. G. Johnson 'An economic theory of protectionism, tariff bargaining and the formation of customs unions' *op cit*

(22) D. Lall 'The wistful mercantilism of Mr. Dell' *The World Economy 1968*, pp. 263-77.

(23) These sentiments have some affinity to those of eighteenth century mercantilisits, who interpreted a nation's economic achievement in terms of the gold it had amassed by balance-of-payments surpluses. Since the world's gold stock was fixed in the short run, the more gold any one country had the less was available to its rivals. The parallel between this eighteenth century idea and the modern accountancy of trade shares was noted in T. G. Congdon 'Adam Smith as a critic of corporatism' *CBI Review* Autumn 1977, p. 44.

(24) To give a simple example. Suppose that it takes one man to make a car and a boat in Japan, but two men to make a car and four men to make a boat in Britain. Then Britain has an absolute disadvantage in making both cars and boats. But the price of a car, in terms of boats, is in Britain half that in Japan. It is therefore worthwhile for Japan not to make any cars, but to concentrate on making boats instead, sending them to Britain and exchanging them for cars.

(25) The right answer to the protectionist who asks on what Britain will specialise is, of course, "I don't know". No individual can foretell how market forces will dispose resources between industries. Someone who pretends that he can is guilty of Hayek's "synoptic delusion". (F. A. Hayek *Law, Legislation and Liberty* Routledge & Kegan Paul: London vol. 1 1973, pp. 14-15.) But the remarks in the text may be forgiven as an indication of possibilities. They are not intended to prescribe or forecast a course of action.

II. *A Conventional Critique of Import Controls*

Adam Smith's message—that the specialisation promoted by free trade leads to economic growth—is one of the most fundamental in economics. However, it does not play a significant role in today's technical literature on international trade, perhaps because his concept of specialisation is difficult to formalise and manipulate within a framework of given production and utility functions.[1] In this chapter, the emphasis shifts away from the Smithian argument towards a case against import controls derived from standard economic theory.

The protectionist is, of course, typically unconcerned about theory; his worries are more down-to-earth, practical and direct. They stem from the simple observation that when goods are imported into this country they drive out goods which would otherwise have been made here, causing losses of output and employment. To boost output and employment the right action is, in his view, straightforward: it is to stop the imports coming in. In a trivial sense, the protectionist is right. It does not require much imagination to see that the demand for British Leyland and Courtauld products would increase if the import of cars and textiles were banned. As this has an obvious common-sense appeal, it is perhaps not surprising that most opinion polls have shown substantial public support for import restraint. For example, a Gallup poll in July 1980 found that 60 per cent of its sample agreed that "one of the main causes of Britain's economic problems is the increase of imports of foreign goods" whereas 32 per cent considered that "blaming foreign imports is only an excuse for something else". Forty-six per cent favoured limiting the quantity of foreign goods allowed into Britain.[2]

But common sense can sometimes be the enemy of insight. The protectionist seems to be correct only because he concentrates on the industry and the workers immediately affected by import competition. This narrowness of focus is his weakness. Import controls on cars and textiles would help Leyland and Courtaulds, but they would have adverse effects on the rest of the economy. These effects can be quite subtle and complicated; they are difficult to analyse and understand. Unlike the protectionist, the free trader has a hard task in public debate.

The task is made more difficult by the apparent heartlessness of the free trade position. Every new wave of imports threatens the jobs of workers producing the same goods here. The damage, actual or potential, to British livelihoods is highly visible. To call for import restrictions seems public spirited and benevolent, to oppose them at best insensitive and at worst callous. It is easy to level the charge of unkindness against free trader economists such as academics or journalists, who occupy comfortable positions insulated from foreign competition. But it is important to realise that most participants in the import controls debate have little at stake personally in its outcome. The protectionist standpoint is a soft option, as it is heart-warming to enjoy the gratitude of producer groups in distress. By contrast, the advocates of liberal commercial policies have no well-defined constituency and are likely to be unpopular for what they say. In this sense, their views are braver than the protectionists'. The protectionist may appear to be philanthropic in intention, but this is a sham since it is not his money he is giving away.

In the next two sections we will show who does bear the cost of import restriction policies. As we have hinted, import controls emerge unfavourably when their effects on the whole economy are contrasted with those on the particular industry most affected.

i

When a tariff is imposed on an import, the price to the domestic consumer is increased.[3] In consequence, the consumer buys less of the goods in question. Here is the first and most clear-cut cost of import controls.

The implication is that consumers suffer from protection, while some (certainly not all) producers gain. But whereas the loss to any individual consumer from any individual protectionist device is small, the loss to a particular producer group from a particular import invasion can be massive. The intensity of its plight gives the producer group an incentive to lobby politicians for relief. The issue soon attracts newspaper headlines and, although growing imports demonstrate its dispensability, various claims are advanced that the industry's survival is in the 'national interest'. The consumers' viewpoint is soon obscured. "While the burden of adjustment is concentrated on a few identifiable producers, whose problems can easily be raised to the level of a national disaster, the benefits of freer trade, which are *truly* of a national dimension, are enjoyed by such large numbers and are thus so thinly spread, that people remain largely ignorant of them".[4]

Governments and politicians are, of course, aware of the temptations to succumb to producer group demands. In 1948 twenty-three countries bound themselves to the rules of the General Agreement on Tariffs and Trade, the basic feature of which is the 'most favoured nation' clause. The MFN principle requires that a country levy the same tariffs on imports from all GATT members, without discrimination between them. The GATT has been successful over the last thirty years in not only enforcing a self-imposed discipline on governments, but also in discouraging them from meddling with tariffs if they do break their vows and indulge in protectionist policies. The tariff is so conspicuous a weapon that other GATT countries would notice and complain if the rate were raised.

However, there has been a consequent tendency to institute non-tariff barriers to trade. One method has been to subsidise industries exposed to import competition so that prices are beneath cost and in line with world levels. In this case it seems that the consumer is not disadvantaged since he is paying the same price as if there were free trade. But this is wrong. Someone has to find the money for the subsidy and, if the government raises it by taxation, the consumer is worse off because his disposable income is reduced. The protectionist error here is to think that there is such a thing as 'government money'. There is not. Since the government produces nothing itself, it can grant a subsidy to an import-competing industry only by withdrawing resources from other groups in the community.

Another approach has been to negotiate informal "orderly marketing agreements" (OMA) with countries whose exports have grown at such speed that adjustment for the importing country is deemed intolerably abrupt unless a temporary (or permanent) check is introduced. Typically, the exporting country accepts that its share of a particular market be limited to a fixed percentage of the total. The remainder of the market continues as a sort of game-preserve for the domestic manufacturers, into which foreign outsiders can intrude only as poachers. Here, again, the consumers lose. As they would buy more than the stated limit if the OMA did not exist, there is excess demand for the product in question. The foreign exporters are therefore sensible to raise prices, earning profits above those that would be found in a truly competitive situation. The domestic manufacturers are also able to keep prices higher than would otherwise be the case. It follows that income is redistributed away from consumers as a whole to a specific producer interest.[5]

ii

It is perhaps unnecessary to labour the point that import controls curtail consumer choice and welfare. They obviously do. What is perhaps not so clear is that they also distort the structure of production. In the last chapter we outlined the argument that a policy to restrict imports by setting up trade barriers is simultaneously a policy to cut exports. It is now appropriate to develop this argument more fully. The costs of protectionism to exporting (and other) industries are among its most important side-effects.

The socially offensive aspect of free trade is that unbridled import competition can cause redundancies and increase unemployment. It would be quite wrong to say that liberal commercial policies cannot have this consequence or to deny that there is hardship for those who are put out of work. But the matter must not be allowed to end there. The question of why workers have lost their jobs has to be examined more closely.

The first part of the answer is that British prices are above world prices, making domestic producers uncompetitive. Since profits must have been whittled away to nothing in the circumstances we are considering, the reason for high prices must be high costs—and wages are the biggest single element in costs for the economy as a whole.[6] There is a definite logic, then, in saying that an industry cannot stand up to foreign competition because its labour is too expensive. But why cannot wages be reduced? Surely, workers would prefer to accept a modest cut in incomes rather than become unemployed. One explanation is that a vulnerable import-competing company cannot lower wages because it would leave them out of line with other employers. Workers would quit and seek jobs elsewhere. There is strong evidence that, over long periods of time, wage relativities and differentials show minor variations across companies and industries.[7] It may be more correct to say that a business has to close because it is unable to match this general wage level than because it is unable to combat import penetration.

It is a corollary of the mere fact that they remain in operation that companies which can match the general wage level are profitable. They may be in a position to recruit workers who have lost employment in an inefficient import-competing industry. If this is the outcome of the free trade process, society is better off. Workers have transferred from loss-making to profitable companies; on the assumption of uniform wages and costs, productivity must be higher in profitable concerns; and it therefore follows that national output is increased by the migration of labour. Free trade encourages workers to shift to those activities where a country has its comparative advantage; import controls, on the other hand, may halt structural adjustment and lead to economic stagnation.

The objection to this argument is that job recycling, however advantageous to the community in the long run, is painful to the individuals affected. In a compassionate society, the short-run costs of change should be balanced against the eventful gains from improved resource allocation. The view that excessive change is undesirable has been formalised in the concept of a 'conservative social welfare function'. Its premise is that significant absolute income reductions for any section of society should be avoided. In terms of welfare weights, increases in income are given relatively low weights and decreases very high weights. In Corden's opinion, the conservative welfare function "helps to explain the income maintenance motive of so many tariffs in the past" and also in "understanding the actual trade policies of many countries".[8]

The use of the word 'conservative' to describe the thinking behind import controls may upset some of their advocates. But it is warranted. The essence of liberalism is that individuals should be able to make different choices if they change their minds or circumstances alter. In its application to international trade, this implies that consumers may opt for an imported good rather than the domestic product which they had previously bought. If jobs are lost as a result, that is the consequence of people being allowed to choose for themselves, of a liberal commercial philosophy. By contrast, protectionism is an attempt to stifle choice and to cocoon vested producer interests from competition. As well as being nationalistic in inspiration, import controls are backward-looking and conservative in intention.

But import control enthusiasts might tolerate being bracketed with 'conservatives' and still insist that society should mitigate the damage from free trade to particular groups. In particular, they may say that the pace of change should be slowed down by temporary import restraints. The trouble is that once a tariff or quota is in existence it becomes extremely difficult to remove. It creates beneficiaries and dependents who, naturally enough, campaign against any suggestion that it should be withdrawn. In consequence, tariffs may survive many years after their initial rationale has disappeared. One study of Britain's tariff arrangements in the 1960s considered it to be an historical relic, largely reflecting the work of the Import Duties Advisory Committee in the 1930s and of little relevance to the British economy's contemporary problems.[9]

There is a further drawback to the seemingly humanitarian approach of trying to regulate the flow of new imports according to the speed at which the domestic industry is run down. Decisions on how and when foreign

competition should be phased in are necessarily political. An element of discretion tends to intrude, creating uncertainty and giving the affected parties an incentive to lobby for continued import restraint. The problem of motivation distortion, referred to in the last chapter, surfaces here in a particularly acute form. In the long run, it may be a kindness to private sector decision-takers to stop import controls of any kind being introduced. The signals to change are then clear and unambiguous; corrective measures can be taken firmly and decisively.[10]

The stickiness of the adjustment process is nevertheless an effective counter to the free trade case. It has gained much of its impact in the public debate because of the high and rising unemployment which have characterised 1980 and 1981. The claim that workers made redundant in import-competing sectors should seek employment elsewhere only makes sense if employment is, in fact, available in other companies and industries. With the unemployment total standing at nearly 2·5 million, that does not seem very plausible. However, the level of unemployment is a variable determined by macro-economic policy. It would be a mistake to contaminate trade policy with the micro-economic distortions caused by import controls when a macro-economic objective is at stake. Quite probably, unemployment would be no lower with import controls than without, but the allocation of labour would be far worse.

As and when demand recovers, the economy will gain far more if workers go into industries which do not require artificial props from new trade barriers. The cost of maintaining British Leyland and Courtaulds at their current scale of operations is not measured by the miscellaneous welfare handouts they receive from the Department of Industry. The true loss to society is the output their low-productivity workers could achieve if they were employed by good businesses, such as Racal and BTR. The same logic applies to import controls. At present Rolls-Royce and the aerospace divisions of Lucas have full order books and need skilled labour. If imports of cars and textiles were checked, Leyland and Courtaulds would retain their present work-forces, and recruitment by the expanding parts of Rolls-Royce and Lucas would be more difficult. As a high proportion of the aerospace orders are for overseas customers, exports would be reduced. In other words, production for export would drop to offset the increased manufacture of Leyland cars and Courtauld textiles. There would be no net increase in national output due to the cut in imports. On the contrary, productivity would be lower and potential gains from specialisation would be foregone.[11]

There is a somewhat apocalyptic counter to this argument. It is that once workers have become unemployed they will never find a job again. The sanguine prospect of better resource allocation and higher national productivity held by free traders is therefore illusory. Trade union leaders, in particular, tend to indulge in forecasts that a British 'wasteland' will result from more intense import penetration; one of their favourite analogies is to compare the number of redundancies with a "casualty list . . . looking like the Battle of the Somme in the 1914 War".[12] The logical blunder in the wasteland argument will be explained in the following section, but for the moment we should note that it contains an accusation against British workers. Imports enter this country because workers in other countries have been prepared to make products more cheaply and efficiently than their counterparts here; if the imports are coming in for the first time, it may mean that foreign workers were not previously involved in their manufacture; they have shown the adaptability and skill required to compete in a new market. To say that British workers should be protected from such competition is equivalent to saying that British workers do not have the same adaptability and skill. The trade unionists who indulge in the wasteland rhetoric are, in effect, putting a slur on the character of their members; they are saying that there is not as much capacity or willingness to change as in other countries. But if workers in Japan and Taiwan have been able to create from nothing world-beating car and radio industries, if they can triple or quadruple their productivity in ten or fifteen years, why cannot the British do just as well? To call for import controls is not to defend the British working class, but to condemn it as irremediably more lazy and unenterprising than elsewhere. This sort of censure is predictable enough from columnists like Auberon Waugh in newspaper diatribes against certain tribal customs of the West Midlands and the East End, but it is not to be expected from trade union leaders. They presumably do not realise that the allegation is implicit in their plea for import control.

In summary then, a protectionist policy distorts the pattern of production and guides resources to industries where they are less well-used than if free trade were to rule. In the long run, extra output and employment at British Leyland and Courtaulds is less output and employment at GEC and Racal, and every import kept out is matched by a lost export order. In the short run, free trade may involve damage to a specific producer interest, but only by allowing the economy to adjust without interference can the wider gains—both to consumers in general and other producers—be reaped.

iii

The wasteland argument provides a useful starting-point for dissecting another common protectionist fallacy. This fallacy was the origin of mercantilism, the first reasoned attempt to justify discrimination against imports, and is also the motivation for the Cambridge Economic Policy Group's recent prescriptions.[13] It is that, by reducing imports by trade barriers, a country can improve its balance of payments. What is wrong with this superficially persuasive view? And why could the ravages of import competition not crush a nation's productive base utterly and leave all its industry derelict?

The answer is very simple. Other countries do not send goods to Britain from charity, but because they expect to receive British goods in return. They would be rather foolish to 'achieve' a vast and continuous surplus on their trade with this country. That would leave Britain as the happy, fortunate and probably unintended recipient of out-door relief from foreign factories. Instead, the rest of the world exports to Britain in order to take back British goods in return. If the British economy were so decimated and pauperised that it had become a true 'industrial wasteland', it would be unable to produce those goods. The imports would be unrequited and the foreigners worse off. Putting the same point another way, if Britain were a wasteland, it could buy no foreign goods. The notion of import penetration would, in such circumstances, be a self-contradiction and an impossibility. Equally, it is difficult to imagine the process whereby import competition could cripple an economy's productive base. Whenever an industry had been destroyed by new imports, *and not replaced by another which generated a matching quantity of new exports,* incomes in Britain—and, hence, the ability to purchase the higher level of imports we are assuming—would be cut. As Britain's economy declined, so would the level of imports from abroad.[14]

The last paragraph brings out the basic error in the balance-of-payments or mercantilist case for import controls. It is that any country which consistently sells more to other countries than it buys is behaving rather foolishly. The best response for its trading partners is not to introduce import controls, but to exploit its generosity. However, the refutation of mercantilism can proceed on more refined lines. In the remainder of this section, we shall develop a thesis that there is no such thing as a balance-of-payments problem between countries, but only between governments. Moreover, a government's payments difficulties are not solved, except temporarily, by tariffs or quotas.

The argument may seem radical. It is, in fact, only now beginning to appear in the academic literature.[15] Let us suppose that an economy is running a current account deficit. In other words, it is incurring net financial liabilities to or losing financial claims on other countries. The economy is divided into the private and public sectors. The current account deficit may be attributable to one, the other or both. Suppose that it is attributable principally or entirely to the private sector. The private sector is running into debt with the rest of the world.

Why does this matter? Within an economy, it is an everyday event for companies and individuals to borrow from one another. They do so with advantage because they have different time preferences, different production opportunities or different cash flow patterns. Equally, it is possible for the set of private companies and individuals which comprise one economy to incur debt to the set of private companies and individuals which comprise another economy. Although every agent is acting independently, in the aggregate the private sector agents in one country have a current account deficit. As the numerous borrowing decisions responsible for the deficit are taken freely, it must be desirable and beneficial. Any other conclusion is an affront to the principle of consumer sovereignty, that people are better able to make choices in their own interest that are other people for them. "One should . . . just assume for the purpose of discussing balance-of-payments issues that the private sector knows what it is doing, and what is good for it, as far as its spending and saving decisions are concerned."[16]

In the past many countries have registered persistent private sector current account deficits with no detriment to their economies. The explanation is that current account deficits are covered by capital inflows, normally attracted by the potential of a higher rate of return than in the source country. This entails, of course, that foreigners own more of a nation's capital stock and may arouse xenophobic hostility. As we saw in the last chapter, a misplaced patriotism is common in international economic relations. It needs no further discussion here, except to note that rhetoric about the 'dependence' of a capital-importing country on other countries can be rather loud. However, the notion of dependence is inappropriate since foreign investors are exposed to risk through, for example, possible nationalisation. By contrast, the capital-importing country has little to fear since, if the foreign investment takes the form of machinery and equipment, it cannot be physically uprooted.

A private sector current account deficit should not be a source of concern. But what about a public sector deficit? In Britain the government owns, through the Bank of England, the reserves of gold and foreign currency. If the government has a deficit on its international financial transactions, the reserves are the most readily available assets to meet it. Depletion of the reserves, through continuous public sector current account deficits, leaves a

country vulnerable to world economic shocks. It is prudent to ensure that the reserves are maintained at an adequate level as a financial stockpile against unforeseen emergencies, such as a major strike or the outbreak of war. In Johnson's words, the definition of the balance of payments "relevant to . . . policy properly defined is . . . the . . . inflow or outflow of international reserves." This definition has been termed the "official settlements balance".[17]

The next question is how government can have a deficit on its international payments. Suppose that it has a budget deficit overall. The only two groups who can finance its deficit are the domestic private sector and the overseas sector; if one does not finance it, the other must. Unless it can sell debt to the domestic private sector equal to the deficit, there must be a change in its international debtor/creditor position. Suppose that the government sells *more* debt to the domestic private sector than its deficit. In such circumstances, it is an arithmetical certainty that the government is a net creditor on the overseas sector and the reserves must rise. Only if it sells less debt to the private sector than its budget deficit will the government experience a decline in the reserves. It follows from this line of argument that the official settlements balance is determined by the interaction between the government budget deficit, in Britain usually measured by the PSBR (public sector borrowing requirement), and the demand for new issues of government debt from domestic sources.[18]

The point can be expressed in different terms. The balance of payments is subordinate to fiscal and debt management policies. As long as a government is managing its own finances soundly, it need never worry about its international reserve position. Moreover, tariffs and quotas are quite unnecessary as devices for "improving the balance-of-payments". A government which runs a budget surplus, or succeeds in selling more public sector debt to its own citizens that its budget deficit, cannot have a balance-of-payments problem. There can be no mercantilist justification for direct import restrictions.

The theory developed here has sweeping implications. A private sector current account deficit is a matter of indifference to policy-makers, while a public sector current account deficit is a by-product solely of fiscal incompetence. This goes much further than the debate between devaluation and import restriction as 'solutions' to an adverse payments imbalance or, indeed, than the familiar contention that a floating exchange rate is a sufficient instrument to cure international payments disequilibria.[19] Curiously, there is a close affinity between the present argument and the 'new Cambridge school' view of the mid-1970s, that an increase in the public sector financial deficit will cause an increase of similar size in the current account deficit. This is a special case within our theoretical framework; it is correct on the assumption that the private sector's net acquisition of financial assets and its demand for public sector assets are constant. The irony is that the protagonists of the 'new Cambridge school' are exactly the same people who are now claiming that the balance of payments is damned beyond redemption by unfavourable and irreversible import trends. They appear to be unaware of an inconsistency. At no stage in the last few years have they disowned their original doctrine, the gravamen of which was that governments—and governments alone—are responsible of balance-of-payments crises.[20]

A parting salvo to the mercantilist case for import controls can be delivered with the aid of a relatively new body of ideas known as the monetary approach to the balance of payments. Its pivotal insight is that a country's reserves of foreign currency are a central bank asset and can expand only in line with central bank liabilities. The principal liabilities are the note and coin issue, and bankers' balances at the central bank. These together constitute an economy's 'high-powered money'. High-powered money is the raw material for commercial banks' operations and the base of their credit pyramid. Suppose that the banks do not want more high-powered money and yet that the central bank is required to hold more government debt because of, for example, a budget deficit. As it cannot increase its liabilities, the central bank must lose other assets, like the reserves, to make room for the government debt. Any reserve loss is equivalent to a deficit on official settlements. In short, the balance of payments may be viewed as "the difference between changes in the demand for high-powered money and central bank domestic credit expansion".[21]

It follows from this proposition that tariffs can help the balance of payments only insofar as they increase the demand for high-powered money. There may be some such effect because tariffs raise prices and therefore the level of desired money balances to carry out transactions. But the resulting current account surplus is necessarily short-lived since the ensuing adjustment of money balances is a once-for-all event. If a tariff is imposed, and the underlying demand for high-powered money is unchanged, the balance of payments will not benefit in any way. The reason is that holders of money balances may buy fewer imports if their price is raised, but they will buy more of the goods which might otherwise have been exported. "More generally, since the balance-of-payments surplus is identically equal to the excess of income over expenditure, a tariff can affect the balance of payments only to the extent that it affects the difference between income and expenditure."[22]

The balance of payments is essentially a monetary phenomenon. It is not a problem if deficits and surpluses stem from the actions of private sector decision-takers. It may be a problem if the reserves are being run down, but that is a consequence of fiscal mismanagement, not of badly behaved imports and exports. Tariffs are futile as a method of overcoming payments deficits because they do not reach down to the financial roots of the difficulties. The balance-of-payments—or mercantilist—argument for import controls is fallacious and has no relevance to Britain's current economic situation.

Although the supposed balance-of-payments bonus is largely responsible for the advocacy of protection from such groups as the CEPG, another common theme—to which we have already referred—is concern for industries vulnerable to foreign competition. Earlier in this chapter we explained that any gains import-competing industries achieve from tariffs are offset by losses to consumers and exporting industries. But protectionists have claimed that these losses, essentially the consequence of static resource misallocation, should be weighed against potential dynamic increases in technical efficiency in the import-competing sectors. We mentioned the possibility in the first chapter, but ridiculed it by asking a simple question. If a 30 per cent tariff on finished manufacturers, as favoured by the CEPG, is advantageous, why not have a 300 per cent or 3,000 per cent tariff? If a 30 per cent tariff would boost productivity, would not these higher levels have an even more spectacular effect in revitalising the British economy?

This section will amplify further the deficiencies of what may be termed the hospitalisation argument for protection. The thinking behind the argument is that an industry helped by artificial import-preventing supports has a breathing-space to facilitate regeneration; it can phase out old equipment and re-invest in better technology; it can bargain with the unions for the removal of inefficient restrictive practices.[23] The underlying premise is clearly that competition is a clog on efficiency and that the suppression of competition stimulates efficiency. This is implausible. If correct, it would imply that the government should set about arranging cartels and mergers in industries which at present have large numbers of independent rival companies.

It also has, as a necessary corollary, the fragmentation of Britain. Although in many product areas imports account for a high proportion of the domestic market, the toughest competition most British companies face is from other British companies. For example, in the first nine months of 1980 the two leading motor manufacturers were Ford with 27·5 per cent of the UK market, about half imported, and British Leyland with 19·2 per cent. The most significant make entirely imported was Datsun with a 5·4 per cent share. It is obvious that, despite the noise from the car industry about the need to curb the Japanese, the main competitor for Ford was BL and the main competitor for BL was Ford. If strong competition is bad for efficiency, the government should not only limit the quantity of Japanese imports. It should also, and much more importantly, discourage the struggle for market share between Ford and BL. Presumably a boundary should be drawn down the middle of Britain, with Ford sales to the west of the line restricted to 10 per cent of the total and BL to 10 per cent east of it. In that way Dagenham would supply the eastern half of the country and Coventry the western, while competition between Dagenham and Coventry would be reduced to a healthy, efficiency-promoting minimum. This ludicrous recommendation, like internecine tariff wars between English counties, is a logical deduction from the hospitalisation argument.

In fact, the erection of tariff barriers against imports is a one-way ticket to industrial decline. Only if competition is intense and sustained are companies forced to improve methods and to raise productivity. Our *reductio ad absurdum* approach suggests another weakness in the protectionist case. Any complex manufactured good has several stages in its production and requires an assortment of different components. Even when a product is made entirely in one country these components may come from a number of regions. Thus, the Ford plant at Halewood in Lancashire uses components from the South Wales and Dagenham plants. But, more typically, some components are of local origin and others are from abroad. Most import control enthusiasts accompany their concern for industry in general with a particular affection for finished articles, perhaps for the chauvinist 'commodity imperialism' reasons described in the last chapter. The bias is reflected in the CEPG's proposal that the tariff rate on finished manufactures should be 30 per cent, while that on semi-manufactures should be 20 per cent and on raw materials zero. We can now see another dimension of the damage such a tariff structure might cause. Although a company making a finished manufacture might be able to charge a higher price were the tariffs to be introduced, it would have to pay more for its components if many of these were imported. Much of the putative 'gain' from protection would never materialise. Of course, there might be a tendency for domestic component suppliers to step in and replace the foreign suppliers whose output was made too expensive by the tariffs. But this would lead to smaller production runs for each item and lost economies of scale through diminished international specialisation. The folly of such an outcome is illustrated by the interdependence of production processes within a country. Components and other intermediate goods are transported from one region to another so that each production stage can be carried out where it is most efficient. The same benefits accrue from the import and export of semi-finished goods between countries. It would be as rational to tax imports of semi-manufactures from France or Germany at 20 per cent as it would be to tax trade in semi-manufactures between Yorkshire and Lancashire.[24] As the geographical spread of multinational companies' operations has increased, this point has acquired more pertinence. It is particularly important for Britain as a member of the EEC since component and semi-finished good trade is on a very large scale because industrial products face no tariff barriers at all.[25]

One more comment is in order. Finished goods are of two kinds, being intended for consumption or investment purposes. A 30 per cent tariff on imports of finished investment goods would be a levy on the import of best-practice techniques. In those instances—and they are many—where Britain does not produce the most advanced capital goods, the discouragement of imports would condemn the industries using them to chronic technological backwardness. The problem is severe in today's circumstances when companies' investment needs are highly differentiated and the widest possible range of sources is required to ensure that the right choice is made. The leading industrial countries no longer export mainly manufactures and import mainly raw materials; instead, manufactures constitute most of both exports and imports; and one study showed that this intra-industry trade was particularly strong in chemicals and machinery and transport equipment.[26] Such international trade facilitaties the diffusion of technology. By hindering imports of sophisticated machine tools and other equipment, protectionism would perpetuate inefficiency in British industry. In this respect too the hospitalisation argument for import control does not stand up.

V

At first sight, the case for import controls is straightforward and compelling. By excluding imports, British producers have improved opportunities in the domestic market while their chances in foreign markets are no worse. For some observers hostile to import controls the main risk is that foreign markets would be closed in retaliation—and this they seem to perceive as the only substantive drawback to protectionism. Thus, Professor Brian Reddaway in a letter to *The Times* on 14 April 1980 criticised a proposal for import restriction on the grounds that Britain was not "a special case" among the developed countries. It would therefore be impossible to command the acquiescence of other nations; counterveiling measures, hitting British exports, would be inevitable.

The danger of retaliation is a valid objection to import controls. But we have been able in this chapter to assemble an array of arguments against protectionism which show that it would be an unwise policy even if Britain's trading partners did not retaliate. It would make consumers worse-off; it would impede structural change and hamper the expansion of industries in which Britain has a comparative advantage; it would do nothing to strengthen the balance of payments and, in any case, a "balance-of-payments problem" is a conceptual chimera; and it would check technical progress even in those industries which benefited at the expense of the rest of the community. The almost unanimous opposition of professional economists to artificial import restrictions may contrast with the more ambivalent attitude of public opinion, but we can understand why well-trained economists reject popular clamour for protection. In the next chapter we shall see what happened to two countries where this clamour was not resisted, but instead exploited for political ends. It deserves to be emphasised that neither Chile nor Argentina suffered significant retaliation when they introduced autarkic policies. They were too small for other countries to care much. But all the worst consequences of protection emerged. Over a period of four decades, the policies were an economic disaster which ended in social and political collapse.

Notes

(1) ". . . [T]he vital contribution that the opportunity to specialize makes towards the dynamic transformation and development of an economy does not appear as one of the gains from trade, although this is of undoubtedly far greater significance than the mere pushing-out of a utility-possibility curve". Thus, a sentence in the concluding paragraph of a standard text. (R. Findlay *Trade and Specialisation* Penguin: Harmondsworth 1970 p. 134) Johnson has suggested that the static costs of protection may be small and, hence, that "the effect of alternative commercial policies on the rate of growth may well be the quantitatively significant issue in the free trade versus protection debate". (H. G. Johnson *Aspects of the Theory of Tariffs* Allen & Unwin: London 1971 p. 206, p. 208).

(2) 'Import controls urged to ease economic ills' *The Daily Telegraph* 21 July 1980.

(3) Against this, there is extra revenue for the government and it is possible that the ex-tariff price of the import will be lowered (the terms-of-trade argument for protection). The welfare loss arises because less of the good in question is imported. Consumption of the good must fall unless resources are released from another activity and then consumption of that good must decline. Only in cases where the terms of trade gain is large enough to outweigh the resource misallocation losses is a tariff worthwhile. See p. 3 above for references on this point.

(4) G. and Z. Curzon 'The multi-tier GATT system', pp. 137-47, in O. Hieronymi *The New Economic Nationalism* Macmillan: London 1980. The quotation is from p. 146.

(5) The arrangement in 1979 and 1980 whereby Japanese cars were not supposed to take more than 10 per cent of the British market had precisely these effects. The price of Japanese cars in Britain was much higher than in the USA, where no OMA was in operation.

(6) Naturally, that is not to say they are the largest component of costs in every company and industry. For example, energy costs were cited as the main influence on the closure in August 1980 of the Bowater paper-making factory, which was responsible for half of Britain's newsprint capacity. However, it would be as wrong for the government to subsidise a particular energy use as it would be to introduce import controls. Energy would be misallocated away from industries which use it economically to those where it is required intensively.

(7) The stability of differentials has been interpreted as the product of "social" factors. However, it is compatible with the view that the labour market is highly flexible and that skills have one price, as the perfect competition model would require.

(8) W. M. Corden *Trade Policy and Economic Welfare* Oxford University Press 1974 p. 107.

(9) N. Oulton 'Effective protection of British industry', pp. 46-90, in W. M. Corden and G. Fels (eds.) *Public Assistance to Industry* Macmillan: London 1976.

(10) The World Bank commended the Chilean government, which reduced nominal tariffs from an average of 90 per cent in 1974 to a uniform 10 per cent in 1979, on precisely these grounds, against criticisms that the policy change was too violent. ". . . [I]n the Government's view, Chilean history of the past four decades had demonstrated that the successful implementation of its long-term policy reforms depended heavily on its giving clear, consistent and unwavering policy signals from the outset." *Chile: An Economy in Transition* World Bank: Washington 1979 vol. 1, p. 166. By 1980 business opinion, initially hostile to the tariff reductions, had moved to being strongly in favour and most of the economy's adjustment difficulties had been absorbed.

(11) There is a high-powered economic literature on the appropriate policy measures when resources are reallocated too slowly in response to new import competition. The conclusion is that "welfare maximisation requires a correction of the relevant domestic distortion by an appropriate tax or subsidy on production, consumption or factor use, and not a tax or subsidy on international trade; and that, given the presence of a domestic distortion, protection designed to offset it may decrease welfare rather than increase it." (H. G. Johnson 'Optimal trade intervention in the presence of domestic', pp. 3-34, R. E. Caves et al *Trade, Growth and the Balance of Payments* North Holland 1965, reprinted on pp. 184-217 of J. Bhagwati (ed.) *International Trade* Penguin: Harmondsworth 1969. The quotation is from p. 213 of the Penguin reprint.) The reasoning behind this is, however, rather technical. It seems better in a work of the present kind to discuss the sticky adjustment problem with the relatively casual arguments in the text.

(12) For example, Mr. Bill Keys of the Society of Graphical and Allied Trades at the Trades Union Congress in 1980, reported in *The Financial Times* 5 September, 1980.

(13) R. Neild, one of the foremost CEPG economists, has said that his advocacy of import controls had as its basis "despair over the efficacy of alternative ways of checking the downward slide in the British economy" and that he "would make the same recommendation for any country where a balance of payments constraint could not be removed by devaluation". ('Report of the discussion', p. 219 in R. Major (ed.) *Britain's Trade and Exchange-Rate Policy* Heinemann: London 1979.) In other words, the balance-of-payments worry lay behind his views.

(14) There is a more subtle variant on the wasteland theme. It relies on the idea that national income is a multiple (the "foreign-trade multiplier") of exports. If the marginal propensity to import rises and exports are unchanged, equilibrium between exports and imports can be preserved only if income falls. An ever rising import propensity could therefore be associated with ever falling incomes. Kaldor has been particularly attracted to this argument, but it lacks empirical support. As we showed in the first chapter, the rising import propensity in Britain has been matched by higher exports.

(15) See, for example, pp. 45-51 of W. M. Corden *Inflation, Exchange Rates and the World Economy* Oxford University Press 1977.

(16) W. M. Corden *Inflation* p. 45.

(17) H. G. Johnson 'The monetary theory of balance-of-payments policies', pp. 262-284, in J. A. Frenkel and H. G. Johnson (eds.) *The Monetary Approach to the Balance of Payments* Allen & Unwin: London 1977. The quotation is from p. 262. To complicate matters, the official settlements balance is defined in more than one way. According to Cohen, the "conventional formulation" relates to official transactions in short-term assets and liabilities, while the "extreme formulation" is confined to transactions in official reserve assets. (B. J. Cohen *Balance-of-Payments Policy* Penguin: Harmondsworth 1969 p. 46.) Official settlements could refer to all transactions in public sector debt, both long-term and short-term. The discussion in the text elides these difficulties by equating the official settlements balance with reserve changes.

(18) The argument is developed more formally in T. G. Congdon 'Can the Bank of England pursue a monetary policy independent of external influences?: some aspects of the interdependence of domestic open market operations and foreign exchange intervention', *mimeo.*

(19) A distinguished indictment of import controls in Britain is W. M. Corden et al. *Import Controls versus Devaluation and Britain's Economic Prospects* Trade Policy Research Centre: London 1975. The argument in the text suggests that its authors are possibly a bit off-beam. The refutation of the Cambridge balance-of-payments arguments can be more incisive than their presentation.

(20) The heyday of the "new Cambridge school' was in 1974 when its theories were examined by the House of Commons Expenditure Committee. See F. Cripps et al. 'Public expenditure and the management of the economy', pp. 1-12, in *Ninth Report from the Expenditure Committee 1974* H.M.S.O.: London.

(21) M. Parkin et al. 'The determination and control of the world money supply under fixed exchange rates 1961-71' in M. Parkin and G. Zis (eds.) *Inflation in Open Economies* Manchester University Press 1976. The quotation is from p. 34.

(22) M. Mussa 'Tariffs and the balance of payments: a monetary approach', pp. 187-221, in J. A. Frenkel and H. G. Johnson (eds.) *op. cit.* The quote is from p. 216. There are even some perverse cases where a tariff can reduce the demand for high-powered money and lead to a payments deficit. See pp. 214-7.

(23) The hospitalisation case for protection is criticised in D. Greenaway and C. Milner *Protectionism Again . . .?* Institute of Economic Affairs: London 1979 p. 17.

(24) It should be pointed out that, because of trade in intermediate goods, rates of effective tariff protection would not correspond to the 30 per cent on manufactures, 20 per cent on semi-manufactures, 15 per cent on services and zero on raw materials laid down by the CEPG. For example, consider an industry in which only 20 per cent of value is added in Britain and the remaining 80 per cent is imported raw materials. The effective tariff rate on the domestic industry would be not 30 per cent, but 150 per cent, because it is only that one-fifth of the value which is relevant. If, on the other hand, the industry had 20 per cent value added in Britain, but the remaining 80 per cent imported were semi-manufactures subject to a 20 per cent tariff, the effective tariff rate would be not much more than 30 per cent. Although it could charge a 30 per cent higher price than foreign competitors, its costs would be considerably greater as well because of the dearer semi-manufactured inputs.

There is a lucid explanation of the effective protection concept on p. 33 of M. Fg. Scott and the Hon. W. A. H. Godley *The Arguments For and Against Protectionism* Bank of England academic papers no. 10 1980. The concept was pioneered by W. M. Corden. See, for a full exposition, W. M. Corden *The Theory of Protection* Oxford University Press 1971. Its implication is that most tariff structures have perverse and unintended repercussions on particular industries. In Scott's words, "Some particular activities with large inputs classified as non-manufactures, but output classified as a manufacture, could be . . . highly protected, and the discrepancies between them and others would inevitably lead to protests. Why should spinning be more highly protected than, say, clothing? Or plywood more than furniture?"

(25) This may account for industrialists' simultaneous hostility to Britain's departure from the EEC (which would reduce foreign competition) and enthusiasm for controls on imports from developing countries (which also reduce competition).

(26) H. G. Grubel and P. J. Lloyd *Intra-Industry Trade* Macmillan: London 1975, p. 37 and p. 39.

III *The Warning—Argentina and Chile since the late 1920s*

Laboratory experiments are not possible in economics. The environments in which particular policies are tried vary from time to time and from place to place. In consequence, it is rarely possible to be confident that a particular outcome reflects policy rather than environment. Nevertheless, if the right decisions are to be taken, some attempt to identify the impact of past policy is needed. As it happens, history provides abundant empirical material on the effects of trade policies. The economist is fortunate in being able to examine this material and compare free trade with protection. The two countries perhaps most affected by the adoption of autarkic policies in the last fifty years are Argentina and Chile where, until recently, governments were committed to curbing imports as part of a broader programme of national economic independence. The results should be a persuasive warning to the supporters of import control today.

Geographically Argentina and Chile are neighbours. It is natural for the outsider to bracket them together. As we shall see, this is justified by a definite similarity of theme in their economic and political development. However, the two countries emphasise their separate identities and it would be wrong to imply that their joint pursuit of isolationist economic policies reflected some sort of collusion. Instead, protection developed piecemeal and sporadically, in response to unforeseen events and aided by an undercurrent of sympathetic public opinion. It was not imposed by design. It is important to make this point as extensive import controls are more likely to be introduced in Britain because of random and unco-ordinated adjustments to producer group demands than because of a decisive once-for-all policy shift. Constant suspicion of 'special' cases is an essential safeguard against a repetition of the Argentine and Chilean experiences.[1]

i

In the late 1920s Argentina and Chile were among the most dynamic and successful economies in the world. In the previous forty years both countries had recorded growth rates of about 5 per cent or 6 per cent a year, well above the international average. Living standards were high and job opportunities plentiful, attracting large inflows of immigrants, mostly from Southern Europe. Although the remark is perhaps rather facile, it is fair to say that Argentina and Chile in the early twentieth century were regarded in the same way as Taiwan and South Korea in the 1970s

Argentina's achievements had been particularly spectacular. Its population had quadrupled in the thirty years before 1914, but a huge export surplus of food products had been made possible by vigorous development of the *pampas,* a belt of fertile agricultural land focused on Buenos Aires. One panegyrist claimed that "no country in the world has ever in so short a time realised so rapid a progress, in respect of the produce of the soil".[2] Although 60 per cent of population growth between 1869 and 1929 was attributable to immigration, the extra numbers had been easily absorbed and in 1929 Argentina was the fifth richest country in the world.

Chile's 'golden age' had been earlier, in the middle years of the nineteenth century, when political stability encouraged faster economic development than elsewhere in Latin America. By the 1920s Argentina had overtaken it in terms of both total population and income per head. However, it was still relatively prosperous by world standards, a position confirmed by the large foreign component in the population. Moreover, it had attained an unusual degree of political stability, with an apparently successful system of parliamentary democracy and a tradition of non-intervention in government by the military. In an only lightly qualified encomium in his classic work on *Modern Democracies,* published in 1929, Bryce said that Chile had been unlike other Latin American states in its avoidance of political turmoil. It

> has been from the first a constitutional Republic, some of whose features recall the oligarchy that governed England during the reign of the first two Georges. Blessed by a temperate climate, a long stretch of sea-coast, and (in its southern regions) a continuous cultivable area sufficient to support a large agricultural and pastoral community, . . . it has also enjoyed the advantage of possessing both a native and Spanish stock of unusually sound quality . . . The machinery of the constitution, under which the suffrage has been extended to include practically all male adults, . . . seems to work smoothly . . . Votes are honestly counted, but there is said to be a good deal of electoral corruption, though, as it is not confined to any one party, it does not prevent the general result from conforming to public opinion . . . The public credit has always been carefully guarded.[3]

With good reason the Chileans considered themselves the most European and sophisticated nation in Latin America.

The economic basis for this wealth and maturity was openness to international trade and finance. Argentina's material progress until the 1920s has been attributed to the economy being "broadly modelled on the classic precepts of Free Trade and international specialisation"[4]; it sent agricultural products to Europe, particularly Britain, and received manufactures in return, while capital inflows financed the development of an export-oriented infrastructure. The volume of Chilean imports grew at an average rate of 5·5 per cent a year between 1880 and 1930, but even so this was usually outpaced by the growth of exports. Foreign investment was welcomed. In Chile it was instrumental in reviving the fortunes of the copper industry, nearly all of whose production was exported, after 1905. The other major export was nitrates, again largely in foreign ownership. No restriction was placed on the repatriation of profits. "The government made few attempts to transform the export sector by developing more products, by attempting to diversify it or by re-investing part of the minerals-generated resources into research and development. If true *laissez-faire* ever came close to existence in Chile, it was in nitrate and copper mining."[5]

Nevertheless, it would be a mistake to think that absolute free trade ruled. Both Argentina and Chile had a history of low tariffs, mostly on manufacured goods, going back several decades. They had been introduced principally for revenue-raising purposes and not to encourage indigenous industries. This is illustrated by the 1906 tariff law in Argentina which set an estimated unit value *(aforo)* in gold pesos on each imported item. The duty was fixed in relation to that value, not the actual price of the article. In consequence, the true tariff rate varied with world prices, being high when they were low and *vice versa*. In 1919 and 1920, during the post-War boom, the average tariff rate was 7·5 per cent and for most of the 1920s it hovered between 10 and 17·5 per cent. This was modest by the standards of other countries and would justify the description of Argentina at that time as a relatively open economy.[6]

ii

The dependence of the Argentine and Chilean economies on trade was a serious liability when the Great Depression struck in the early 1930s. Export prices and earnings dropped abruptly and the accompanying adverse shift in the terms of trade reduced real incomes. The League of Nations judged that no country suffered more terribly from the worldwide economic downturn

than Chile.[7] Its plight was exacerbated by the discovery of a new technology for fixing nitrate from the atmosphere, which made extraction from Chilean mines too expensive. In both Argentina and Chile resentment had grown in the 1920s at the size of the outside stake in their economies and the super-normal profits earned by foreign capitalists. The political momentum for more inward-looking policies received extra impetus from the disastrous decline in the demand for their export products. In this section we shall discuss the evolution of protectionism, and its effects, in Argentina and in the next section we shall turn to Chile.

Initially, Argentina's commercial policies did not undergo much change. Although exchange control was established in 1931 and a number of official export marketing agencies were set up subsequently to help maintain prices of agricultural products in world markets, no determined effort was made to shut out imports. True tariff rates rose because of lower world prices, not because of any significant revisions to the 1906 tariff law. But by 1940 the emergence of new products, combined with the often perverse effects of minor tariff amendments dating from 1923 and 1931, had made the tariff arrangements chaotic. A new set of tariff rates, based on a reformed categorisation of imports, was introduced. It was ultra-protectionist. Many rates were above 100 per cent and the deliberate aim was to foster import-substitution. It has been said of the attitudes behind this change that, "In the minds of most Argentines exports are linked automatically to oligarchical and feudalistic rural landlords allied with foreign interests, while protection is linked with import substitution, industrialisation, nationalism and social democracy".[8]

In the 1940s these trends were intensified. An army *coup d' etat* was staged in 1943 amidst widespread social and economic discontent, partly fomented by rapid inflation. In 1946 a general election brought Colonel Juan Peron to power on a platform of national populism. This envisaged, in addition to closing the doors to foreign trade and investment, extensive state control over the economy. The years from 1946 to 1948 were Peron's 'period of assault'. Social security was expanded and made more generous; minimum wages were increased; a system of *aguinaldo* (an extra month's pay at Christmas) became statutory; foreign-owned public utilities were nationalised; the Argentine Trade Promotion Institute was established to regulate agriculture and the import of essentials; price controls were strengthened; rents were frozen; bank deposits were brought under central bank control; the stock market was subjected to regulation; and, favoured by new legal privileges, trade union membership quadrupled. Argentina has never recovered from this convulsion of 'reform'. It has been said that from 1948 onwards Argentina became "trapped in a persistent stop-go cycle produced by severe balance of payments and domestic inflation problems accompanied by great political instability".[9]

An integral aspect of Peronism was favouritism towards industry at the expense of agriculture. High tariff barriers were necessary if industry was to be viable. These enabled manufacturers to raise their prices above world levels, obviously making other groups in Argentine society worse off than they would have been under free trade. It has been estimated that from 1947 to 1955 the resulting implicit tax on the farm sector was equivalent to 30 or 40 per cent of income. Not surprisingly, agricultural output, employment and exports contracted. In the early 1930s, Argentina's share in world exports of fresh meat was 40 per cent, of wheat 23 per cent, of maize 64 per cent and linseed 79 per cent; the corresponding figures in the early 1960s were 18 per cent, 6 per cent, 17 per cent and 7 per cent.[10]

There was some offsetting expansion of industrial production. Given the levels of protection this was hardly surprising. The effective rate of protection on all manufactured imports has been calculated at 162 per cent in 1958, but on many products it was much higher. On textiles the nominal tariff approached 400 per cent. But it would be quite wrong to think that industrial growth permitted substantial increases in living standards. Import restriction did not promote economic growth. Instead it handicapped the farm sector, in which Argentina's comparative advantage lay, and led to an inappropriate diversion of resources into inefficient manufacturing industries. One of the most unhealthy aspects of this process was an internal migration within Argentina from the land to the cities, particularly Buenos Aires. An industrial proletariat, which had a vested interest in protection, was created.

Apart from one or two spurts of unsustainably rapid growth, reflecting frenzied and short-lived reflationary demand injections, industry did not flourish. An awkward problem was that certain manufactured products were both inputs to other manufactures and subject to a high tariff. Some manufacturers complained about the structure of protection, while others campaigned for its continuation and that it be tilted even further in their favour. Occasionally disputes arose because of the difficulty in classifying a particular import. A rather comical example was provided by the hat industry which objected in 1940 that it was being victimised by the tariff. "Felt made off rabbit skins is used in this industry . . . rabbit felt pays higher duty than hats made of it."[12] Inspection of Argentina's tariff lists show that the *ad valorem* rates on the following items were as follows:

	%
Felts, in pieces, woollen or mixed	32·0
Adherent felts, for hats	53·6
Non-adherent felts, for hats	53·9
Felt, in pieces, especial for hats	85·1
Hard felt hats, woollen	54·0
Hats of silk felt	53·9
Hard hats, other materials	54·0
Soft felt hats, woollen	144·4
Soft hats, other materials	100·7

Importers, hat-makers, custom officials, lawyers and politicians must have spent a great deal of time on subtle verbal niceties. It is a reasonable deduction that less time was devoted to making hats than would otherwise have been the case.

Although imports of manufactures dropped as local producers took over the domestic market, manufactured exports did not develop. Any potential for export was stifled by features of the protectionist system. Import and exchange controls combined to keep the currency artificially overvalued, which hampered the sale of Argentine products in world markets. Moreover, many industries relied on imported raw materials, spare parts or capital goods. Erratic changes in tariff levels, exchange control regulations and the exchange rate made both the price and availability of these items highly uncertain. Serious attempts to develop manufactured exports were futile. "Manufacturing activities which potentially could export were forced to buy high cost inputs from inefficient domestic firms. Through input-output interrelationships the protected inefficient branches of manufacturing hurt the export potentialities of other sectors of the economy."[13] There could not be a sharper contrast between this situation and the high proportion of imports taking the form of components and intermediate goods in today's thriving free trade city-states of Hong Kong and Singapore.

To give Argentina's policy of autarky its due, on one measure—the ratio of trade to national income—it did lead to a greater measure of national economic independence. Exports of agricultural products and imports of manufactures fell, while national income stagnated or rose sluggishly. But there was no emancipation from the balance-of-payments constraint, as the mercantilist argument for protection would imply. Instead payments deficits and reserve shortages became chronic. Its origin, as the reasoning in the last chapter helps us to understand, was financial mismanagement. Budget deficits were continuous, as governments tried to resolve the conflicting demands of agriculture and industry for subsidies, cheap credits and so on. Since Argentines themselves had lost all confidence in their government and would not buy its debt, it had to run down its foreign assets or borrow from abroad. Even tariffs of 400 per cent could not stem the haemorrhage of reserves caused by bad government house-keeping. Only by bringing state revenues and expenditure into better balance could the overseas payments problem have been solved.

In the 1950s and 1960s there were occasional attempts to rationalise economic policy, with devaluation and tariff cuts linked to more responsible budgetary policies. They had significant repercussions on the distribution of income between farming and industry. In consequence, political opposition came from the relatively deprived groups, often culminating in strikes, disorder and violence. One particularly serious aspect of the malaise was the special position of industry. The urban working class artificially created by Peronist autarkic policies in the 1940s suffered from attempts to restore a more sensible economic framework. As it was concentrated in Buenos Aires, whereas the rural working class was geographically diffused and not organised in unions, it had much greater political leverage. The unwise industrialisation of the 1930s and 1940s therefore posed a permanent threat to social cohesion. Despite their increasingly manifest failure, the reversal of protectionist policies was regarded as 'politically impossible'—or, at any rate, only possible at the cost of severe civil unrest. Peron, who was overthrown in 1955 and sent into exile, watched the unhappy economic situation of his country from afar.

iii

In Chile the Great Depression's impact was cataclysmic. With both a decline in export volume and an adverse shift on the terms of trade, its ability to pay for imports was drastically curtailed. Rather than meet the crisis by the textbook measures of devaluation and deflation, the government resorted to repeated tariff increases and an assortment of other import control devices. A law of 1928 had delegated to the president the power to adjust tariffs. In 1930 he increased rates on average by about 70 per cent. In addition, exchange control was introduced in 1931, while various duties and charges were imposed. Rates were increased steadily, culminating in a 300 per cent gold surcharge on existing tariffs in 1935. Moreover, the arrangements became ever more complex. A list of "the major policy tools" included "multiple exchange rates, a myriad of indirect taxes and surcharges on imports, direct taxes on the major export producers, licensing, quotas, permitted and prohibited lists, prior deposits on imports, special regimes for exports and

imports, explicit and implicit subsidies, tax rebates, bilateral and compensation agreements, and regulations concerning direct investment and related flows and capital movements".[14] Some notion of just how tortuous the system became is given by the following calculation of the levies on the import of a tyre, with a c.i.f. value of 0·605 escudos, in early 1942[15]:

Basic duty	0·300
Warehouse charge (4 months)	0·018
Embarkation and disembarkation charges (Law 3852)	0·002
Statistical duty	0·0212
Additional duty (Law 4851)	0·030
Port fiscal duties	0·005
	0·3744
300 per cent gold surcharge	1·1232
	1·4976
"Ad valorem" tax (Law 5786)	0·1959
	1·6935 escudos

Aside from the true nominal tariff rate of over 250 per cent, the time consuming and expensive administrative tedium of ensuring that all the duties were paid represented a strong barrier against the importer.

Despite the obvious eccentricity of the import regulation machinery, there was no political initiative for simplification or reform. On the contrary, both the Popular Front government of 1938 to 1945 and the administration of President Gabriel Gonzalez from 1946 to 1952 were committed to checking imports and promoting industrialization. In this way, they thought they could regain "control over the Chilean national destiny" or something of the sort. The consequences were the same as in Argentina. Agriculture declined, as resources shifted towards industry, and Chilean self-sufficiency in farm products was slowly eroded. Equally serious was that little attention was paid to expanding copper production, the dominant export. In other words, although protection did help the industrial sector it was only at the expense of the rest of the economy. The share of trade to national income fell sharply from its peak of about 30 per cent in the late 1920s to under 10 per cent in the early 1950s.

Chile is interesting in that, unlike Argentina, it remained a democracy throughout the economic troubles of the forty years following the Great Depression. The kind of problems faced by trade liberalising politicians in Chile may be similar to those that would face their counterparts in Britain if a protectionist structure came into being and they had the task of dismantling it. By the 1950s there was a widespread, if far from unanimous, realisation among the Chilean elite that protectionism was not working. An insistent pressure for liberalisation, made more persuasive by the bureaucratic nonsenses of the tariff and exchange control systems, began to rival the nationalistic, import-repressive ideas which had dominated economic opinion in the 1930s and 1940s. The difficulty was that trade liberalisation had to succeed within the electoral time-table.

To the outsider, this time-table would seem generous. Presidential elections were held every seven years and, as the Chilean Constitution granted more limited powers to the legislature than in other democracies, the president had a free hand in policy-making. But in no case were liberalisation efforts sufficiently systematic and prolonged to guarantee success. Indeed, the Klein-Saks programme of 1955 to 1958, which involved the removal of several exchange controls, led to an abrupt increase in unemployment and had the effect of stigmatising orthodox economic policies throughout Latin America. As one left-wing assessment puts it, "The Chilean bourgeoisie was not particularly happy with the results of the programme of stabilisation, which had succeeded in reducing the rate of inflation at the cost of industrial growth and its own profits."[16]

Nevertheless, another attempt at freeing international trade was made between 1959 and 1961. Its main elements were devaluation and relaxation of exchange controls rather than a reduction in tariff barriers, but the net effect was to raise the price of exportable goods relative to imports and so encourage the growth of trade. The episode was short-lived. The government was unable to keep its own expenditure and budget deficit under control, with the result that by the end of 1961 liquid exchange reserves were down to the equivalent of about ten days' imports. On 27th December the central bank revoked all authority to deal in foreign exchange and instituted prohibitive 10,000 per cent prior deposits on imports. The liberalisation programme was sabotaged by the government's fiscal irresponsibility.[17] The failure to curb the budget deficit reflected the pressures of a parliamentary democracy combined with a lack of determination among the politicians, including the conservative Jorge Allessandri who was President from 1958 to 1964.

His Christian Democrat successor, Eduardo Frei, did no better. Initially his administration was characterised by a tightening of the new import restrictions which have been introduced in late 1961 and 1962. Some imports were banned entirely, while those remaining on the permitted list had to obtain central bank approval before they could be shipped into the country. One consequence was particularly disturbing to a government which, like many others in the developing world at that time, remained enthusiastic about industrialisation and import substitution. Several of the prohibited imports were vital spare parts or raw materials for industries whose establishment had originally depended on other protective arrangements. In other words, one part of the protectionist framework was undoing the intended work of another part. Inevitably there was discontent all round.

In 1965 the government therefore tentatively eased up on import restrictions. The number of items on the permitted list was increased and in June 1966 taxes on machinery imports were lowered. In January 1967 the tariff structure was considerably rationalised. The miscellaneous hotchpotch of duties, levies and surcharges dating from the Great Depression was consolidated into a more straightforward list of specific and *ad valorem* tariffs. Further liberalisation continued until the end of the Frei government in 1970, but its speed and coverage was conditioned by the need not to antagonise significant producer interests. As in Argentina, the long period of protection had promoted a variety of inefficient industries and, employed in them, a large urban working class; and, again as in Argentina, its potential for causing unrest in the capital city, Santiago, limited politicians' willingness to remove import controls. In recognition of this constraint, it was still true in 1970 that no imports of cars, television and radio receivers, cigarettes, alcoholic beverages, carpets or toys were allowed.

The message of liberalisation efforts in the 1950s and 1960s was that it was difficult to reconcile the long-term benefits of opening up the economy to trade with the imperative to achieve short-term results to satisfy the electorate. For example, it has been said of the Klein-Saks mission that, "The basic problem was a lack of sufficient short-run success in the over-all stabilisation programme to allow the maintenance of political momentum."[18] The same conflict between long-term economic advantages and short-run political dangers would no doubt be found in Britain if a fully-fledged protectionist system had been created and it was decided to end it. The implication is that it is much easier to slide into protection than it is to escape from it. Politicians, who like to keep themselves rich in alternatives, might bear this in mind.

If protectionist support of industry in general had harmful economic and political consequences, the government's selection of particular industries for import control favours was rather careless. The competitiveness of Chilean democratic politics had the effect of subordinating economic common sense to political expediency. The most glaring example, and one which has become notorious among development economists, was the aid given to the automobile industry. Of course, under free trade Chile would manufacture no cars, but import its requirements and pay for them with exports of products in which it has a comparative advantage. But in 1960 the government decided that Chile should have its own independent car-making capacity. Car imports were virtually prohibited and a number of foreign companies were induced to set up plants in Arica, a small town close to the Peruvian frontier about a thousand miles from Santiago. (Needless to say, Arica is politically a 'marginal' with a known local tradition of left-wing militancy and also a tendency to identify with Peru, to which it once belonged.) At the outset free import of equipment and components was permitted, but this was to be gradually replaced by indigenous supply. Indeed, under certain 'national integration' requirements the foreign companies had to buy a stated proportion of Chilean-made parts, which rose each year, if they were to retain the govenment licences they needed to be in business. Unfortunately, Chilean parts were not always available and cost quotations, invariably from a distant Santiago supplier, could be up to ten times higher than those for the imported equivalents. This did not ensure that they were of the appropriate quality. A study of the Chilean car industry noted that in 1965

> One plant manager obtains the front doors for his automobile from Santiago, but imports the back doors from Europe . . . He complained that his plant had to rework every single door that had been delivered from Santiago.[19]

The companies were well aware of the problem and deferred orders for components until late in the year, when purchases had to be finalised if the national integration requirements were to be met. (The requirements were specified on a calendar year basis). By giving domestic suppliers sufficiently long notice, the parts had a better chance of being up to standard. As the components were delivered in October and November, car production would rise. It would then drop back in January and February as the search for more locally-made components resumed. In consequence, "assembling cars in Chile—like growing carrots—was a seasonal business."

But the national integration requirements were only one part of the administrative bother imposed by the politicians in their quest for a truly Chilean industry. A precondition for the purchase of imported components was foreign exchange authorisation from the central bank. Before it would grant this, the central bank had to have information about the length of production runs. As the companies were usually rather uncertain about how many cars they would be able to make, they tended to bid for more foreign exchange than necessary. Not surprisingly, there were squabbles between central bank officials and car company executives. They were resolved by a peculiar formula in which the allocation of foreign exchange depended on the monthly profile of car production.

Ironically, access to foreign exchange—which at the official exchange rate was very underpriced—was the main commercial justification for the car producers staying in business. They could not earn much profit from assembling autromobiles, but the exercise was worthwhile if it was a pretext for obtaining cheap dollars. In 1964 Chile had therefore 'succeeded' in attracting 20 car companies to set up operations, with annual production varying from 1,533 units at Citroen Chilena S.A. to 6 at Sociedad Importadora Willys Ltda. As one author remarked somewhat acidly, "The variety and quality were impressive. Chile, a country of fewer than 10 million inhabitants, had more auto assemblers or producers than the giant United States."[20]

It may well be asked how any country could not only tolerate, but actively encourage such absurdities. Chile has a large, well-educated professional class and its members knew, like outside observers, that protectionism was making their country a laughing-stock. But in a democracy it was difficult to reverse the process. The establishment of the car industry reflected the popular belief that the final production stage in every industry should be located in Chile; it was commodity imperialism taken to bizarre extremes. To politicians, for whom patriotic slogans tend to be more effective spurs to action than sound economic reasoning, the benefits in terms of flattered national vanity outweighed the costs which would in any case be borne by someone else. Once the car industry, and a number of similar'autonomous manufacturing' activities, were in being, they had their own political lobbies and electoral constituencies. Perhaps even more important they had the funds necessary for the discreet financial persuasion of congressmen who might otherwise have decided that import controls had been taken too far.

iv

Protectionism stalled economic growth in both Argentina and Chile. From being among the most dynamic economies in the world until 1930 they were only able to match the international average growth performance in the next two decades. In the 1950s and 1960s the rise in output per head was modest. It has been estimated that between 1950 and 1963, when there was the closest approximation to autarky, the annual increase in Argentina's gross domestic product *per capita* was only 0·5 per cent.[22] In Chile the figure was 1·4 per cent between 1940 and 1960 and, in the decade after 1960 when there was a slightly more relaxed attitude towards imports, it was 2·6 per cent.[22] These statistics are far from favourable to the protectionist case, but they may overstate the welfare gain in the period. The most satisfactory measure of well-being is the sum of individuals' consumers surplus, not the value of national production. It is quite possible that the misdirection of consumption patterns, due to protection-distorted price relationships, was so great that welfare rose less than output. Moreover, it seems that technical progress was negligible because resources were induced to enter the wrong industries by tariffs and other government interferences.[23] The hospitalisation argument for protection was emphatically disproved.

But the failures of the 1950s and 1960s were trifling compared to the câtastrophes of the 1970s. The trend towards greater state intervention, of which protectionism was the earliest and most conspicuous aspect, had been under way for over forty years, but now it accelerated rapidly. It soon led to economic chaos and shortly after that to political disintegration.

Chile was the first country to tear itself apart. In the general election of 1970 Salvador Allende, the Communist candidate, achieved a narrow majority over Jorge Allesandri. He became President after Congress had given the necessary approval and, for the next three years, he led a government of Popular Unity on a programme of sweeping changes sharply in the socialist direction. It was similar to Peron's 'period of assault' between 1946 and 1948, except that it was more extreme and undertaken in a particularly fragile domestic political environment. Private enterprises were nationalised or subjected to punitive price controls, while large wage increases were legislated. Of course profits, and the incentive to produce, vanished. The foreign-owned copper mining companies were expropriated without compensation, resulting in a reduced volume of copper exports and contributing to a severe balance-of-payments crisis. This was exaggerated by price controls on food and 'land reform', which discouraged agricultural production and necessitated imports to compensate for the shortfall. "From 80 per cent self-sufficiency in agricultural products in 1965-70, Chile moved to only 74 per cent reliance on domestic supplies in 1971 and only 67 per cent in 1972."[24] As world food prices rose simultaneously, the balance-of-payments effect was even worse. Less money was available for other foreign products, with the result that "the scarcity of essential imported inputs became a famine, with grave social effects." The folly of artificial industrialisation during the protectionist years from 1930 became increasingly evident. It is probably a safe assumption that the car workers of Arica nevertheless remained well-fed during the Popular Unity period.

In late 1972 and 1973 the crisis deepened from month to month. A succession of hastily-conceived socialist measures battered domestic industry and commerce, while the government attempted to nationalise the import trade entirely. Price controls caused bewildering distortions. The paper around a sack of cement was supposedly worth more than the cement it contained, while the black market price of an egg was above the official price of a hen. Production and distribution became totally disorganised. Exports in 1972 were two-thirds of their value in 1970 and, although there was a sharp recovery in 1973 because of increased copper prices, a massive current account deficit persisted and the reserves came close to exhaustion. With all sections of society suffering from the economic disarray, violence erupted throughout the country and by the middle of 1973 civil war seemed imminent. A military *coup* on 11th September 1973 overthrew Allende and his government. After a week of street-fighting and sporadic terrorist attacks on the armed forces, some semblance of law and order was restored. The military was left with the bitter and unwelcome task of putting the pieces together again. The circumstances of the *coup*, and allegations of the widespread use of torture against the government's opponents, relegated Chile to the rank of a pariah nation. It was the same nation that Bryce had said forty-five years earlier possessed "a native and Spanish stock of unusually sound quality" and whose constitutional machinery seemed "to work smoothly".

The story of Argentina's collapse is in some respects much easier to tell. In the early 1970s widespread disillusionment with semi-permanent and rather unconvincing military rule encouraged a yearning among the Argentine public for strong leadership. The obvious candidate was General Peron. He returned from exile in 1973 and won a decisive victory in a general election. As in 1946 he indulged in a burst of 'reformist' measures. Taxes were made more progressive; a law allowing the expropriation of unproductive estates was passed; trade with the Eastern Bloc was promoted; and so on. Macro-economic policy was marked by little respect for the laws of arithmetic. After a short while the budget deficit began to rise and monetary growth exploded. The death of Peron in June 1974, and the succession of his wife, Isabel Peron, caused no real change of course. By the fourth quarter of 1975 the deficit on Treasury operations was equivalent to over 15 per cent of gross domestic product, the money supply was climbing at an annual rate of over 500 per cent and inflation was running at 1,000 per cent. The military allowed the government, which contained a motley coalition of politicians, a few months to demonstrate more thoroughly its total imcompetence. The ruling factions obligingly made the mess even worse. "The loss of authority of the government, the anarchic behaviour of the members of the coalition and the very high price increases created a sense of chaos and doom."[25] The inevitable military *coup* took place in March 1976. As in Chile, the army's methods of restoring law and order did not meet with international approval.

Superficially, therefore, the reason for Argentina's economic breakdown was straightforward—financial mismanagement culminating in hyperinflation and consequent political anarchy. However, the long protectionist tradition was also responsible. Among the most socially divisive characteristics of the final phase was that significant changes in economic policy affected different groups in different ways. As a result, it became a universal assumption of thought that income distribution was not determined by market forces, but by the aggressiveness of the pressures applied to politicians to bend policies in favour of particular interests.

Protectionism, which as we have seen is capable of granting particular producer interests large income gains while impoverishing society as a whole, must have helped the development of this highly unstable and subversive view of the economic system. It was understandable that the Argentines should come to think in that way. In the frenzied conditions of the mid-1970s, events moved faster than policies could respond. Major economic variables frequently became unrealistic and the correction, which it was for politicians to decide, involved drastic upheaval. For example, despite rapid inflation, the exchange rate was fixed from 1971 until February 1975, when it was devalued by 50 per cent. Naturally, a devaluation of this size had a very favourable impact on exporting and import-competing industries. Resentment was aroused among the rest of the community, exacerbating the tendency towards political polarisation. Interestingly, by 1975 and 1976 the potential to mount organised opposition to the government was held not only by the industrial unions, but also by agriculture. The urban working class, which had most to gain from import restriction, no longer held a monopoly of protest. In late 1975 two lock-outs in the cattle industry, which remained vital to the balance of payments, were designed to coerce the government into taking measures that would favour the farm sector. The functional division of labour into agriculture, industry, and services became not the key to improved productivity through specialisation, but the motive force behind grave social fragmentation.

The most effective lobbying technique of each vested interest in Argentine society was to take to the streets, make a noise and cause trouble; and the most powerful catalyst for the *coup* was the need to end the frantic jockeying for relative advantage by competing groups. "When relative price shifts were attempted as part of the policies of the government, they proved difficult to sustain, particularly when they did not accord with the relative power of the groups affected."[26] The lesson is that it should not be the government's task to arbitrate on the functional distribution of income. Instead that should be left to the market, which has the virtue of being impersonal and therefore

difficult to blame. In Argentina's case the interference with the market's allocative and distributional role was greatest in international trade. The military regime in power since March 1976 has begun to remove, with some success and despite opposition from industrialists, the protectionist excesses which date from the early 1930s. Trade liberalisation is considered desirable not only because of its economic efficiency, but also as a necessary ingredient of political stability.

Argentina has much ground to recover. In 1929 it was the fifth richest nation in the world; today it is labelled a 'developing country'. In the quinquennium from 1915 to 1919 exports averaged 28·5 per cent of gross domestic product and imports 17·8 per cent; today the corresponding figures are under 15 per cent. Even this is an improvement on the nadir of Peronist autarky between 1950 and 1954, when exports were 6·3 per cent of gross domestic product and imports 7·6 per cent.[27] But to quote these economic statistics is a petty indictment of protectionism in Argentina. Its real damage was to undermine the idea that there is a connexion between the market value of work-input and the material reward for that input; instead it made people believe that they could maximise their incomes by lobbying government and led to a confusion of economics with politics. In consequence, as Lord Salisbury warned over a hundred years ago might happen in any democratic society, the battle for political power became "merely an effort . . . on the part of the classes who wage it to better or to secure their own position". It did not take many years for Argentina to decline to complete social disintegration. "The broad distinction between a civilised and uncivilised community is this—that in a civilised community individuals or bodies of men who quarrel submit their difference to an arbitrator, while in a savage state they fight it out."[28] On that criterion Argentina in early 1976 was close to savagery.

Advocates of import controls in Britain, including the Cambridge Economic Policy Group, will no doubt say that it could not happen here. There is no decisive way of disproving them, just as there is no decisive way of proving that economic isolationism was largely responsible for the sad and terrifying collapse of Argentina and Chile. It is possible that economists who choose the two countries as the prime examples of protectionist folly have overestimated the costs of their international trade policies and underestimated the difficulty of reconciling deep-seated antagonisms between conflicting economic groups.[29] It is in the nature of social science that counterfactual propositions cannot be demonstrated conclusively. One such proposition is "If Argentina and Chile had adopted liberal commercial policies in 1930 they would now be rich and politically stable societies". But we do know that Argentina and Chile adopted the opposite of liberal commercial policies in 1930 and forty-five years later they were relatively poor and politically shattered.

The smallness of Argentina and Chile highlights their mistake. The smaller a country is, the more it has to gain from specialisation and free international trade. But their lesson is of wider applicability. Britain is now only a medium-sized nation and the possible economic damage from protectionism could be severe. If the experience of the Southern Cone countries is of any relevance, there might also be very unpleasant social and political repercussions.

Notes

(1) Uruguay should also be included in the Southern Cone group of countries, but it is too small to warrant separate discussion.

(2) Quoted on p. 1 of D. Rock *Politics in Argentina 1890-1930* Cambridge University Press 1975.

(3) J. Bryce *Modern Democracies* Macmillan: London 1929, vol. 1, pp. 216-7.

(4) D. Rock *op. cit.* p.2.

(5) M. J. Mamalakis *The Growth and Structure of the Chilean Economy: from Independence to Allende* Yale University Press: New Haven 1976, p. 33. It should be noted that Mamalakis does not seem necessarily to approve the extent of government non-intervention in the early years of this century.

(6) C. F. Diaz-Alejandro 'The Argentine tariff 1906-40' *Oxford Economic Papers* 1967 pp. 75-98.

(7) J. R. Behrman *Foreign Trade Regimes and Economic Development: Chile* National Bureau of Economic Research, Columbia University Press: New York 1976, p. 20. It could argued that the difficulty faced by Argentina and Chile—a drastic adverse terms-of-trade movement implying a quasi-permanent real income loss—was the same problem, except in reverse, as that faced by Britain in the 1980s because of North Sea oil. As Forsyth and Kay have shown, major structural changes in the economy are appropriate to exploit the real income increase attributable to North Sea oil. (P. J. Forsyth and J. A. Kay 'The economic implications of North Sea oil revenues' *Fiscal Studies* July 1980, pp. 1-28.) Because it all arises on a tradable good, the contraction of the non-oil tradables sector is necessary. Logically, Argentina and Chile in the early 1930s would have been prudent to follow policies which expanded their production of tradables. Instead they did the opposite.

(8) C. F. Diaz-Alejandro *op. cit.* p. 94.

(9) R. D. Mallon *Economic Policymaking in a Conflict Society: the Argentine Case* Harvard University Press 1975, p. 9. There is perhaps more than a slight resemblance between the measures in Peron's period of assault and some recent recommendations from the Labour Party's National Executive Committee in Britain.

(10) I. M. D. Little et al. *Industry and Trade in Some Developing Countries* Oxford University Press 1970, pp. 42-3. The implicit tax estimate was taken from C. F. Diaz-Alejandro *Essays on the Economic History of the Argentine Republic* Yale University Press 1970.

(11) R. D. Mallon *op. cit.* p. 10.

(12) F. J. Weil *Argentine Riddle* John Day: New York 1944, p. 140, quoted on p. 88 of C. F. Diaz-Alejandro 'The Argentine tariff 1906-40'.

(13) C. F. Diaz-Alejandro *Essays* p. 169.

(14) J. R. Behrman *op. cit.* p. 21.

(15) J. R. Behrman *op. cit.* p. 86. The illustration is taken from P. T. Ellsworth *Chile: an Economy in Transition* Macmillan. New York, p. 50.

(16) I. Roxborough et al. *Chile: the State and Revolution* Macmillan: London 1977, p. 37. The Klein-Saks programme was so called after an American consulting firm which advised on it.

(17) J. R. Behrman *op. cit.* p. 309. Behrman is the main source for this and the following paragraphs.

(18) J. R. Behrman *op. cit.* p. 308.

(19) L. J. Johnson 'Problems of import substitution: the Chilean automobile industry' *Economic Development and Cultural Change* 1967, pp. 202-16. The next quote is also from Johnson.

(20) M. J. Mamalakis *op. cit.* p. 158.

(21) R. D. Mallon *op. cit.* p. 10.

(22) M. J. Mamalakis *op. cit.* p. 90.

(23) H. J. Bruton 'Productivity growth in Latin America' *American Economic Review* 1967, pp. 1099-116.

(24) L. Whitehead 'Inflation and stabilisation in Chile 1970-7', pp. 65-109 in R. Thorp and L. Whitehead (eds.) *Inflation and Stabilisation in Latin America* Macmillan: London 1979. The quotations are from p. 77.

(25) G. Di Tella 'The economic policies of Argentina's Labour-based government 1973-6', pp. 181-226 in R. Thorp and L. Whitehead (eds.) *ibid.* The quotation is from p. 207.

(26) G. Di Tella *ibid.* p. 208.

(27) Figures from the Central Bank of the Argentine Republic quoted in R. Zinn 'The evolution and the main structural problems of the Argentine economy' *mimeo,* paper presented to the Argentine-American Forum, 6th-8th May 1979.

(28) P. Smith (ed.) *Lord Salisbury and Politics* Cambridge University Press 1972, p. 242, p. 345. The second quotation ("The broad distinction . . .") is from Salisbury's celebrated 1883 essay on 'Disintegration'. In 1860 he had written a remarkably far-seeing admonition about the trade unions in England which students of Peronism in Argentina might read with profit. ". . . [T]he stupid barbarism of their economical creed, the ferocity with which their secret conclaves pronounce the doom of a horrible death against all who thwart their projects, the readiness with which they find instruments to execute their murderous decrees, warn us that, if ever England should really pass under their power, we should welcome the military despotism that should relieve us." (p. 143).

(29) It is important to emphasise that the tensions were between different functional groups (agriculture and industry; exporters and importers; government and the private sector), not between classes, as a hackneyed Marxist interpretation might

suggest. The relationship between the nature of the tensions and protectionism is transparent.

One conventional economic analysis in the late 1950s estimated that the welfare loss to Chile from its protectionist policy was tiny, at only 2½ per cent of gross domestic product. (A. C. Harberger 'Using the resources at hand more effectively' *American Economic Review Papers and Proceedings* 1959 pp. 134-46.) The misleading impression given by this estimate is that it assumes production functions are unaffected by whether a country is protectionist or not. In view of the dynamism of the Chilean economy since the move to relatively free trade began in the mid-1970s, it seems likely that the true benefits from trade liberalisation arise because of specialisation and consequent economies of scale and experience; easier access to foreign inputs and, in particular, more advanced technology; and the alleviation of the bureaucratic burden on productive work. Such benefits almost certainly amount to much more than 2½ per cent of gross domestic product.

IV. *Protectionism and anti-economics*

Economics provides an elaborate theory of resource allocation and price determination. Its principal conclusion is that free competition and free trade are of more benefit to the community than alternative policies.[1] The theory is of great analytical robustness and power. It is able to identify weaknesses in the case for liberal economic policies and to show in what ways, if any, governments may amend such policies to their own advantage. The only significant argument for protection arises when a country can turn the terms of trade in its favour by imposing a tariff. Even then the world as a whole is worse off and it is worthwhile for the losing countries to bribe the protectionist country to return to free trade. This rather unusual possibility exists solely because there are boundaries between countries. If all nations were united under one government it would emphatically not be in the interests of world society for any particular nation to break away and declare economic isolation.

Protectionism is a form of anti-economics. It lacks intellectual artillery of the same calibre as economic liberalism and is understandably presented at a more populist level. The Cambridge Economic Group, despite their ritual description in the press as 'distinguished', has virtually no work published in academic journals apart from those edited by its own members; it relies instead on newspaper articles and 'Letters to the Editor'.[2]

This indulgence in pressure-group activity is easy enough to explain. In every society, even those which are economically prosperous and dynamic, one section can gain at the expense of others by the introduction of import controls. Only governments can enforce import controls. The avenue to business gain therefore becomes political rather than economic. Indeed, the readiness with which protectionists take part in political lobbying illustrates the anit-economic character of their position; and if there is a demand for anti-economics, there will also be a matching supply. It follows that such bodies as the CEPG have arisen in response to market forces. They have found a sales opportunity in the market for economic patent medicines and, sensing the potential profit in terms of public applause, they have exploited it to the full. As we said in the introduction, they are entrepreneurs of economic opinion. All believers in the free market must admire them for their efficiency and success. But they have made no contribution to economic thought—and they should not pretend otherwise.

Although the demand for protectionist anti-economics is nearly always present, it is strongest in slow growing economies subject to severe import competition. Corden's notion of the conservative welfare function helps to account for this. Suppose a society attaches a high welfare weight to income decreases and a low weight to increases. If an economy is growing quickly, the number of people experiencing income increases may still be high enough and their gains large enough to outweigh the losses of those suffering income decreases. In dynamic economies, such as Hong Kong and Singapore, the political momentum is towards liberal commercial policies. Several familiar free trade themes seem plausible. If some industries are expanding vigorously, it makes sense to say that workers who have lost employment because of import competition can find new jobs elsewhere. But, in a relatively static society with unemployment rising, the free trade canon sounds hollow, unrealistic and even cynical.

Perhaps not surprisingly, opposition to import controls has been bracketed with monetarism and the two together have become bogeymen for "moderate" professional communicators, the sort of people who, because they cannot make up their minds, have had so much influence on the formation of British public opinion. Rather than think through debated issues, their approach is to find out what are the diametrically opposite positions and steer a compromise course between the two. As a result they want neither free trade nor outright protectionism, but prefer 'selective' import controls. Support for this supposed solution has become trendy and acceptable to the social democratic consensus, the middle-of-the-road politicians, leader-writers and television producers who believe themselves to be the inheritors of the British liberal tradition. This is a sad comment on present-day political attitudes.

The truth is that import controls are not liberal, but backward-looking and chauvinistic. Instead of looking forward to change, they are intended to preserve an existing economic structure; instead of looking to new initiatives and stimuli from outside, they symptomise prejudices whose fulfilment would shut Britain off from the rest of the world. In this sense, the current enthusiasm for protection is another example of what Benda called *le trahison*

des clercs—the tendency for intellectuals in the twentieth century to emphasise the separateness of people. Import controls are a retreat from cosmopolitanism, "the simple desire to enjoy the advantages of all nations and all their cultures, which is generally exempt from moral dogmatism".[3] Instead they foment nationalism and class rivalry, which as we have seen, were an integral part of the protectionist story in Argentina and Chile. It is ominous that these ugly thought-patterns are now a powerful undercurrent in import control rhetoric in Britain.

Regrettably, the redistributive aspects of the trade policy debate hinder its early resolution. Some groups unquestionably do gain from import controls. Although this essay has argued that the rest of society loses more, honesty must force the admission that the conclusion rests on the premise that interpersonal comparisons of welfare are possible. In practice, they are not.[4] However, there is something artificial about saying that, because we cannot compare the welfare of British Leyland workers with that of car buyers, we cannot establish a decisive economic case for free trade. In a flexible economy, the people who are British Leyland workers at one point in time are not British Leyland workers at another. There is a continuous circulation of manpower, conditioned by the push and pull of market forces. Without that circulation, and the associated reallocation of capital, there cannot be economic growth. The market may often make errors and seem cruel, but centralised anti-economic methods of allocating resources may be even more mistaken and brutal. They may—as in Argentina and Chile—arouse greater resentment, provoking hostility to the social order. "Real-world markets, with all their faults, have to be compared with real-world politicians, civil servants, pressure groups and experts."[5]

Protectionism is an expression of naive faith in the perfectability of all things, of a belief that if there is a 'social problem' there must be a 'government solution'. The answers to industrial decay, so the newspaper leaders tell us, are straightforward, 'more money', and 'more planning'. But the money has to come from somewhere and the planners have to be found. The protectionist habit of invoking the state whenever certain industries are in difficulties is merely a category mistake. The state has no money and no planners. It can only obtain them from other industries which afterwards produce less at a higher cost. The mentality of the import restraint advocates is the same as that behind children's comics and James Bond films. At the most critical and perilous moment there is always a lucky break, an unexpected rescuer. In the protectionist's fantasies the rescuer is called a 'selective import control'.

The political folly of import controls is, perhaps more than any of the well-established economic objections, their real defect. They create expectations of government which government cannot meet[6]; they therefore undermine the assumption, essential to the open society, that the prime function of the state is to arbitrate impartially between conflicting interests. In its respect for this assumption, the case for free trade should be seen as part of a broader argument for political freedom.

Notes

(1) Apart from the standard price and market theory, economics has recently begun to develop a theory of property rights, which contrasts the efficiency implications of alternative property regimes (capitalism, workers' ownership, centralised public ownership). Interestingly, the capitalist system, characterised by private property and free markets, tends to perform best. See several papers in E. G. Furubotn and S. Pejovich (eds.) *The Economics of Property Rights* Ballinger: Cambridge, Mass. 1974. This is, of course, by no means a conclusive recommendation for capitalism since there are social and political, as well as economic efficiency, aspects to consider.

(2) This would be fair enough if protectionists could appeal to a weighty body of evidence and theory to support their view. Economic journalism is a respectable calling. But the protectionists cannot so appeal.

(3) J. Benda (translated by R. Aldington) *The Treason of the Intellectuals* Norton: New York 1969, p. 92.

(4) It seems better to make this admission than indulge in a convoluted discussion of Pareto-optimality and compensation tests, the subjects to which some of the more high-powered economic articles on the gains from trade are devoted.

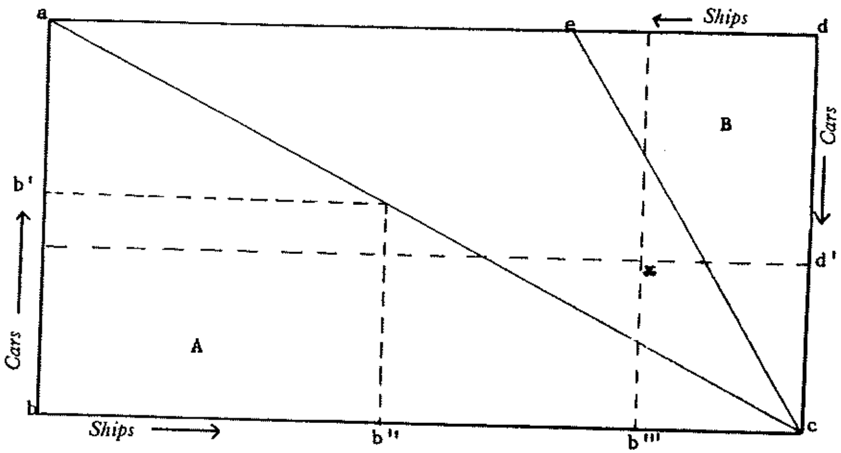
(5) S. Brittan *The Economic Consequences of Democracy* Temple Smith: London 1978, p. 230.

(6) "The mass says to itself, *'L'état, c'est moi',* which is a complete mistake." and ". . . [T]he mass-man sees in the State an anonymous power, and feeling himself, like it, anonymous, he believes the State is something of his own." Ortega y Gasset *The Revolt of the Masses* Allen & Unwin: Londin 1932, p. 32 and p. 132.

Appendix on the Gains from Trade and the Notion of Consumers' Surplus

1. Gains from trade

The following diagram shows how trade increases the consumption possibilities of two nations even though their ability to produce is unchanged.



The triangle abc indicates the production ability of nation A. It can make ab cars and no ships; bc ships and no cars; or some combination of cars and ships determined on or within the ac line (for example, bb' cars and bb'' ships). In a no trade situation, its consumption possibilities are also limited by the ac line (or "production frontier").

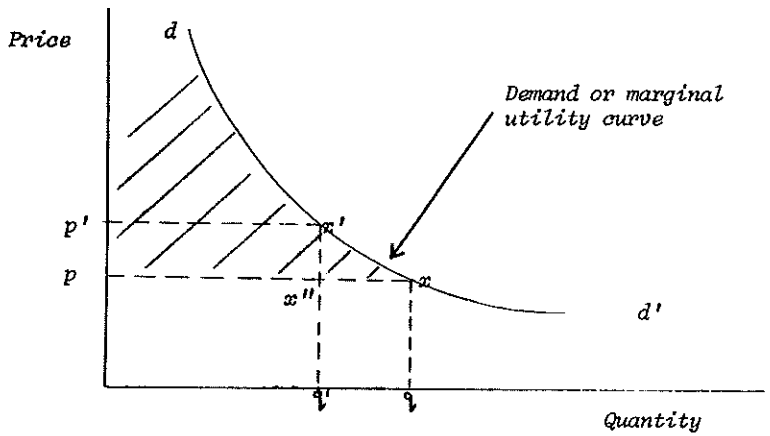
Similarly, the triangle cde indicates the production ability of nation B. In a no trade situation, its consumption possibilities are limited by the ce production frontier.

Now open up both countries to trade and allow A to specialise on ships and B on cars, so that A makes no cars and B no ships. Then it is possible for A and B to consume combinations of cars and ships in the triangle ace, *outside their production frontiers.*

For example, imagine a point x in ace. A produces bc ships, keeps b''' for domestic consumption and exports b''' c to B. B produces cd cars and, in return for the ships, exports cd' cars and retains dd for domestic consumption. A's consumption is bb''' ships and cd cars, while B's is b''' c ships and dd' cars. Neither economy could attain these consumption levels without trade, even though their ability to produce is unchanged.

Hence, Ricardo's remark that, "No extension of trade will immediately increase the amount of value in a country, although it will very powerfully contribute to increase the mass of commodities, and therefore the sum of enjoyments".

2. Consumers' surplus



A consumer buys a good because the utility he expects to receive is valued more highly than the costs he has to pay. It is a principle of economics that the more of a good a consumer buys, the smaller the increase in total utility (or marginal utility) accruing to each extra item of the good acquired. This is illustrated in the diagram by the downward sloping marginal curve, dd'.

The consumer buys that quantity of a good at which the price equals marginal utility. Consider, for example, the purchase of q' when the price is p. If the consumer expands his purchases to x, his additional cost is measured by the rectangle, x''q'qx. But his marginal utility is measured by the area x'q'qx, which is greater than the cost by the triangular area x'x''x. Clearly, it is sensible for the consumer to purchase q rather than q'.

The area x'x''x indicates the gain (or consumers' surplus) from buying q instead of q'. By extension, all of the area under the marginal utility curve, dd', and above the price line, px, is the consumers' surplus from buying q rather than nothing at all. It is shaded in the diagram.

The interesting point here is that if q' had been sold at p' the consumers' expenditure (q' x p') would be not much different from q sold at p (q x p), although consumers' surplus would be higher in the second case. The figure for consumers' expenditure appearing in the national accounts would be similar whether q' was purchased at a price p' or q at p, although welfare would be quite different.