

## Protectionism: Prescription for Stagnation

*Not all economic change constitutes progress, but all economic advance involves change. The changing production, employment, income, and trade patterns that constitute economic improvement for the great majority of people inevitably adversely affect some persons — those in the declining firms, industries, or regions. This applies to the international sphere as well as domestic — advantage of specialization in production and trade knows no country boundaries. But when adversely affected minorities are politically powerful, governments often intervene with special-privilege legislation to insulate the “injured” parties from the effects of international competition or to give them special advantage in the international arena. As the chronic worldwide inflating of the past few decades has left its usual legacy of faltering economic performance in virtually all countries, protectionist sentiment and practice again has risen to a high pitch, threatening to impede international flows that foster economic advancement and thus to set back even further the chances of reviving sustainable economic growth. In view of the propensity of politicians in the free-world nations to pander to domestically powerful special-interest groups, we fear that protectionism will increase dramatically in the coming years, compounding the economic difficulties already so evident.*

The general economic relationships associated with international trade and protectionism often are lost among the pro and con arguments about trade policies for particular industries; yet, the general relationships should serve as the guide for policies. In this report we focus on the economics of international trade and trade restrictions, and we offer some comments about the possible outcome of the recent widespread concern about the U.S. international trade imbalance.

One of the hindrances to a wider acceptance of free-market economic views is the hypocrisy of some of its ardent supporters. For example, businessmen often support the general idea of a free market, but then they favor and lobby for special consideration for their own industries or firms. The most heavily regulated industries such as transportation, communications, or finance are notorious for preferring the cocoon of regulation to the rigors of the marketplace.

On a national level, after World War II, the United States took the lead among nations in seeking freer trade. Why not? This Nation then was in a highly favorable competitive position, and policymakers could expect clear benefits to accrue to U.S. citizens from such a situation. U.S. businessmen and labor union leaders fully supported efforts toward freer trade.

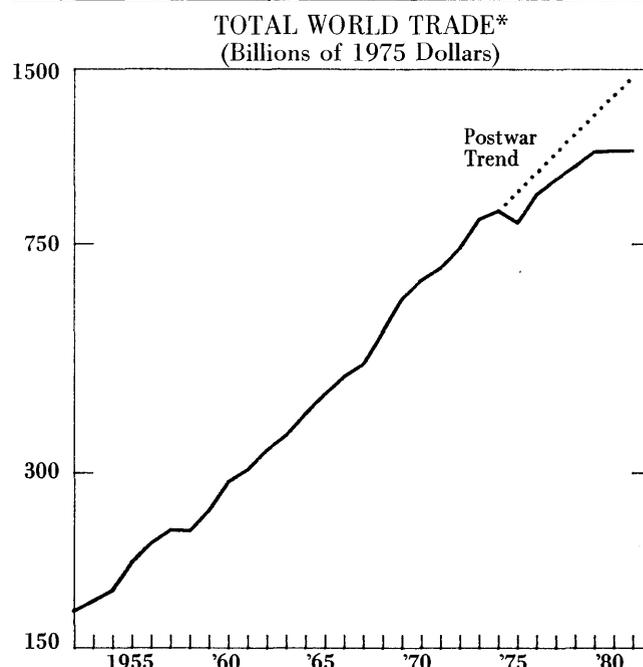
Many things have changed markedly since the late 1940's with reference to international dealings. After decades of inflating and the overconsumption it has fostered

in the United States, the competitive position of this country in world markets no longer is unchallenged — at least within some major industries, such as steel and motor vehicle production. Consequently, and as one might expect, businessmen and labor union officials in these industries have begun to clamor for favored treatment from the Government, and politicians increasingly have heeded and acted on their requests with threats of or actual legislation to change the market patterns of international trade. The danger of protectionism is especially great during times such as these, when there is perceived inadequate economic growth in many major nations.

If ordinary citizens throughout the world were asked to give reasons for unsatisfactory economic conditions, many different responses would be given, but unfair international trade probably would be listed often. “Imports are killing us, and the government should do something,” goes the worldwide refrain.

That this belief is widely held does not make it sound. In fact, as the accompanying chart indicates, world trade has faltered along with other aspects of economic activity during recent years. Thus, even on the simplest level, assertions that imported items have been edging out local production are simply not so on a worldwide basis.

The recent decrease in the growth of world trade has



\* Total world imports (in 1975 dollars). Total imports are equal to total exports plus insurance and freight charges.  
Source: International Monetary Fund.

involved several factors. Most often cited are the sharply higher relative prices for internationally traded energy products (not only oil but also natural gas and coal) and recessionary conditions worldwide. Both of these factors have served to curb demand for all products, imported or not. Artificial barriers to international commerce are maintained by government in the form of tariffs and more subtly by bureaucratic regulations, often in the form of quotas, and "red tape." It is not entirely clear to what extent these barriers have increased during recent years, and thus retarded the growth of world trade, but it is clear that the clamor for such barriers has increased.

In particular, it is widely feared that the ministers of the 88-member General Agreement on Tariffs and Trade (GATT), who on November 24 were scheduled to begin their first formal meeting in 9 years, will be unable to agree on steps to reduce trade restrictions. Instead, they might legitimize and extend trade barriers that have arisen during recent years. Such an outcome would be tragic. Reductions in trade barriers following World War II was one of the sound sources of economic advancement. Let us examine why trade improves the economic situation of trading parties, and why protectionist policies would make advancement all the more difficult.

### *The Economics of International Trade*

Trade — international or domestic — is economically desirable because not all economic units produce goods with the same efficiency, and by specializing in production and then trading, all participants can improve their scale of living. Whenever an economic unit can produce one good with greater relative efficiency than it can produce another good, such a unit can advantageously specialize in the production of that good and trade with an economic unit that is relatively more efficient at producing some other good. Specializing in this manner is undertaken according to the comparative advantage in production that one producer has over another. The economic advantage of such specialization can be better achieved when international trade is not prohibited or restricted.

To illustrate the potential advantage of international trade, let us use a hypothetical example. Suppose that during a week of work an American farmer can produce *either* 100 bushels of wheat or 75 bushels of corn and a French farmer can produce *either* 50 bushels of wheat or 25 bushels of corn with equal cost and effort. In this example, the American farmer obviously is more efficient at producing both goods; he has an absolute advantage in the production of both wheat and corn. However, note that compared with the French farmer, the American farmer is relatively more efficient at producing corn (75 bushels against 25 bushels; a 3-to-1 advantage) than wheat (100 bushels against 50 bushels; a 2-to-1 advantage). Thus, the American farmer has a comparative advantage in the production of corn. Therefore, the American farmer should produce corn and trade with the French farmer, who should produce wheat.

Let us see how such specialization and trade would benefit both parties. If the French farmer worked 1 week to produce 50 bushels of wheat and the American farmer worked 1 week to produce 75 bushels of corn, the French farmer could trade the product of his effort (50 bushels of wheat) for 30 bushels of corn from the American. After the trade, for his effort of 1 week the French farmer would have corn (or the equivalent in purchasing media) which would have taken him 1.2 (30/25) weeks to produce. What about the American farmer? After the trade mentioned above, for his 1 week of effort he would

have grain (or the purchasing media equivalent) equal to an effort of about 1.1 (45/75+50/100) weeks. He, too, would have benefited, although he had an absolute advantage in the production of both goods.

One should remember that the benefits of trade are not limited to those directly involved in the trade. From the American viewpoint, the American farmer presumably would spend all or most of the added income he received. His expenditures would be additional income to firms that would employ additional labor to produce the additional product the farmer would purchase. In this way the benefits of international trade would be distributed throughout the economy.

### *Conditions Change*

The illustration above is intentionally very simple; nevertheless, the point of the illustration is relevant to the trade that flows across national boundaries even today. Why, one might reasonably inquire, do nations have a comparative advantage in the production of particular products? In some cases the reason is obvious, as it is when a nation lacks specific natural resources. For example, the United States has to import all or nearly all of its tin, nickel, natural rubber, bauxite, cobalt, manganese, and chrome, among other things. The fact that the United States could not produce a single jet engine if it imported nothing at all illustrates how world trade is essential even for a nation as "rich" as the United States.

Another condition that can give one nation an advantage in production over another is an abundance of a particular type of labor. Nations with large populations and relatively unskilled labor forces should enjoy a comparative advantage in labor-intensive industries. One should not be surprised that much of the world output of goods requiring a large unskilled labor input (for example, curios, handicrafts, etc.) should be produced in those nations that have large unskilled labor forces.

Nearly as obvious is the comparative advantage that some nations have because of a large available supply of a particular type of capital equipment. Of course, this is true mainly for highly industrialized nations. In such cases, the capital-intensive industries (such as computer, motor vehicle, electrical equipment, chemical, construction equipment, etc.) should play a more important part in the economy. Underdeveloped nations obviously have a disadvantage in the production of such goods. Just as clearly, well-developed nations should expect to have a disadvantage in the production of goods requiring a different make-up of labor skills.

As the world becomes more developed, an advantage that is becoming clearer is that associated with product research and innovation, and marketing capabilities. New product development requires large investment and skilled labor. The worldwide marketing of new products allows the innovative firm to enjoy the economies of large-scale production, which makes it difficult for new firms to enter that field. Such is the advantage the United States for many years enjoyed in fields such as computers, petrochemicals, telecommunications, aircraft, etc. Over time, as the productive techniques for such products become more widely understood and the availability of the product becomes so widespread that marketing is not a significant problem, the U.S. advantage in the production of these things should have been expected to erode. In their place, the United States should have achieved an advantage in the production of new products.

Thus, comparative advantages are enjoyed for many different legitimate reasons. If these comparative advan-

tages can be utilized through unrestricted international trade, the citizens of all nations should benefit.

### *Some Effects of Trade Restrictions*

From the viewpoint of laborers, international trade contributes to higher *real wages* in general. International trade, which allows firms within a nation to specialize in those goods that can be produced most efficiently and are demanded in world markets, offers higher profit opportunities than would be available in the absence of such trade. Higher profits provide firms with the wherewithal to offer higher wages to attract the laborers they need to take advantage of the profitable opportunities. In short, because laborers are more productive due to the advantages of specialization, they are more valuable to employers and, accordingly, would be paid more, other things being equal.

Although the general level of real wages would rise, wages of laborers in industries having a comparative disadvantage would decrease, and some of these laborers would have to find other work. Such changes are similar to those resulting from technological developments and changes in consumer demand that are unrelated to international trade. No doubt the application of computer technology eliminated some jobs, but it created many more, which, in general, involve higher wages than did the jobs lost. If anyone were to allege today that computers should be eliminated, one of the arguments against such a proposal probably would be that it would put many people out of work. Thus, when workers ask that their jobs be protected against international competition, they are seeking to withhold better opportunities from other laborers and, perhaps, themselves.

An even more negative aspect of trade restriction involves the matter of individual freedom. When imports are restricted, voluntarily or mandatorily, a special privilege is granted to some members of society at the expense of others. Such restrictions replace consumer sovereignty with worker sovereignty. As a result of tariffs and import quotas, consumers are forced to provide a subsidy to the workers employed in the production of the protected product. In other words import restrictions force the consumer to pay more for a product than he otherwise would have to pay, and the difference is funneled to the workers and firms in the protected industry. However, where does the consumer obtain the purchasing media to pay for the items he buys? The answer is obvious: he works for them. Work, of course, usually involves the sacrifice of time and effort by the worker, for only rarely are individuals in a position to combine their vocations and avocations. Thus, when consumers are forced to pay higher prices for restricted items, they are denied the freedom to use their time as they choose and, in effect, are forced into slavery for the benefit of the laborers in the protected industry.

### *What About Unfair Foreign Competition?*

The recent U.S. moves toward protectionism have been defended in part with the argument that Japanese trade policies are highly restrictive toward importation of foreign products, while actively favoring export industries. Proponents of "fair" competition assert that such favored treatment of Japan's domestic producers must be eliminated, or U.S. authorities should take retaliatory steps.

We shall not assert that Japan is innocent of charges of restrictive trade practices, for evidence conclusively demonstrates quite the opposite. In spite of this situation, for the United States to retaliate with like policies would simply compound the problem. Let us examine why.

As we described above, the benefit of free trade is the production (and availability for consumption) of goods in the most efficient manner according to comparative advantages held by the competing productive units. Any policies that block such functioning of the economic system, force adjustments to second-best, more costly alternatives. Thus, Japan's restrictions on imports entail a cost to the Japanese as well as to foreigners (including Americans). The goal of officials should be the elimination of such barriers, so that the best, most efficient arrangement of production might occur.

If Japanese authorities refuse to remove these barriers and U.S. authorities retaliate with their own barriers, what would be the probable result? Aside from the possibility of escalating retaliation, the result would be further forced adjustments to third-best alternative means of production, with consequent further higher costs of production and reduced standards of living. This hardly seems to be a course of action favorable to the interests of U.S. citizens.

But should the United States let Japan "get away" with favoring its domestic industries at the expense of U.S. producers? This question presupposes that there is only a set amount of production that can take place and that if Japanese producers "keep" more of theirs while attracting some of the U.S. output, there will be less production and employment in the United States. That supposition is totally without merit. If Japan will subsidize shipments of goods to the United States, all the better for U.S. citizens. They can benefit from the lower cost of such goods, and U.S. producers can commit resources to the production of other things to satisfy other wants.

### *Strangling the Economy*

The economics of international trade and trade restrictions described above are widely understood — we suspect even by the labor union leaders, businessmen, and politicians now pleading for protection. In spite of this, they can recommend protective policies because they are concerned about *their own* members (in the case of unions), profits (in the case of businessmen), and reelection (in the case of politicians with constituents who immediately might be harmed). These leaders desperately want their members to avoid the temporary hardship associated with industry and employees having to adjust to changing economic conditions. For example, those involved in the motor vehicle industry want to avoid the contraction in U.S. car output that worldwide competition is forcing.

That such individuals seek protection is understandable, but from an economic viewpoint, to grant the protection they seek would be suicidal. Universal application of the policies these persons seek would straitjacket the economy at the current level of advance. It would guarantee that no further progress would occur in living standards, for progress requires change. The willingness and readiness of U.S. labor and businessmen to lead the way for progressive change seem to have vanished, as has the mirage of perpetual prosperity promised by Keynesian theory.

We submit that the danger to the economy in the years immediately ahead will come from increasing pleas for policies to protect first one special interest group and then another from the rigors of competition — both domestic and international. If these pleas are heeded, stagnation almost surely will be the result. The cost to society associated with the end of economic progress will be far greater than that cost of required adjustments to changing patterns of trade.

## BOOK REVIEW

*Stalin's Secret War*, by Nikolai Tolstoy, 1981, Holt, Rinehart and Winston, New York, New York, 463 pp. (with notes and index), hardbound, \$18.50.

Soviet preoccupation with force often is defended as an understandable reaction to heavy Russian losses during World War II. The actual number of Russians who died between 1939 and 1945 is uncertain.\* The figure most often cited, 20 million deaths, was apparently not made a "fact" of Russian history until 1965 when Mikhail Suslov, the party ideologist, declared that number had perished in the war. Earlier Soviet estimates had been far lower. However, according to Nikolai Tolstoy, the author of *Stalin's Secret War*:

"...A careful analysis of the first post-war census, that of 1959, revealed that something like twenty-five million more people died in the war years than normally would have been expected. In addition the projected birth-rate was down by twenty million; a figure to be accounted for by a possible wartime decline, and greatly inflated infant mortality. It seems that, in all, a staggering total of not less than thirty million Russians died in the war years, if we make the modest assumption that at least a quarter of expected births took place."

German casualties on the Eastern front included about 2.5 million killed or missing. The Soviets did not keep, or at least have not made public, records of their battlefield casualties. Russian battlefield losses were no doubt much higher than those of the Germans, if only because they used bizarre tactics such as clearing minefields by marching troops over them or sending ill-trained and ill-equipped "penal battalions" (composed of "enemies of the people") against German positions, with NKVD machine gunners to their rear for "encouragement." But, even estimating two or three Russian casualties for every German, and adding in estimates of Russian civilians who starved (in the siege of Leningrad, for example), of Jews murdered, and of Russian prisoners who died in the hands of the Nazis still means that, the author concluded, "casualties directly attributable to the Germans account for only a third, or at most, half, of Soviet overall losses in manpower in the years 1939-1945."

In other words, during this period anywhere from 7 to 15 million people died at the hands of the Soviet regime itself. In most instances, as chronicled by Mr. Tolstoy, these people were killed in one way or another by the Soviet Secret Police, which was founded by Lenin in 1917 at the very onset of Communist rule. Moreover, as the author makes clear, this wholesale slaughter of its own citizens was only an intensification of a practice that began soon after the overthrow of the Tsar. And it continued after the end of World War II.

Such savagery so readily acted out for power, and not the suffering inflicted on the Russian people by Hitler's armies, was and is the central experience of the Russian Communist regime. The function of the entire state apparatus is the perpetuation of the regime in power. Little more and nothing less. No means to this end are excluded. Although the incidents of brutal excesses in the

\* By no means the least significant reason for this uncertainty is that assigning a nationality to many of the dead is somewhat arbitrary. Some of the highest death rates occurred among people who might or might not be considered Russian. These, of course, include Eastern European Jews and the residents of Lithuania, Latvia and Estonia, Eastern Poland, and Bessarabia (areas that are now under Soviet control), prewar Russian exiles, and "Volga Germans." Up to one million of these latter groups actually fought with the Nazis against the Soviets.

slave-labor camps, the jails and interrogation chambers seem to be fewer, it need not reflect a more humane attitude of today's Soviet leaders. The ruling elite has so crushed opposition that remaining troublemakers can be conveniently cared for in "mental hospitals." And whereas in the old days an official who was asked to dine with Stalin never knew if he would go home to bed or out to be shot after the meal, today Russian leadership positions are opened and filled in almost a gentlemanly manner.

Stalin's rule may seem to be ancient history, but it would be well to remember that the current crop of Soviet leaders survived and even prospered under it when some see in Mr. Andropov's swift and peaceful accession to power reason to have higher hopes for reform in the Soviet Union. *Stalin's Secret War* is a timely reminder of the type of system that Andropov has helped to make and in turn has made him.

The book also provides useful reminders that: (1) The alliance between Hitler and Stalin was genuine, not merely a convenience. The two dictators agreed to divide Eastern Europe between them, and the Russians supplied the Reich with war materiel and intelligence nearly until the German armies invaded Russia. (2) The "left" was by no means in the "vanguard" of opposition to Hitler or "fascism," as subsequent mythmaking would have it. Western communists and "fellow travelers" were highly pro-axis during the early part of World War II. (3) Western diplomacy (with its emphasis on accommodation and compromise) has seldom, if ever, been effective in dealing with the Soviets' single-mindedness of purpose and unimaginable ruthlessness. Even today, Western leaders, including the Reagan Administration, refuse to confront the Russian leadership in its use of poison gases (yellow rain) in Cambodia and Afghanistan for fear of harming relations with Russia. And millions of Westerners apparently believe that the Russians would leave us alone and would destroy their nuclear weapons if only we would do it first. Never mind that there is not a scintilla of evidence to support this view, but that there are millions of corpses and of captive people to contradict it.

A question that the author raises but never seems to deal with quite satisfactorily is why the brutalities and outrages perpetuated by Stalin were widely ignored in the West. Among some left wing "intellectuals" he, perhaps correctly, observes that the belief that the Russian Revolution was a "noble experiment" (whose outcome could be safely observed at a distance) blinded them to what was actually happening. Among those who were neither Marxists nor Socialists there does not seem to be any excuse.

Nikolai Tolstoy is a relative of Leo Tolstoy, the great Russian author. His ability to bring passion to his subject, while retaining an impressive mastery of the facts, is greatly needed at this time to remind comfortable Westerners that the history of Russian leadership is total contempt for human rights and life.

### PRICE OF GOLD

	1981	1982	
	Nov. 24	Nov. 18	Nov. 24
Final fixing in London	\$404.00	\$408.50	\$409.00

*Research Reports* (ISSN 0034-5407) (USPS 311-190) is published weekly at Great Barrington, Massachusetts 01230 by American Institute for Economic Research, a nonprofit, scientific, educational, and charitable organization. Second class postage paid at Great Barrington, Massachusetts 01230. Sustaining membership: \$12 per quarter or \$41 per year.