The high costs of U.S. quantitative restrictions

Quantitative restrictions cost the United States three times what the protection-equivalent tariff would cost—because two-thirds of the higher cost to consumers goes straight to foreign producers. Why the giveaway to foreigners? U.S. producers have a louder voice than U.S. consumers, and foreign producers lobby aggressively to face a quota rather than a tariff—and thus get a higher price in the U.S. market.

A long with the rising U.S. trade deficit in recent years has come rising pressure for more protection—pressure that is strongest during presidential election campaigns. There are calls to protect high-skill sectors to keep real wages up, suggesting that failing to do so would turn the United States into a low-skill "McDonalds chain" economy. There are also calls for an industrial policy on somewhat similar grounds. After all, tariffs are mere shadows of their former selves.

Are there grounds for such calls? World Bank economists Jim de Melo and David Tarr built a model of U.S. trade to find out.*

To the informed economist, the popular wisdom that the succession of multilateral trade negotiations has reduced barriers to trade to insignificant levels is clearly false. Tariffs may be way down, but quantitative restrictions and other nontariff barriers are way up, now

covering about a fifth of U.S. imports.

Likewise, economists frown on the other policy theme that often surfaces in U.S. presidential campaigns—that "unfair foreign trade practices" should be counteracted. If the Koreans dump steel on the United States, the proper response should be to send them a thank you note—not to turn to antidumping measures or voluntary export restraints (VERs). But as is often the case with policy debates, informa-

tion is lacking—or when available, it is manipulated to support a narrow position.

At a time when negotiations on the Uruguay Round are floundering and an alternative to significant liberalization is continuing, or increasing, the reliance on bilaterally negotiated trade restrictions (such as VERs), it helps to know some of the costs associated with the three most important nontariff barrier measures in the United States. These are the restrictions on textile and apparel imports through the Multi-Fiber Arrangement, the system of bilaterally negotiated quotas on steel imports (started in 1985), and the VERs on Japanese auto imports (initiated in 1980).

To give an idea of the costs, de Melo and Tarr ran general equilibrium simulations for 1984-85, when all three measures were in effect—particularly instructive since they allow for easy comparisons with the costs of protection that tariff measures afford.

First, the costs of protection from these three nontariff barriers are huge in comparison with the distortionary costs occasioned by the remaining tariff structure (which includes an 18% average tariff on textile and apparel imports). Removing quotas in these three sectors alone would have yielded a gain in welfare of $21 billion. Of this $21 billion, $14.5 billion came in the form of transfers to foreign exporters who controlled the licensing arrangements to

Key numbers

• The quotas on steel, autos, and textiles and apparel have a tariff-equivalent of between 13% and 24%, far higher than the average U.S. tariff on manufactured goods since the second world war.

• Removing those quotas would bring welfare gains of $21 billion—$14.5 billion in transfers to foreign exporters and $6.5 billion in tariff-equivalent distortions.

• The benefit-cost ratio for removing the quotas is 28:1—yielding a net benefit of $107 billion.

import in the restricted U.S. market.

To some extent, this cost can be viewed as the unavoidable price of doing business outside GATT, since foreign exporters must somehow be compensated for agreeing to sign these bilateral deals. But there is also a $6.5 billion cost to U.S. exporters who are curbed in foreign markets, an amount that looms large when compared with a benefit of $900 million from removing all

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remaining tariff protection. Such relative magnitudes give an idea of where efforts at improving the efficiency of the world trading system should be directed—at all forms of nontariff barriers rather than at further tariff reductions.

Second, by any estimate, the costs to the rest of society of protecting the jobs of those who would have to relocate if these quantitative restrictions were removed (294,000 workers) are extremely large. Even after subtracting from the calculated benefits all the earnings losses that would be incurred while the displaced workers look for other jobs, the benefit-cost ratios still range from 4:1 in steel to 44:1 in textiles, where the premia are high and the wages are low. For all three sectors combined, the ratio is 28:1. That means that for every dollar of lost earnings for displaced workers, the economy gains $28 (the net

benefit from removal of the quotas in the three sectors is $107 billion). The imputed rent extraction from protection-lobbying activity is very high indeed.

Third, the "special" features of the auto and steel industry (significant economies of scale, strong union activity, and, for autos, a very oligopolistic structure) do not significantly affect the estimates obtained under the more traditional assumptions of perfect competition and a competitive wage structure. Economies of scale do, however, dampen the estimates, but only marginally. The reason: protection, by deflecting demand to domestic producers, allows them to expand scale, so long as new producers don't enter the industry (far from certain).

And what about the high wages paid to auto and steel workers because of labor union activity? Do they make a case for advocating protection on strategic grounds? If it is recognized that wage demands are likely to be related to the tightness of the labor market, the wage distortion from labor union activity is reduced when protection is removed.

If anything, de Melo and Tarr's estimates suggest that wage distortions do not provide support for an active industrial policy.

Finally, how much would tariffs have to be raised from present levels (set in 1984) to produce the welfare losses associated with the quantitative restrictions in these three sectors? (The calculation of course depends on how tariffs are restricted from their existing levels.) If the tariff structure is uniform,

the estimated average tariff is higher, at 24%, because the inefficiency costs of a tariff depend both on the average level and on the variance.

An alternative is to try to reproduce what was achieved through the multilateral tariff negotiations, which have tended to lower tariffs proportionately. With such a proportionate increase since 1984, an average tariff of 13% would

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result in the same welfare loss as that from quantitative restrictions in the three sectors. Compare that with an average tariff rate on manufactured goods of 10% in the United States just after the second world war. It is thus no exaggeration to say that protection through quantitative restrictions is setting freer trade back several decades.

What would removing nontariff barriers mean for developing countries? On the minus side are the reduced transfers (in higher prices) to producers now benefiting from them. The plus would be a move toward freer trade—developing countries wouldn't lose out to the stronger lobbying of the major producing countries in the allocation of quotas, and they could be specializing where they should be specializing. Bigger gains (under GATT) all around.