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THE CASE AGAINST TARIFF COMPENSATION: A COMMENT

STUART HARRIS*

Australian National University

In his recent paper, Peter Warr makes a number of points that are useful developments of various arguments in the 'tariff compensation' discussion (Warr 1978). His critical comments, however, regarding the political judgments made by those raising the 'tariff compensation' issue impel me to attempt to put the question in a more appropriate perspective. My comment deals first with a substantive technical issue and then covers some aspects of broader question of political judgments in economics.

With many of the technical points that Warr makes I would not wish to quarrel as I consider them helpful and desirable elaborations of the earlier arguments. On one technical point, however, a comment is warranted. Warr criticises the use of the term exchange rate or devaluation 'equivalent' of the tariff as ignoring the difference between the real nature of the tariff and the essentially monetary nature of exchange rates. It is true that the concept of an exchange rate equivalent of the tariff is a simplified one, used partly for analytical convenience, which by defining the exchange rate in real terms (usually the traded/non-traded goods price ratio) largely assumes away changes in monetary factors as well as making a number of other simplifying assumptions. It was also argued by many economists as a 'positive' element in the tariff debate in helping to remove some of the fears of tariff reform, by explaining the adjustments likely to occur in the system in a way that could be easily understood.

Warr is right to emphasise the importance of the monetary effects which could influence conclusions drawn from non-monetary models. Even if one were to accept, however, that the exchange rate 'equivalent' of the tariff is a concept whose time has passed—though I am not yet so persuaded—Warr goes too far to argue that the exchange rate is an essentially monetary phenomenon. While the theoretical issues concerning exchange rate determination remain unsettled, it would be generally accepted that both real and monetary factors determine the general equilibrium exchange rate. As Dornbusch (1976) has pointed out, for example, a change in the composition of production between home goods and traded goods could change the equilibrium exchange rate with no accompanying change in the money supply or real money demand.

My principal comments, however, are more general. Warr says that

* Thanks are due to Fred Gruen, Bob Gregory and Ben Smith for comments on an earlier draft. None necessarily agree with any point made, nor condone the inelegance of the expression of points with which they might agree.

'what motivates the tariff compensation argument is the belief that tariff reductions are politically infeasible. It is disturbing to reflect on the degree to which judgments, often implicit, of the political feasibility of this or that policy change underlie economists' policy recommendations . . . the tendency to mix economic analysis with implicit loosely founded political guesswork does little for the professional credibility of economists as social scientists' (p. 87).

He then quotes examples of political judgments made, presumably in error, by noted economists. Fred Gruen commented to me that this may simply mean that economists are fallible; it would be equally possible to quote examples of errors in economic analysis by noted economists but we do not normally conclude from that that they should not undertake economic analysis. It is the purpose of the remainder of this comment to suggest that political judgments are inevitable in arguing against or for specific policies, such as against or for tariff compensation; and that Peter Warr himself makes a number of such judgments in his paper.

Essentially, the tariff compensation argument consists of two issues. The first is in the nature of an objective question: what is the situation if tariffs cannot feasibly be reduced? It is to this question that the technical discussion has largely related. The second inevitably involves mainly political judgments about the conditions influencing the reduceability (or otherwise) of tariffs. (Warr does extend the argument to suggest the two are not independent and I discuss this below.)

Basically, Warr denies the plausibility of the proposition that the general level of tariffs is 'given' (for some relevant period). This is, of course, a political judgment. His conclusion that 'it is my contention that economists are more likely to have a favourable impact on trade policy formation by consistently arguing the case for reductions in levels of protection in all industries than by arguing for tariff compensation' (p. 97), is no less based on the 'political guesswork' that Warr deprecates than the argument he criticises. In any case, the question is one that is sufficiently plausible to be worth pursuing to a number of economists, including presumably Kym Anderson who, in an article in the same issue of the *Journal*, which is cited approvingly by Warr, says, 'If . . . we accept that some piecemeal government intervention is simply a regrettable inevitability . . . we may be able to make more impact on policy' (Anderson 1978, p. 111).

Second, Warr's arguments about the problems of information and the related risks of error are an important contribution. In general, however, the same information needs and similar possibilities of error would seem to apply to any microeconomic policy measure.

In Warr's approach, this information problem is overcome, or avoided, by judging any single tariff decision not on its own merits but as part of a more general policy measure—in this case, a policy of reducing levels of protection consistently over time and across industries.

The question is then—if any specific microeconomic policy can only be judged as part of a more general policy measure, where does the process stop? By what criteria are we to judge what is a general policy and what is a component part with whose allocative efficiency we are not concerned? Is the gain from across the board tariff reduction itself, for example, to be judged on its own merits or not? Recent work by

Sjaasted (1979) has suggested that it is not just in the Australian context that tariffs and export subsidies have been seen as needing to be judged not simply on their own terms but in the context, for instance, of the exchange rate regime.

There seem to be two possible answers. The first is that the general policy guide should be to remove all distortions; thus, for example, Sjaasted's starting position, that the distorted exchange rate regime is given, would also be rejected as inappropriate 'political guesswork'. With this general policy guide the technical problem, ignoring complications due to factors such as externalities and public goods, is resolved. The practical problem, however, is that we are not then merely concerned with the feasibility of removing distortions caused by the tariff but with the more fundamental issue of the feasibility of removing all distorting policies.

Warr seems to step back from the full implications of concerning himself with all distortions. He draws on his consideration of cost-benefit analysis (where he accepts the possibility of political or administrative infeasibility of first-best policies), and bases his argument on the 'separation of powers'—that is, on whether the decision unit for the particular policy measure is, or is not, able to determine more general policy. Thus political infeasibility makes sense 'only if the policymaker concerned with tariff compensation has no control over the tariff as a policy instrument' (p. 89). He regards it as unlikely that the separation of powers really holds for tariffs on the one hand and tariff compensation on the other. Apart from the 'political guesswork' that that particular judgment involves, it presents logical difficulties.

What criteria should one use to judge the 'separateness' of powers? Legal, regulatory, customary or similar bases of 'separation' are insufficient as criteria since either they involve the political judgment that they cannot be changed; or one accepts that, through political action, they can.

Third, I have made the point elsewhere that a complex issue for economists in policy discussion is, in fact, how to judge, at any time, what are parameters in a given economic situation and what are the variables on which policymakers and policy advisers can operate (Harris 1979). Economists do not customarily avoid this issue in practice by confining themselves to advocating first-best policies only. We do not find public finance experts, for example, maintaining that economists should continue to press for lump sum taxes and lump sum transfers. The issue is not, as Warr at one point implies, because advocacy of first-best policies might be unwelcome (p. 88), but that rightly or wrongly, many economists have judged that advocacy of first-best policies is frequently not wholly relevant; and that if economists continue to press only for 'pure' solutions, they will in practice be opting out of policy advising and leaving the field to others who may have less understanding of the issues or be interested in more distorting interventions.

Fourth, Warr argues that the debate over the principles of the tariff compensation argument is not independent of the question of the applicability of those principles in practice. In other words, that by accepting the tariff compensation argument in principle, the feasibility of tariff reform may be reduced. This, too, is presumably a political judgment. I do not necessarily disagree in general with the proposition that

the two issues are possibly connected, but I have problems with the implications drawn from it.

As I have said before (Harris 1975), the argument against tariff compensation that acknowledgment of the validity of the tariff compensation case even in principle may lead to its use by lobbyists and others in their 'rent seeking' is to me unacceptable on the grounds that it is undemocratic to argue against revealing 'truth' because it will be misused. My value judgment (and one that seems to me to hold at least as well as that of Alan Peacock that Warr cites to support his view), is that the community should be free, among other things, to make what I might regard as mistakes. Our function as economists is simply to point one what we see as the truth even if it can appear to be used to argue against what we consider sensible policies.

The adverse effects that Warr presumes must follow do not in any case seem to me inevitable. A further piece of 'political guesswork' is involved when Warr argues that if we 'succeed in persuading policy-makers that tariff compensation is "in principle" a good thing, there is little reason to expect that the levels of subsidies will be influenced at all by the subtleties of second-best analysis' (p. 93). This follows from the distinction made between the practical problems of determining second best compared with the 'certainty' of first-best policies. Thus Warr argues that the directions of the welfare effects of the lowering of a specific tariff, subsidy etc. are frequently uncertain but those of reducing levels of protection consistently over time and across industries are not (p. 97).

Historically the application of the general second-best principles in the specific tariff compensation context in Australia arose primarily in response to arguments that existing low levels of effective protection to the wheat industry should, in the interests of allocative efficiency, be further reduced (Edwards and Watson 1978). In this case, the lowering of effective protection would not 'certainly' have improved aggregate welfare. As a judgment, combining economic analysis and political assessment, however, I accept Warr's view, as an outcome of high probability, as to the direction of the community gain from general tariff reductions. As a scientific judgment, however, the terms and conditions under which welfare gains occur need rather more careful spelling out—is the reference, for example, to a potential or an actual welfare improvement?

We need to qualify the certainty of first-best arguments, even when we accept or argue their desirability. In the present context the relevance of this is that, as argued by Little (1960) amongst others, if we demonstrate a greater willingness to accept the limitations of our analyses, including the uncertainty attached to our first-best, as well as to second-best, analyses, we might have more credibility and therefore have more readily accepted our recommendations for efficiency improving policies. On these grounds, it can be argued that unwillingness to accept the necessary qualifications to our first-best conclusions, such as the 'in principle' tariff compensation arguments, frequently leads to the rejection of, or makes plausible—or even 'legitimate'—opposition by vested interests to first-best arguments. Thus it is not implausible to argue that the possibilities of tariff reductions are likely to be enhanced by a less dogmatic assertion of our certainty.

Finally, because of the information needs and the possibilities in practice of error, it may be that tariff compensation in particular circumstances is not worthwhile on a straight cost-benefit basis.[1] This is an argument which Warr's analysis, like that of Peter Lloyd before him, suggests warrants substantial weight. Neither Peacock's assertion that 'selective state intervention will proliferate across the whole of government, producing . . . an administered centralised so-called planned economy . . .', whatever that means and whatever the evidence for it might, or might not, be; nor Warr's assertion that arguments for tariff compensation 'mean more government control, more bureaucracy and threaten to divert attention from the central issues of commercial policy' seem as helpful.

Both could be correct, although the long history of government intervention makes it possible to ask whether it is necessarily so. Neither, in any case, seems to have emerged from the careful application of scientific method to political and historical phenomena that Warr correctly argues we accept, but nor should we expect to obtain answers that will absolve us, as economists, from exercising—preferably in public discussion such as this—political judgment.

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[1] Of course, those accepting the 'in principle' validity of the tariff compensation argument and the consequent proposition that the issue is an empirical one, as argued in Harris (1975), cannot be assumed to support any or all specific empirical judgments made subsequently against or for (or both?) the applicability of the principle to particular interventions such as the superphosphate bounty decision (see Warr 1979).