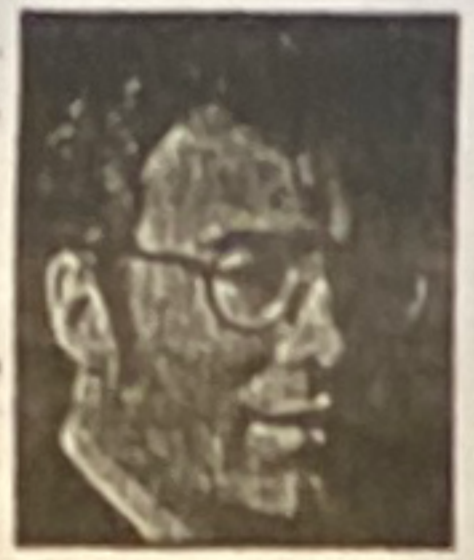
Vigilante America plays a risky trade game



ECONOMIC VIEWPOINT

Threats from the US of sanctions against the Japanese could backfire and set a precedent for protectionism that will hurt everyone, warns Dr Gerard Lyons

THE US authorities are playing dangerous games with world trade. First, they abandon the dollar, letting it plummet against the Deutschmark and yen. Now they threaten trade sanctions against Japan. One can understand why they are fed up with the Japanese position on trade but it is a dangerous precedent. Sanctions could be increasingly adopted by different countries as a policy tool, and not just against the Japanese but any country. Historically, we have been down this path before and it always ends in tears, for everyone.

Economic policies should be geared towards domestic interests. That was the painful message the British government learnt from sterling's exchange rate mechanism debacle.

Domestic interests are clearly coming first in US economic policy-making. The trouble is that US actions can have a dramatic global impact. And in present circumstances, US policies are not good for world trade.

The policy of benign neglect towards the dollar has helped US competitiveness and the economy. But it has weakened the German and Japanese economies as their currencies have soared. Such problems have reduced capital flows needed for world trade, with investors keeping their money at home, or in safe havens.

These problems are now being compounded as the Americans take a step along the road to managed trade.

The White House has announced it will impose tariffs on a range of Japanese goods sold in America. The problem is Japan's persistently large trade surplus with the US, 60% of which is in the area of autos and auto parts.

The US believes that Japan has complete access to American markets, while restrictive practices do not allow US car makers similar access in Japan. Japan has 24% of the US car market but America has only 1.5% of Japan's. They want to correct this imbalance, enforcing a level playing field.

There is talk of large tariffs on Japanese exports of luxury cars. The aim is to hurt Japanese car exports and, in turn, force Japan to open up its domestic car market.

The US approach has been an aggressive two-fronted attack. First the US has filed a complaint that has to be submitted within 45 days with the World Trade Organisation, who oversee such trade disputes.

SECOND, the US is pursuing sanctions through US trade law. To do both is strange. It is akin to taking someone to court (the WTO) but instead of waiting for the verdict you carry out your own retribution. Essentially the US is behaving like a trade vigilante and that is dangerous.

Financial markets are taking a relaxed view. This is because sanctions cannot be put into effect until mid-June, at the earliest. That leaves time for compromise.

Often in bilateral negotiations countries talk tough then reach a last-minute deal. This time, it is not clear things will happen that way. Autos and auto parts have been the perennial stumbling bloc in US-Japan trade talks.

What does all this mean for the dollar? Much depends on how Japan responds to sanctions. In recent years, when fears of a trade war prevailed, the view of Japanese investors was that sanctions would trigger a flight of capital back to Japan and a buyers' strike of US debt.

If that happened now, sanctions would have a nasty sting in the tail for the dollar, weakening it and not the yen. The trouble is that Japanese investors have repatriated so much money since last summer it is difficult to see them bringing more back home.

The timing of sanctions says a lot about the US economy and the concerns of the Administration, which is worried that the economy may already be slowing too much.

During his defence of sanctions, Trade Representative Mickey Kantor explained that the US auto industry averaged 4.4% of US gross domestic product during the last decade and it employed 696,000 directly and 2.5 million when affiliated industries are included.

Facing tremendous domestic economic difficulties, US auto sales have fallen sharply since last year and will fall further. Alongside the downturn in housing and construction, this suggests that previous increases in US interest rates are already slowing the economy.

Given the importance and lobbying pressure of US car makers it is hardly a surprise that there is cross-party support and widespread political enthusiasm for sanctions. It is difficult to see America backing down. Genuine concessions have to be achieved.

Are the Americans right? I think they have some legitimate concerns. Even though the Japanese government is deregulating its economy, it is dragging its feet. The pace must be speeded up, with discriminatory measures against foreign firms dropped. But the Japanese car sector is equally important in Japan.

The fact that the Americans have demanded specific measures in Japan, even including greater stocking of US parts, presents a stumbling block to a deal, with many in Japan fearful that this is the first step towards managed trade.

WE ARE some way from a trade war. But games should not be played with world trade. History is littered with cases where countries have imposed tariffs to overcome domestic difficulties. Faced with high unemployment, a country may seek to restrain imports and boost exports. But what may at first instance appear to be a sensible policy is soon doomed to failure if everyone follows.

This happened in the Thirties and the net result was lower world trade, which was not good for jobs.

There is a danger that protectionist pressures could resurface in coming years, particularly if global growth disappoints. The emergence of regional trading blocs and the intense competitive pressures emerging from South East Asia will add to tensions.

The US Administration is playing a risky game. Sanctions could backfire, triggering retaliatory action by the Japanese. Just as important, US behaviour could set a dangerous precedent, whereby countries in the interests of domestic economic and political objectives pursue a more protectionist line.

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