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NUMBER I

THE RATIONALISATION OF THE
PROTECTIVE TARIFF

INTRODUCTION

Rationalisation is the main slogan of the present generation, though its need is felt more or less in all ages. Nor is its need limited to the world of industry. It is required in various other fields. In connection with the tariff, too, its need is keenly felt if one would only take pains to look over it. One may indeed say that in no other field is rationalisation more urgently necessary than that of international tariff. There is a movement in our own country advocating free trade. The movement probably has as its object a rationalisation of the tariff. One should, however, doubt the wisdom of going extremes in carrying out such a scheme. On the other hand, it should be noted that, while the existing protective tariff arranged and enforced in great confusion is highly irrational, its reckless abolition would not give rise to a better situation. It would be impossible

to adopt an unqualified free trade policy in a country like Japan having an over-population and industries still in their infancy, and being confronted with the necessity of undertaking greater industrialisation in every phase of her economic life. In such a country it would be necessary to adopt a protective policy of some form to be enforced to some extent. Thus, we face the question as to how such a protective tariff can be made most rational in the circumstances.

I shall not here touch in detail the question of tariff for revenue purposes. Although its rationalisation is desirable, suffice it here to point out that its reform is to be made according to the general principle of the domestic consumption taxes. I have discussed this question on many other occasions and I will not repeat myself here. For many years my mind has been occupied with the problems of protective tariff, but I have been unable to think out any definite solution until quite recently. This brief essay, I hope, will offer some material toward the solution of this important problem.

PART 1.
RATIONAL PROTECTIVE TARIFF BASED UPON OLD
NOTIONS AND THE DIFFICULTY
OF ITS REALISATION

(1). Old rational protective tariff—In practical application it is impossible to distinguish clearly between protective tariff and revenue tariff, although such a demarcation has been recognized in theory. In actual practice, protective customs duties contain fiscal intentions. This has been especially shown in the case of nations suffering from post-war financial difficulties. Protective tariff may be defined in the abstract as a duty imposed on a particular article produced abroad for equalising its production cost (including all the transportation charges levied on the article before it reaches the market) in case the production cost of the same article produced within the importing country is higher

than the value of the imported article. The purpose of a protective tariff is to maintain domestic industry or industries and assist their growth so that they may become enabled to compete with foreign industries.

(2). Difficulties of realisation.

(A). Difficulty experienced at the time the amount of difference is decided on.

(a). Difficulty of comprehending production cost—As I have stated, the rate of a protective tariff may be fixed at the difference between the production costs of the exporting and importing countries. However, it is a most difficult task to comprehend production cost. In trying to find the production cost for some particular industry in this country, we shall find that different industrial units are placed under varying circumstances, so that the cost of some establishments will be greater or less than others. Under such circumstances, one will have to decide which one of the following alternatives to choose,—greater cost, small cost or their average. Whichever one is adopted as the basis of calculation, there will be a great difference in the result. From the standpoint of the consumers, the adoption of the smallest production cost would be highly desirable but it would prove cruel for the producers. The adoption of the highest production cost would be welcome to the producers, but would require too great a sacrifice on the part of the consuming public. Thus, the adoption of the average would be sound. However, some respect may be paid to the view that, in view of the greater importance of the interests of the consuming public over those of producers, the smallest production cost be adopted and the industry be left to fortune as to survival and development. Thus, the choice is narrowed to the two alternatives, namely, the average production cost and the smallest production cost. As to the production cost in exporting countries, the adoption of the smallest cost should be advocated as greater power of competition will be developed against the importing country's industry. Thus, the selection of the production cost offers a preliminary

theoretical difficulty. Even after deciding on the cost, the practical quest for such a cost would be very difficult. Moreover, such a production cost is subject to a perpetual change, so that it is most difficult to grasp with precision. The difficulty is increased because of the uncertainty in the nature of the materials used in the computation of the production cost.

(b). Difficulty of estimating the degree of the effect of the tariff on prices—The imposition of customs duties does not necessarily raise the domestic prices always *pari passu* with their rates. In some cases, they do raise the prices: in other cases the effect is partial: in still other cases, the effect is nil. The nature of the effects is dependent on so many things. It depends on the degree of power of the importing and exporting countries. Or, to be more specific, such factors as the following will determine its nature: the degree of necessity of the commodities for people's life; whether there is a substitute for them or not; the extent to which the foreign supply of the commodities satisfies the domestic demand; the importance of the amount of demand on the part of the importing country for the exporting country; the comparative ratio between the production costs of the commodities in both countries; the amount of fixed capital employed by the supplying country; whether there is any competition among several supplying countries; whether there are cartels, trusts and other combinations in the supplying country or countries. Where the commodity comes under the category of necessaries, its duty tends to raise not only its price, but also the prices of other commodities, so that utmost attention must be paid to the customs duties on necessaries. At any rate it is most difficult to predict to what extent a tariff duty will raise the commodity on which it is levied in the demanding country, and its valuation is bound to prove somewhat incorrect. Such a valuation, however, could be modified after the enforcement of the duty. Such a modification may be made several times if necessary. Of course, frequent modifications

are possible only in theory. Modification in the light of actual experience is also difficult of practice. In short, the prediction of the effects of a tariff duty on prices is liable to fail because of their complex nature. Nor can the frequent revisions of tariff duties be desirable as the unstability of the life of any one rate of duty will shake the foundations of business and industrial production. For this reason, the tariff duties once fixed are often maintained for a long period of time, and in case the first valuation is mistaken, the duties may prove to be unjustly high, or low as the case may be.

(B). Existence of tariff duties rendered unjust by later changes.

(a). Viewed from the development of domestic industries—It is possible that some tariff duties which were appropriate at the time of their institution and enabled domestic industries to be developed may become inappropriate by reason of the changed conditions of later times. In the first place, ordinary protective tariff assists industries. It helps producers at the expense of consumers who are affected by the temporary inflation of prices. It enables producers to make various needed improvement so that they are enabled to reduce their cost of production and thus be placed in a position where they can compete against foreign producers even in the absence of the tariff. Thus, the purpose of protective tariff is to promote the lasting interests of consumers and producers at the temporary sacrifice of the interests of consumers, and to cultivate the productive capacity of a country. This means that protective tariff is destined to come to an end at a certain point in the course of time. In actual practice, however, it is continued indefinitely despite the fact that productive output is increased and production cost is reduced. Because of this continuation of protection, the great mass of consumers are continuously placed in a position of loss and detriment, while producers gain unjustifiably great profits; prices in general are also raised (as has been already said the rise would be greater in the case of tariff

duties on necessaries than on luxuries), export business is placed in an unfavourable position; and balance a nation's financial position with difficulty.

For this reason, it is the duty of the government authorities to make a constant study of the conditions of protective tariff and should reduce or abolish the duties once established. In case an industry is unable to stand on its own feet and needs perpetual protection, it should be left to its natural fate as being unentitled to protection. In such a case, the discontinuation of protection is desirable at least from the standpoint of the consumers. Unless there be some special reason for protection, no perpetual protection should be given to any industry. In actual practice, however, this point is often neglected and the irrationality exists of continuing a tariff duty even after its use has been outlived by real needs and necessities, thereby resulting in undue profits for a few producers and in loss and detriment to the mass of consumers as well as to the producers that use as material the object on which the duty is imposed.

(b). From changes in foreign industries—Domestic industries may make some progress or improvement, but at the same time foreign industries in the same field may make still greater strides forward. Seldom does it happen that foreign industries make a retrogression, in which case a given tariff becomes excessive even though domestic industries do not make any advance. Where foreign industries make an advance to a much greater degree than do domestic industries, the tariff once fixed would become incapable of protecting domestic industries but at the same time would oppress the interests of the consuming public. In such case, a close enquiry into the situation should be made, and if the industries do really need protection, the rates should be raised to a reasonable extent; or, if there be no justification for such a step, the tariff should be abolished outright. But in the former case when foreign industries fail to keep up to the mark, thereby making protection too great, the tariff should be reduced. In all cases, it is a most difficult task

to keep up the tariff rates commensurate with changes in domestic and foreign conditions.

(c). From changes in prices—Changes in prices may be due either to foreign or domestic causes, the result being that a tariff may become either too high or too insufficient to afford protection to domestic industries. Different causes give birth to different results. Prices are also subject to constant variation. From this point alone it will be seen that it is almost impossible for a tariff to give adequate protection to industries. Let us consider this question by taking several typical cases. Suppose prices have become depreciated. When this has come to pass because of some domestic causes, supposing that price levels have become reduced by ten percent on account of the raising of the gold export embargo by this country. This would amount to a raise of ten percent in the tariff rate in the case of a specific tariff and thus would prove a too great protection; but in the case of an ad valorem tariff, protection would be somewhat insufficient. Again, suppose prices in the United States have become depreciated by five percent due to economic depression. Then she can supply her commodities to this country that much cheaper, and we will have to lower the market prices of our domestic commodities which are in competition with those produced in America, even though there be no internal reason to do so. In this case, if the duty is due to a specific tariff, the insufficiency of protection would not be so great as in the case of an ad valorem tariff, because in the latter case the duty would be lowered which fact would prove detrimental to the native producers who will be hit also by the five per cent fall of American prices while in the former case the duty is constant.

Let us next consider the cases in which prices have risen. Suppose prices have risen due to some domestic causes such as the inflation of currency or an embargo on the export of gold. In the case of a specific tariff, its amount remains unchanged as it is fixed; but its real value is lowered and protection becomes highly insufficient. The

more prices rise, the greater will be the inadequacy of tariff protection. In the case of an ad valorem tariff, the results would differ according to the nature of the proportion between the foreign exchange and the rise in the prices of domestic commodities. If proper balance be maintained between the two, there would be neither an excessive protection nor an inadequate protection. When prices in a country are raised by some extraneous causes—for instance, by placing an embargo on the export of gold and by expanding currencies—the prices of commodities imported from the countries adopting such financial methods would become cheaper in the importing country, which has already raised its gold embargo and restored its monetary system to normality. The results would be the same as if the commodities came from the countries where prices are low; a specific tariff would provide insufficient protection, but an ad valorem tariff would be insufficient to a greater degree than the former, and domestic industries would be forced to demand a greater protection. It is under such circumstances that a flexible tariff and a coefficient of increase, with which I shall deal shortly, came to be adopted in some countries.

PART II. METHODS OF TARIFF RATIONALISATION

As I have pointed out, it is highly difficult to institute a rational tariff, and a rate once fixed and proved appropriate at the time of its institution may become otherwise as time passes. I shall now deal with the problem of how to rationalise the tariff, and enumerate some important methods of tariff rationalisation as follows:

(1). Abolition of protective tariff—This method will be the only way of meeting tariff problems from the standpoint of the free trade theory. Those who advocate free trade declare that each nation should pursue only those industries in which she excels. A policy such as this would be impossible of immediate adoption by such a country as Japan

which is faced by a great industrial depression and unmanageable unemployment, especially in view of the fact that the freedom of migration is strictly limited at every turn and the free movement of commodities is universally prevented by tariff walls.

(2). Further raising of the protective tariff—This may appear rational from the standpoint of tariff protection. Advocates of this scheme are so earnest in their program of protection that they are willing to undergo the risk of national exclusion as a consequence. They argue something like this: "Although free trade is an ideal for all nations, it is impossible for this country alone to adopt such a principle in the face of the fact that all other nations are occupied in erecting higher tariff walls against one another. She will be placed in a great economic difficulty if she resort to such a trade policy, for her imports will be greatly increased while her export business would come to a standstill. We should, therefore, cease depending on foreign markets and should direct our efforts toward the development of our domestic market for domestic industries. This is safer and better." Such a view has a measure of truth and should have a rightful place in economic thought. However, its impracticability in the case of a country like Japan is too obvious to require special demonstration. We are not self-sufficient in the supply of raw materials and foodstuffs, and we have to export manufactured goods to an amount equal to that of the deficit in raw material and foodstuffs. Nay, we have to export in order to make up previous loans and the interest on them, and to do this we must reduce the prices of domestic commodities as much as possible; and this, in turn, will require that tariff rates should be kept as low as possible. We must, therefore, strenuously oppose any attempt to raise the tariff rates.

(3). Middle ground—All that discussion brings us to the middle ground. In other words, the status quo should be taken as the basis but improvements should be made thereon, by rationalising its features. In dealing with such a

policy as the tariff affecting the economic life of the masses, radical changes should be regarded as taboo. Gradualism should dictate all changes. Thus, the middle ground seems to be the best attitude. In medio tutissimus ibis. There are the following practical methods each of which is based upon the recognition of the advisability of this wholesome attitude.

(A). Constant examination and revision of tariff—That the tariff should be placed under constant examination and re-examination and the needed revisions be made in order to adapt it to changing conditions, is a fine idea but difficult of realization. Conditions often change even immediately after a re-examination of the tariff has been completed and by the time a revision is effected by law, it has become belated and hence, inappropriate. Frequent revisions of the tariff would disturb the stability of business and prove detrimental to the traders concerned. Because of all these considerations, the adoption of this method does not seem well-advised.

(B). Tariff on a Sliding Scale—This method is intended to adapt tariff rates to price levels. A similar idea after the Great War has led to the application of sur-taxes and a coefficient of increase to tariff by nations on the ground that their currencies had depreciated and prices had soared. This method is not without its merits. Under this scheme, tariff rates vary according to the basis of the index number of prices and thus protection is assured independently of the arbitrariness of government officials. But it cannot be said to be a desirable method inasmuch as it does not consider factors other than price levels in fixing the tariff rates.

(C). Flexible Tariff—This method has been practised in the United States in recent years. The American tariff law contains the so-called "flexible clause". Under the operation of this special clause, when a given tariff is recognised to be inadequate to make up the difference between production cost in the United States and foreign production cost, the President is empowered to raise, subject to the

approval of the tariff committee, the rate by less than five percent. In case the raise thus made by the President should prove insufficient, he is also empowered to make a public declaration of the same fact, and to levy a new rate based upon sale prices in the United States, within 15 days following the time of the Presidential declaration.

The adoption of a similar scheme was recommended by the Tariff Investigation Commission of our country in 1929 in presenting its recommendations regarding the preparations to be made for the lifting of the embargo on the export of gold. The Tariff Commission favored the empowering the Government to alter tariff rates within ten percent upon the recommendation of a special tariff body to be created. A similar power is given the Government regarding the tariff on rice alone. A flexible tariff enables the adaptation of rates to changes not only in prices but also in the production of both importing and exporting countries. However, there is a legal limit to the percentage of revision (although this is not the case in the United States), and this may prove unsatisfactory. Moreover, the empowering a special tariff body to decide on the matter may give rise to party scandals and arbitrariness. Nor will it be possible to carry out calculations of high complexity regarding thousands of commodities. One cannot adopt this method without hesitation.

(D). Diminishing Tariff—In my opinion, no tariff should be perpetual. On the contrary, its time limit should always be specified by law. (This does not apply to agricultural tariff which is national in importance and whose chronic disadvantages may place consumers in a condition of unbearable suffering.) Producers should be urged to make improvements in their methods within the specified time limit so that the cost of production may become reduced. I would suggest successive diminution of tariff rates, each such diminution being made at the expiry of the fixed period, so that in course of time the tariff would be abolished all together. Suppose a given industry requires 20 years in which to develop itself so as to stand on its own feet in

competition with foreign producers. (Different limits of years may be fixed for different industries.) Then, the tariff should be put into force for the period of 20 years. When the first five years have passed, one fourth of the tariff rate should be reduced. At the end of the next five years, the reduction should be made to the extent of one half of the original rate, three-fourths at the end of the third lustrum and the entire rate abolished at the end of the fourth and last five years. If such a scheme be adopted, producers receiving protection would be ever diligent and industrious and would endeavor to reduce the cost of production as far as possible, thereby resulting in the harmony of interests between producers and consumers. If no improvement in this respect is made by the expiration of the period of tariff, producers are to blame. If they are unable to carry on their enterprise unaided by tariff protection, it is because they have neglected to do their utmost in improving their industrial enterprises, and the State has no responsibility to assist them any longer. Some producers may effect the desired improvements before the period of protection has ended and thus may receive its special benefits. However, such benefits should be conferred on them as a sort of bonus for their endeavors, and consumers should be content with such an arrangement. True, it would be a difficult task to decide on the proper original rate, and often protection thus given may prove excessive. But inasmuch as a definite period is provided and a diminishing rate part of the scheme, consumers may as well make a graceful sacrifice. Such a scheme would be easily borne by the public for the sake of a definite period, even when a rate, though at first à propos, may become otherwise under changed conditions. Some may say that my plan would not be competent to adapt the rate to changes in the prices of commodities; but the fact is that no tariff scheme is entirely adequate to meeting this difficulty. Moreover, better results may be obtained by supplementing my plan with the coefficient of increase, so as to adjust the rate more efficiently to the changed prices. It may be said that

protection would prove insufficient if foreign producers should make much greater improvements than domestic producers under my scheme. But industries that are not able to compete with foreign industries despite the tariff protection given them, should be left to its natural fate.

CONCLUSION

The ideal object of a protective tariff is to make up the difference between the domestic cost of production for some specified commodities and that of foreign competitors. It is difficult to fix an appropriate rate of tariff in the beginning, and a rate appropriate at its inception becomes otherwise when changes come with later times. Although under tariff protection domestic industries may be developed, production cost be reduced, and the profits of producers increased, if protection is maintained for a long period of time, producers will secure too great profits at the expense of the consuming public. Under some circumstances, protection may prove inadequate. Something must be done in order to eliminate all this irrationality. The abolition of the tariff or the erection of higher tariff walls would be too extreme a step. The middle way should be pursued. Constant revision of the tariff may be proposed but it is impracticable, and pregnant with abuses. I urge the adoption of a system of successive diminutions of tariff rates, as I believe it has numerous merits when compared with other systems. Should it prove unsatisfactory, some other method might be attached in order to supplement it.

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