THE NEW PROTECTIONISM AT WORK IN RUSSIA'S AUTO INDUSTRY

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Protecting domestic automobile production in any country is contentious. Europe has long imposed quotas on imported Japanese cars. During the late 1970s, the United States persuaded the Japanese government to impose voluntary export restraints on Japanese cars to the U.S. to protect Ford, General Motors, and Chrysler. When Chrysler faced potential bankruptcy in 1979, the U.S. government provided a multi-billion dollar loan guarantee to keep it afloat. Russian auto makers are no different in their desire for protection.

In a recent article posted on this web site ("The New IMF Orthodoxy for Russia is the Old Protectionism for Africa"), we commented on the growing trend toward protectionism in Russia. The Russian government, reinforced by a mid-July IMF Report, emphasized domestic industrial output as a principal source of growth in 2000 and 2001. Future growth, on this view, requires sustaining domestic production, which means holding down imports. The goal of Russian and IMF officials is to prevent real appreciation of the ruble (RAR), which would cheapen imports, thus reducing demand for domestic goods. This strategy for growth amounts to a rediscovery of the African model of import substitution of the 1960s, 1970s, and 1980s, which was a universal failure. Despite this intellectual consensus, the African model of import substitution appears to be making a comeback in Russia. If it develops further, it will have deleterious consequences for long-run growth because what will be protected in Russia is value-subtracting industry. (See Chapter 1 in *From Predation to Prosperity*.)

News reports state that AvtoVAZ, GAZ, and related car-producing enterprises met with the president on June 6, 2001, to lobby for increased domestic protection. They urged the government to raise duties on used foreign cars. They pointed to a European Union requirement, which comes into force on January 1, 2006, which requires European manufacturers to pay the cost of recycling cars that are older than 7 years. Russian producers fear that European manufacturers will sell these old cars to Russian consumers at knock-down prices. Public opinion polls show that a majority of Russians prefer older European cars to new Russian cars.

Cars that are more than 3 years old currently face import taxes of 50-55% on the declared cost. Among the recommended changes, tariffs would rise to 75% for cars 3-7 years old, and to 150% for those over 7 years, effectively pricing the latter out of the market.

On August 6, 2001, the governmental commission on protection measures in foreign trade announced that import duties on foreign cars older than 7 years would be increased to the level of those on new cars, beginning January 1, 2002. The commission hinted that the government was considering further measures to protect other categories of Russian producers from used foreign goods. One Russian correspondent characterized the decision as follows: "Vice-Premier Klebanov's statement indicates that a new kind of protectionism has emerged in Russia: creating greenhouse conditions for technologically backward domestic manufacturers to enable them to produce noncompetitive products." (http://therussianissues.com/print/9971710l99.htm)

The road of protectionism is a slippery slope. It necessarily spreads from one industry to the next in the guise of encouraging domestic production. The output of any protected industry is an input of many other industries. Costs increase down the line, making each industry less competitive. This leads to additional demands for protection. Historical evidence from Africa and other developing countries in Asia and Latin America demonstrates that this road leads to higher prices, lower quality, inefficiency and contraction. Killing competition is killing technological progress and long-term economic growth. The prevalence of value subtraction in Russian industry makes protectionism a dangerous strategy.

Russia's recent growth, as we have explained in several articles (see, for example, "The Secret of Russian Economic Growth: Testing an Old Hypothesis with New Data"), is due to higher prices for energy exports combined with the Central Bank's requirement that a percentage of foreign currency earnings be repatriated and converted to rubles (recently reduced from 75% to 50%.) These two measures have eased what we call the payment jam, facilitating a marked reduction in enterprise, payroll, and tax arrears, which have retarded growth. Irrational fears about RAR have prompted the Russian government to embark on a protectionist path. Higher duties on automobile imports is the first step.

Where will protectionism lead? If energy prices fall, coupled with the recent reduction in mandatory repatriation of foreign currency earnings, growth will slow from its current modest level. (The Russian government and IMF believe, in marked contrast, that a decline in dollars flowing into Russia will increase growth by preventing the RAR that is deemed to harm domestic production.) A substantial decline in world energy prices and/or substantial further reduction of mandated repatriation of export revenues will return the economy to contraction, increase tax non-remittance, and ultimately lead to further defaults.