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## The Political Economy of Trade Policy

Robert E. Baldwin

**I**nternational trade seems to be a subject where the advice of economists is routinely disregarded. Economists are nearly unanimous in their general opposition to protectionism, but the increase in U.S. protection in recent years in such sectors as automobiles, steel, textiles and apparel, machine tools, footwear and semiconductors demonstrates that economists lack political influence on trade policy.

The type of protectionism chosen does not follow economists' advice, either. A frequently asked question on undergraduate trade exams is why a small country's welfare losses are less when it curtails imports with a tariff rather than by negotiating "voluntary" export-restraint agreements (VEAs) with foreign suppliers.<sup>1</sup> Even though generations of students have correctly pointed out that the equivalent of the domestic tax revenues raised by a tariff is transferred as a windfall gain to foreign countries when VEAs are introduced, these agreements are now the preferred means by which countries pursue protectionism. Moreover, if the purpose of protection is to redistribute income to producers, production subsidies (financed by lump-sum taxes) dominate both tariffs and import quotas on efficiency grounds, since the consumption costs of protection are avoided. Yet governments generally prefer to assist industries by providing import protection rather than production subsidies.

Economists have tended to attribute such disregard for their policy conclusions to a lack of economic education. However, while many consumers still do not seem to

<sup>1</sup>As trade economists have long pointed out, if a country is large so that the import supply curves it faces are upward sloping, import taxes can improve its terms of trade by decreasing the prices at which foreigners supply their exports. An optimum set of such taxes coupled with lump-sum redistribution arrangements can raise everyone's welfare in the country. However, if foreign countries are also large, retaliation on their part can reduce all countries' welfare levels below what they were before the import taxes.

know where their economic self-interest lies when it comes to trade matters, it seems clear that today's top policy leaders are quite aware of economists' conclusions on most trade issues. Some economists, consequently, have begun trying to understand the policy-making process that leads politicians to disregard the advice of economists on issues of international trade.

Two broad approaches have been developed to analyze the political economics of trade policy and the processes that generate protectionism.<sup>2</sup> One approach emphasizes the economic self-interest of the political participants, while the other stresses the importance of the broad social concerns of voters and public officials. This paper outlines the nature of the two approaches, indicating how they can explain the above anomalies and other trade policy behavior, and concludes with observations about integrating the two frameworks, conducting further research, and making policy based on the analysis.

## **The Economic Self-Interest Approach**

Under the economic self-interest approach, an individual favors or opposes a particular trade policy depending on whether the policy increases or decreases the person's real income. Hillman (1989) provides a comprehensive survey of this approach.

In the standard two commodity, two factor Heckscher-Ohlin model with identical, homothetic preferences and perfect competition, this perspective implies that if the imported good is produced in a labor-intensive manner, a worker in an economy facing fixed international terms of trade will favor an import duty, while a capitalist will favor free trade.<sup>3</sup> Consequently, under a majority voting rule, protection would seem to be the outcome if there are more workers than capitalists. But if, as is generally assumed in this model, income redistribution is a costless activity, free trade will be chosen, since gainers under free trade (in this case, the capitalists) can always more than compensate those who lose under this policy and still be better off than under protection. The capitalists will tie the redistribution scheme to the voting outcome.

<sup>2</sup>The focus in this paper is on explaining the protection process, that is, on positive political economy. However, there is also a body of literature that analyzes the welfare implications of lobbying for or against protection and lobbying for the rents created by protection. Bhagwati (1988) describes the first type of lobbying efforts as "downstream" activities and the second as "upstream" activities.

<sup>3</sup>This follows from the Stolper-Samuelson theorem, which states that the real return to the factor used intensively in producing the import good (in this case, labor) will increase when the domestic price of the import good increases. As Mayer (1984) has shown, if an individual supplies both labor and capital services, the person will favor protection or free trade under the assumed factor-intensity conditions depending upon whether his or her capital/labor endowment is less or greater than the economy's capital/labor endowment.

### **Costs of Redistribution and Voting**

When the assumptions of the model are eased to allow for costs of redistribution or voting, the conclusion that free trade will be chosen no longer holds. In the situation described above, if redistribution costs plus the compensation to workers required to secure a majority vote for free trade amount to more than the capitalists gain from free trade, a compensation scheme tied to voting behavior will no longer be undertaken by capitalists and popular vote will select the protection option.

The existence of voting costs also can lead to protectionism, especially in situations where the benefits from free trade are quite small for many individual voters. Consider a specific-factors model in which both capital and labor are industry-specific (Baldwin, 1984). In these circumstances, the losses in real income to individual workers and capital owners in an industry subject to a significant increase in foreign competition are likely to exceed their individual costs of voting for protection. In contrast, the fraction of income spent on the industry's product by individual workers and capitalists employed in other sectors, who gain from the decline in the import price, may well be so small that the higher costs of the protected good for each are less than the per capita costs of voting against protection or acquiring detailed information about its effects. Consequently, the comparatively small number of people employed in the injured industry all vote for protection and the large number of people working in other industries may not vote at all.

### **Money, Votes, and Coalition Politics**

Protectionism may also be selected because of the well-known free-rider problem associated with public goods (Olson, 1965). Trade policy has the characteristic of a public good, since a beneficiary from a policy such as free trade cannot be excluded from its benefits, even though the person does not contribute to the costs of obtaining this policy. The decision to contribute campaign funds to officials favoring free trade has the structure of a prisoners' dilemma game for individual consumers. If each consumer believes his or her contribution is too small to affect the policy outcome, the individual will conclude that it is best not to contribute, regardless of whether all other consumers do or do not contribute. Thus, the dominant strategy for each consumer is not to contribute in support of free trade, and the outcome is that all end up worse off than if they had contributed.

As Olson points out, a common-interest group is more likely to overcome the free rider problem and raise the funds needed for effective lobbying if the number of its members is small or if the benefits from a particular policy are unevenly distributed, since then some members of the group will have a significant economic stake in the policy outcome. For a large firm with (say) 25 percent of the domestic industry's market that is threatened by import competition, it may pay to lobby, no matter what the other firms in the industry do.

However, in making this decision, such firms must also take into account the anti-protection lobbying of large firms in other sectors who use the industry's output as an intermediate production input. For example, as Destler and Odell (1987)

document, the Caterpillar Company vigorously opposed the extension of steel quotas in 1984, claiming to be the largest American steel user as well as the biggest exporter of U.S.-made steel. Furthermore, in these authors' view, the active opposition of copper users was the main reason for the failure of this industry to obtain import relief in 1984.

In contrast to Olson, Caves (1976), in stressing the importance of the voting strength of an industry in gaining protection, hypothesizes a negative relationship between the level of protection and the degree of industry centralization both in geographical and market share terms. He argues that a geographically dispersed industry can obtain the support of a larger number of elected representatives than a regionally centralized one, while a low level of firm concentration will attract greater political support from customers and suppliers. However, although most countries studied support the importance of the employment size of an industry as a determinant of the level of protection, they also generally bear out Olson's contention that a high level of industry protection is associated either with a small number of firms or a high degree of market concentration (Anderson and Baldwin, 1987).<sup>4</sup>

The importance of an industry's voting strength for gaining protection is nowhere better supported than in the textile and apparel industries. With nearly two million employees in many firms scattered over a wide geographical area, these industries have been highly successful in using their voting strength to gain import protection. The approval of the Textile Bill of 1985, which tightened textile quotas, by both branches of the Congress illustrates the industry's political clout. (However, the bill was vetoed by President Reagan.) Tosini and Tower (1987) found that the proportion of textile and apparel workers in the total work force of a congressional district or state was the most significant variable explaining the pattern of voting.

In contrast to the textile and apparel sectors, which have managed to hold the ratio of imports to consumption to less than 15 percent, the much smaller leather and leather products industry has been unable to prevent the ratio from rising to over 25 percent. The import ratio for women's footwear, for example, rose from 5 percent in 1965 to 33 percent in 1985.

Differences in market structure seem to influence the manner in which industries lobby for protection. As noted above, the textile and apparel sectors, which are composed of a large number of employees and firms, rely mainly on the voting pressure they can exert directly on individual members of Congress and the president

<sup>4</sup>Caves (1976) finds industry protection to be negatively related in a significant manner to market concentration. But Saunders (1980), in a later study of Canadian protection utilizing two-stage least squares estimation, finds a positive (and nearly significant at the 10 percent level) relationship between concentration and industry protection. When both the number of firms and the concentration ratio are included in the same regression equation, the concentration variable has a negative (though insignificant) sign in some of the countries studied, while the coefficient on the number of firms is generally significantly negative. One possible reason for this may be a perception by elected officials that voters are skeptical about their motivation in responding to the petitions of the dominant firms in a concentrated industry, but not to firms in an industry where the number of companies is small but the concentration ratio is not high.

to gain their objectives (Bauer, Pool, and Dexter, 1972). They do not launch large lobbying campaigns aimed at the general public. In contrast, the steel and auto industries, which have also been very successful in securing import protection but which are not as large in voting terms and are oligopolistically organized (thus presumably having higher profits), spend large sums lobbying the general public as well as public officials on the merits of their case for protection. Lacking the voting power of textiles and apparel, they seem to believe it is necessary to convince the public that granting protection is desirable on such grounds as “fairness,” national security, or the need for a temporary adjustment period, before legislators not dependent directly on their votes will go along with protection. Industries like steel and autos also tend to focus their lobbying efforts on the Senate, where the typical member has more influence and faces the voters less often than in the House. Small industries have little chance of receiving industry-specific protection, although they can sometime free-ride on a politically powerful industry. They usually lobby through general business associations and direct their efforts at securing general changes in the trade laws that make it easier to obtain protection.

Whether it is an industry’s voting power or financial strength that create pressures for protection, these pressures are powerful enough that many presidents have made protectionist concessions to improve the chances that Congress would approve a general trade-liberalizing bill. President Eisenhower, for example, felt it necessary to promise to impose oil import quotas to minimize the opposition of congressional members from the oil and coal-producing states to the extension of the Trade Agreements Act in 1955, while President Kennedy agreed to seek an international quota system for cotton textiles in order to minimize opposition to the Trade Expansion Act of 1962. President Nixon increased the likelihood of Congressional approval of the Trade Act of 1974 by renewing steel import quotas and agreeing to negotiate an international textile agreement covering man-made materials, wool, and cotton.<sup>5</sup>

### **Triggers for Self-Interested Action**

Olson (1983) has recently argued that, before a group organizes and undertakes lobbying activities, a crisis like a sudden increase in imports or a decline in employment may be necessary to focus attention on a group’s common interests. This view is supported by the success in resisting tariff cuts during the Tokyo Round of multilateral trade-liberalizing negotiations (1974–1979) of industries in which employment had been declining and import penetration ratios rising in recent years (Baldwin, 1985). The psychologists Kahneman and Tversky (1979, 1984) also find empirical support for the view that individuals place a greater welfare weight on the loss of a

<sup>5</sup>When the bill first came before the House Ways and Means Committee in 1973, the textile and apparel unions testified against the bill. However, by the time the bill reached the Senate Finance Committee in 1974, the Multifiber Arrangement had been approved, and they did not testify at all.

given amount of income than on a gain of the same amount.<sup>6</sup> This would seem to be part of the explanation why protection is usually given only to industries in which profits and employment are declining. Both workers and capitalists are prepared to exert greater efforts to recoup income declines than to gain increases above historically normal levels. In addition, firms may lobby more vigorously for protection when faced with losses, because in bad times they are less concerned that greater protection will attract new entrants to the industry.

One also expects vigorous efforts to secure protection (or resist trade liberalization) in the face of significantly increased import competition by those industries where a substantial part of earnings is due to industry-specific physical and human capital or to the success of unions in raising wages. The extensive (and successful) lobbying activities of the auto and steel industries, where fixed costs are substantial and wages are 55 percent and 40 percent higher, respectively, than the average for all manufacturing sectors, seems to be motivated by this consideration. Even union leaders in the apparel industry, in which wages are low compared to manufacturing generally but high relative to many service sector jobs, recognize the importance of maintaining the rent component in their wages. Sol C. Chaikin, President of the Ladies' Garment Workers, has often indicated that he would be glad to accept free trade in the industry if someone could tell him where his members can find other jobs at wages near what they are currently making.

However, when changes in protection as a result of international trade-liberalizing negotiations or levels of protection across industries are analyzed, high levels of human capital per employee in an industry are generally found to be associated with high duty reductions and low levels of protection (Anderson and Baldwin, 1987; Ray, 1981). As is explained more fully later, these relationships support the social concerns approach to trade-policy determination: specifically, the view that public officials seek to protect workers whose skills and wages are relatively low from the market pressures resulting from liberal trade policies.

If uncertainty is introduced into the self-interest model along with incomplete insurance markets (due, for example, to moral hazard and adverse selection), risk averse economic agents may prefer protective policies that reduce the variability of price or income fluctuations to free trade (Cassing, Hillman, and Van Long, 1986; Newbery and Stiglitz, 1984). This may be why the developing countries have long argued for international commodity stabilization schemes for most of the primary products they export.

Greater certainty about the restrictive effects of quotas than tariffs seems to be a major reason why protection-seekers generally lobby for quantitative restriction in preference to tariffs. Also, their chances of obtaining this form of protection are improved if they lobby for country-selective quantitative restrictions, such as VEAs. When quantitative restrictions apply only to those countries that are the main sources of increased imports, injured domestic industries (and government officials) do not

<sup>6</sup>I am grateful to Joseph Stiglitz for calling my attention to the literature on this point.

have to be concerned about counter-lobbying from other countries whose exports have not been increasing and who would be hurt by overall restrictions.

The countries selected for export restraint are likely to lobby against protection, but the windfall gains accruing to them from allocating the export quotas among their own producers act to soften their opposition.<sup>7</sup> The importing government loses the revenue that could be collected with a tariff but, since special interest groups recognize the difficulty of securing general revenues through lobbying, this is not likely to lead to objections from very many domestic interest groups. Furthermore, because VEAs are made outside of the rules of the General Agreement on Tariffs and Trade (GATT), government officials do not have to face the domestic political problem of reducing protection in some other industry to compensate other countries for the increase in protection in the injured industry or, if this is not done, of having foreign countries retaliate by increasing protection against some other domestic industry.

The self-interest framework also can be used to explain why most governments use tariffs and quotas more often than domestic subsidies for assisting injured import-competing sectors. Subsidies are more transparent than tariffs and quotas, since they appear in the government's budget and must be financed with taxes or by borrowing. Consequently, industries seeking assistance are concerned that subsidies will be more difficult to obtain politically than import protection and be provided for a shorter time duration. Elected officials also seem to believe they will lose fewer votes of those outside the injured industries and face less anti-protection lobbying pressures if they supply assistance in the form of import protection rather than domestic subsidies. The welfare loss to the general public is, of course, greater under import protection, but poorer knowledge about the consequences of tariffs and quotas compared to domestic subsidies means this does not translate into greater political resistance.

### **A National Prisoner's Dilemma**

The discussion to this point has dealt only with the domestic political economy of trade policy, that is, the manner in which public officials and domestic interest groups interact in determining a country's trade policy. But the manner in which public officials interact with their counterparts in other governments also shapes the nature of trade policies. Viewing these interactions in game theoretic terms has proved helpful in understanding certain aspects of international political economy. For example, Brander (1986) employs the structure of the prisoners' dilemma game to illustrate why countries may end up with protection, even though they would all be better off under free trade. Assuming we can use numbers to represent the net trading benefits perceived by mercantilistically-minded political leaders, suppose two large countries, *A* and *B*, each gains 400 (only the relative size of the numbers are important) if they both follow a free trade policy. However, if one country protects and the other adopts

<sup>7</sup>As Krishna (1989) shows, quantitative restrictions such as VEAs also facilitate collusive behavior between competing firms.



*Figure 1*  
**A Perceived Prisoner's Dilemma in Trade Policy**

		Country <i>E</i>	
		Cooperate	Defect
Country <i>A</i>	Cooperate	400, 400	50, 500
	Defect	500, 50	100, 100

free trade, the country imposing protection gains 500, while the other gains only 50, since the protecting country gains employment and improved terms of trade at the expense of the free trade nation. When both protect, each gains only 100. As is evident from Figure 1, the dominant strategy for each country is to protect, since this yields each country the highest gain no matter what strategy the other country follows. The belief that they were involved in this sort of game may account for the protective policies adopted by many industrial countries in the early 1930s, when the possibility of increasing employment through unilateral protection was especially appealing.

### **The Social Concerns Approach**

The basic idea of the social concerns model is that trade policies are explainable mainly by the government's concern for the welfare of certain social and economic groups and by its desire to promote various national and international goals. Among the goals that have been most widely discussed are preserving the status quo distribution of incomes, redistributing income, or building political power through trade alliances. Proponents of the social concerns approach to analyzing trade policy formation have not been very precise as to why governments seek to implement these various goals, or why one goal is sought in one case and not in another. Most seem to hold to the view that the general public endorses these objectives and that the reelection possibilities of government officials are dependent on the extent to which these goals are implemented. Presumably, they envision each person's voting behavior as being guided by his or her social welfare function, possibly involving interpersonal comparisons based on the individual's ethical postulates.

Since economists tend to prefer models that rely on self-interest, models of social concerns are sometimes taken too lightly. But it should be recognized, as authors like Kau and Rubin (1982) and Andreoni (forthcoming) point out, that many individuals do not free ride even though it is in their narrow economic self-interest to do so, either for ethical reasons or because they gain satisfaction from participating in these

activities. An illustration of this point is the refusal of many consumers to buy cheaper foreign goods, even when the country of origin cannot be discerned by others, on the grounds that foreign workers are being exploited or are taking jobs away from American workers.

### **Concern for the Changing Distribution of Income**

Corden (1974, p. 107) attempts to interpret trade policy with a conservative social welfare function, namely that “any significant absolute reductions in real incomes of any significant section of the community should be avoided.” This means that increases in income are given relatively low welfare weights and decreases very high welfare weights. Corden believes that this particular set of social values is especially useful in explaining the temporary protection often granted industries seriously injured by rapid increases in imports.

The Reagan administration’s pressuring of the Japanese into voluntarily limiting their exports of autos to the United States so that the industry could have some time to become competitive in the small car market seems to fit this objective of trade policy especially well. Another example was the government’s 1973 action of freezing the price of domestically produced oil up to the output levels existing prior to the oil crisis in that year. As Kalt (1983) finds, the pattern of voting in the Senate during the oil crisis was motivated mainly by the desire to prevent a significant shift in income away from oil consumers and in favor of domestic oil producers.

Other authors stressing the income distribution goals of government, like Cheh (1974) and Lavergne (1983), argue that trade policies of governments are motivated by a desire to minimize (or delay) adjustment costs, especially to workers. In examining the Kennedy round of multilateral trade negotiations, Cheh found a pattern of low tariff cuts in industries with high proportions of elderly workers, declining employment, and rising import penetration ratios. These findings support the adjustment-assistance hypothesis.

In contrast, Constantopoulos (1974) and Fieleke (1976) believe governments use trade policy not just to maintain the status quo but to promote relative increases in the standard of living of the lowest income groups. This view is supported by the finding in most country studies that industries with high proportions of unskilled workers or low wages tend to have high levels of protection and low tariff cuts in multilateral trade negotiations (Anderson and Baldwin, 1987). U.S. industries for which this relationship holds include textiles, apparel, leather and leather products, furniture and fixtures, and miscellaneous industries such as toys and sporting goods, jewelry, and musical instruments.

One incident illustrating the income distribution concerns of elected officials was the threat in 1979 by many members of Congress to vote against approving the government procurement code negotiated in the Tokyo Round, when they discovered that preferences were no longer going to be given to small and minority domestic firms in bidding for government contracts. Ambassador Strauss, the U.S. Trade Representative, quickly negotiated an exception to the code’s general principle of national treatment and nondiscrimination that allowed set-asides for these firms.

However, the use of trade policy to promote a more equitable distribution of income can run into problems of inconsistency over time, as Staiger and Tabellini (1987) argue. They consider the case of a country where free trade is the Pareto optimal policy. In this case, the government will have an incentive to announce a policy of free trade to achieve the optimal allocation of labor, but then to surprise the workers with a tariff that improves the distribution of income by raising wages in the import-injured industry. The original announcement of a free trade policy is, therefore, not time-consistent. In this model, the import competition must cause price to decline enough in the industry so that it is advantageous for some workers to move even if they must accept a lower wage (because of their lower level of industry-specific skills). But after the tariff is imposed, the workers who had moved to another industry will not return to the industry of their initial employment because they would have lost their sector-specific skills and thus will have to start again as unskilled workers.

However, workers will recognize that because the government cares about income redistribution, the policy commitment to free trade is not credible. Workers will come to expect the tariff and fewer will leave the import-threatened industry after a price decline. Yet the very fact that they do not leave will make the tariff even more necessary on income-distribution grounds, to prevent wages in the industry from falling even below the level that could be earned as unskilled labor in other industries.

The final outcome is a distribution of income where the expectation of a tariff prevents the economy from adjusting, thus lowering social welfare due to the production and consumption distortions associated with protection. Then the enactment of the tariff restores the income distribution only to a level that would have been achieved by a policy of free trade. The loss of economic efficiency buys no gain in equity.

Thus, according to Staiger and Tabellini, the inability of a country to precommit to a liberal trade policy becomes the reason for protection. One policy implication of this analysis, according to the authors, is that a commitment to a simple set of trading rules, which preclude the idea of the government attempting or the industry expecting a policy surprise, may often be superior to an activist but discretionary trade policy.

This analysis may help to account for the long-standing import protection of such industries as textiles, apparel, and sugar. The preamble of the international Multifiber Arrangement (MFA) for textiles has for many years included as an objective "the reduction of trade barriers and the liberalization of world trade in these products" (General Agreement on Trade and Textiles, 1974). However, producers in the industrial countries know that the MFA also permits quantitative restrictions as a safeguard against injurious import increases. Consequently, they have an incentive not to undertake the difficult process of adjustment needed to bring about trade liberalization, since they know they can expect continued protection if they do not adjust.

Deardorff (1987) argues that income distribution concerns also may explain why governments seemingly prefer to handle import surges with VEA's rather than tariffs. As he points out, an industry can be seriously injured by increased imports (and thus qualify for protective action by the government under the safeguard provisions of the GATT) before the full extent of the price-reducing increase in imports is known.

Consequently, if policy in trade matters is guided by Corden's conservative social welfare function, namely, that income reductions for any significant group should be avoided, the government will be reluctant to use a tariff to provide import relief because of the uncertainty about the extent of the price reduction. Too low a tariff will leave productive factors in the import-competing sector worse off than before the import surge, while one that is set too high will reduce the income level of the productive factors employed in other sectors below what they had been receiving. (For simplicity, Deardorff assumes all factors to be sector-specific.)

In contrast, an externally allocated quota set at the import level prevailing prior to the increase in imports—or, what is essentially the same, an agreement by foreign suppliers to restrain their exports to these levels—holds welfare levels of both groups of domestic factors at their pre-import surge levels. Furthermore, if the increased imports are from only a few foreign countries, such a VEA can raise the welfare of these exporting countries above pre-import surge levels due to the quota rents they gain and, at the same time, maintain the income levels of other exporting nations. However, as Deardorff recognizes, the motivation for trying to avoid harm to foreign countries may be related more to national self-interest, namely the fear of retaliation or loss of goodwill, than to a social concern not to take policy actions that reduce the income levels of other countries.

Income distribution concerns may also be a reason why governments generally prefer to assist an import-injured industry by protective measures rather than by providing a production subsidy. By restricting imports and thereby raising the price of the industry's product, the government puts the burden of helping the injured industry on those consumers who benefitted from the initial decrease in the price of this good. If the price returns to its level prior to the increase in imports and even if the tariff revenue is not returned to the good's consumers or its equivalent is given to foreign producers, these consumers are no worse off than initially. In contrast, a production subsidy financed by general taxes leaves those taxpayers who do not consume the import good worse off than initially.<sup>8</sup>

### **Trade Policy as Foreign Policy**

The social concerns approach can be extended to cover various international objectives of the government. In fact, foreign policy has been used as a justification both for protectionism and for liberalizing trade.<sup>9</sup>

Gilpin (1987) and others have argued that hegemonic states, such as the United States after World War II and Great Britain during the latter part of the nineteenth century, adopt liberal trade policies as a mean of inducing other countries to accept

<sup>8</sup>Since the sum of consumer and producer surplus is greater when a production subsidy rather than a tariff or quota is used to restore income levels in the injured industry (even if the tariff revenue or its equivalent is retained in the domestic economy), this argument assumes that income-redistribution measures by the government are not feasible.

<sup>9</sup>Government policies such as national defense can be explained on the basis of the narrow self-interest motivations of citizens, whereas the concerns for the welfare of others discussed up to this point are based on forms of altruism, such as an implicit social insurance contract.

their political leadership in the world. The major international political objective of the United States in the early postwar period was to limit the spread of Communism by strengthening the free world economically, and these writers maintain that the liberal U.S. trade and aid policies in this period were largely motivated by this purpose. This may explain why the United States (and Great Britain in the nineteenth century) did not take advantage of its economic power to improve its terms of trade nor to prevent small industrial countries and developing nations from free-riding on its trade concessions and those of other larger countries. National security considerations still play an important role in trade policy determination, as the U.S.-Israel free trade agreement indicates.

Income distribution concerns at the international and domestic levels also may influence countries' foreign economic policies. For example, the comparatively large amounts of untied aid and extensive duty-free treatment provided to developing countries by a number of small industrial countries seems difficult to explain entirely on self-interest grounds. Helleiner (1977) suggests that government officials adopt a mercantilistic attitude in trade negotiations and try to obtain the greatest cuts in protection from others in return for the least cuts by their own country. Minimizing the domestic adjustment problems associated with trade liberalization could be one motivation for this attitude.

## **Some Conclusions**

As economists will readily recognize, protectionism does not seem to be just a matter of which sectors have the best social welfare reasons for public assistance. Within a range of social values, the particular social justifications for various trade policies that are accepted by the electorate seem to be significantly influenced by lobbying activities on the part of economic interest groups and the government itself.

In fact, economic self-interest almost always dominates a person's concern for the welfare of other groups or the nation as a whole, when a significant part of an individual's income is affected by a trade policy. One does not, for example, observe workers or managers in import-injured industries opposing protection for their sectors on the grounds that this may cause unemployment in other industries and reduce the real income levels of low-income consumers. National and group concerns are likely to dominate personal economic welfare considerations only when the economic self-interest effects of a trade policy on an individual are small or unclear. Furthermore, the larger the decline in individual economic welfare as a person chooses to support various social goals that only benefit others, the less willing the person seems to be to sacrifice additional economic welfare to promote additional desirable social objectives.

However, the economic self-interest approach cannot stand alone, either. In its pure form, it requires an electorate that is ill-informed or unwilling to participate in the decision-making process due to the high costs of political action or to the free rider problem. But the considerable attention given to trade issues by the modern media, the extensive efforts undertaken by politicians and others to determine the views of

voters, the widespread lobbying activities by all sorts of common-interest groups, and the fact that a substantial number of citizens do vote in elections all suggest that the economic self-interest model by itself is inadequate for explaining either general trade policies or particular industry trade policies.

Many individual decisions on trade and other economic matters have only a small effect on a person's real income, and the individual's various social concerns can play an important role in shaping his or her decisions. To expand their already substantial contributions toward understanding the policymaking process, economists should integrate such social motivations into their microeconomic optimizing framework. In doing so, they should also include in their models the various imperfections that characterize real world economic and political markets.

I believe that the studies presented here establish that an analytical framework including both economic self-interest and concern for the welfare of others as motivating forces for political action is needed for understanding policy formation in the trade field. The economic self-interest and social concerns approaches are not contradictory; both motivations are included in the standard formulation of an individual's social welfare function. Under Corden's conservative social welfare function, for example, the typical voter is willing to accept the small decrease in his or her own economic welfare and the welfare of other consumers that results from a tariff increase on an imported product, if this prevents a significant real income decline for workers in an important domestic industry. Consequently, declining industries are more likely to receive protection than prosperous ones, not only because of the self-interested lobbying from capitalists and workers who face income losses, but because the typical voter is more willing to grant protection to a declining industry.

### **Directions for Further Research**

A multitude of possible reasons for protection have been outlined. The problem now is to weigh the reasons against one another, weed out those that are less relevant, and combine the others into a more unified theory. To make progress along these lines, there is a need to test the various hypotheses in the self-interest and social concern models with variables that better reflect the key ideas behind the two approaches.

Efforts should be made, for example, to obtain better measures of the extent of political pressures from an industry than such indirect measures as the number of firms in the sector, the industry's concentration ratio, or its growth rate. Information on the size of an industry's lobbying expenditures on a particular issue, the volume of testimony and public statements on the issue by its members, the extent to which industry members make their views known to public officials through visits and letters, and so forth would enable investigators to measure the political demands for protection more accurately.

Similarly, as Bale (1977) has shown, better measures than growth rates in employment or the proportion of older workers in an industry can be estimated to measure the labor adjustment costs associated with increased imports. More complete socioeconomic information on workers in an industry than just wages alone should

also be used to measure the conditions under which voters and policy-makers are willing to grant protection on equity grounds. While obtaining improved data is costly and time-consuming, the effort seems necessary if we are to make significant progress in understanding the relative importance of the various political and economic determinants of trade policy.

### **Policy Recommendations**

If economists wish their advice to carry weight in the political process, they must be more willing to examine the influences of institutions and procedures on policies. On the international level, for example, the ability of an organization such as the GATT to obtain adherence to an agreed-upon set of trading rules and to settle disputes among nations is crucial for the degree of order in world trading conditions.

Domestic examples of the importance of political institutions for the degree of protectionism are easy to find. Since 1934, the willingness of the Congress to allow the executive branch to handle most modifications of individual tariffs has had a major effect in reducing protection over the years, since the president has traditionally been more liberal on trade-policy matters than Congress, probably because of the special foreign policy responsibilities of the president. Congress has recently attempted to push the executive branch in a more protectionist direction. For example, the Omnibus Trade and Competitiveness Act of 1988 shifts responsibility for the enforcement of U.S. rights under trade agreements (so-called Section 301 responsibilities) from the president to the U.S. Trade Representative, a political appointee subject to Senate confirmation.

The manner in which the International Trade Commission (ITC) and the president announce their import-injury decisions illustrates the importance of procedures in shaping policy decisions. The ITC is charged with determining whether an industry has suffered serious injury (or the threat thereof) as a result of increased imports, and the public report it issues after its investigation deals only with this issue. The possible effects of protection on the welfare of consumers and industries using the product as an intermediate production input, as well as on the national interest generally, are considered by the president only after receiving an affirmative injury decision from the ITC. Furthermore, the report of the interagency committee established in the executive branch to consider these and other implications of granting protection is not published. In addition, Congress has prohibited members of the International Trade Commission who vote negatively in import-injury decisions, when the majority of members vote affirmatively, from participating in the Commission's decision determining how much protection to recommend to the president. The president usually issues only a very brief statement explaining whether protection is granted and, if so, to what degree and in what form. Thus, while the public learns about the economic problems faced by the petitioning industry and the benefits firms will receive from protection, it learns very little about the social costs of the protection.

This government practice of giving the public only one side of the story biases the entire process toward greater protection. A requirement that the interagency report be published or that some federal agency (perhaps the Council of Economic Advisers?)

investigate the costs of granting protection and publish the results of its study would bring a much better balance to the procedures. If the decision-making process for U.S. trade policy is made more open and transparent to the general public, it would tend to reduce import protection or change the form of industry assistance.

Economists should also be careful to distinguish between the economic and political feasibility of policies. A number of explanations for protection provided in this paper rely on the inability of government to use theoretically first-best policies to maximize social welfare for economic reasons. For example, in accounting for protection in an environment of price uncertainty, it was assumed to be impossible to establish complete insurance markets to deal with the uncertainty because of moral hazard or adverse selection. Similarly, redistribution by means of lump-sum taxes and subsidies was ruled out as being too costly in Staiger and Tabellini's explanation of why social welfare-maximizing governments adopt protection and in Deardorff's account of why governments use Pareto-inferior means of protection.

In other cases, certain policies may be economically feasible but appear to be politically infeasible. For most of the industries receiving import relief, especially such industries as textiles, apparel, sugar and steel that have been protected for many years, there appear to be economically feasible policies other than protection for meeting the income distribution concerns about those employed in these sectors, policies that would raise social welfare above the level associated with protection. However, as efforts to deal with the income problems of farmers by using income transfers indicate, groups being assisted by the government often use their political power to block the use of these alternative redistribution means to increase the likelihood they will continue to receive assistance in the form they are used to.

If they are to make policy recommendations, economists need better empirical and experimental studies of the economic and political feasibility of well-known policy measures as well as greater efforts to devise feasible new policies and political means for carrying out generally accepted economic and social goals. An illustration of promising economic research along these lines is the recent work (Woodbury and Spiegelman, 1987; Lawrence and Litan, 1986) aimed at devising adjustment-assistance measures that provide the same income assistance to displaced workers as existing programs, but encourage economic adjustment rather than unemployment and immobilized resources. An example at the theoretical level of this sort of analysis is the work of Dixit and Norman (1980; 1986), which demonstrates that a system of taxes and subsidies on goods and factors can accomplish the same redistributive goals as lump-sum taxes and subsidies, while requiring less information (and thus presumably being less costly) and also avoiding the many practical problems of lump-sum transfers.

Even if further research along these lines confirms that there are some real world situations where protection would be the best available measure for maximizing social welfare, economists should be very cautious about surrendering the efficiency argument for liberal trade policies. A final insight from viewing how trade policy is made is the readiness of protectionist entrepreneurs to twist the policy analyses of economists to promote their own welfare at the cost of national welfare. For example, arguments



based on the so-called new trade theory emphasizing imperfect competition and increasing returns are beginning to be made for providing government assistance to a wide variety of industries, even though the empirical work done so far in this field suggests that the case for government intervention on strategic grounds in imperfectly competitive markets is quite limited (Richardson, 1989). Presuming that a liberal trade policy promotes national welfare best and permitting exceptions only if based on careful empirical documentation is likely to yield the highest national welfare in the real world of policymaking.<sup>10</sup>

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