THE POLITICAL ECONOMY OF TRADE POLICY

J. Michael Finger

It takes a perceptive mind to find logic in U.S. trade policy. Our steel import policy destroys 50 jobs in the rest of the economy for each one saved in the steel industry. Restrictions on auto imports have added no jobs in the auto industry but transfer $2 billion each year from American to Japanese products. And we are considering supplementing it with a program that will provide a handful of jobs at the bargain price of just $750,000 per annum per job. The economy of the country might be at risk, but the prosperity of the policy community is assured. Indeed, the solutions this community provides for each year's trade-related industrial problems create even more problems the following year, and the public's response has been to encourage that process.

Other countries have done no better. European agricultural policy costs European consumers some $20 billion per year. For every $20,000 per year job protected in Swedish shipyards, Swedish taxpayers pay an estimated $50,000 annual subsidy. When Japanese consumers pay eight times the world price for beef, Japanese farmers are not made eight times better off. It costs them that much more to produce it. And, though Swiss wine drinkers pay $50 million more than they would at world prices, Swiss producers have nothing left over for high living. Internationally, though hard evidence demonstrates that developing countries do not need tariff preferences and that industrial countries derive net benefits from them, the industrial countries resist their extension and the developing countries waste political capital on their defense.[1]

Cato Journal, Vol. 3, No. 3 (Winter 1983/84).

The author is Chief of the International Economic Research Division, Development Research Department at the World Bank, Washington, D.C. 20433.

[1]World Bank, *World Development Report 1981* (Washington, D.C., August 1981), p. 33; Tracy Murray, "Preferential Tariffs for LDCs," *Southern Economic Journal* 40 (July 1973): 35–46; J. M. Finger, "GATT Tariff Concessions and the Exports of Developing Countries—United States Concessions at the Dillon Round," *Economic Journal* (September 1974); and Finger, J. M., "Effects of Kennedy Round Tariff Concessions on the Exports of Developing Countries," *Economic Journal* (March 1976).

The uniformity of effects of recent policy demonstrates that the only meaningful difference is between policy and no policy. And the nature of these effects suggests that the best thing policy advisers can do for the economy is to leave it alone. The intent of my discussion is to move us a little bit in that direction.

The Policy Players

I will first discuss the role of those who work on the economic theory of trade policy. Their distinguishing characteristic might be summed up as a very determined irrelevance to anything that actually takes place. Sometimes, however, they stray inadvertently into the "real world." I recently attended a seminar by a very prominent economist, eminently respected as a member of the liberal (in the free-people, free-markets sense) wing. His topic was the "Dutch disease," the generic term for countries that discover a rich new resource like oil or natural gas. He presented a masterful taxonomy of 16 cases in which one sort or another of government intervention was needed—the taxonomy being based on which sort.

Discovery of a buried treasure is something we would normally consider a stroke of good fortune. Only in the light of the most dismal of sciences would such a serendipitous occasion be described as a "disease." And only within the logic of a system that gives you the trade policies already mentioned would someone acknowledged as liberal discover the need for 16 different types of political intervention.

Next, there are economists who specialize in trade policy. Their theory and their empirical work is, in brief, a retrofitting of "political" variables onto conventional "pure trade" models. The primary characteristics of these studies are their conviction that the truth is in such models and calculations, and their insistent ignorance of any information about how things actually work—other than their own t-statistics. In general, economists have found that the U.S. government tends to protect industries with a comparative cost disadvantage, either natural (e.g., apparel) or man-made (e.g., steel).[2] To the economist, this is a comforting conclusion. If one knows the potential gains from protection, then one knows the structure of protection. Politics, history—everything but contemporary economic theory—cancels out in the solution, and modeling the determination of this structure requires no knowledge of how decisions about protection are made.

[2]See J. M. Finger, "Ideas Count, Words Inform," paper presented at Conference on International Trade Problems and Policies, Monash, Australia, February 13–15, 1984.

The most damaging criticism I know for this approach is that the industry of people who make a living representing or resisting petitioners for import relief are mostly unaware of the material it has generated. Let me emphasize that I am not siding with the lobbyists-lawyers. Nothing tests the digestion more than the $15 "policy forum" lunch, to the tune of a lawyer, newly infatuated with numbers, explaining his views of protection. However, one important rule in Washington is, "Never tell two jokes about someone who makes more money than you do." Hence, I will confine my lighter criticisms to economists, most of whom do not live well, even by the standards of bureaucrats. When I discuss lawyers I will be appropriately somber.

The Policy Making Process

The most intriguing characteristic of trade policy is how dull it is—an unbroken murmur of administrative regulations, gray suits, pages of numbers without text, and endless international negotiations over one millimeter more or less on the circumference of tomatoes. If indeed "trade theory is about whose hand is in whose pocket, and trade policy about who should take it out," how do we manage to make the policy process so dull?

A first answer is that we have allowed the process to become professional. Trade policy is not a sideline for people who buy and sell goods across international borders, or compete with those who do. It is the profession of a Washington community that represents these interests in the day-to-day struggle to identify and exploit the opportunities provided by the set of policies on the books, or to nudge that policy set in a direction favorable to the interest they represent.

How, in this colorless community, do we distinguish the free traders from the protectionists? Easy. The free traders always say "Externality!" before they take your money. You will find on their business cards, in a special ink visible only through venal eyes, the inscription, "Externalities fitted to any proposed plunder of the public purse."

The worst part of making the trade policy business professional is that the dominant instinct of everyone who knows anything about it is to keep the process going. Anthropologists have observed the same instinct in four-footed animals. When wolves or foxes fight for possession of territory, a mate, or some choice morsel of food, they do not kill each other. At some traditional signal—the flick of an ear, the lowering of the tail—the dominant protagonist relaxes just sufficiently to allow the other to escape. Thus, rights to the prize are determined and the species is preserved. Anthropologists call this displacement. In Washington, we call it, "Leaving a little something in the pot."

Unlike lower forms of animals, the Washington policy community has no natural predators. Worse, this den of foxes has convinced the farmer that only they are competent to mind the henhouse. When they squabble over a hen, their instincts lead them to do no permanent damage to each other—these rules do not apply to the hen. Given the record of trade policy since this species evolved, it is hard to find joy in discovering that it will survive.

Evolution of Trade Policy Professionals

In the true manner of science the answer to one question is a question itself. If the disaster of trade policy in the last decade is related to the evolution of this species of trade policy professional, what aberration of nature started its evolution?

The beginning of the answer is to realize that the success of far-sighted North American and European leaders in restoring the convertibility of currencies and reestablishing an open international trading system after World War II was a victory of *tactics* not of *principle*. They built on the public's mercantilist beliefs that exports are the gains to the domestic economy and imports the costs. To this they added the strategy of reciprocity, of exchanging mercantilist "concessions," and arranged the negotiations about tariff reductions so that in each country the import-competing sector's pressure for protection was stalemated—but not overcome—by the exporting sector's interest in opening foreign markets.

Stalemating a major force in opposition to trade liberalization does not by itself generate a momentum toward it. There were, however, two other elements present, elements that put the system of tariff reductions into motion. One was a leadership elite convinced of the political and strategic necessity to construct an open economic system among the Western democracies. The other was the presence of strong public concerns on which the leadership elite could base its request for the authority to negotiate the reduction of trade barriers. In the United States, the public concern was the spread of Soviet communism; in Europe it was the feeling that the interwar depression and World War II came out of the beggar-thy-neighbor trade policies of the 1930s.

The sound basis of authority that the liberal-minded elites had allowed them to use such illiberal "details" as antidumping and safeguard mechanisms to advance their objectives. They could buy off resistance by writing in rules that specified when countries might "escape" their general commitment to maintain open markets; that is, when they could impose import restrictions. These rules, like those that defined the trade liberalization process, were soundly mercantilist. Protection was justified when import competition injured domestic producers, so that only those interests favoring protection were taken into account. The efficiency and user gains from freer international trade were ignored in the process.

The rules-defined mechanism for imposing trade barriers was effectively limited by the fact that national governments were led by people who still believed in the liberal system. In governing, this elite could be sure that there would be limited use of escape clauses, and that their strategy, on net, would promote freer world trade.

The GATT system established two distinct mechanisms for promoting trade liberalization: (1) the trade negotiations process through which trade barriers can be removed, but not imposed; and (2) the "administrative protection" process through which import restrictions can be imposed, but not removed. This second and less well known mechanism was a monster from its inception, but initially a small one chained to the service of an internationalist master. Over time, however, this domestic beast, nurtured by the same mercantilist forces that propelled the international mechanism it once served, would come to dominate. In both Democratic and Republican administrations, the species of policy professionals who could invent and manage the administrative mechanisms of U.S. trade policy would evolve symbiotically with the dependence of the United States on these mechanisms for controlling protectionist pressures. Accordingly, what was once a sop to the mercantilist-minded masses has become a national standard used to measure the public's interest in keeping domestic markets open to import competition.

Many elements have contributed to this reversal, to the protectionist footnote becoming the national text. Expansion of the general feeling that the government is responsible for each citizen's economic security is one. Perhaps more important is the changed mentality of the leadership elite. More of today's leadership generation develop their concept of the national economic interest by reading the law and participating in the Washington policy making process than by reading Adam Smith or the trade chapter in any economics text. To this mentality, protection is a victimless crime, and opposition to it is considered old-fashioned.

Finally, there is the willing complicity of political leaders in the emergence of these mercantilist administrative mechanisms as *the* way to gauge the national economic interest in keeping our markets open. There is also their complicity in the country's accompanying dependence on a technocratic professional class to operate those mechanisms; that is, to tell the country where its interests lie. Spinoza pointed out in 1677 that nature abhors a vacuum, Harold Hotelling in 1931 that economics abhors a discontinuity. We are discovering today that politics abhors a fair fight, and therein lies the source of that complicity. It does not take very long in government to realize that nothing retards the pace of policy formation so much as a good clear statement of the costs (as well as the benefits) of each proposed course of action. Lester Thurow, in the modern fashion of a bookfull of numbers and technocratic phrases such as "zero-sum game," makes the same point.[3]

Mechanisms that focus only on the costs of import competition are thus tailor-made to get things done. And the technical complexity of the mechanisms, involving literally thousands of lines of rules and administrative regulations, has obvious appeal to the tactical, technocratic mentality that we now confuse with education and impose on most of our best minds. (I myself, not qualifying for this group, never had a very good education, hence have been able to overcome it and revert to a more natural state.) The complexity of the process serves also to obfuscate—the busier we are working out the answer to the wrong question, the less likely we are to realize what the right one is. This is particularly important for those who bear the costs of the policies we come up with.

Taming the Mercantilist Beast

Let us turn now to remedy. What might be done to chain the mercantilist beast and to destroy its symbiotic species of policy professionals?

Rules, Retaliation, and Reciprocity

More detailed rules? They sustain the policy professionals, while the national economic interest lies in destroying them—in giving policy control back to the amateurs. Remember, the rules represent only the import-competing sector. The law is on their side.

Retaliation—the threat that the partner country will respond tit-for-tat by closing his markets? It is to modern policy as DDT is to modern boll weevils. There have evolved forms of policy that are impervious to it; for instance, the orderly marketing agreement (OMA) and voluntary export restraint (VER). In these, one country gets restricted import volume, the other gets supported export prices.

[3]Lester C. Thurow, *The Zero-Sum Society* (New York: Basic Books, 1980).

Moreover, if the agreement covers an intermediate product (e.g., steel), there is an advantage in the sale of finished goods (e.g., autos, made with lower-priced Japanese steel). The evolution of the OMA and the VER have turned retaliation into fertilizer for import restrictions, not insecticide. I am reluctant to laud the skills of our trade negotiators. It takes no particular craft to induce firms to do what the antitrust laws try to prevent them from doing voluntarily.

Reciprocity? Irrelevant to the rules-defined procedures for administered protection. Though imposing and removing import restrictions are, in economic logic, opposite directions on the same scale, they are in government completely different processes. What makes good economics a political force in one process is not built into the other one.

Revealing the Costs of Protection

The three Rs of the GATT—rules, retaliation, reciprocity—are not principles from which a solution to contemporary problems can be distilled. We need another idea—not necessarily a new one, just one newer than mercantilism. The idea is that there are mutual gains from free trade and costs of protection. An obvious task is to begin a process to create a greater public awareness of the domestic costs of protection, a process to educate the groups that bear the costs of their own government's protectionist policies, and thereby to help bring into the public mind a nonmercantilist sense of the gains from international trade. The problem is how to do it.

Harry Truman was fond of saying, "I never give the opposition hell, I just tell the truth on them and they think it is hell." Merchants who face trade barriers in foreign markets they covet should ask themselves what they, not their governments, might do. Armed with Harry Truman's attitude and some calculations of the internal costs of the trade restrictions he faces (i.e., the costs to consumers in that market), an exporter could make his own case. For example, an Argentine meat packer might sponsor a TV commercial in Japan to show an Argentine family enjoying a big roast beef and to show Japanese families how much of that roast beef they would have after the Japanese government took its slice.[4] Estimates of the internal costs of protection are available. It just takes a good ad agent to bring them to life.

At present we have bureaus and commissions to determine the costs to domestic producers of import competition. If exporters,

[4]For other examples, see J. M. Finger, "Incorporating the Gains from Trade into Policy," *The World Economy* 5 (December 1982): 367–78.

following their own self-interest, created a public awareness of the *gains* from import competition, there might arise pressures for similar bureaus and commissions to determine savings to other industries that use imported inputs and to consumers. The community of professionals should see in this strategy many opportunities for gain. User industries could become clients just like import-competing firms. And if there is money to be made from it, the professionals might find ways to organize consumer interests. (It might be too much to ask that the commissions identify the costs and benefits of the proposed government action rather than of import competition.)

One result would be a more balanced presentation to society of gains and losses. When we take up international trade now, Ringling Brothers with all their company stage the show of costs, while outside the tent a 28-year old econometrician with a calculator and a blackboard explains the benefits. The policy professionals would be pitched more directly against each other over a diminishing number of conflicts that would become political matters. (Remember, the political system abhors a fair fight.) Under this pressure, they might overcome the instinct that preserves their species, and like the calico cat and the gingham dog, eat each other up and be gone.

The Role of Economists

What role is there in this for the economists? It is too much to ask that they do something good, but perhaps we can bring them to a basic standard of the medical profession—that their medicines do the economy no harm. Let them refrain from building models in which, in the name of Pareto, the blessings of nature must be offset by political interventions. Let them look instead for instances in which mankind would be better off if the means for these interventions had never been invented.

The lesson we must keep in mind is that the problems that trade issues deal with are not analytically complex, though they might be politically difficult. The complication that is associated with them is not analysis; it is alibi—the product of an instinct to avoid the political difficulty. The lesson, in short, is that if complexity did not exist, the politicians would have to invent it. Which is exactly what they did in the case of liberal trade policy.

"THE POLITICAL ECONOMY OF TRADE POLICY": A COMMENT

Subroto Roy

Michael Finger has given us a most engaging paper.[1] The fundamental paradox he sets before us is one that is both ancient and simple to state. The intellectual case for free trade and against mercantilism appears clear, compelling, and conclusive. From Adam Smith, Ricardo, and Torrens to Haberler, Heckscher, and Ohlin, it has been among the most obvious contributions that economics has made to objective knowledge. Yet, at the same time, nowhere is the academic economist more at a loss in explaining to his students how it is that the theory on the blackboard and the reality outside the window are so widely at odds with one another. For, in practice, it appears almost always and everywhere that it is the argument for free trade that has to be made over and over again.

There are, it seems to me, two ways to respond to this paradox. The first is to think that the theory must be mistaken, or at least that the descriptions the theory is based upon are seriously incomplete. The second is to think that there are dark forces of power and interest that prevent truth and reason from coming to light. Mr. Finger's arguments seem to tilt heavily—perhaps too heavily—toward the second explanation.

He offers us a vivid picture of society. On the one hand is the Great Anonymous Consuming Public, consisting of the multitudes of grocers, bricklayers, watchmakers, carpenters, truck drivers, cooks, shop assistants, plumbers, and so on. On the other hand is the tiny group of the educated and the powerful whom Mr. Finger calls "the policy community." Within this community are first, the academic economists who teach and publish in the field of international trade, and

Cato Journal, Vol. 3, No. 3 (Winter 1983/84).

The author is Assistant Professor of Economics at Virginia Polytechnic Institute and State University, Blacksburg, Va. 24061.

[1] "The Political Economy of Trade Policy," *Cato Journal* 3 (Winter 1983/84): 743–50.

second, the trade policy professionals. This latter group consists of lobbyists, who are paid by various coalitions of domestic interests to persuade, tempt, or cajole politicians to look kindly at their particular cause, and colorless, equivocating government officials, who are less concerned with questions of truth or falsity than with papering over differences and pleasing all sides at any cost.

The picture of a tiny ruling class, or "policy community," extracting rents from, and enjoying the good life at the expense of, the public at large is one that is shared, interestingly enough, by both the libertarian and the honest Marxist. While it is a depressing picture, I am prepared to accept it as accurate in important respects and as a reminder of the neoplatonism of our times. In another respect, however, it is a somewhat romantic picture, in which the damsel is helpless in the clutches of the dragon and needs to be saved by the heroic knight.

Mr. Finger strongly implies that the main responsibility for the full gains from international trade not reaching the general public lies with the policy community. In particular, he notes that although the U.S. International Trade Commission must investigate any adverse effects of imports on domestic producers in import-competing industries, it is evidently not authorized to investigate the *benefits* of imports to domestic consumers. As a result, an absurd bias exists in the recommendations that public officials receive regarding whether or not imports of a particular commodity should be restricted.[2] It is this absurdity that Mr. Finger protests.

The dice have been loaded against free trade and in favor of protectionism by the fact that the liberalization of trade is a slow process requiring complex negotiations among many nations, while the restriction of trade is more easily accomplished by administrative fiat in response to domestic political pressure. Mr. Finger thus recommends—and I have no doubt rightly—that the dice be fair, that the absurd asymmetry in the advice received by an administration be removed. What this requires, according to Mr. Finger, is the creation of *other* government bureaus and commissions charged with reporting the benefits of trade, in order to balance the influence of those bureaus and commissions that presently report only the costs of trade.

Surely the recommendation should be slightly different. All that need be called for is that *existing* agencies report the benefits of trade liberalization. Could not a commission with the words "International Trade" in its title be expected to report the benefits of trade as well

[2]On this same point, I have benefited from J. M. Finger's earlier paper, "Incorporating the Gains from Trade into Policy," *The World Economy* 5 (December 1982): 367–78.

as the costs? What we do not need, it seems, is even more bureaus and commissions—even ones with names like "The Bureau of Free Trade" or "The Commission on Consumer Gains," whose job advertisements would have to say that only free traders need apply. Surely, the absurd bias against which Mr. Finger protests can be rectified without expanding the existing bureaucracy.

I now want to return to the picture of the Great Consuming Public being taken for a ride, so to speak, by the unholy triad of ivory-tower economists, self-seeking lobbyists, and colorless officials. I think Mr. Finger has been too harsh on the triad and too easy on the public.

Samuel Johnson reputedly observed that "there are few ways in which a man can be more innocently employed than in getting money." If lobbyists are making small personal fortunes petitioning for or against import-relief measures, and if there are no legal barriers to entry into their occupation, then it really does seem to be as innocent an activity as any. Of course, such an activity can be thought to be "socially wasteful" insofar as it diverts the energies and abilities of many highly capable people toward unproductive activities. But if the rules of playing this political game provide powerful incentives to make money by playing it, then we should not be surprised to see individuals engaging in rent-seeking behavior in the capital city. As to government officials being bland and equivocating, at least in public, one might argue that such behavior is more often a virtue than a vice when one has chosen to make a living in a bureaucracy.

The task of making a living by publicly distinguishing truth from falsity, and of preserving the former and exposing the latter, falls mainly to academicians and the press, at least in free societies. Mr. Finger dismisses the academic trade theorists as irrelevant and sterile. In this he is partly wrong and partly right. Outstanding work has been done by distinguished academic trade theorists over the last 15 years, especially in the United States. The problem of determining the effective rate of protection, and the analysis and consequences of alternative foreign trade regimes in low-income countries, have both received widespread attention. On the other hand, it is perfectly true that there have been strong incentives for the modern economist who desires rapid academic success to be concerned with anything but reality. Achieving academic success means the economist must have a Ph.D., and then maximize the length of his curriculum vitae as quickly as possible to get promotions, pay raises, and tenure—even if that might mean being obscure, unoriginal, uncritical, or trivial. Above all, an academic economist must not be controversial. But controversial is exactly what he will have to be if he tries to take and describe reality seriously.

Thus, I am neither surprised nor appalled by the fact that the lobbyists are self-seeking, that officials are often equivocating, or that academic economists are prone to irrelevance. An economic analysis of such phenomena would look not so much at these actual outcomes as at the private incentives which are being acted upon and which are engendered by the particular rules of the game.

This leaves finally the "responsibility" of the public at large to be discussed. Mr. Finger makes a very interesting observation that the perception of the public as to what constitutes good trade policy is more often than not mercantilist: exports are good; imports are bad. I would not be surprised if a study of the history of public opinion on the question of what constitutes good trade policy (if such a thing can be written) showed that mercantilism has always been the dominant perception and free trade has always been viewed with suspicion. Does this imply that the public is grossly ignorant and should be taught the doctrine of comparative advantage? I think not. That would be at best only a part of the answer.

The costs of trade liberalization are immediate and tangible, and are perceived as such. Domestically produced goods are displaced by better-quality or less-expensive imports. Domestic firms manufacturing these goods are in immediate difficulties. In significant parts of the country there are a multitude of layoffs and loss of incomes, leading to falling expenditures and further loss of incomes, blighted towns and lengthening dole queues—with the television cameras zooming in to record it all for the evening news. There is definite and real pain and hardship involved for large numbers of men and women who may have had nothing whatsoever to do with the decisions that restricted imports in the first place. In such a milieu, it would be a poor and risky sort of joke to murmur that, "Well, after all, the cheaper imports are allowing consumers all over the country to achieve higher levels of utility"—true as this will be.

Liberalizing trade logically entails changes in the domestic division of labor. Some jobs will most definitely be lost, while others will appear. If I am reasonably sure that trade liberalization will destroy *my* job and force me to auction my house, then it may be perfectly rational for me to be pro-mercantilist, regardless of my expected gains as a consumer. In other words, mercantilist perceptions in public opinion can be seen as the rational response of economic agents who are averse to risk. These individuals will prefer the certainty of a job in hand plus high-priced, low-quality domestic goods to the uncertainty of employment plus low-priced, high-quality imported goods. This is by no means a defense of protectionist policies, but a hint toward an explanation of why the public may resist trade liberalization.

In sum, I am inclined to eschew the picture of the general public as the damsel in distress who must be saved from the "policy community" dragon. Instead, I am inclined to suggest that the social outcomes we observe are—for better or worse—usually "equilibrium" outcomes, in the sense that the economic agents whose beliefs and actions resulted in the observed outcomes may have little or no incentive to change them. That, in turn, may help explain why when the theory on the blackboard cries out that reform should occur, the scope for reform is in practice so limited.