



## Integration and Protectionism: A Comparative Institutional Analysis\*

Prof. Dr. Bruno S. Frey  
and Heinz Buhofer  
Institute for Empirical Economic Research  
University of Zurich

### What Determines Protection?

Interest groups organized along economic sectors exert a dominating influence on the extent of tariffs and other protectionist measures across industries. Import competing and therefore protectionist producers (which here include the trade unions representing the suppliers of labour) have much greater weight in the politico-economic process than anti-protectionist consumers (and importers). Protectionism tends to increase under unfavourable economic conditions; in particular, when unemployment rises, tariffs and non-tariff barriers are raised in order to protect domestic industries and labour.

These are the essential findings of the political economy of protectionism. This approach carefully differentiates between the demand for, and the supply of, protectionist measures, and derives the determinants of the resulting politico-economic equilibrium. In such a system, tariffs can be interpreted as «prices» which equilibrate demand and supply. The propositions derived have been subjected to empirical tests for various periods and countries, with good results.

Various models of trade protection have been constructed theoretically<sup>1</sup> and estimated econometrically<sup>2</sup>; there is no need to present them

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<sup>1</sup>See e.g. Baldwin (1976 and 1982), Brock and Magee (1978), Findlay and Wellisz (1983), Finger, Hall and Nelson (1982) and Messerlin (1981).

<sup>2</sup>See e.g. Caves (1976), Cheh (1974), Lavergne (1983), Magee (1982), Marvel and Ray (1983) and Pincus (1977).

here, as they have been surveyed elsewhere.<sup>1</sup>

The studies of the politico-economic equilibrium assume a given institutional structure (representative democracies) and take the extent of other nations' protectionist measures as given, i.e. they deal with the internal causes for protection. In contrast, this paper looks at the impact of different stylized *institutional arrangements* on this politico-economic equilibrium; it studies the effects of increasingly integrated political structures – ranging from independent nations forming ad hoc trade agreements to unified states – upon protection. The relationships are extremely complex and involve a large set of aspects, instruments and actors. In order not to be overwhelmed by these complexities, the dominating effects on protectionism of different institutional arrangements are compared with each other. For the same reason, the different institutions which are to be considered should be thought of as «Idealtypen», in order to allow concentration on their essential features. The question of how the possibility space for protection is affected by increasingly integrated political units is considered.

The following institutional arrangements are studied: Independent nations forming ad hoc agreements (section I); free trade association (section II); economic community (section III); and unitary «presidential» democracy (section IV). Section V offers concluding comments.

It will be argued that it is not possible to state unequivocally that a higher degree of integration leads to lower protectionism. This conflicts with the often heard assertion that an economic community contributes to freeing trade.<sup>2</sup> It is, however, possible to indicate *specific features* of protectionism under the different institutional arrangements. It will, in particular, be shown that there are systematic shifts in the kind of protectionist instruments used, e.g. from tariffs to other forms of nontariff barriers (quotas) and to general economic policies (sectoral and regional subsidies and cartels). There is no perfect institutional solution from the point of view of welfare increasing free trade. Instead, one has to choose between institutions, each of which has its specific advantages and disadvantages.

The analysis intends to show that to look at the *economic* effects of integration only is misleading.<sup>3</sup> It is necessary to take into account the changes

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<sup>1</sup> See Anderson and Baldwin (1981) for the corresponding World Bank studies and Magee (1984) for the theoretical approaches. Frey (1984) summarizes both theories and econometric results.

<sup>2</sup> For instance: «Ganz sicher würde der Protektionismus noch hässlichere Blüten treiben, wenn es den Gemeinsamen Markt nicht gäbe ...» (Kommission 1983, p. 6).

<sup>3</sup> See e.g. Johnson (1958), Meade (1955), Meyer (1966), Robson (1971), Sannwald und Stohler (1961), Tinbergen (1965).

induced in the politico-economic equilibrium of protectionism. A more integrated structure of the polity transforms the possibility space for the various actors involved (interest groups, governments etc.) and thereby affects the benefits and costs of intervening in the politico-economic process. The demand and supply functions for protection are shifted, and a new equilibrium of the actors competing for and against protection is established. The analysis is thus in the tradition of the comparative theory of institutions of modern political economy.<sup>1</sup>

The specific features of the politico-economic equilibrium of protectionism under the five institutional arrangements mentioned will now be discussed in turn.

## I. Agreements Among Nations

The governments of the nations involved are free to determine all aspects of the agreement as they see fit without being constrained by any external (international) rules. What are the forces for free trade and for protectionism when an independent nation chooses to close an agreement with one or several other nation(s) with the purpose of benefiting from the advantages of free trade?

There is a practically unlimited set of possibilities for such agreements between the nations of the world, and it is therefore difficult or impossible to state the characteristics of the resulting politico-economic equilibrium.<sup>2</sup>

A dominating feature of all such agreements are the *transaction costs* involved. They are of two kinds:

- (a) the costs of exploring profitable agreements and of designing mutually acceptable rules for freeing trade from protectionist barriers;
- (b) the costs of maintaining the agreements in the current politico-economic process.

The corresponding two levels of decision making (the rules or «constitutional» level and the current process level)<sup>3</sup> differ basically according to whether the agreements are bilateral or multilateral.

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<sup>1</sup>See Alchian (1977), Alchian and Demsetz (1972), Buchanan (1977), Demsetz (1964), Mueller (1979).

<sup>2</sup>Employing game theory has been only partially successful. See Allen (1979), Hamada (1979), Young and Magee (1983).

<sup>3</sup>See Buchanan (1977) and Frey (1983).

In *bilateral agreements* between nations the transaction costs are high on the rules level. It is costly in terms of resources and time consuming to find the most profitable opportunities for establishing free trade for specific goods and between specific nations. Moreover, even when such an opportunity has been found, it is costly to arrange for mutually acceptable rules because each nation involved has an incentive to act strategically: it has an interest in the other nation tearing down its trade restrictions, while seeking ways and means to maintain its own tariff barriers.<sup>1</sup> The attempt of particular nations to introduce an escape clause in their favour into the contract leads to the breakdown of many negotiations. Other potentially profitable arrangements will not materialize because the nations concerned distrust each other. It follows that only a limited share of total world trade will be opened to free trade.

In the current politico-economic process, however, transaction costs are low in bilateral agreements. As only two nations are involved, it is easy to ensure the fulfilment of the agreements. A deviation from the letter and the spirit of an agreement is easy to detect and leads to an immediate reaction by the partner nation. The ease of policing bilateral agreements relates to tariffs and non-tariff barriers, as well as to other economic policies: when a nation attempts to substitute other forms of protectionism for those it agreed to decrease, this will induce the partner country either to do likewise (and thus to nullify the free trade move), to retaliate by punishing the partner, or to recontract.

In *multilateral agreements* the transaction costs of making beneficial free trade moves are lower because generalized rules exist<sup>2</sup> which a particular nation may join in (e.g. such as GATT which includes about ninety nations). A larger share of world trade will be covered than in the case of the nations involved relying on bilateral agreements. But protectionism will be reduced in a lesser degree because the nations' conflicting interests would otherwise prevent a multilateral agreement.

On the other hand, there is little incentive to monitor the rules in multilateral agreements: the agreements create a classical Prisoner's Dilemma situation in which it is advantageous for every government to be uncooper-

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<sup>1</sup> «As the traditional terms-of-trade literature and recent analyses of trade policy under imperfect competition have shown (for example Brander and Spencer 1982), it is usually in the national interest of a country to introduce tariffs if foreign governments do not respond in kind.» (Baldwin and Thompson 1984, p. 272). See also Curzon-Price (1986); a more conventional view («the mercantilist calculus» of governments) is lucidly outlined by Wolf (1985, pp. 21ff.).

<sup>2</sup> It is important that such generalized rules are supported by a dominant or hegemonic nation, such as in the case of GATT the United States. See e.g. Keohane (1984).

ative and to break the rules by maintaining and/or imposing trade barriers.<sup>1</sup> These usually consist of non-tariff restrictions such as quotas or quality requirements, national subsidies, orderly marketing agreements, or voluntary export restraints, rather than easily detectable tariffs.<sup>2</sup> Even if one or several nations participating in the multilateral agreement get(s) informed about such a violation of the rules, it does not necessarily pay to punish the offending nation, because the gains from such action benefit *all* members of the agreement (they constitute a public good), while the costs fall only on the nation undertaking the action (they are private). If there is any reaction, it tends to be in kind, i.e. another violation of the rules on the pretext of the first violation, which further erodes the multinational free trade agreement.

The free riding, i.e. rule breaking and protectionist, position being advantageous for any member of the agreement, Pareto optimal free trade is no stable equilibrium maintainable in the long run. There will be *protectionist cycles*: multilateral agreements abolishing barriers to trade are closed and subsequently undermined due to the free riding incentive.<sup>3</sup> When the newly erected protectionist barriers are felt to impede trade and thereby economic welfare to a certain degree, a new agreement is formed which is in turn eroded in the course of time (Buchanan 1980).

This process is shown graphically in Figure 1. In the initial state (given by point PE) a free trade rule is established by (multilateral) agreement. The movement from PE to P<sub>1</sub> comes about because nation B is able to achieve one-sided utility gains through protectionist measures. Nation A in turn resorts to protectionist measures, increasing its utility, while harming nation B. The sequence of such protectionist reactions moves both nations towards the origin of the utility possibility set. Only when the nations involved have suffered sufficiently large utility losses in this process, will they form a new (multilateral) agreement beneficial to all, thus moving from point P<sub>4</sub> back to the efficiency frontier (P<sub>E</sub><sup>1</sup>).

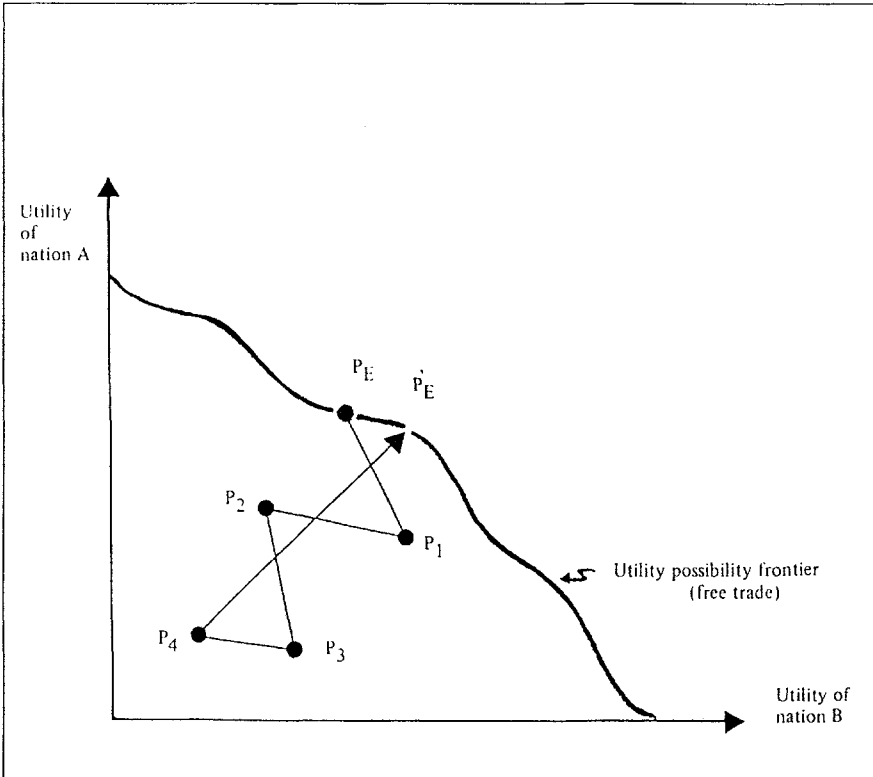
<sup>1</sup>This is a clearly observed result in modern trade theory, see e.g. Goldstein and Krasner (1984, p. 284). See also Wolf (1985, pp. 21ff.) and Yarbrough and Yarbrough (1986).

<sup>2</sup>According to Baldwin and Thompson (1984, p. 273): «It has turned out to be much more difficult to undertake successful multilateral negotiations that reduce the use of these (non-tariff) measures than to cut tariffs», or Goldstein and Krasner (1984, p. 283): «The GATT has been ineffective in dealing with a wide range of problems, especially those not directly related to explicit tariff barriers».

<sup>3</sup>The danger of such erosion has been stressed by Buchanan (1977). Weizsäcker (1982) describes a similar cycle within a nation. It is shown to apply for GATT by Baldwin (1970, p. 18) and Bergsten and Cline (1983, p. 94 et seq.) and specifically for the Kennedy Round by Destler (1980).

**Figure 1**

*The erosion of an efficient free trade rule ( $P_E$ ), and the reestablishment of a new efficient rule  $P'_E$*



The discussion of the agreements among independent nations leads to two (empirically testable) theoretical propositions about protectionism:

*Proposition 1:* Bilateral agreements among independent nations lead to a smaller share of total (potential) trade covered by trade liberalizing agreements, but the agreements formed tend to be more liberal than corresponding multilateral agreements.

*Proposition 2:* Multilateral agreements among independent nations produce protectionist cycles with periods of increased free trade being followed by a gradual erosion of the agreements by the individual nations participating.

## II. Free Trade Association

This arrangement goes one step further than ad hoc agreements by establishing in a «constitution» that internal tariffs are prohibited. Each member nation is free, however, to establish external trade barriers towards non-member countries as it wishes.

In this way, the politico-economic equilibrium of protectionism as sketched in section I of this paper is thrown off balance: the protectionist demands of import competing producers are no longer met, because producers from other member countries no longer face any protectionist barriers. The constitutional change to a free trade association should not be expected to basically affect the influence of protectionist and anti-protectionist forces in any particular member state. The protectionist interest groups will endeavour – to a large extent successfully – to reestablish the former protectionist equilibrium by using more intensively the instruments still available. This means that the *external tariffs* towards non-member countries will be raised to such a level,<sup>1</sup> that the overall extent of protection achieved for each good will be similar to what exists when there is no free trade association.<sup>2</sup>

*Proposition 3:* In a free trade association external trade barriers towards non-member countries will, on the average, be higher than if the association did not exist (holding all other influences on tariffs constant).

## III. Community

The constitution of a community combines free trade among the member countries with a common tariff towards non-member countries. It thus goes a step further towards integration than does a free trade association. Moreover, the community is governed by a «government» and administered by a bureaucracy. This government will in the following be called

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<sup>1</sup>In the case of goods whose former degree of overall protection cannot be reached by tariffs on imports from non-member countries (because an insufficient amount is imported), internal subsidies are used in addition.

<sup>2</sup>Members of a free trade association may discourage a particular member country from liberalizing trade with third countries in order to maintain the expected return from the membership in the free trade association. As Victoria Curzon-Price pointed out, member countries are free to raise the external tariffs but are certainly not free to lower them.



*commission*; it should, however, not necessarily be identified with the Commission of the European Community, though they share several characteristics. The authority of the commission is in competition with the national governments and administrations of the member states, and lacks definition. Its influence relative to the individual nations is not determined fully by the constitution of the community, but depends on the abilities and incentives of the various actors involved. Each nation may appoint a certain number of the members of the commission.<sup>1</sup> The commission's activities are (at least partly) financed by the revenues from the community's external tariffs.<sup>2</sup>

The specific features of the protectionist tendencies prevalent in a community can be analyzed by focusing on the behaviour of the additional actor, the commission. This does not mean that the commission is necessarily granted much «power» (however defined), but rather that the protectionist pressures exerted in the various member nations take a new shape: the national governments may now use the commission as a means with which to try to satisfy the protectionist demands of their constituents.

The members of the commission can be regarded as pursuing their *own* utility subject to the constraints imposed from outside, the most important of which is to get along with the economic interest groups and to be reappointed by the respective national governments. The commission members' utility is positively connected with the importance and role of the community. They are thus faced with a difficult task, namely how to increase the influence of the community (and thereby their utility) at the cost of national interests, while at the same time serving the interests of their respective nations in order to secure their own reappointment.

The commission members' utility grows for various reasons when the community's importance and role rises. Their own prestige is enhanced when the commission increasingly resembles a supranational government. The budget and administration over which they have control rises almost automatically, which also entails higher salaries and perks (see Niskanen 1971). For these reasons, the members of the commission actively search for policies which give the community more importance in politico-economic decisions and which make economic interest groups more dependent on the commission's discretionary activities.

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<sup>1</sup> In the European Community this principle, while not formally established, is indeed practice.

<sup>2</sup> In 1981, 33% of the expenditures of the European Community were financed by tariff revenues.

There are three policy areas in which the commission has a relative advantage in extending its sphere of influence in politico-economic decisions, relative to national governments:

- (1) The national governments' role can be encroached on by the commission intensively pursuing the community's major goal, namely the abolishing of trade barriers between member countries. The members of the commission take pains to make sure that the decrease in internal tariffs is not substituted by *autonomous national* non-tariff measures or internal subsidies. The commission thus has a selfish interest in the constitution of the community being followed as closely as possible in this respect.
- (2) The commission also takes an active role in fixing the rates of the common external tariff towards non-member states, thus occupying another area of the policy at the expense of the individual nations (with respect to the EC, see Wolf 1985, p. 31ff., with reference to further relevant literature). As a decrease in external tariffs tends to improve the economic welfare of the community as a whole, which in turn strengthens the commission's position, it tends to favour free trade arrangements with countries outside the community. As their finance depends (at least partly) on the revenues from external tariffs, this incentive is strongly reduced,<sup>1</sup> so that the net effect on the level of external tariffs is uncertain. It may be expected, however, that the commission's interest in lowering external trade barriers is pursued more rigorously by decreasing *non*-tariff barriers which do not produce any revenue for the commission.
- (3) Finally, the commission can increase its sphere of influence in general economic policy by embarking on community programs in the member states. The strongest demand for such policies will be exerted by the protectionist national interest groups (see below). The commission therefore designs community programs which serve to protect such groups from the damages suffered by freeing trade. Such policies extend the commission's influence by increasing the community's budget (as in subsidy programs e.g. for agriculture) or by allowing ad hoc regulations and interventions (as happens in the European Com-

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<sup>1</sup>This financial aspect should not be underrated. The architect of the German Reich, Otto von Bismarck, changed his free trade to a protectionist stance, because the success of the Reich depended on revenues from indirect taxes and tariffs making it more powerful relative to the individual member states. See Borchardt (1984).

munity's steel policy).<sup>1</sup> The commission makes sure that it is the addressee of the demands for protection by devising *general* rules which prohibit national protectionist measures but which allow for exceptions if they are decided and administered at the community level.<sup>2</sup> The official free trade goal of the community is thereby paid lip service, and at the same time the commission's authority is extended.

It should be noted that in this third policy area, the commission benefits from a protectionist policy, which runs counter to the free trade policies<sup>3</sup> in policy areas (1) and (2). Thus, even on the level of goals, the commission wants to pursue *both* free trade and protectionist policies. It tries to conceal this contradiction by employing different instruments for the two purposes: tariff reductions for freeing trade; non-tariff barriers, especially subsidies and regulations, for protectionism.

The commission's *possibility space* is constrained by various other actors, the most important of which are (1) the organized interest groups and (2) the national governments.

- (1) The protectionist *national interest groups* adjust to the fact that internal tariffs are abolished, and that the commission has some influence over the common external tariff and may intervene in national economic policy with various types of interventions. They have an incentive<sup>4</sup> to influence decision making at the community level and will exert protectionist pressure on the commission in order to reestablish as far as possible the previously existing politico-economic equilibrium. At this higher level of decision making of the community as a whole, the public good problem connected with the organization of general economic interests becomes even more severe due to the larger number of actors involved.<sup>5</sup> As a result, the producers' interests, which are already well established

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<sup>1</sup> See e.g. the discussion by Dürr (1980) of protectionism by the European Community, and the type of official justification offered by the Commission of the European Communities for the case of steel (Kommission 1982).

<sup>2</sup> The Commission of the European Community rejected less than 4% of the applications for authorisation of subsidy schemes in the member nations (Twelfth Report on Competition Policy 1983).

<sup>3</sup> This is clearly supported by evidence from the European Community. Thus Joliet (1980/81, p. 436) writes: «The fact remains that the Commission has itself taken measures which run counter to the free movement of goods within the Community».

<sup>4</sup> Compared to a purely national setting, the rents achievable by influencing community trade policies are larger because the economy is larger.

<sup>5</sup> The trade unions as representatives of the suppliers of labour are in an intermediate position. Their interests are more global than those of the producers of specific goods (and thus more affected by free riding), but in many countries they have a quasi-official status in national wage negotiations and incomes policy, and therefore have a better basis for organizing on the community level than have the consumers and tax payers.

on the national level, will have little difficulty in establishing corresponding organizations on the community level. On the other hand, the consumers' and tax payers' interests, which are weak enough on the national level, will be still weaker on the community level, as the incentive to free ride is larger. The producers' information advantage (which has to extend over specific goods only) relative to the rest of the population increases. For these reasons it is to be expected that the asymmetry in favour of the protectionist producer interests is even *larger* on the community level. The consumers favouring free trade and the citizens favouring low public expenditures and taxes have little if any influence *as interest groups* in community decisions.

The commission reacts to the pressure of the organized producers by offering policies to compensate for the loss of protection suffered by the existence of the community. As the external tariff is a common one for all member countries, it is not very suitable for the protection of specific industries concentrated only in some member countries, because the costs of raising the common external tariff affects the whole community negatively and may endanger the success of the integration. The commission will fight protectionist measures of national governments for the same reason. An appropriate instrument from the point of view of the commission's interests are direct interventions by the community in the form of «sectoral» and «regional» policies. Such policies allow the commission to extend its authority. Its bureaucracy finds a field for which it can devise «community plans» and in which it can administer. The community bureaucracy enters into direct negotiations with particular economic sectors, thus establishing a direct relationship of mutual dependence. This starts the process well known within nations: the branch of the public administration responsible for an economic sector becomes a strong political advocate for the demands of that sector, and the corresponding sectoral interest groups are used by the administrative branch concerned to increase its size and influence in the overall public sector.

- (2) The second set of actors which decisively determines the commission's possibility space are the *national governments*. The national politicians have a clear interest in fighting for the demands of the protectionist producers, because they are rewarded for the rents gained, while the resulting costs are distributed over the whole community (and beyond). To strive for the interests of the consumers or tax payers at the community level is not normally profitable for national politicians,

because the benefits achieved are distributed over the whole community, i.e. beyond the constituency he or she depends on for re-election. The representative national politician's tendency to fight for national producers' interests is augmented at the level of the national government where the national interest groups intervene. It follows that the national governments, while *in general* supporting the community's free trade policies, in *specific* cases act strongly in favour of national producer interests.

The individual members of the commission are forced to be on good terms with their national governments because their re-election depends on them.<sup>1</sup> The individual members are therefore responsive to the demands of the national governments. At the same time they try to be as independent as possible in order to maintain their position in the politico-economic process. The success of the individual members of the commission and the commission as a whole will depend on how successful they are in finding compromises between these conflicting demands.

The compromises often take the form of benefiting particular nations and shifting the resulting costs in as imperceptible a way as possible to the other member governments. One of the commission's foremost tasks is to suggest, form and support log rolling arrangements between national governments. In order to achieve its own protectionist demands each government is prepared to allow other governments to do likewise in return. The majorities attained are beneficial for all the governments involved, but the succession of various log rolling deals may easily lead to a Pareto-inferior state for all members of the community.<sup>2</sup> In particular, the community may end up with a net of protectionist measures devised for specific industries, but which as a whole severely impedes trade. Provided this process does not go so far as to completely erode the basis of the community, the commission is a sure winner in the log rolling between governments. Its political and administrative services are demanded by the participants in each round, and it ends up in a position of increased authority and influence. The commission serves the national governments' interests by doing the «dirty» protectionist work.<sup>3</sup>

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<sup>1</sup> The German member of the European Commission, Karl-Heinz Narjes, ran the risk of not being reappointed because he was accused in Germany of not having promoted with sufficient vigour the rather idiosyncratic German «Reinheitsgebot für Bier» (Beutler 1984).

<sup>2</sup> Riker and Brams (1973), Brams (1975).

<sup>3</sup> See also Vaubel (1985).

By restricting the competition among them, the commission may offer yet another service to the national governments: a common policy makes it impossible for the citizens to judge their own government's performance. Due to the lack of information the national governments can shift the responsibility to the community if the policy turns out to be unsuccessful, but can still claim the rewards if it is successful.

The discussion has shown that the politico-economic equilibrium establishing itself in a community does not favour free trade with respect to both internal and external protection. The major reasons are that the protectionist producers' interests gain in importance relative to the consumers' and tax payers' at the community level,<sup>1</sup> and that the commission may extend its power relative to the national governments by intervening for the protection of ailing industries in the various member countries. The main effect of establishing a community is the shift in the *type* of instruments used for protection: (internal) tariffs are substituted by policy interventions by the commission in the form of subsidies and regulations. We thus have

*Proposition 4:* An economic community is not less but rather more protectionist than free trade associations or independent nations, but the instruments of protection shift from (internal) tariffs to subsidies and regulations designed by the commission.<sup>2</sup>

#### IV. Unitary «Presidential» Democracy

This institutional set-up moves in two respects further towards complete integration as compared to a community: the government («president») is directly elected by the voters in a single political constituency, and the

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<sup>1</sup>This contradicts the well known view by Olson (1982, Ch. 5) that the formation of new boundaries reduces the influence of organized interests (which will reestablish themselves only over time), and that jurisdictional integration leads to freer trade.

<sup>2</sup>This proposition is e.g. supported by, among many others, Page's (1981, p. 37) analysis of the European Community: «It has been argued in the past that joint trading actions or joint negotiations restrict the growth of protection because the least protectionist participants restrain the rest, but it appears that the reverse has been true both within the EC and in its role relative to other industrial countries ... In agriculture ... the Community (program of assistance) is more restrictive than any of (the national ones was)».

budget is less dependent on tariffs (direct taxation of income and turnover/value added is used).

The government of such a «presidential» democracy is faced with a completely new constraint (which is irrelevant for a community commission). It must ensure re-election by the voters in order to stay in power. Dependence on the demands of the voters – as compared to those of the organized interest groups – drastically increases. The government is forced to take the preferences of the consumers and tax payers into account. Elected in a single constituency, the government is held responsible for *all* the benefits and costs of trade policy affecting the country. A free trade policy increasing the net economic welfare of the country is politically beneficial. This contrasts with the institutional set-up in an economic community where a voter makes his national government responsible for the welfare of his own nation only, which inevitably produces a prisoner's dilemma game between the national members of the community, which results in a Pareto-inferior equilibrium of higher protectionism.<sup>1</sup> Vote trading (as between member countries within a community) which shifts costs to non-participants leading to a significant overall rise in protectionism is excluded, provided information is reasonably good. Producer interests are still dominant within organized groups, but they find it more difficult to burden the consumers and tax payers, because the government is forced to take the latter's voting potential into account. The government may directly benefit from a liberal trade policy if it positively affects the home economy within a reasonably short time.<sup>2</sup> This leads to

*Proposition 5:* Unitary «presidential» democracies tend to have lower degrees of protection than an economic community in which the commission is appointed by the national governments.

As has been shown in a great number of studies,<sup>3</sup> the government's popularity and chances of being re-elected depend systematically on the state of the economy. The lower the rates of inflation and unemployment, and the higher the growth of real disposable income, the higher is the government party's share of the vote. The government will therefore use protec-

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<sup>1</sup>For related general models see Fiorina and Noll (1978), Shepsle and Weingast (1981).

<sup>2</sup>The time horizon of a democratic government does not end at the next election because it can expect with a certain probability to be in power over another election period.

<sup>3</sup>E.g. Frey and Schneider (1978a, 1978b, 1979) for the United States, the United Kingdom and Germany. A survey of a great number of studies is given in Paldam (1981). See also the recent causality tests by Kirchgässner (1985a, 1985b).

tionist policies in order to influence general economic conditions and thereby its prospects of re-election. It will use the instruments of protection more and more strongly, as the election date approaches. In periods of recession, when unemployment is high and the growth of income low, the government will tend to increase the protectionist barriers in order to restrict foreign competition. If, on the other hand, there are inflationary tendencies in a boom period, the government tends to lower protectionist barriers (in particular tariffs) in order to increase foreign supply and thereby to fight increasing prices.<sup>1</sup> The *protectionist cycle* produced<sup>2</sup> follows the *general business cycle*. It thus has a quite different shape from the protectionist cycles identified for multilateral agreements between independent nations which are unrelated to the business cycle.

*Proposition 6:* Governments of unitary «presidential» democracies produce protectionist cycles following the general business cycle.

## V. Concluding Remarks

Our analysis of the effects on protectionism of different institutional arrangements allows the following conclusions.

(a) With respect to the *extent of protection*:

- bilateral free trade agreements cover fewer nations more intensively; multilateral free trade agreements cover more nations less intensively (Proposition 1);
- free trade associations tend to have higher external tariffs than the member countries would have without such an association (Proposition 3);
- economic communities are more protectionist than the member countries would be in case of independence (Proposition 4);
- unitary «presidential» democracies are less protectionist than corresponding economic communities (Proposition 5).

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<sup>1</sup>For econometric evidence see Takacs (1981), Magee (1982).

<sup>2</sup>See also Gallarotti (1985).



(b) With respect to *cycles of protection*:

- multilateral free trade agreements are subject to an erosion and recontraction cycle (Proposition 2);
- unitary «presidential» democracies are characterized by a protectionist cycle moving in the opposite direction to the business cycle (Proposition 6).

(c) With respect to the *instruments of protection* used:

- in free trade associations external tariffs are the main instruments for rent-seeking (Proposition 3);
- in economic communities there is a shift from (internal) tariffs to subsidies and regulations designed by the commission (Proposition 4).

Each institutional arrangement has advantages and disadvantages with respect to the extent and stability of protection, as well as to the instruments used. An «optimal» international trade policy based on a consistent ranking would require a social welfare function. The main lesson that modern political economy has taught us is that this approach is logically deficient (there exists, under realistic conditions, no social welfare function), and that a corresponding policy has no chance of being put into practice (because no actor has an incentive to achieve the «social good») (see Buchanan 1977, Frey 1983). The social welfare maximizing approach does not serve as a useful guide for the design of (international) economic policy.

A useful approach starts from the behaviour of the various actors involved in the politico-economic process. One should in particular look at the possibilities and incentives to participate in politico-economic decision making. Given an appropriate definition of the rights of the individuals, a constitutional contract will emerge which takes the various preferences into account. As long as the consumers and tax payers are not involved more directly in decision making, it cannot be expected that their preferences will be reflected appropriately in the results of international economic policy.

What is needed is an analysis of ways of guaranteeing (by internal institutional arrangements) that the preferences so far largely disregarded have a better chance of making themselves felt. This requires imaginative *institutional designs*. A possible means of increasing the influence of the consumers and voters in international policy making would be direct refer-

enda.<sup>1</sup> Another possibility would be to facilitate and encourage the organization of consumers' and taxpayers' interest groups, which would act as a counteracting force to the well organized protectionist groups.<sup>2</sup>

Quite another consequence of our analysis relates to the exceptions to the most favoured nation clause accepted by GATT (Article XXIV) which made it possible to form economic communities (the European Community). While the development of integration in Europe can certainly not be reversed, the international trading nations should seriously consider whether further economic communities – which according to our analysis tend to increase, and not decrease, protectionism – should be allowed.

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<sup>1</sup>It should be noted that this is only partially achieved in Switzerland; most foreign economic policy decisions are not subjected to popular referenda.

<sup>2</sup>So far, the corresponding efforts are mostly ill designed. The consumers' organizations existing at the European Community are largely disconnected from the consumers and are acting in a bureaucratic way because there is no institutional mechanism which gives the executives of the organizations an incentive to serve the interests of the consumers. For a general account of interest groups in the European Community see the *Wirtschafts- und Sozialausschuss der Europäischen Gemeinschaft (Generalsekretariat)* (1980).

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