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9 The Political Economy of Protection

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INTRODUCTION

Economic theory argues convincingly that free trade leads to the most efficient allocation of resources and maximises a country's economic welfare. Empirical research shows that unilateral and bilateral tariff reductions yield significant welfare gains (see Greenaway 1983a, chapter 6). Reality teaches us, however, that tariffs (and other trade restrictions) are prevalent in all periods and countries, and that there is a continual danger of ever-increasing protectionism in the world. The attempts made to reduce protectionism are based on the notion of reciprocity: that is to say, the propositions of trade theory about the welfare-increasing results of free trade do not seem to be accepted.

The glaring gap between theory and reality could be attributed to two causes. First, it might be argued that the policy-makers are misinformed and/or of limited intelligence and therefore do not know the welfare-increasing effect of unilateral tariff reductions. It may well be that producers and workers in some export sectors do not fully comprehend that higher import tariffs may threaten export sales because the costs of imports rise, other nations relatiate, or foreign income falls. The same may sometimes apply to consumers who are not fully aware that import barriers increase their cost of living. However, misperception and lack of intelligence can only explain a (small) part of protectionist activity; detailed studies of debates over trade legislation reveal a rather remarkable degree of knowledge on the part of the groups affected.

The second explanation is more relevant. It notes that the assumptions underlying the pure theory of international trade do not fully obtain in reality. In particular, it should not be assumed that markets

are perfect: real economies are subject to imperfect competition which distorts relative prices, and there are non-negligible costs of information, transactions and bargaining. Markets are thus not perfectly flexible, and it proves to be difficult, and sometimes impossible, to undertake the redistributions necessary to compensate the losers from a (potentially) Pareto-optimal trade-liberalising measure.

Once the world of perfectly competitive and frictionless exchange is left, *political* forces must be taken into account. This has been neglected in the established international trade theory. The traditional approach does away with the question of how the free trade optimum can be attained. Instead, it postulates the existence of a benign, omniscient government that can use non-distortionary taxes and subsidies to place society at a point on the utility-possibility frontier. If these assumptions are found not to hold in reality, a protectionist stand can be interpreted to be a *rational* policy for decision-makers in a democracy.

PROTECTIONIST PRESSURES IN A DEMOCRACY

In a democracy, the will of the majority should decide. As a (unilateral) shift to free trade increases welfare according to economic theory, it could be expected that the government would win votes by abolishing tariffs. By definition of Pareto optimality, either a majority of the electorate benefits directly, or the gains accruing to a minority can be redistributed so that a majority of the electorate is better off. In a system of direct simple majority rule in an assembly, the *median voter* (the one who makes a majority out of a minority) would cast his vote in favour of free trade. The median voter model is, however, based on a set of assumptions which in important respects do not represent reality. Their modification provides an explanation for the existence, and possibly growth, of tariffs in a democracy. There are five important modifications and extensions to consider (Baldwin, 1976b).

1. The losers of a tariff reduction, the people engaged in the domestic production of the goods concerned, are not necessarily compensated. If they form a stable majority, they will obstruct the reduction and/or elimination of tariffs. The median voter model would then predict that protectionism prevails.
2. Prospective gainers have less incentive to participate in the vote, to inform themselves, and to organise and support a pressure group than do the losers. Tariff reductions are a 'public good' whose

benefits are received by everybody, including those not taking the trouble and incurring the cost to bring about the reduction. The benefits for the gainers of a tariff reduction are moreover uncertain and take place in the future, and are therefore less visible. The losers of a tariff reduction, on the other hand, feel its effects much more directly, and will therefore engage more intensively in the political process.

3. It is possible that the prospective losers from free trade may be better represented in parliament than the prospective winners. This is the case, for instance, when the prospective losers are favourably distributed regionally. If they have a 51 per cent majority in two out of three voting districts, they need only 33 per cent of the total votes to gain a majority in parliament. If they have a 51 per cent majority in thirteen out of twenty-five voting districts, the group dominates parliament on the basis of a vote share of 26 per cent.

4. Logrolling, or vote trading, can strongly affect the outcome of majority voting. Vote trading may happen if groups of voters have unequal preference intensities for two issues. Consider a group of voters, group I, engaged in domestic, import-competing activities. Their main preference is against the reduction of tariffs for their *own* products (proposition A) and weakly in favour of reduction of tariffs for some other products (proposition B). Assume another group of voters, group II, whose main interest lies in maintaining the tariff for the products concerned in B, and who have a weak preference for tariff reduction in A. If neither of the two groups has a majority, and the other voters perceive the benefits of free trade, both propositions A and B would be accepted and free trade established. If, however, groups I and II combined have a majority, they can agree to exchange votes: group I votes against the tariff reduction which group II strongly opposes (i.e. votes *against* B), provided group II votes against the tariff reduction which group I strongly opposes (i.e. votes *against* A). This then leads to a majority vote against tariff reductions, i.e. propositions A and B are both defeated.

5. Tariffs provide revenue for governments, which in their absence would find it more difficult to finance public expenditure. This is especially true in developing countries, where due to the inefficiency of the tax system there is little tax revenue. Table 9:1 shows that in many less developed countries, tariff revenues constitute a dominant part of total tax revenues. In Gambia the share was 66 per cent, in Yemen, Swaziland, Rwanda and Zaire the tariff revenues accounted still for more than half of total revenues. A government in such a country will have a great interest to secure this income source, and will for this reason oppose free trade (see Greenaway, 1981).

TABLE 9.1 Tariff revenue as a proportion of central government revenue, 1972–7,[1] selected developing countries

Gambia	66%
Yemen	63%
Swaziland	54%
Rwanda	52%
Zaire	52%
Bahamas	49%
Chad	48%
Ecuador	47%

[1]The average figure may for some countries relate to less than six years.
Source: Greenaway (1981).

The five modifications of the simple median-voter model combine to explain why free trade, which is optimal from the point of view of the country as a whole, is not actually found in reality. The discussion suggests that there is, on the contrary, a *political market* for protection. Protection is demanded by particular groups of voters, firms and associated interest groups and parties, and supplied by politicians and public bureaucrats. Economic interests try to gain advantages and to improve their position by turning to the political system. They invest resources in order to influence political decisions in their favour. Such activities, which are directly unproductive because they do not increase the value of goods and services available, are a special form of profit-maximisation. Such profits can be gained by lobbying for trade barriers which generate rents that the particular actors can acquire for themselves (rent-seeking); or they can be gained by appropriating the monetary revenues from tariffs (revenue-seeking).

THE DEMAND FOR PROTECTION

In Figure 9.1 the horizontal axis measures the increase in the tariff level attained; the origin thus indicates the tariff level existing at the outset. The vertical axis measures the costs and benefits from such action in comparable monetary units. *OA* is the 'cost-of-lobbying' curve, showing the total cost in monetary terms of securing tariff protection by lobbying. This curve has a rising slope because it is reasonable to assume that it becomes increasingly difficult for a particular economic interest group to raise the tariff in its favour, i.e. there are rising marginal costs. The cost-of-lobbying curve reflects the willingness of political suppliers to grant additional protection to that particular economic interest (sector or industry). The cost curve

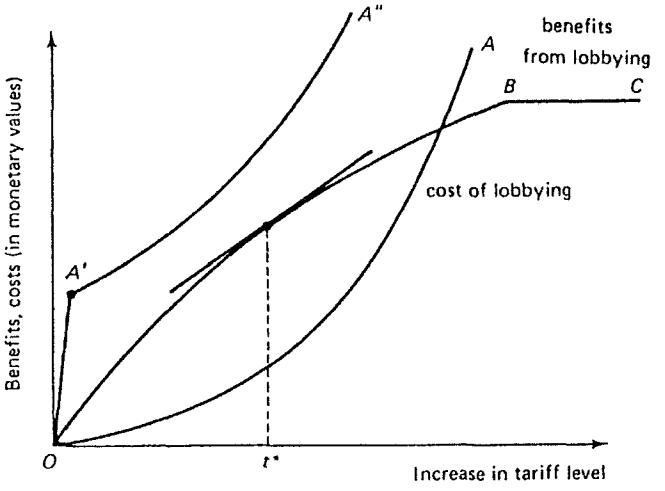

Figure 9.1 The optimal amount of lobbying for tariff protection

will be lower, (a) the better the economic interest is organised; (b) the more efficiently the lobbying activity is undertaken, and (c) the more the other groups in society feel that this particular economic interest should receive tariff protection. An example are farmers, whose protection against foreign competition is rather altruistically favoured for traditional reasons by many people in society. (A less altruistic reason for the willingness to favour a tariff increase may be that other interest groups think that such action will increase their own chances of receiving tariff protection themselves in the future, i.e. they endeavour to bring about a type of political exchange).

Returning to Figure 9.1, *OBC* shows the 'benefits-from-protection' curve. It indicates the monetary value of tariff protection from the point of view of the group undertaking the lobbying activity. The larger the increase in the tariff, the higher the benefits are accruing to the group, up to a maximum of B, which indicates the prohibitive tariff. The benefit curve's slope is not *a priori* determined; it is not inconceivable that increasing tariffs yield increasing marginal benefits, at least over a limited range. The curve shown in Figure 9.1 depicts decreasing marginal benefits over the whole range. The group's lobbying effort is optimal when it leads to an associated tariff increase t^*, at which point the 'rent' in the form of the difference between benefits and cost is maximised. The figure is able to illustrate that a lobbying activity to increase tariff protection need not necessarily be

worthwhile for a particular economic interest group. Initial costs of lobbying (given by OA') may be so high that the cost curve $OA'A''$ lies above the benefit from lobbying curve OBC over the whole range.

This cost constellation may occur when the economic interests are difficult to organise, i.e. if there are high set-up costs to engage in political lobbying. The figure stresses the importance of having an established organisation to further one's interests in the political market for protection (or in any such market). If the cost of initial organisation were already covered (for instance because the organisation already exists for other purposes such as social gatherings), it would be advantageous to embark on lobbying. In that case, the cost of lobbying curve is OA, and the associated optimal tax increase is t^*. This explains why economic interests which are already organised have a tendency to get additional advantages, and so even more strongly establish their priviledged position, while newcomers find it difficult to make their demands felt in the political struggle.

While the model is instructive, the extent of lobbying and protection achieved in reality can only be explained if the factors determining the position and slope of the cost and benefit curves can be empirically measured. This has indeed been done by comparing the conditions existing in various sectors or industries. We now turn to these aspects.

Pro-tariff groups

Domestic firms in competition with foreign firms supplying the home market have the strongest interest in *tariff protection*, and generally oppose free trade policies. They are joined by the workers and trade unions of the particular economic sector, who know that they can share the rents achieved by tariff protection. Firms producing complementary products and supplying inputs to the import-competing firms also favour protection (provided they do not themselves strongly depend on imported raw materials). The protectionist groups usually have strong political interests because the effects of a change in protection are visible and direct, and therefore carry a lot of weight in the political debate. They can easily argue that a tariff reduction would result in a direct loss to them, reducing output and employment, while the foreign interests are favoured. Increased protection, on the other hand – so they will claim – obviously increases employment output and profits at home. These arguments are particularly forceful, and are actively promoted by trade unions when there is an abnormally high level of unemployment in the domestic economy.

Anti-tariff groups

The main group in society favouring trade-liberalising policies and opposing protection are the *export suppliers*. Firms offering their products on foreign markets realise that increased protectionism at home may lead to retaliations by foreign countries, threatening their sales. They cannot expect to widen their access to foreign markets if their own country is not prepared to reduce its own protection. It is, however, quite difficult to translate these export interests into effective political action. The damage suffered through import restrictions is indirect; it has the character of a foregone opportunity which is difficult to quantify. Among the firms opposing tariffs are the *multinationals*, who tend to favour free trade because they are able to compete efficiently on international markets. Protectionist tendencies may also lead to restrictions in their own activities, in the extreme leading to the nationalisation of their property in the foreign country in retaliation for protectionist actions in the home country. Domestic firms using imported inputs for their production are also interested in trade liberalisation. Such firms, however, often belong at the same time to the import-competing sector with an interest in protection, so that their political position becomes equivocal or even pro-tariff.

Consumers and their organisations (as far as they exist) have an interest in low tariffs. Trade barriers burden consumers as they have a smaller choice of products and have to pay higher prices. Consumer groups have, however, little effect on trade policy. One reason is that consumers are normally also employees and workers. Their income is usually exclusively from this source, while expenditures are distributed over many different goods, some of which are not (directly) affected by tariffs. As a consequence it is individually rational for consumers to pay most attention to their position on the producer side, which often benefits from import protection. Furthermore, consumers have little impact on trade policy as the loss of consumer welfare through the imposition of tariffs is rather difficult to identify. It is hard to see what the prices of the various products would be if tariffs were reduced or abolished, especially in an inflationary environment. The 'invisibility' and indirectness of the opportunity cost of tariffs hardly motivates consumers to fight politically for tariff reductions. This lack of engagement is only partially compensated for by the importers and distributors of foreign-produced consumption goods (such as retail chains, mail-order houses and discount firms) which have an obvious interest in low trade restrictions.

Political organisation

Whether pro-tariff or anti-tariff interests prevail depends on the political weight of the corresponding groups, and the intensity with which they raise their demands in the political process. A crucial factor is the ability and incentive to organise and to obtain the financing necessary for effective lobbying. As has been pointed out, protection constitutes a public good affecting all the members of a particular economic sector or occupation. There is an incentive not to join the interest group or to contribute financially, because one may profit from the outcome by free-riding. Even if in an industry the benefits from further protection might be very large, it may be difficult or even impossible to raise the lobbying funds due to free-riding. The same problem holds even more strongly for anti-tariff interests, since the benefits of trade liberalisation are even more widely diffused.

There are three conditions under which interest groups are likely to form in the presence of public goods:

1. when the group has been formed for some other reason than a lobby, or has been established by government decree (as in some countries the farmers' organisations);
2. when group members only get specific private goods from belonging to the organisation, such as information or insurance;
3. when there is a small group situation in which the members can impose sanctions on would-be free-riders.

Generally these conditions are more likely to obtain on the producer than on the consumer side. In a given sector, there are often only a few producers who find it easy to organise. As we have seen, import-competing and associated producers have on balance more to gain from protection than others. The opposite holds for those consumers interested in free trade. Because of their large number and diffuse interests, they are difficult to organise in an effective way, and it is almost impossible to raise funds for such general consumers' interests as low tariffs. Consequently, anti-tariff lobbying is comparatively weak.

We therefore have *two general propositions* concerning the demands for protection:

1. Pro-tariff interests have strong lobbies and mainly consist of import-competing producers (which includes the workers).
2. Anti-tariff interests have weak lobbies as consumers and exporters find it difficult, and have little incentive, to organise and to lobby effectively.

It should be noted that it is maintained throughout that the interests organise along *industry* or *sector*, and not along factor, lines as suggested by the Stolper–Samuelson (1941) approach (or much earlier, of course, by the Marxist theory of the struggle between capital and labour). This traditional theory of trade suggests that all capital interests would promote free trade (if that factor is internationally more competitive) and all labour interests would seek protection, or vice versa (if labour is internationally more competitive). It would not be expected that part of labour should be for protection, and the other part for free trade, and that capital interests should be similarly divided on the free trade issue. In contrast to the traditional Stolper–Samuelson view, the politico-economic approach emphasises the *rents* which the factors of production acquire through protection from foreign competition. In an industry which gains monopoly profits, the trade unions will attempt to get a share of these rents. As a result, the industry will be characterised by high wages and barriers to entry in the factor market of this industry. Factor mobility is curtailed by the actions of the interest groups, so that one of the basic assumptions of the traditional model of international trade no longer obtains. *Both* factors of production have an interest in defending the rent they share among themselves, and they will therefore act in concert. (For an empirical analysis of these contrasting views, see Magee, 1980.)

THE SUPPLY OF PROTECTION

Tariff levels and changes are determined by political decisions in which politicians (in particular the government) and public officials (or bureaucracy) are dominant. Trade policy is not decided by direct referendum (even in Switzerland). Protection versus free trade is only one of the issues over which an election is fought, and in most countries and periods trade policy is dominated by internal economic and political issues.

Every government may be assumed to pursue certain ideological goals, but is subject to a variety of constraints. One element among the ideological goals may be the position with respect to protection. The most important constraint perceived by most governments is the need to be re-elected. When a government fears it will lose a forthcoming election, it will undertake a policy which promises to raise its popularity with the voters. A party committed ideologically to free trade may be forced to resort to protectionism if it appears that such a policy may improve its re-election chances. We have seen that in the case of foreign trade, the consumer-voters interested in free trade

are not very active, while the interest groups demanding protection try to exert as much influence as possible by lobbying. A government uncertain of re-election will therefore turn its attention to the demands for protection raised by the organised interests, hoping that they will deliver some votes, especially in marginal constituencies, and/or provide help in financing the election campaign.

The government has to act within the constraints set by the budget and the balance of payments. The extent to which these constraints restrict the government depends on the structure of the economy and on the prevailing economic conditions. A substantial balance of payments deficit may induce protectionist measures as an indication of willingness to act even if the politicians in charge are ideologically opposed to raising tariffs (or find this an ineffective remedial measure).

Another actor playing an important role in tariff formation is the *public administration*. This body has considerable influence on the 'supply side' of the tariff because it prepares, formulates and implements trade bills. The activity of public bureaucrats with respect to tariffs may again be analysed with the help of the 'rational' model of behaviour, e.g. by assuming that they seek to maximise their utility subject to constraints set from outside. The main elements in the bureaucrats' utility function may be assumed to be the prestige, power and influence which they enjoy relative to the group of people they are officially designed to 'serve' – their clientele. In most cases this clientele will be located in a specific economic sector. For example, in the case of public officials in the ministry of agriculture, the clientele would be those groups with agricultural interests. Public officials are moreover proud of being able to show that they are competent in their job ('performance excellence'). Public bureaucrats will therefore tend to fight for the interests of 'their' economic sector, and will work for tariffs and other import restrictions in order to protect it from outside competition. Moreover, they will prefer to use instruments under their own control rather than to follow general rules imposed by formal laws, various kinds of non-tariff protection and support (subsidies, voluntary export restraints, etc.) rather than general tariffs.

The political constraints faced by public bureaucracy are imposed by parliament and government. However, both of these actors have little incentive to control public administration tightly, because they are dependent on it in order to reach their own goals. In addition, political actors have less information available to them than the public bureaucracy, in particular with respect to the sometimes very complex issues of protection. The limited incentive of politicians to control the public administration gives bureaucrats considerable dis-

cretionary power which they can use to their own advantage in the area of trade policy.

The idea that public officials pursue the common interest or collective welfare and therefore fight for free trade has to be rejected. Indeed, it may be argued that they favour greater protection than politicians. As many public bureaux are organised along industry lines, they depend more on the relationship with this particular industry than the politicians. Moreover, bureaucracies have a more limited set of instruments available than the government, which has control over the whole range of economic policy. As a consequence, individual bureaucracies must reach their goals by using the instruments at hand *more intensively*: they strive to protect the economic sector they are associated with against foreign competition more strongly than do the government politicians, who have other means available to support the respective industry if it is in their interest to do so (Messerlin, 1981).[1]

EMPIRICAL EVIDENCE

A number of studies provide interesting evidence about the quantitative aspects of tariffs and other protective devices, and provide strong support of the politico-economic approach. As is common practice today, econometric methods have been applied, in particular multiple regressions which take a number of influences into account and which are able to isolate the contribution of each determining factor to tariff formation, holding other influences constant. Empirical analyses have been used to explain both the differences of protection between industries (cross section) as well as the cyclical development of protection (time series).

Explaining protection between industries

Voting on tariffs. Baldwin (1976b) seeks to explain the differences in political pressure for or against protection in the USA. The specific issue examined is the *trade-liberalising* bill introduced to the House of Representatives by a Republican President in 1973. The probability of a Congressman voting for or against the trade bill is explained by four determinants:

1. The proportion of import-sensitive industries in the Congressman's constituency. A positive influence is expected here because the Congressman has an incentive to vote *against* the liberalising trade bill in order to please his voters.

2. The proportion of export-oriented industries in his constituency. The more export-oriented a constituency is, the more likely it is that a Congressman supports the liberalising trade bill.
3. The financial contribution to the Congressman's campaign made by the three major trade unions opposing the bill. A Congressman being sensitive to the size of monetary contributions received, it is expected that this induces him to vote against the bill.
4. The party affiliation.

As theoretically expected, the larger the weight of the industries in competition with imports in his constituency is, the more likely a Congressman is prepared to yield to their pressure and to vote against the trade-liberalising bill. (It is interesting to note that export-oriented industries do not have a statistically significant influence on the Congressman's vote decisions; this corresponds well with the theoretical notion that anti-tariff interests are politically less influential than pro-tariff interests.) Financial contributions of protectionist trade unions are able to influence a Congressman's behaviour: the more money he gets, the more likely he is to vote against the free trade bill. Finally, it stands to reason that due to party allegiance, a Republican Congressman is more likely to support the trade bill introduced by a President coming from his party than is a Democratic member of Congress. The results of this econometric analysis of the voting behaviour in the American Congress accords very well with the political economy approach to tariff formation discussed earlier.

Actual tariff rates. Several studies have analysed the differences in *tariff rates* between industries as the outcome of the political struggle between demand and supply of protection in Canada. A particularly interesting contribution to explain the tariff structure (Caves, 1976) compares three competing models:

1. The government sets tariffs to maximise the probability of winning the election given a geographically represented electorate.
2. Interest groups determine the structure of tariffs, the various industries having different benefits and costs of lobbying for protection.
3. The government sets tariffs to effect a collective nationalistic feeling about the industrial composition of the economy ('national policy model').

These three models emphasise different aspects of the politico-economic processes behind tariff setting. A multiple regression was run for between twenty-nine and thirty-five industries. Explanatory variables were chosen which were intended to represent the typical

features of each of the three models. The *interest group* model comes out best: the more low-skilled and low-wage workers are employed in an industry, the higher are the tariff rates, since the respective pressure groups have better arguments to ask for protection. When the firms buying a product are strongly concentrated, and when they are confronted with a high seller concentration, they are induced to organise more strongly and are (*ceteris paribus*) able to keep tariff rates low. The slower the growth of an industry, the more it seeks political assistance for tariff protection. This latter influence is, however, not statistically significant. By contrast, the national policy and rate maximisation models perform poorly.

An alternative interest group explanation of Canada's tariff structure stresses *international* political influences (Helleiner, 1977). A time series analysis for the period 1961–70 suggests that labour and multinational firms have the largest influence on tariffs: labour seeks increased protection because of the rising supply of industrial products from low-wage countries, while multinationals are generally interested in free trade.

Similar studies on the determinants of the tariff structure between industries have been carried out for other countries such as France, West Germany, Japan, the United Kingdom and the United States in the context of a research project sponsored by the World Bank. The results suggest again that the import-competing industries tend to get higher tariff protection than the industries with export interests. It also turns out that labour-intensive, low-wage industries and sectors with few firms and large numbers of employees tend to be protected more because they can more convincingly argue in the political discussion that they are directly threatened by foreign suppliers; because of the large number of voters involved it is of particular interest to government to yield to their demands for protection (see Anderson and Baldwin, 1981).

One of the most recent studies (Lavergne, 1983) distinguishes three sets of determinants of the level of, and the change over a time period in, tax rates. The first is 'political' and refers to the pressure group influences; the second contains 'mixed' economic and political influences such as the effort by decision-makers to minimise displacement cost, the comparative advantage of the industry relative to foreign competition, and tariff setting as a means of international bargaining; the third set of determinants includes 'principles' such as the maintenance of historical continuity, as well as miscellaneous aspects related to a public interest view of tariff setting. The econometric test is applied on 300 manufacturing industries in the United States from 1930 to the present. The estimates reveal that the most important influence on the tariff-setting process is conservatism: The

structure of tariff rates between industries tends to be maintained over time. Of considerable importance is the possibility to use home tariffs in the international bargaining process over protectionism and free trade. It also turns out that the more competitive an industry is in the international field, the lower is its tariff level. Contrary to almost all the other econometric studies of tariff formation, the pressure groups do not seem to exert any systematic influence. The study is useful, however, because it shows that there are a great number of different factors which may influence the tariff-setting process.

Non-tariff barriers. Tariffs are not the only instrument for protection from foreign competition. There exist a great many forms of non-tariff barriers to international trade (see Greenaway, 1983a). An explanation of the typical features of the formation of non-tariff barriers may be based on the economic theory of regulation (see, for example, Peltzman, 1976). It argues that the regulators serve special interest groups. Government intervention in a market may be viewed as a politically optimal way of redistributing wealth from some constituents to others. When an outside interference takes place, the regulatory interventions have to be changed in order to re-establish political equilibrium. In the international trade area one such intervention was the Kennedy Round, the purpose of which was to reduce tariffs across the board by 50 per cent – the so-called linear rule. The negotiations were quite successful. The simple average tariff reduction on United States manufacturing products was 46.8 per cent between 1967 and 1972. The share of imports in domestic sales of manufactured products rose from an average value of 4.8 per cent in 1967 to 7.3 per cent in 1972. However, the structure of protection was not strongly affected by the Kennedy Round because the tariff reduction was *substituted* by other forms of protection, in particular by regulatory non-tariff barriers.

This interaction of tariffs and non-tariff barriers to international trade has been empirically tested for the year 1970 (when most of the Kennedy Round reductions had already materialised) by Marvel and Ray (1983). They confirm that non-tariff barriers are related to the historical political equilibrium before the Kennedy Round (in the form of the tariff rate of 1965). Furthermore, they found that those industries having the highest tariff protection *also* have the political influence to reach high non-tariff protection. The two forms of protection are, however, not equally attractive for specific industries. The estimates indicate that non-tariff barriers are more accessible than tariffs for low-concentration industries (which have greater difficulties in exerting political influence, mainly because of the free-

rider problem). For firms in industries with a great number of suppliers, the rents generated by tariffs cannot easily be appropriated because they may be bid away through the rapid entry of new domestic firms into the industry. Non-tariff barriers are more advantageous because the rents generated can often be distributed selectively to punish free-riders, and can be withheld from new entrants. An example are import quotas based on historic sales of the firms already in the market.

Finally, Marvel and Ray suggest that *both* tariffs and non-tariff barriers tend to be high in consumer goods industries because the consumers who are burdened therewith find it difficult to organise themselves effectively.

On the whole, the estimates strongly support the political economy interpretation of the process of protectionism. They indicate that there is a systematic influence of special interests which undermine the linear type of trade liberalisation agreed to in such agreements as the Kennedy Round. It is shown that the factors that make if possible for industries to gain more protection than others can be empirically identified.

Voluntary export restraints. As we have seen in Chapter 7, in recent years international trade relations have witnessed the emergence and rapid expansion of voluntary export restraints. They have been applied to a large number of manufacturing goods, such as steel, colour television sets and automobiles. VERs differ in three main respects from global tariffs or global non-tariff barriers.

1. Voluntary export restraints are discriminatory, lowering the import share of restraining suppliers.
2. They lead to a deterioration in the importing country's terms of trade and a share in the rents created are appropriated by the restraining exporters.
3. The agreements are reached in clandestine consultations.

These three characteristics offer specific incentives to certain decision-makers to favour such exports constraints (see K. Jones, 1983). The government and public bureaucracy in the importing country find it a suitable instrument to achieve protectionist ends with low political cost. Being 'voluntarily' agreed to by exporters, they do not violate international trade agreements such as the GATT restrictions on trade barriers. It is targeted at 'disruptive' suppliers, so that no retaliation has to be feared by other suppliers. (On the contrary, as they reduce the competition of the most efficient suppliers, they benefit from them.) Voluntary export restraints are quickly implemented and are in the hands of the government and its administration, while

parliament need not be consulted. The import-competing producers reap the normal benefits from protection. They receive rents by being able to raise prices and increase output. They are not easily made responsible for the cost of such protection because attention is focused on the foreign exports which are said to have 'disrupted' the market. Voluntary export restraints are also beneficial to foreign exporting firms because the reduction in exports creates monopoly rents which they can appropriate (provided that exporters from other countries do not compensate the reduction). In order to implement this agreement, the foreign government must set up an export cartel which tends to favour the established firms in the economic sector concerned. Competition is weakened by the allocation of export market shares and the entry of new firms is prevented. Consumers are the group which has to carry the burden, as with all other kinds of protection from international competition. Compared to tariffs, they have to pay twice: once in the form of higher domestic prices, and again in the form of foregone tariff revenues. Consumers are excluded from the decision-making process; the agreements are negotiated by highly specialised experts on a technical level, removed from the public view. The costs involved by such voluntary agreements are not only difficult to understand and measure quantitatively, but they are so far not part of the political debate in which the opponents of this form of protectionism are capable of, and willing to, raise their voices. For these reasons it is not surprising that this new protectionist tool has gained in importance as a substitute for more open, and politically sensitive, protectionism by tariffs.

Explaining the cyclical development of protection

Protectionism is strongest when a country's economic position is weak; attempts at liberalising international trade have the best chances when economic conditions are good. These statements are almost common-place; the question is, however, whether they are supported by serious empirical analyses.

Number of petitions. One way to measure the intensity of the *demand* for protection is the number of 'escape clause' petitions to the International Trade Commission under the trade legislation of the United States. It may be hypothesised that the number of such petitions is larger (a) the worse domestic economic conditions are

(measured by the level of the Gross National Product, unemployment or unused capacity) because the industries threatened by foreign competition can establish a 'convincing case' that the bad state of the economy is due to 'unfair' competition by foreign suppliers; this raises the expected rate of return from political activity; (b) the worse the balance of trade is as an indicator of the (unsatisfactory) international competitive position of the country; (c) the larger import penetration is, because this is an obvious sign to which the domestic industries can point to in order to 'prove' the damaging influence of foreign suppliers; (d) the larger the number of *successful* escape clause petitions is in recent years, because a firm considering making a petition takes this as a favourable element in its benefit-cost comparison.

Work by Takacs (1981) covering the thirty years from 1949 to 1979 in the USA supports the theoretical hypotheses: macroeconomic conditions significantly affect protectionist pressure. The number of escape clause cases rises, the lower the level of real GNP, the higher unemployment, and the lower capacity utilisation are. Foreign trade conditions also have the expected influence: the worse the trade balance and the larger import penetration are, the more petitions will be filed which demand protection. Finally, the larger the share of successful petitions in the past, the more new ones will be made, *ceteris paribus.*

Dumping cases. In another study (Magee, 1982) protectionist pressure is measured by the number of dumping cases filed with the US Bureau of Customs. Protectionist pressure is again hypothesised to rise with unemployment. Increasing inflation, on the other hand, leads to pressure from households and consumer groups to liberalise imports.

The period covered is 1933–1977 and Magee finds that a 10 per cent increase in the rate of unemployment (e.g. from 5 per cent to 5.5 per cent) is associated with a 9 per cent increase in protectionist pressure; each percentage point rise in the rate of inflation (e.g. from 7 per cent to 8 per cent) lowers the protectionist pressure by 5.7 per cent.

The econometric estimates of the cyclical influences on the tariff formation process are so far limited to the demand side. The difficulty is, of course, to find sufficiently long and comparable data series to perform a similar type of analysis on actual tariffs or on other protectionist measures as the outcome of the political struggle.

CONCLUDING COMMENTS

International trade theory proves that a (unilateral) move to free trade by a country maximises economic welfare. The corresponding welfare loss of protectionism can and has been calculated. In reality we observe intensive bargaining and reciprocity agreements for tariff reductions. Theory and reality can be reconciled by taking into account that information, transactions and bargaining are not free of cost and that not all interests are represented equally well in the democratic political process. Tariffs are decided in a *political market*; it pays to invest resources in order to gain the rents from protection. The pro-tariff groups mainly composed of import-competing industries (capital owners, management and workers) have a strong political position because their demand for protection are visible and understandable and the organisational problem is more easily manageable. The anti-tariff groups mainly composed of consumers find it difficult to organise effectively because of the free-riding effect. The level and structure of protection is the result of the interaction between the actors of the demand side (mostly interest groups organising along industry lines) and of the supply side (government and public bureaucracy). This political equilibrium can be modelled in various ways.

The unequal degree of protection of the various industries against foreign competition in the politico-economic process has been analysed by econometric methods, considering the demand side (voting on tariffs) and the political equilibrium outcome (actual tariff rates). Non-tariff barriers can be empirically explained by a similar set of determinants, because the two means for protection are partly used as substitutes. Tariffs and non-tariff barriers are found to be positively linked with the importance and degree of concentration of import-competing industries. Declining industries, and sectors with low-skilled, low-wage and a large number of employees have a good chance of getting protection. The more competitive an industry is (among them the multinational firms), the lower is protection, *ceteris paribus*. Important influences on tariffs and non-tariff barriers are also the historically given structure of protection and the possibilities for international bargaining. As theoretically expected, the export-oriented industries and consumers have little or no influence on issues of free trade and protection.

Recently, voluntary export restraints have become important as a protectionist device. They are advantageous for both the home industry and the foreign suppliers (the latter can appropriate the monopoly rents of curtailed supply), as well as for the government and public bureaucracy, mainly because there is no possibility or

incentive for consumers (who carry the burden) to oppose such agreements.

Protectionism is empirically shown to be strongest when a country's economic conditions are weak, in particular if GNP is low and unemployment high, and when the foreign trade position is bad. Rising inflation, on the other hand, leads to pressure to reduce tariffs.

The econometric studies presented provide on the whole strong support for the political economy of protection.

GUIDE TO FURTHER READING

The economic theory of politics on which this chapter is based is well developed in Mueller (1979). A survey of the application of this mode of analysis on politico-economic interaction in the international sphere is given in Frey (1984). Important early contributions are Hirschman (1945) and Kindleberger (1970).

Further articles on the political economy of tariffs and other restraints on trade are Baldwin (1982), Brock and Magee (1978) and Findlay and Wellisz (1983).

A forerunner to the empirical analysis of the determinants of protection is Schattschneider (1935). He advanced the idea that the tariffs obtained by an industry are a function of the degree of pressure which it is able to organise. His empirical analysis relates to the politics surrounding tariff formation in the United States. The public hearings held by Congress are used as indicators for political pressure. Another early champion of the interest group approach is Kindleberger (1951), who illustrates his approach mainly by historical examples. One of the first econometric studies, Pincus (1975), has been used to explain the United States tariff structure of 1824, again based on a pressure group process.