1 What Shapes National Trade Policy

In the private enterprise economies of the world, the great driving force behind an expansive trade policy is and always has been the commercial search for access to foreign markets and sources of supply. It has forever been counterbalanced by hardly less powerful commercial interests–those of the domestic producers and workers who have to face competition from imported supplies. The balance of interest between groups influenced by these opposing forces has never been static. It is in endless flux as groups on both sides respond to economic growth and change at home and abroad. Trade policy, however, is not simply the outcome of the tug-of-war between these groups. Nations and the political elites or parties who govern them have other aims besides satisfying the wishes of commercial interests. Everywhere, national security takes precedence over commercial interest. For the more powerful nations, trade policy has often been a vehicle used in achieving the political aims of foreign policy. Most recently, many citizens in Western countries now push for the use of trade policy to advance human rights or to enforce environmental or labor standards.

Besides such political concerns, trade policy is profoundly influenced by prevailing ideas about what constitutes the national economic interest. The ascendant ideas and beliefs are usually consistent with the dominant commercial interests; but the intellectual rationale that they provide for national policies also has to be more broadly acceptable. Further, both current ideas and interests work within an established framework of domestic laws and institutions. Inherited from the past, the framework embodies other ideas and interests that are usually not easily dismissed.

WHAT SHAPES NATIONAL TRADE POLICY

SEARCHING FOR MARKETS: THE COMMERCIAL INTEREST

Throughout history, the primary commercial driving force behind the trade policies of countries has been the search by their traders and entrepreneurs for access to foreign markets and sources of supply. Both the trade merchants of medieval times and the heads of large corporations today have been assiduous in seeking the help of their princes or governments in gaining easier access to foreign markets and sources of supply. In generations past, one course of action often resorted to by the more powerful states was the use of force or the threat of force to create colonial empires or "spheres of influence" that assured their traders or manufacturers access, often on an exclusive basis. Indeed, such use of force was elevated by the Marxist-Leninists into a general explanation for the trade of the capitalist "imperialist" powers. As Stalin put it, with his usual bluntness, "countries which consider themselves inadequately provided with raw materials and export markets try usually to change the position in their favor by means of armed force" (quoted in Kissinger 1994, 440). While such an explanation of trade relations may seem mildly ludicrous to most of us today, ample support can be found for it in the history of earlier centuries, and many people in developing countries now subscribe to this imperialist interpretation. But even in the nineteenth century or earlier, it failed lamentably to provide an explanation for the evident and vigorous growth of trade among countries that were in no sense threatened by each other. In relations among states where military force was not a feasible or desirable means of gaining access to markets or supplies, the instruments that countries turned to were trade policy and trade diplomacy.

Industrial Development as the Driving Force

The commercial search for access to foreign markets and sources of supply has greatly intensified over the last two centuries as industrialization has taken root and spread throughout the world. The endless advance in technology, organization, and skills that raises productivity and drives economic growth has given a powerful impetus to foreign trade. The long and continuing decline in transport and communication costs, aided in the nineteenth century by such transforming innovations as the railroad and the steamship and symbolized today by the advent of the Internet, has greatly lessened the natural barriers that distance imposes on trade. At the same time, the opportunities for specialization have been vastly enhanced as markets have grown and as the introduction of new products has diversified output.

Such dynamics have caused world trade to rise faster than world output over most of the decades since the onset of the modern industrial era (see table 1). The upward trend in the share of world output that is traded was broken only during the interwar years, when the economic dislocations of the 1920s were succeeded by the Great Depression of the 1930s. It was sometime after the Second World War before the share of trade recovered to the level it had attained at the end of the belle epoque, but the share of output that is traded as merchandise exports today is almost double what it was in 1913. (It stood at over 22 percent of gross domestic product in 1998–a measure that takes no account of trade in services, which could raise the share to as much as 28 percent.)

Since the early nineteenth century, the composition of merchandise trade has gradually shifted in favor of manufactures. After industrialization first took off in Britain, a significant part of international trade became an exchange of factory-made manufactures for primary commodities. In the later nineteenth century, as other countries industrialized, some measure of interindustry specialization appeared, and the exchange of manufactures for manufactures started to grow. Only after the Second World War, however, did the value of trade in manufactures begin to overshadow that of primary commodities.

The core of postwar trade has been the exchange of manufactures and semimanufactures among the industrially more estab-

TABLE 1. World Merchandise Exports as Percentage of Gross Domestic Product

1850	1880	1913	1950	1973	1985	1993	1998
5.1[a]	9.8[a]	11.9[a]	7.1	11.7	14.5	17.1	22.4

Source: World Bank 1995. The 1998 estimate is based on data from World Trade Organization 1999.
[a]Data refer to OECD countries only.

lished countries of North America, Western Europe, and Japan. It has increasingly taken the form of an exchange of products coming from within the same industries and differentiated only in quality, price, or design. In the last two or three decades, the extent of specialization in world trade has taken another large step, appearing at the level of component parts traded within individual firms. Innumerable corporations have outsourced part or even all of their production to their affiliates in other countries. Many firms have gone further: their production is now broken down among different facilities located in several countries, with the assembly of the final product taking place close to the markets of yet other countries. According to estimates by the United Nations Conference on Trade and Development (UNCTAD), perhaps roughly one-third of world trade in goods and services during 1993 consisted of intrafirm trade between multinationals and their affiliates.[1]

When we look at the economic histories of most countries, it is evident that industrialization has been of underlying importance in bringing about shifts in national trade policies. Certainly, there is no simple and mechanical relation; as I will discuss later in this chapter, prevailing ideas about economic policy have also been influential in affecting the timing of the shift in policies. But a country's move toward greater trade cooperation has commonly occurred when manufactures have begun to account for a substantial share of its total exports.

There is a simple reason for this. As exporters of primary commodities, countries have generally faced low trade barriers. Certainly, this has generally been true for exporters of agricultural or mineral raw materials and of noncompeting foodstuffs; only for competing agricultural products have trade barriers been a major and persistent issue–especially in the latter part of the twentieth century. In manufactures, however, the case has been consistently different. As a consequence, governments wanting to satisfy their own manufacturing interests but faced with protectionist barriers abroad have been pressed into negotiating with other countries to gain access to the latter's markets.

The export history of the United States provides an instructive example. Total U.S. merchandise exports in 1969 actually comprised a smaller share of gross domestic product than was the case one hundred years earlier. Still, U.S. trade policy shifted dramatically over that period, from highly protectionist to relatively open. Matching this change was a rise in the share of manufactures in total U.S. exports (see table 2). Manufactures did not bulk larger than primary commodities in the United States until the interwar years, and as I shall discuss in chapter 4, a real change in attitude toward trade policy began to take place only then. A similar rise in the share of manufactures in total exports has been taking place over the last thirty years in a growing number of developing countries. As table 3 shows, manufactures now bulk large in the exports of a number of developing countries that have been industrializing fast. It is not surprising that the attitude of these countries toward trade cooperation has likewise been changing, as I will discuss in chapter 8.

In its later stages, industrialization has been accompanied by a search for foreign markets by service industries (paralleling the same search by manufacturing industries). While long present, this search by service industries gained a new impetus in the last quarter of the twentieth century, as broad economic policies within countries underwent significant changes. When countries began to deregulate and privatize major service industries, such as financial services or telecommunications, new opportunities for private capital opened up, and pressure for governments to gain access to foreign markets mounted. World trade in services

TABLE 2. Exports of Manufactures as Percentage of Total Merchandise Exports, United States

Year	Percent of Total Merchandise Exports
1869	22
1889	23
1909	41
1929	63
1949	66
1969	80
1989	79

Source: U.S. Bureau of the Census 1976; and U.S. Bureau of Economic Analysis 1991.

consequently burgeoned, outpacing the growth of trade in manufactures. This has been of especial importance in altering the content of the most recent international trade negotiations, extending them beyond trade barriers to include domestic laws and regulations that govern the operation of enterprises in specific service industries.

Foreign investment has likewise been influential in affecting the commercial interest of countries in each other's markets. Significant in the era before the First World War, then falling away in the interwar years, it has undergone a great expansion over recent decades. Some of the motives behind the recent expansion have been the same as in postwar decades. Direct investment, especially in developing countries, has continued to

TABLE 3. Exports of Manufactures as Percentage of Total Merchandise Exports, Selected Developing Countries

	Percent of Total Merchandise Exports		
Country	1965	1985	1998
Argentina	6	18	35
Brazil	9	41	54
Egypt	20	10	38
Hong Kong	89	95	93
India	49	49	75
Indonesia	4	11	44
Korea, Republic of	61	91	86
Malaysia[a]	6	27	79
Mauritius	–	30	70
Mexico[a]	16	28	85
Morocco	5	40	32
Pakistan	36	63	84
Philippines[a]	6	51	88
Singapore	34	58	85
Thailand	4	35	74
Tunisia	19	42	78
Zimbabwe	29	25	27

Source: World Bank 1987, table 12. World Trade Organization 1999, table IV, 31.

Note: Definitions of manufactures for 1965 and 1985, on the one hand, and for 1998, on the other, differ slightly: the former include SITC 9 (commodities not classified elsewhere).

[a]Data for these countries include significant exports from processing zones.

be undertaken in order to gain market access by leapfrogging over trade barriers or in order to secure access to raw materials. Some direct investment has also taken advantage of the low wage costs in developing countries and has been linked to new opportunities for global specialization within firms in the production of specific manufactures. But the most notable thing about the recent expansion in foreign direct investment is that it has been dominated by investments within and among the industrially more established countries. The investments have been mainly undertaken not to overcome barriers that impede exports or to tap cheaper sources of supply for the home market but, more simply, to increase the sales of corporations and strengthen their competitive position in an increasingly unified market.[2]

Competing Commercial Interests

The commercial interests pushing for easier access to foreign markets have almost always had their counterpart at home in demands to restrict foreign access to the domestic market. The trade of individual countries is always a two-way process, and (unless there are large outflows of capital) an expanding export trade is inevitably matched by rising imports. In medieval and renaissance Europe, traders perhaps encountered little opposition at home to the merchandise that they brought from other countries, such as silks or spices from Asia, since these did not threaten to supplant domestic production. Likewise, all countries today import some products that are noncompeting since their production depends on natural advantages that the importing countries do not have; imports of petroleum or of tropical fruits by temperate climate countries are examples.

More generally, however, imports are in actual competition with domestic production or could potentially be replaced with domestic substitutes. So, in modern times, an endless internal conflict between those commercial interests threatened by imports and those oriented around exports has been the hallmark of trade policy.[3] This has posed an insoluble dilemma for governments; in assisting their export industries to gain easier access to the markets of other countries, they have been confronted with demands from the other countries for comparable improvements in access to their own market, running counter to the interests of those at home who are threatened by imports.[4]

The Endless Tug-of-War

In any country, the composition of the conflicting commercial groups and the relative intensity of the pressures that they seek to exert on their government change ceaselessly over the years. Objective economic circumstances, both within the country and in the international economy, endlessly modify the composition and preferences of the two groups. Over the term of several decades, the most important source of internal economic change is economic growth itself; this creates structural changes that lead to the emergence of new export activities. Comparable unending changes also take place in the international economy. Long-term economic growth in other countries brings about global shifts in comparative advantage among individual industries and activities, and these shifts have inevitably had adverse effects on the older producers. One example is the shift to developing countries in comparative advantage in textiles and apparel that has taken place over the last twenty to thirty years. Another is the emergence in the 1870s of the regions of recent European settlement in the Americas and Oceania as huge, low-cost producers of temperate climate agricultural products.

Changing macroeconomic conditions over shorter periods, both at home and abroad, also affect export- and import-competing interests, altering the balance of opposing pressures that they bring to bear on their government. One destabilizing source can be fluctuating exchange rates. The kind of instability that beset the international monetary system in the 1920s or the large currency misalignments that have recurred since the early 1970s, for instance, repeatedly affected the balance of interests between exporting and import competing industries. A more general experience is the effect of recessions at home in intensifying protectionist sentiment; in prosperous times, politicians are more likely to shrug off the economic dislocations caused by foreign competition than in periods of recession or stagnation. The business failures and the social distress suffered by workers are likely to evoke a more sympathetic response when there are many in society who feel that their economic security is under threat.

However, it would be a great mistake to conceive of trade policy as no more than a summation of the influences exerted by competing commercial claims. The struggle of conflicting commercial interests to gain recognition for their claims takes place within a larger national environment where collective ideas about political aims and economic policy also have their impact. In open societies, the debate about policy is carried on endlessly in the political arena, in the media, and in academia, while in more closed societies, it may be largely confined to official circles. In both cases, there are two separately identifiable strands to these ideas and beliefs. One is the foreign policy that trade policy may serve. The other is comprised of the ideas and beliefs about economic and trade policy that best suit the nation.[5]

TRADE, PEACE, AND SECURITY

Over the centuries, nations allying themselves with others have sought to strengthen their ties by promoting trade cooperation.[6] Innumerable bilateral treaties of commerce—often pointedly called treaties of commerce and friendship—have been signed and honored. In modern times, trade policy has served political aims in more dramatic and far-reaching ways through the formation of customs unions and free trade areas. A prime instance in recent history was the signing of the Treaty of Rome in 1957, which founded the European Common Market. While the Common Market was advanced mainly on grounds of its economic benefits, an underlying motive of its architects was to bring an end to the long and bloody history of political and military conflict among European nations. It was with a parallel motive of promoting unification that Prussia came to use the creation of a common market among the German states in the early nineteenth century. On the North American continent, the inclusion of Mexico in the North American Free Trade Agreement furthered U.S. foreign policy in cementing its southern neighbor into the free market system.

The instance most directly relevant to the present history of advances in multilateral trade cooperation is the American initiative that was taken after the Second World War to establish a new trade regime. In no small part, the drive to establish the regime, as well as to set up the Bretton Woods institutions, derived from the conviction, held firmly by Secretary of State Cordell Hull, that the economic nationalism of the interwar years had greatly exacerbated political tensions and antagonisms among states and had contributed to the outbreak of war. A framework of rules and institutions was conceived to ensure that the postwar conduct of economic relations among nations would not revert to its former, anarchical and mutually destructive state. It was a remarkable piece of economic statesmanship and the basis for subsequent progress in trade cooperation. The new economic order might not have materialized had it not been seen to serve this larger, political purpose. (American commercial interests could have been met by more modest means, such as the negotiation of a series of bilateral trade treaties.) In the years that immediately followed, the increasing preoccupation of American foreign policy with the Cold War only added strength to a trade policy that made the multilateral trade regime its cornerstone. As the United States and the Soviet Union vied with each other to draw other states into their camps, the participation of these states in the multilateral trade regime was a way of linking them to the West.[7]

The large view of trade policy as an instrument for encouraging more pacific relations among states was not a new strand of thought in foreign policy. Though Cordell Hull had arrived at his assessment of the political benefits of an open trading system through his reflection on a different, particularly turbulent historical experience, he shared his belief with some of the great British economic thinkers and publicists of the nineteenth century. David Ricardo wrote in his panegyric to free trade that it not only raises the efficiency of production but also "diffuses general benefits, and binds together by one common tie of interest and intercourse, the universal society of nations throughout the civilized world" (Ricardo 1951, 133–34). Richard Cobden was even more insistent on the political benefit of trade; like Ricardo, he stressed the common interest in their material well-being that manufacturers and workers of different nations created through the exchange of their products. John Stuart Mill, too, lent his authority to the same benign interpretation of the political benefit of trade.

Most of us today take a less sanguine view but could nonetheless agree that expanding trade relations are, if anything, likely to moderate other sources of tension among nations. In the long debate that took place in the United States during the 1990s about trade relations with China, for instance, some sensibly emphasized the political dangers of excluding China from the world trading community, pushing it into adopting more self-sufficient policies that almost surely breed a more nationalistic view of the world.

Is a Hegemon Necessary?

The major role that U.S. foreign policy played in creating the postwar multilateral trade regime was, for a time, taken by some American political and economic thinkers to indicate that trade cooperation depended on the existence of a hegemonic power.[8] The view was that in the absence of a supranational authority that imposed its will on countries, only the existence of a hegemonic power—willing to persuade, cajole, and bully other states—could bring about cooperation; otherwise, states would remain caught up in their egoistical and shortsighted calculations. Proponents of this view supported it by pointing to the positive state of trade cooperation in the decades before the First World War and after the Second World War and to its parlous state in the interwar years. The periods of cooperation mostly coincided with the Pax Britannica and the Pax Americana. In the interwar years, by contrast, Britain's power had drained away, while the United States had refused to assume the hegemonic mantle.

But the argument claimed too much. As I shall discuss in chapter 3, Britain did not play an active role in promoting the network of trade agreements that formed the elements of a new trade regime in the latter part of the nineteenth century. Likewise, the need for a hegemon, such as the United States, has not proved a precondition of trade cooperation throughout all the years since 1945. Though the U.S. role in promoting trade cooperation over the decades immediately following the Second World War was much less equivocal than had been that of Britain in the nineteenth century, its hegemonic status gradually eroded as the nations of Western Europe and Japan established themselves as other centers of economic power. It has not simply been the overwhelming power of one country that has pushed others into acceding to trade cooperation; it has been their recognition that cooperation advances their own economic and commercial interest.

Of course, the dominant country has not refrained from exercising its power. Between the hegemonic model (in which the dominant power is able to impose its wishes on others) and the cooperative model (in which equally powerful countries freely enter into agreements with each other), there is a spectrum of possible relations. Relations between the very powerful and the very weak are closer to the former model, while those between the somewhat more powerful and the somewhat less powerful lie closer to the latter.

If not acting as a hegemon, the role of the United States has nonetheless been critical for trade cooperation in the postwar years. Without a leader to generate proposals for cooperation, to initiate discussions, and to confront others with negotiable deals, the global willingness to cooperate might have languished. It is only the largest and most powerful country that can exercise such leadership; the game could not be played if the principal player opted to sit on the sidelines.

ECONOMIC IDEAS AND BELIEFS: FREE TRADE AND NOT-SO-FREE TRADE

Ideas about the economic and trade policies that governments should pursue come from many sources and vary greatly in their level of intellectual sophistication. They run the gamut from, on the one hand, emotional appeals to nationalist sentiment that lightly cloak the self-interest of particular producers or workers to, on the other, intellectually disciplined analyses of national interest that respect both logic and fact. The most carefully reasoned arguments have come from economists. Over the generations, however, economists–no less than others–have put forward different and conflicting ideas. They have been influenced by the economic circumstances of their times, by the political and social institutions of the countries within which they have lived and worked, and by their own political beliefs (not least the role they assign to the state in economic and social affairs).

Beyond economists, the circle of people who influence opinion and make decisions about trade policy is wide and diversified. Each individual brings his or her own, more general understanding of political and economic affairs to the assessment of policy. For many the prescriptions of economists–drawn as they are from theories that focus only on economic activity and that abstract from the interconnected social and political conditions of real life–may seem too narrow to serve as a solid guide to policy. This is especially true for political leaders, who, by the nature of their business, are always searching for ideas that seem best to "fit" the preferences of their supporting political coalitions.

Whatever level of intellectual sophistication underlies them, the ideas and beliefs that have played some part in influencing or substantiating trade policies can essentially be differentiated by one key yardstick: the extent to which they have either favored or distanced themselves from free trade. Those favoring undiluted free trade have set the extreme limit to the debate. Their critics, while accepting that benefits flow from trade, have argued for varying degrees of protection in particular circumstances. In practice, the trade policies of most countries have reflected a mix of ideas, a mix that has changed over time as both national and international circumstances have altered.

The Free Trade Doctrine

The argument in favor of free competition in international trade is based on the simple and commonsensical notion that it is always best to buy in the cheapest market and to sell in the dearest. The idea that a country's national interest is best served if it specializes in whatever it produces more efficiently and if it imports what it produces less efficiently has long appealed to many of the smaller countries of the world whose size precludes highly diversified production. It should be no surprise that the smaller countries of Western Europe, for example, have been among the most enthusiastic advocates of an open, multilateral trading system.[9] The openness of the trade policies of Hong Kong and Singapore are also indicative of the influence of size in favoring the idea of specialization. But the outstanding historical example of a country embracing specialization as the foundation of its trade policy is Britain from the mid–nineteenth century to the outbreak of the First World War. As I will discuss in chapter 3, Britain was then exceptional in its unequivocal adoption of a free trade policy.

Among economists, the line of thought supporting free trade has had a long and distinguished history.[10] Adam Smith took up the simple notion of buying in the cheapest market and selling in the dearest and applied it to trade among nations. He saw the advantage of free trade, not only in the exchange of currently produced goods, but also in the increasing specialization that would follow from the expansion of markets. David Ricardo took the logic further and demonstrated that even if a country could produce all its manufactures or agricultural commodities more efficiently than its neighbor, it would still find it advantageous to trade (because of differences between the two countries in the relative efficiency with which each produces specific products). Among mainstream economists in the Anglo-Saxon, neoclassical tradition, the logic of free trade has been forcefully advocated right up to the present day, even though recent strategic trade theory has raised some significant qualifications.[11]

The prescription on trade policy from classical and neoclassical economists is inextricably linked with their belief in freely competitive markets. The central message of neoclassical theory is that freely competitive markets (which presume a set of social institutions that respect private property and freedom of contract) result in the most efficient allocation of productive resources among different possible uses and therefore bring about the optimum output of goods and services. (The theory deals with the allocation of existing productive resources and has less conclusive things to say about the process of increasing the volume and productivity of these resources to generate economic growth.)

The neoclassical view of free trade is presently in the ascendancy in economic circles within the United States, as it was in Britain during the country's heyday in the nineteenth century as the leading world industrial power. Its influence on policy toward the end of the twentieth century was nowhere more evident than in what John Williamson dubbed the "Washington consensus," the set of views that U.S. administrations and international financial agencies held on the economic policies that developing countries should pursue. Together, these administrations and agencies urged trade liberalization as part of a package of measures–including conservative fiscal and monetary polices, the deregulation of financial markets, and the privatization of public enterprises–designed to establish free competitive markets. (They did so with little regard for the wide differences among countries in the inherited social institutions or in the stages of development, or for the limited relevance of the theoretical base for the problems of economic growth.)

Popular Criticism of Free Trade

Numerous economic commentators from various times in history have flatly rejected the cosmopolitan, free market view of the world economy and have advocated more restrictive trade policies instead. In their approach to international trade, they have begun from a more frankly nationalistic position. Some have put forward powerful economic reasons for their position. Others have made less rigorous cases but have nonetheless struck a popular chord with electorates.[12] Among the latter are many recent commentators, both in the United States and the European Union, who have leaned toward the realist view of the world as composed of nation-states endlessly vying with each other for political or economic advantage. Seeing trade in that context, they have portrayed it as a competitive struggle among nations. For them, it is not a mutually advantageous exchange of goods and services but a zero-sum game in which there are winners and losers. Trade deficits with other nations are read as evidence that the game is being lost. Closely related–in rhetoric if not in logic–is the fear that increasing imports of manufactures from low-wage developing countries are depressing wages in the developed countries and generating unemployment.

Neither of these views are new; both have recurred, with slight changes, again and again in modern history. The first view has its roots in the mercantilism of the seventeenth and eighteenth centuries, when the wealth of nations was seen as a fixed quantity to be struggled over and (until Adam Smith challenged this major premise) not as something that could be increased through economic change and innovation. The second view also has a long history. Judith Goldstein has observed that in the United States during the decades between the Civil War and the First World War, the persistent theme of congressmen in election campaigns was the need for protection of the manufacturing industry, to safeguard the high-wage economy from being undermined by imports produced by "pauper labor" in Europe (Goldstein 1993).

Such arguments have always been popular with those working in import-competing industries, but they have gained broader support because of their apparent common sense. The arguments do not counter the free trade logic demonstrating that trade is mutually advantageous; they simply ignore it.[13] Though flawed in logic, they reflect, at root, a legitimate reaction to the social costs of the economic adjustments that are inescapable in a world of dynamic technological and economic change.

The Keynesian Critique

Undoubtedly, there have been periods in economic history—and there may well be again—when the international economy has justifiably seemed to be an anarchical and dangerously unstable place. It has sometimes been difficult, even for the most inveterate optimists, to take a benign and cosmopolitan view of the world economy. Such were the conditions that followed the onset of the Great Depression, and the response was widespread advocacy of more nationalistic trade policies.[14] In defending import controls and, more especially, restrictions on international capital flows, John Maynard Keynes was among the most cogent advocates of this view. Its advocates argued that under the circumstances of massive unemployment of both labor and productive capacity, the impoverishment of a nation could only be relieved by taking measures to increase the domestic utilization of these productive resources; if these measures conflicted with open trade policies intended to exploit comparative advantage, they should nonetheless override the latter, since they would yield greater present benefit. The ghost of this argument often haunts countries when they are hit by recession.[15] Action on this basis, however, is usually held back by the knowledge that if other countries retaliate, exports could decline too, thus offsetting any gains in employment in newly protected industries.

Protection and Economic Growth

The argument in favor of protectionist policies that has historically carried most weight, at least among economists, has been related not to the business cycle but to economic growth and development. The most powerful reason economic commentators have found for rejecting the free trade doctrine has been the disparity that they have seen to exist between their own nation's level of development and that attained by other, industrially more advanced countries.

Alexander Hamilton, for instance, was an early exponent of this view. He saw no reason why the citizens of the newly founded United States should not be as adept at producing industrial goods as their erstwhile enemies and distant cousins in England; his country possessed the markets, the natural resources, and a skilled and enterprising people.[16] As the first secretary of the treasury, he was able to translate his own ideas into action (which, incidentally, he did on his own initiative, not merely in response to pressures from commercial interests). He stood ready to make extensive use of his power and influence to support new enterprises through import duties, bounties, and bank credit. He was in fact instrumental in forming a corporation that selected a "green field" industrial site in New Jersey (named Paterson after the then governor) and that built factories to house textile machinery.[17]

Some decades later, in the 1840s, Frederick List, impressed by the industrial predominance of Britain and eager that Germany should attain comparable strength, put forward a similar case for protectionist policies in more articulated and extensively reasoned form (List 1885). His argument came to be known as the "infant industry argument." Protection of new industries from foreign competition was justifiable on the grounds that these industries required time to learn the new industrial skills that were necessary to become competitive with the more established foreign enterprises.

Whether directly influenced by the infant industry argument or not, almost all countries with relatively developed economies have, at some time, resorted to significant protection to promote domestic industrialization. In the nineteenth century, the nascent industries of Western Europe and of North America grew up behind protectionist barriers, and Japan had begun to follow suit by the turn of the century. In the first half of the twentieth century, the same pattern was followed in the countries of Eastern and Central Europe, and after the Second World War, they were joined by the numerous industrializing countries of Asia, Africa, and Latin America.

It is not plausible to say that these shifts in trade policy can be explained solely by the responses of governments to the demands of new manufacturing industries. For some countries, such as Japan or Russia, the need to build defense industries was an important incentive. But more generally, countries have been motivated by a strong sense of economic nationalism. Not only entrepreneurs but national elites have wanted to see industrialization take root and prosper within their own territories. They have embraced measures that would encourage their own citizens to find ways of making their own national resources more productive both by utilizing and adapting imported technologies and by improving their own skills, organization, and methods of production. But in a world already populated by more technologically advanced nations, their nascent industries faced competition from foreign industries that were already well along the learning curve and that enjoyed external economies not available to newcomers. Most countries have believed that without protection, they would have deprived themselves of the opportunity to initiate the indigenous process of learning new skills and of creating more efficient ways of production, a process that lies at the heart of economic modernization. Indeed, it is a fair speculation that in the absence of such nationalistically driven industrialization, the geographical spread of industrial modernization would be much less than it is today.

Protection and Trade Cooperation

The pursuit of protectionist policies has by no means been inconsistent with advances in multilateral trade cooperation. In an analysis of the conditions favoring trade cooperation, the proper contrast to be drawn is not between countries pursuing open trade policies and those pursuing protectionist policies but between countries pursuing export-oriented policies and those following more inward-oriented policies.[18] Throughout modern economic history, the use of protectionist measures has proven to be quite consistent with the search for foreign markets and the vigorous growth of exports.

In recent decades, the most successful industrializing countries in Southeast Asia–South Korea and Taiwan–amply illustrate the combination of export promoting and protectionist policies. The ideas about trade policy that have been influential in these countries (and, in earlier decades, in Japan) have recognized both the value of specialization in the international economy and the need for protection of infant industries. These countries have understood that by linking the development of some industries to foreign as well as domestic markets, they could tap into the benefits of specialization (economies of scale, externalities, technological innovation) in the process of their own industrialization. What differentiated them from the world of neoclassical free trade theory is that their governments did not leave the identification and emergence of these new industries to the free market but participated actively in their selection and fostered their growth through the use of specific policy measures. A condition of such active participation has been a pattern of close government-business relations entirely different from that assumed in the Anglo-Saxon, neoclassical model of free competition. They have broken ranks with the free trade protagonists who stress that the free play of market forces, operating within the environment of an open trade policy, will bring about the most efficient use of productive resources.[19]

The earlier postwar trade policies of many developing countries–particularly in Latin America, but also in India and elsewhere–conformed more to the inward-looking model, and these countries were generally less active in searching for access to foreign markets. That was not simply–or even mainly–because levels of protection were high. It was because they pursued a combination of policies (e.g., on trade or the exchange rate) that undermined the incentive to export. Protectionist measures, however, can justifiably be blamed as a contributory factor, since high levels of protection channeled labor and capital into high-cost industries that could not become internationally competitive. Domestic producers earned comfortable returns and acquired a vested interest in the retention of protection. Worse from a long-term point of view was the fact that if they enjoyed a monopolistic or oligopolistic position in the domestic market, these industries were relieved of the need to make the innovations that continually improved their competitive efficiency. The learning and adaptation that had taken place at first behind protectionist barriers could largely give way, in the absence of any competitive spur, to a tolerance of high levels of inefficiency. But all this was not to be laid at the doorstep of protection per se; it was the fault of excessive and indiscriminate protection.

INSTITUTIONAL CONDITIONS

Both commercial interests and ideas about trade policy can only gain expression through a country's established political institutions. Current policy decisions are made within institutional conditions that are inherited from the past, and these conditions embody the interests and ideas dominant in former years. It need hardly be said that these conditions can greatly affect both the timing and the content of shifts in national trade policies.

In open societies, the different commercial and labor interests press for policy changes through the political parties, industry associations, trade unions, other nongovernmental organizations, and personal ties. The outcome is shaped by how the changes are perceived as affecting other political and social groups, by the distribution of political power among the groups, and by the prevailing ideas and beliefs about the national interest. It can sometimes be a long time, however, before the actual distribution of political power catches up with shifts in the balance of commercial interests.

A clear example is the decades-long struggle by manufacturing interests in Britain during the nineteenth century to abolish the Corn Laws. These laws protected domestic agriculture and raised the price of staple foods for the working masses, and the manufacturers believed that this raised wages and undermined their competitive advantage. But despite the manufacturers' status as a powerful commercial interest and despite the intellectual support coming from the widely acclaimed free trade doctrine, Parliament resisted repeal for decades. Repeal directly threatened the economic interests of the landed aristocracy and gentry, who comprised the class that dominated Parliament. A realistic assessment of this situation caused the leader of the Anti–Corn Law League, Richard Cobden, to insist that political reform of the electoral system was the precondition for the abolition of the Corn Laws. Of course, such reform was also a long uphill struggle. (In one of the twists of history, Cobden was, in the end, proved wrong. Repeal of the Corn Laws came before electoral reform, in part because of the unrest caused by the bad harvests of the "hungry forties.")[20]

A still more idiosyncratic instance of how institutional conditions affect the timing and content of shifts in trade policy comes from the United States, and it has had large consequences for the progress of trade cooperation in the world as a whole since the end of the Second World War. At the time when the U.S. Constitution was drawn up, tariffs were a major source of public revenue. The Constitution assigned revenue-raising powers to Congress as the legislative body. This meant that trade policy came within the purview of Congress rather than that of the president, the head of the executive branch of government. The business of tariff setting was thus drawn into local politics. It became a back-scratching exercise in which congressional representatives helped each other to pass legislation that raised tariffs to please particular commercial or labor interests within their constituencies. With such an institutional arrangement, negotiations with other countries for mutual reductions in tariff barriers were impractical.

Only after the Great Depression, when the reaction against the notorious Smoot-Hawley Tariff Act put tariff raising beyond the political pale, did Congress agree to delegate some of its powers to the president. The delegation of power was highly conditional, however; and since the 1930s, there has been a long, slow, uncertain expansion in the negotiating powers that Congress has granted the president. Because of the leading role that the United States has played in postwar trade cooperation, this gradual institutional change has (as I shall demonstrate in this book) significantly affected the pace of advances in multilateral trade cooperation.[21]

In the present day, the multilateral trade regime itself, as represented by the World Trade Organization (WTO), is woven into the institutional conditions that confront the individual member countries. The rules of the WTO are embodied in the national laws and practices of the individual member countries, and their existence limits member countries' maneuvering room in making choices about their trade policies. Members have considered themselves bound by the rules and, if dissatisfied, could only seek redress by persuading others to make changes. Thus, each successive step in elaborating the norms and rules of the trade regime has added a new layer to the constraints within which subsequent decisions are made. Through this progressive modification of the existing institutional conditions, advances in trade cooperation have taken place.