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**Political Economy of Protectionism
and the World Trade Organization:**

*A “Public Choice” Approach to Trade Policies
of the EU and the US*

DOKTORA TEZİ
(Ph.D Thesis)

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Writing a Ph.D thesis has two difficulties. First, you have to have a good sense of concentration over a topic for which you are expected to produce new ideas and approaches. The initial uncertainty in selecting the field of interest and the thesis proposal is followed by other obstacles. It is a long process that requires the discipline of spending innumerable hours for reading books and various documents when not engaged in other forms of scientific activity. The wish to make a contribution to the selected field sometimes drives you to become more interested in being 'perfectionist' and spend most of your time searching for details though many times unrelated to what you write, than employing yourself for more useful activities.

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List of Abbreviations

AD:	Anti-dumping
ADD:	Anti-dumping Duty
BEUC:	European Bureau of Consumers' Associations
BOP:	Balance of Payments
CAD:	Current Account Deficit
CAP:	Common Agricultural Policy
CCMAC:	Committee of Common Market Automobile Constructors
CCP:	Common Commercial Policy
CCT:	Common Customs Tariff
CEFIC:	European Chemical Industry Council
COPA:	Committee of Agricultural Organisations in the EC
COREPER:	Committee of Permanent Representatives
CVD:	Countervailing Duty
DG:	Directorate-General (in the European Commission)
DUP:	Directly Unproductive Profit-Seeking
EC:	European Community
EP:	European Parliament
ECJ:	European Court of Justice
EEA:	European Economic Area
EEB:	European Environmental Bureau
EFTA:	European Free Trade Association
ESC:	Economic and Social Committee
ETB:	European Textile Bureau
ETUC:	European Trade Union Confederation
EU:	European Union
Eurofer:	European Confederation of Iron and Steel Industries
GATT:	General Agreement on Tariffs and Trade
GATS:	General Agreement on Trade in Services
GDP:	Gross Domestic Product
GNP:	Gross National Product
IPE:	International Political Economy
ITA:	International Trade Administration
ITC:	International Trade Commission
MFA:	Multi-Fiber Arrangement
MFN:	Most-Favoured Nation
MITI:	Ministry of International Trade and Industry
MTN:	Multilateral Trade Negotiations

NAFTA:	North American Free Trade Agreement
NCPI:	New Commercial Policy Instrument (in the EC)
NIC:	Newly Industrialising Countries
NTBs :	Non-Tariff Barriers
NTE:	National Trade Estimates
OECD:	Organization for Economic Co-operation and Development
OJ:	Official Journal (of the EC)
OMAs:	Orderly Marketing Arrangements
RTAs:	Regional Trading Arrangements
RTAA:	Reciprocal Trade Agreements Act
SCM:	Subsidies and Countervailing Measures
SII:	Structural Impediments Initiative
TAA:	Trade Adjustment Assistance
TBR:	Trade Barriers Regulation (of the EC)
TPRB:	Trade Policy Review Body
TPRM:	Trade Policy Review Mechanism
TRIMs:	Trade-Related Investment Measures
TRIPs:	Trade-Related Aspects of Intellectual Property Rights
UNCTAD:	United Nations Conference on Trade and Development
UNICE:	Union of Industrial and Employers' Confederations of Europe
UK:	United Kingdom
US:	United States
USTR:	United States Trade Representative
VCRs:	Video-Cassette Recorders
VERs:	Voluntary Export Restraints
VIEs:	Voluntary Import Expansions
VRAs:	Voluntary Restraint Arrangements
WTO:	World Trade Organisation

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*“Because our lords have taxed the staff of life,
The working man, his children, and his wife
All slave together, yet they must not eat-
Toil gives an appetite, but brings no meat!
The price of bread by law is kept high,
That what we earn suffices not to buy.
But, why is this? What makes our bread so dear?
Far cheaper this abroad than it is here!
Yes, but a tax is laid on foreign grain,
To make our home-grown corn its price maintain...”*

J. Watkins, *The Northern Star*, 1 January 1842.¹

¹ in, B. Turner (1971), *Free Trade and Protection*, Longman, p. 113.

INTRODUCTION

The role of the economist in discussion of public policy seems to me to prescribe what should be done, politics aside, and not to predict what is politically feasible and then to recommend it.
Milton Friedman (Essays in Positive Economics, 1953)

Neo-classical theory of international trade upholds that *free trade* maximises national income and welfare of the society and benefits individuals by enlarging their consumption possibility. Almost all international economics textbooks verify that it helps to minimise the misallocation of resources in production. Despite theoretical challenges and political denouncement, the economic case for free trade is always well-founded. Moreover, beyond its economic dimension free trade has a moral case. Freedom to trade internationally is not intrinsically different from the freedom to exchange in the domestic market of a single country. Thus, the government, if believes in the freedom, shall follow policy that recognises its citizens' right to engage in voluntary exchanges.

Nevertheless, peoples right to trade freely has often been denied even in societies like the EU and the US with high economic, political and social development levels. In reality, the warnings of trade theory did not preclude policy-makers from intervening in trade. Protection increased tremendously covering a large spectrum of sectors in which restrictive trade policy measures like anti-dumping duties (ADDs); import licensing requirements; various quantitative import restrictions and politically negotiated voluntary export restraints (VERs) became a common practice. Protection was perceived as essential for the survival of especially older sectors (declining industries) in Europe and the US - particularly heavy industries and labour intensive manufactures such as automobiles, electronics, chemicals, pharmaceuticals, steel, shipbuilding, textiles and clothing, footwear and agro-industries¹. Bhagwati (1989, p.43) in his seminal study *Protectionism*, described

¹ Laird and Yeats (1990) put forward that the total share of imports covered by at least one type of restrictive non-tariff barriers rose from 15 to 58 percent in the EC and from 27 to 57 in the United States between 1966 and 1986. See also, Nogues, Olechowski and Winters (1986); Low and Yeats (1994) and Irwin (1994).

that “the negotiated tariff reductions were accompanied, and their incremental effect in loosening the restraints on the world trading system was seriously compromised, by the growth of non-tariff barriers”. The gap between the rhetoric and reality caused a significant burden of the cost of protection which many empirical studies revealed. The deviations from free trade has two major explanations. The first is relevant to conceptual fallacies that many protectionists fail to grasp. These fallacies generally stem from the misunderstanding of the assumptions of the neo-classical trade theory². They cause more governmental intervention in the economy with no pareto-optimal results. The second is more structural and can be associated with “rent-seeking” activities within the society. The tendency towards economically less efficient policies such as trade protection or more restrictive forms of trade protection (i.e. quota rather than a tariff to protect the domestic industry) may be the outcome of not the decisions of policy-makers acting for the common interest of the nation but of their blessings that they confer on a certain segment of the society. Thus, the reason for an inefficient policy in a developed country is political and a result of special privileges claimed and demanded by special interest groups. Such a policy (other than free trade) is a political intervention which distorts the functioning of the economy (Tollison, 1982), produce social waste (Buchanan, 1980) and is a serious threat to individual freedoms (Brittan, 1988 and McGee, 1996). Furthermore, the institutionalisation of protection will encourage these groups to undertake activities that are “unproductive” as they use the real resources but bring no produce of goods (Bhagwati, 1982). The protection-seeking interest groups engage in lobbying activities that cost them less than the expected gains from protection but which however cost more to the national economy than the total gains. As Weidenbaum (1983) proposed once “the

² There are always critical statements which claim that the theory was based on some ideals that cannot be realised in practice (Barry Jones, 1983); it is too much concerned with the consumers’ welfare than the interests of producers (Calleo and Rowland, 1973); it assumes static, given endowments of factors of production (Cohen and Zysman, 1987); it ignores the fact that comparative advantages can be created; free trade is only valid for perfectly competitive markets (Krugman, 1987); markets may fail to reach optimal conditions and may require governmental intervention etc. All these arguments seek to explain that trade protection can be an effective policy if the assumptions and principles of the liberal neo-classical trade theory are loosened. Nevertheless, all these do not diminish the case for free trade. Bhagwati (1991, p.112) refutes these challenges to free trade as “writings of ill-informed amateurs and none-too-careful scholars”. There is a large literature which claim that the theory asserting free trade is still relevant and which bring satisfactory replies to these fallacious statements. See, for example, Johnson (1965); Willett (1971); Deardorff and Stern (1987); Bhagwati (1989) and Dillon, Lehman and Willett (1990).

basic reason for the popularity of protectionism is that it is a means by which small and well organised groups use *political process* to their advantage”.

The latter explanation for the existence of practical deviation from free trade also explains the reasons as to why certain policy (protection vs. free trade) is adopted and provides an access for the understanding of the (trade) policy decision making process which constitute the major scope of this study. Indeed, there have been extensive analysis concerning the reasons of protectionism. Several attempts aimed to bring a structural explanation³ of the new protectionism in trade policies of the United States and the EC. However, these explanations do not provide a completely organised view. In our study, what we do is to categorise the explanations for trade policy formation and policy choice in a different setting based on alternative methodical analyses. These analyses can be grouped in three main theoretical avenues.

The first group consists of studies that place the trade policy process at a *systemic* level. Approaches that employ this analysis normally regard the position of sovereign states as the unitary. It treats countries as individuals which possess a personality. Hence, the international system (i.e. world trading system) is in anarchy and the existence and the level of protection is a consequence of the “power” relations among countries. Nevertheless, method of analysis has too many shortcomings. It gives very little or no

³ These explanations have different perspectives each focusing on various factors. One possible explanation is made by studies which indicate different “market structures” as the main cause of protectionist practices. Hughes and Krueger (1984) claimed that the more the industry’s structure is imperfect, the more possibility exist for import restrictions. This view is correct for certain sectors but fell short of explaining the existence of trade protection in more competitive sectors like textiles, agriculture and footwear etc. Second type of explanation comprises studies emphasising the changing economic conditions in the world economy and the “shift in comparative advantage” towards developing countries (see, Salvatore, 1993). This approach, albeit the facts and realities that affect the situation of import-threatened domestic industries, seems not completely satisfactory when we consider that protection can also prevail during periods when the world economy is in more stable conditions (Grilli and Sassoon, 1990). Third way of explanation includes studies that rests on “hegemonic decline” arguments. Accordingly, many authors (Bhagwati, 1990) claimed that the US economic decline relative to the rest of the world has caused further requests for protection. However, this approach is open to critics, too. As Goldstein argues hegemonic stability theory does not provide a developed form of analysis. It can only be complementary factor that shape the interests of those involved in trade policy process. It is also irrelevant to explain the case of protection in European countries and the EC. There are other less structural explanations. However, none offers a comprehensive approach that consider the interactions among policy actors.

attention at all for the roles of special interests of endogenous policy shaping actors. It rather focuses on the “national interests” in aggregate terms but forgets the influence of “special interests”. States are not real persons and the interest of a nation cannot be different than the totality of interests of its citizens. A Wicksellian approach may well articulate it “if utility is zero for each individual member of the community, the total utility for the community cannot be other than zero”⁴. Disregarding the utility of individuals do not provide an ample description to the questions as to *why protection is larger in some industries compared to others in one country at a time period; or that the level of import restrictions change in time within the same industry of the same country; or why particular industries are protected by certain means of protection like anti-dumping duties or voluntary export restraints*. Thus it does not explain why steel industry has managed to obtain more protection in early 1980s in the US than footwear industry; or that the share of imports in textiles covered by non-tariff barriers increased in two decades (from 1960s to 1980s); or that chemical industry in the EU is protected by anti-dumping duties but not simply by tariffs. Therefore, other methodical approaches are needed to explain the *domestic-level* factors that motivate trade policy decision making process in a country.

Second method is a group of analysis based on a different viewpoint in which the role of state institutions take a greater attention. Like the systemic-level, the analysis emphasise the determinant and influential position of the state (i.e. the government, state bureaucracy) in its own domestic setting rather than in the world system. Therefore this approach can be entitled as *state-centred* or *institutionalist*. As Frieden and Lake (1995, p.9) describe researches under this group “tend to downplay the impact of constraints emanating both from the international system and from domestic societies”. Goldstein, one of the ardent supporters of this view (1993, p.6) criticised that other methods of analysis paid little attention to the institutional attributes of the system. Nonetheless, state-centred approach methodically contains a flaw as it considers the functions of institutional system and the policy-makers beyond the societal pressures. It is plausible to claim that none of

⁴ For more detailed analysis of Wicksell’s approach see Buchanan (1987 b, pp.244-245).

the governments or bureaucrats are totally immune from the influence of domestic interests. As Buchanan asserted (1987 a) individuals' characters do not change when they shift roles as buyers and sellers in the market place to roles as politicians and bureaucrats in the political process. Thus, a better analysis is vital to appreciate why some interests in the society receive greater attention of policy suppliers. The last point can be put as follows: Why do some groups or individuals obtain tariffs, quotas or other measures to protect their domestic production while others cannot ?

A third method of analysis starts at this point by relaxing the assumption of the "systemic" inquiry that state is the unitary level of analysis and the "state-centred" researches that state is immune from societal demands asking for privileges. This is a *society-centred (interest group)* analyses and mostly regarded as the *Public Choice*⁵ approach. It seeks to investigate political process and political economy of policy choice, by using the tools of neo-classical analysis. Its main assumption is to regard all actors -governments, politicians, bureaucrats, interest groups and voters- within the domestic policy setting as "rational utility maximisers". Therefore, studies applying public choice methods assume the individual as the basic unit of analysis (methodological individualism) who seeks to maximise his/her interests (homo economicus). Public choice explains the changes in policies not attributable to the shifts in individual preferences but changes in the *constraints* to which s/he is exposed (Frey, 1984). Thus, for example, a recent increase in the protection of a specific domestic industry, which has previously been protected by means of tariffs, through an anti-dumping duty, if considered under public choice approach, may be the result of the *institutional or other social constraints and alternative set of rules*⁶ rather than the fact that the industry no longer prefers other trade policy

⁵ Buchanan (1987 a, p.82) defines that the Public choice as an inquiry concentrating its attention on analyses of alternative political choice structures and on behaviour within those structures and it moves beyond the relatively narrow constraints of orthodox neo-classical economics. Public choice has been developed in the writings of Downs, Arrow, Olson, Buchanan, Tullock, Niskanen, Frey, Tollison et.al. and forms the basis of "Constitutional Economics".

⁶ Peacock (1992) observes that this view derives from the analyses made earlier by Adam Smith in his *Wealth of Nations*. According to Peacock (p.68) "Smith's contribution to this analysis is to determine that whereas people may behave differently depending on 'the situation in which they are placed' they do so not because their personality changes but because the constraints under which they act to maximise their utility differ from one situation to another.

instruments. Public choice analysis “developed as a response to explorations which argued that “market” mechanism fails to achieve a Pareto-optimum allocation of resources” (Baldwin, 1988). As Buchanan (1974) described the objective of public choice school;

“Theoretical welfare economists continue to develop sophisticated demonstration of market failures; public choice theorists, who have been charged with dabbling in “welfare politics” match the welfare economists with their own demonstration of governmental failures” (p.174).

Accordingly, it tends to prove that political decisions are also doomed to fail simply because the policy makers (state officialdom) pursue their interest maximisation in many times in almost all policy decisions. Therefore it is the “politics” that fails to achieve the optimality rather than the “markets”⁷.

Public choice rests on the economic self-interest approach in which individuals and group decision making process is examined under the “receptive government”. The policy suppliers are assumed to reflect the interests of policy demanders like a mirror. The more efficient the groups in the society in influencing the process the more likely that they receive a special treatment from the government. The more well-organised the interest group and the less likely the dissent among members, the more likely that they turn policy outcome in their own favour. Following Olson’s theory smaller groups lobbying for protection may become more effective within the “political market for protection”. This explains why more restrictive and socially costly policies are sometimes adopted. Nonetheless, public choice approach with “receptive government” does not provide satisfactory answer in all cases. It is not, for instance, easy to explain why certain weak lobbying industries are able to maintain or reach trade protection or that there are tariff reductions in industries traditionally under heavy protection. Therefore, it is conceivable to

⁷ In this respect, public choice is largely relevant to the presumptions of classical liberal thinkers. It defines the character of an individual in the same way and therefore derives its normative arguments from the supposition that state is composed of individuals whose ideas and acts are open to discussion and therefore governmental replacement of the market and excessive public intervention should not be allowed. In this streamline, Hayek, in *Road to Serfdom*, claimed that governmental planning is detrimental to people’s freedom and liberty. Hume, in his *A Treatise of Human Nature*, said that “nothing is more certain than that men are, in a greater measure, governed by interest” (Of The Origins Of Government, p.81).

acknowledge the complementary influence of factors to remove the complexities in the political economy of trade policy. These factors may include social values, beliefs and ideas and institutional constraints within which societal actors interact. The latter approach is a relaxation of the receptive government concept and a *revision* to public choice.

This study is based on the assumptions of the *public choice* (interest group) approach but defends to broaden it by a “revision”. It proposes that the choice of trade policy in major industrialised economies depends on three main elements:

1- *Domestic political pressure of interests*. Thus public choice is a sound method to comprehend the reasons of protectionist US and European trade policies during the period of “new protectionism”. It recognises that domestic pressures for protection and hard-core non-tariff barriers proliferate if coupled with “information” and “participation” asymmetries. The former is available if free trade supporters are largely unaware of the consequences and costs of trade protection (Destler and Odell, 1987) or have collective action problems. This problem is also relevant to the case of free trade lobbies, i.e. exporters, upstream industries using import materials. (Olson, 1965). Misinformation or non-transparency in the process as well as common fallacies about free trade will help policy suppliers to serve special interests rather than large community that benefit from free trade in practice. The latter asymmetry is essentially both political and legal in nature. Voters whose interests rest on free trade may not consider to participate in the policy process as s/he does not deem it economically worthwhile. It is so when participation is expensive and requires the investment of time and resources (i.e. high costs of lobbying) or that they are legally denied the right to be heard because they are not directly involved in the administrative process. In anti-dumping or safeguard investigations consumer groups are not invited to express their opinion whereas import competing industries are. In addition to asymmetries factors like wide bureaucratic discretion and protectionist-designed trade laws also help domestic pressures for protection. For example, if the profitability of domestic firms or trade unions in industries facing import competition becomes more heavily dependent on official decisions, resources begin to be diverted from production to lobbying or “rent-seeking” (Tollison, 1982 and Bhagwati, 1982).

2- *Social motives, ideas and domestic institutional constraints are effective on demand for and supply of protection ('revised' public choice approach).* Most studies⁸ in the realm of public choice do not directly consider these factors. Social values like altruism (Arrow, 1975), “tariff as a social insurance” (Hillman, 1989 a; b), or Corden’s (1974) conservative social welfare function arguments can play strong roles in the shaping of individual values and interests. Ideas that there must be *fairness* and *reciprocity* in trade (that foreigners have unfair domestic laws and practices that help them produce relatively cheaper or close their markets to our exports or does not buy from us in equal amounts) may become a widespread national belief that even consumers who should normally-at least in terms of the assumptions of neo-classical economy- demand protection turn to favour protectionism in the name of vague national interests.

3- *Public choice can be extended to include the role of 'external' pressures and constraints on the domestic policy-making process.* The study also consider the influential case of political coalitions of external interest groups with their domestic allies and international constraints like the obligations of international agreements and institutions like GATT/WTO. The former point is observed in the share of quota rents between foreign exporters and domestic producers when they collectively limit the availability of supplies in the market under voluntary export restraints which proliferated in sectors with powerful rent-seeking lobbies. The latter is relevant to the internalisation of the effects of international constraints and brings an “institutionally enriched analysis” (Moser, 1990) in the domestic policy formulation process.

The study consists of five chapters. The first part lays down the theoretical foundations of free trade and the economic costs of trade protection. It also analyses the welfare implications of lobbying for and against protection as well as the distortions caused in the economy when rent-seeking activities attempt to capture the government. It also evaluates the ‘ethical’ dimension of free trade which many orthodox theories of international trade

⁸ Baldwin (1985), Marks and McArthur (1990), Weck-Hannemann (1992) and Bhagwati (1988) are exceptions.

policy fail to consider. It considers that public choice can be utilized in the investigation of rent-seeking motivations in foreign trade policy. The second part provides an introductory step to categorise alternative methodological explanations to trade policy formation. The pros and cons of rival methods are examined with an emphasis of the advantages of public choice approach. Third and fourth parts examine the trade policy making process in the European Union and the United States respectively each employing the assumptions of the 'revised public choice'. Last part consider *constitutional* aspects of the case of GATT and potential role of the WTO as constraints on the domestic process. It puts forward that the previous GATT system, contrary to common belief, did not provide a satisfactory institutional device to prevent protection. If public choice theory brings a programme of study that directs its inquiry to the operation of rules and institutions within which individuals interact and leads its attention to the *choice among constraints* rather than under existing ones (Buchanan, 1990), GATT could be designed to form a constitutional constraint over protection and to provide an institutional safeguard for free trade interests and to bring a more humanitarian approach to protect *rights of individuals* but not special lobbying groups that seek rents through governmental interventions in the free exchange of goods.

CHAPTER 1- THE THEORETICAL AND ETHICAL ASPECTS OF FREE TRADE

The case for Free Trade versus Protection ...is a battle not only between truth and error, but between light and darkness; that, in the realm of trade, it is a constant struggle of honest industry and intelligent enterprise against corruption and intrigue...It is that on the ethical plane there are no two sides of this question.

Russell Rea, Insular Free Trade, 1908

A necessary step in the process of genuine constitutional revolution is a consensual redefinition of individual rights and claims. Many of the interventions of government have emerged precisely because of ambiguities in the definition of individual rights.

James M. Buchanan, The Limits of Liberty, 1974

1.1 Free Trade vs. Protection: An Everlasting Dilemma for Governments

Since the inception of modern economics, the debate between the policies of free trade and protection exists. Almost all economists, at least those being in the classical economy camp, have been united around the generally accepted idea that, the application of a free trade policy is more advantageous for the national economy compared to a protectionist one⁹. According to this idea free trade is Pareto-efficient and is a means to maximise the

⁹ Although it is possible to find economists who disagree, this assumption is the backbone of orthodox international economics. There have always been opponent views trying to emphasise the merits of a protectionist trade policy. This line of thinking goes as back as to the arguments of A. Hamilton in US and Fredrich List in Europe who insisted on nationally protected domestic industries. It can even be said that, the idea that 'the protection should be the case in certain times' has been a regular argument than an exception. For more recent examples, R. Batra (1993), for instance claimed that "The real cause of America's unprecedented economic debacle is the policy of free trade". Prestowitz, Tonelson and Jerome (1991) go further to argue that "(free) trade policy is no substitute for the nurturing of national economic strength". Non-economists have also alleged that free trade is harmful. Among these, there are politicians, thinkers, journalists etc. M. Gandhi said that "Free trade for India has proved her curse and held her in bandage". Goldsmith (1994) expresses that "if it (global free trade) is implemented, it will impoverish and destabilize the industrialized world while at the same time cruelly ravaging the third world". Culbertson (1986) argued that "beneficial trade exists only as a theoretical construct, with little relationship to the real world".

national welfare. A liberal trade policy; that is free from all public interventions via various governmental instruments, in the free operation of the import and export markets, is assumed to bring about several gains for the economy in general.

The assumption that free trade benefits the individuals and society and the national economy in general, also faced counter-attacks from different circles (*see, supra footnote 1*). The most important reaction came from within. Like many neo-classical economists Keynes started to emphasise the gains to be accrued from an unrestricted trade policy. He originally regarded free trade “not only as an economic doctrine which a rational person could not doubt, but also as part of a moral law”¹⁰. However, he later went on to claim otherwise:

“It does not now seem obvious that a great concentration of national effort on the capture of foreign trade, that the penetration of a country’s economic structure by the resources and the influence of foreign capitalists, that a close dependence of our own economic life on the fluctuating economic policies of foreign countries are safeguards and assurances of international peace. It is easier in the light of experiences and foresight, to argue the contrary” (quoted in Lang and Hines, 1993, p.28).

1.1.1 Free Trade Benefits the Society

Coming back to the benefits of a free trade policy, it increases wealth. However, this is not the only effect. A free trade policy, as argued in orthodox trade theory, enables an increase of the variety of goods available to the consumers, thus helps to raise their satisfaction. It contributes to the national economic growth through a better allocation of resources¹¹; while at the same time increasing the technical efficiency due to a decrease in the average production costs. It decreases the monopolistic power of domestic firms in the national market and provides a competitive structure with reduced prices. It can be said, in this context, that a free trade policy is a best competition policy. The employment rate will also

¹⁰ On this point see, Moggeridge ed. “*The Collected Writings of J. Maynard Keynes*”, Macmillan Press, London.

¹¹ Thus it opens the way for the release of capital and labour resources from the inefficient and distorted sectors of the industry.

increase due to reduced imperfections previously caused by trade restrictions in the labour market¹². As McGee (1993) stipulates “free trade...benefits the masses”.

Consecutive studies of many trade theorists¹³ revealed that there are potential gains from trade. As Corden (1984, p.69) argued, “...given certain assumptions, not only is free trade Pareto-superior to autarky but it is also Pareto-efficient, being superior to various degrees of trade protection”.

Free trade benefits producers as well. Exporting industries, for instance, will have a better access to a much larger world market. Increased sales in other countries can lead to lower production costs through economies of scale, leading to lower prices and further efficiency gains. Free trade also induces lower-priced inputs imported from abroad, which leads to lower prices for the finished products. This helps exports to expand further. Increased competition from imports provides innovation among domestic firms while protecting consumers from monopolies. Free trade policy pursued, therefore, support the country to prosper while a protectionist policy causes stagnation.

Trade also accelerates the diffusion of knowledge and helps a country to have a progress in technical innovation. Kenen (1994) notes this aspect of free trade:

¹² The economic gains from trade are not limited to these. It is clear that a liberal trade policy is closely related to the economic growth. Though in neo-classical economics this relationship is assumed to be indirect, it can be summarised as follows: Free trade provides the efficiency in production and this brings about a rise in savings. The allocation of these savings into additional investments is essentially a means for economic growth. Concerning this connection see, Bhagwati (1969); Johnson (1971) and Riedel (1988). While there is a growing consensus that open trade policies are necessary for economic growth, there is however disagreement on how to achieve this. Agosin and Tussie (1993) is interesting both for its theoretical and country specific studies. The discussion that free trade also helps underdeveloped economies to develop needs further clarification. It can be claimed that free trade allows a country to obtain foreign exchange by which it can buy foreign technology and which in turn allows it to increase factor productivity. Bhagwati (1988) claims a two-way relationship between trade expansion and growth. According to him “an increase in income generally leads to a corresponding expansion of trade” (p.5) and “it is plausible that liberalization-induced trade expansion, through its efficiency effects, fed the postwar growth of incomes” (p.7). He posits this as a virtuous circle “if tariff cuts lead to more trade, and more trade produces more income, and more income facilitates more tariff cuts...”.

¹³ Of these, the most notable ones are those of Samuelson (1939) who argued that there are gains from trade to be derived in the case of a small economy. There are extended arguments after him, by Baldwin (1952); Samuelson (1962); Kemp (1962); Bhagwati (1968) and Dixit and Norman (1980) to name but a few.

“Trade is beneficial in other ways. Improvements in technology developed in one country are shared automatically with other countries. They are shared directly when they are embodied in new capital equipment that is sold on world markets. They are shared indirectly when they raise efficiency or product quality in the export industries of the country in which they originate” (pp.1-2).

1.1.2 The Classical and Neo-Classical Views on the Gains from Trade

The case for free trade has constituted an essential part of the works of classical thinkers. Adam Smith was in favour of open trade policy. He emphasised the rationality of buying from abroad a product that can be produced expensively at home. According to Smith (1981 [1776]):

“To give the monopoly of the home-market to the produce of domestic industry,...in almost all cases be either a useful or a hurtful regulation. If the produce of domestic can be brought there as cheap as that of foreign industry, the regulation is evidently useless. If it can not, it must generally be harmful. It is the maxim of every prudent master of a family, never to attempt to make at home what it will cost him more to make than to buy. The taylor does not attempt to make his own shoes, but buys them of the shoemaker. The shoemaker does not attempt to make his own clothes, but employs a taylor... All of them find it for their interest to employ their whole industry in a way in which they have some advantage over their neighbours...” (pp. 456-57).

David Hume, like Smith, attempted to point out the gains from trade. He was also considerate to explain the differences of factor endowment among nations and the mutual gain from trade as a result of specialisation. Both assaulted the pre-classical mercantilist ideas that international trade is a zero-sum game. They claimed that free trade helped increase the national wealth and employment. They had played pioneering roles in defending the case for openness in trade¹⁴.

¹⁴ This is not to mean, in any case, that their views never involves exceptions to free trade. Both Hume and Smith proposed cases whereby the imposition of tariff might be justifiable. Hume, for example, in his essay, *Of the Jealousy of Trade*, seems to be aware of the costs of free trade in the short run and accepts the use of a tariff in specific cases. For more details on this see, Sally (1998).

Albeit the contributions of both Smith and Hume, the discussion of free trade -indeed the whole body of the pure theory of international trade- begins with Ricardo's 'theory of the comparative advantages (costs)'¹⁵. Accordingly, under free trade each country will start to specialise in the manufacturing of those goods which it can produce relatively cheaper than others and import those which foreign countries can produce relatively cheaply.

Thus, free trade should be the rule and the markets must be allowed to work unhampered¹⁶. The concept observes that every country has something to produce more efficiently than it produces other goods¹⁷. For example, let us assume that, with one unit of resources, country A may be able to produce four cars or twelve computers, while country B may be able to produce one car or eight computers. In this case, country A is more efficient in producing both cars and computers. However, we have to compare not countries but the production of the goods. Accordingly, country A is much more efficient at producing cars. It is four times more efficient at producing cars but only one-third more efficient at producing computers. Thus country A has a *comparative advantage* in the car production.

1.1.3 Free Trade Benefits All Nations

So far, it has been stressed that free trade benefits the society without its repercussions for the other societies. Bhagwati (1993) rightly posits that advantages of free trade for a country can easily be true for the other countries and the world in general. According to him:

¹⁵ This theory is generally attributed to Ricardo. Nevertheless, there are many arguments that it has been initially developed by Torrens shortly before him. (However, it is not important who invented the 'electricity', it is important whether we utilise it efficiently or not).

¹⁶ Actually, it is inevitably true to say that the arguments regarding the free trade policy as tantamount to the production under comparative advantage have some flaws. As Schydrowsky(1984) points out "The equivalence between free trade policy and a comparative advantage policy only holds under very restricted and idealized conditions. In most real word situations, market prices do not reflect social scarcities, countries can affect some prices to some extent, externalities and learning by doing exist, and markets are not fully competitive"(p.439). Nevertheless, these critics do not necessarily reduce the case of the theory for the discussion of free trade.

¹⁷ It is essential to note that the 'Comparative advantage' is to be distinguished from Smith's 'absolute advantage'. The latter occurs when a country manufactures a good more efficiently than does another country. According to the assumptions of the Ricardian economics, the simple divergences, among different nations, of absolute costs has no relevance to the comparative cost advantages.

“While the study of commercial policy by economists has focused on national advantage and hence on the national formulation of the case for free trade, there is also the cosmopolitan formulation of the case for free trade... The cosmopolitan argument simply elevates to the world level what the national argument did at the nation-state level” (p.19).

He concludes that an increase in world efficiency is a result of free trade¹⁸. Indeed, the previous example concerning the comparative advantage theory presents a good arithmetical illustration for this. If country A shifts one unit of resources from the production of computers to cars, four more cars will be produced globally with twelve fewer computers. If, on the other hand, country B shifts two units of its resources from the production of cars into computers, there will be sixteen more computers and two fewer cars in the world market. Then the net increase in worldwide production is two cars and four computers. Thus, if countries specialise in the production of goods in which they have comparative advantage, then the world’s net output will increase¹⁹. It is argued that the General Agreement on Tariffs and Trade (GATT) was premised on the concept of comparative advantage. Jackson (1992, p.1231) for example, claims that “the basic policy underlying the GATT is...to pursue the benefits described in economic theory as comparative advantage”.

Samuelson (1980) in explaining the merits of free trade asserts that:

“There is essentially only one argument for free trade or freer trade, but it is an exceedingly powerful one, namely: Free trade promotes a mutually profitable division of labor, greatly enhances the potential real national product of all nations, and makes possible higher standards of living *all over the globe*” (p. 651).

The framers of GATT were of the opinion that liberalising trade was essential in order to “raise standard of living, ensure full employment and a large and steadily growing volume

¹⁸ This is a natural consequence, if all countries follow a free trade policy. In other words, all countries are expected to have a *unilateral* free trade policy no matter what other countries are doing or expected to do.

¹⁹ This illustration, of course, represents an extremely simple case. In the real world there are hundreds of trading nations exchanging thousands of goods.

of real income and effective demand, develop the full use of resources of the world and expand the production and exchange of goods”²⁰ .

Samuelson (1962) concluded that “...free trade and ideal transfers could be used to give maximal *world* production in the sense of a farthest out world production possibility frontier” (p.829). This helps increase the world’s welfare. Though the increase in wealth of nations attributable to trade is difficult to quantify there are numerous empirical studies attempting to prove that it has a positive effect. There are many studies (See ANNEX 1) seeking to estimate the macroeconomic implications of the liberalisation of trade after the Uruguay Round of trade negotiations. Many of them claimed that the global increase in real incomes would exceed \$ 200 billion annually. Some of these studies which were mostly based on the computable general equilibrium modeling were concerned with the effects of liberalisation in various sectors such as processed foodstuffs, textiles and clothing, iron and steel and natural resource based products. Of these, GATT (1993) claimed that the increase in incomes would be equivalent to \$ 230 billion; OECD (1993) to \$ 274 bn.; Goldin et.al. (1993) to \$ 213 bn.; Nguyen (1993) et.al. to \$ 212 bn. Francois et.al. (1994), in their study under the assumptions of tariff cuts; elimination of quantitative restrictions and a freer trade in agriculture, were more interested in the dynamic effects of free trade. The income raise, according to their study, would go up to \$ 512 bn. annually by the year 2005²¹ .

Actually the economic benefits of free trade is higher than envisaged. Romer (1994) is critical on this point and argues that free trade facilitates the introduction and exploitation

²⁰ See, Preamble of the General Agreement (para.2). For more detail on this, see *Guide to GATT Law and Practice: Analytical Index (6th ed. 1994, pp.21-22)*.

²¹ However, the results reached in these studies usually underestimate the real gains from trade. Actually they can only reflect a part of it. We have to acknowledge that in reality the gains from liberalisation of trade (that is a movement towards free trade) are much higher for the nations. The reasons for the lower results may be attributed to a couple of reasons. First, these studies concentrate on tariff reductions and do not generally take into account reductions in non-tariff barriers. Second, they tend to focus only on agriculture and certain sectors of manufacturing. Third, the computable general equilibrium models are not capable of considering the dynamic gains efficiently as they omit important gains such as economies of scale and increased capital flows. Fourth, the studies considered only the existing trade liberalisation schemes omitting the ongoing negotiations which would bring about further gains. Finally, the likely effects of liberalisation in some of the negotiation areas like services, intellectual property rights (TRIPs) etc. were not considered by these studies at all.

of new goods besides the existing ones and therefore substantially augments the size of the economy. According to him, therefore most existing studies are inaccurate depiction of the real case for free trade. Indeed, the GATT Secretariat had to revise its own estimates which fell short of potential figures of the increase in global income to over \$ 500 bn. annually (GATT Focus, Oct. 1994, p.1).

1.1.4 Free Trade as a Means for Peace

Free trade has also political effects as well as economic ones. Trade itself increases contact and subsequently promotes the cooperation among nations. Many philosophers insisted on the positive relationship between free trade and peace. Gilpin (1987) on this point states that:

“ From Montesquieu’s statement that “peace is the natural effect of trade” through the writings of John Bright and Richard Cobden in the nineteenth century, to contemporary theorists..., liberals have viewed international economics ...as a force for peace....Trade and economic interdependence create bonds of mutual interests and a vested interest in international peace” (p.56).

Cain (1979, p.229) claims for Cobden that “he had in mind a picture of an ideal society based on a coherent system of thought within which Free Trade and international peace were indispensable, interlocking parts”. Immanuel Kant, for example, argued that the “spirit of trade cannot coexist with war”. John S. Mill perceived trade as “the principal guarantee of the peace of the world”. According to Baldwin (1988, p.139) this idea was also embedded in the minds of the framers of GATT who believed that “cutting duties multilaterally would reduce these international political tensions”. The notion that trade is an important factor for a harmonious worldwide relationship was also apparent in the writings of Ricardo:

“Under a system of perfectly free commerce, each country naturally devotes its capital and labour to such employments as are most beneficial to each. This pursuit of individual advantage is admirably connected with the universal good of the whole... It (free trade) diffuses general benefits, and binds together by one common tie of interests and intercourse, the universal society of nations throughout the civilised world”.

Rosecrance (1986) believes that free trade, if adhered by all nations, could be a solution in ending wars. He notes:

“There was no sense in using military force to acquire power and wealth when they could be obtained more efficiently through peaceful economic development and trade. The increasing prevalence of the trading option since 1945 raises peaceful possibilities that were neglected during the late nineteenth century and the 1930s” (p.139).

1.2 The Economics and the Costs of Trade Protection: The Theory and Evidence

In the best of all possible words, the model of free trade ensures an unrestrained competition in everybody's interest. The opposite argument is also true. Accordingly, a protectionist trade policy distorts the economy and imposes a heavy burden on everyone. However, it is often difficult to observe the real impact of protectionism, especially for non-tariff barriers (NTBs) kind. The difficulty of estimating precisely the level of trade diversion and the economic loss resulting from protection stems mainly from the variety of trade barriers applied²². Nevertheless, there have been innumerable studies undertaken to grasp the long term effects of trade barriers on the economy as a whole and on different parts of the society in particular. Before a survey of the studies explaining the costs of protectionist measures, it is essential to briefly demonstrate their effects in economic theory.

1.2.1 The Meaning of “Protection”

Frequently the protection is identified with the imposition of a *tariff*. It is true that tariff is one of a diversified protection measures such as price control measures (i.e. countervailing duties) or other taxes and charges. Nonetheless, one should consider all trade protection measures from different viewpoints, depending on the expected effects of deriving from their imposition. For example, a tariff is expected to produce favourable effects on the competitiveness and consequently on the profitability of a domestic producer as a result of the increase of the price of the competing import and on the government budget as a result of collecting revenues. The identification of protection with the introduction of a tariff

²² It is relatively easier to measure the effects of a tariff cut (trade liberalisation) in terms of trade creation, such as the studies estimating the effects of Uruguay Round trade negotiations, the variety and complexity of NTBs, on the other hand, are much more difficult to quantify.

without making a distinction on the anticipated effect may be misleading for the interpretation of protection. Furthermore, restricting protection merely to situations where tariff is applied makes it hard to understand the real dimension of protection in especially countries like the US and members of the EU having a wide range of tools available²³, such as *quotas; import licensing; anti-dumping duties; countervailing duties; voluntary export restraints; health or other technical standards; export subsidies and a variety of other measures.*

In this view, it is possible to define trade protection as “*the governmental application of measures which either positively affect the competitiveness of the relevant domestic producers, or prevent foreign competitors from causing damages to the competitiveness of domestic producers by means other than the market dictates*”. This definition clearly indicates that protection is a means to distort the efficiency.

1.2.2 The Economic Effects of Trade Protection Measures

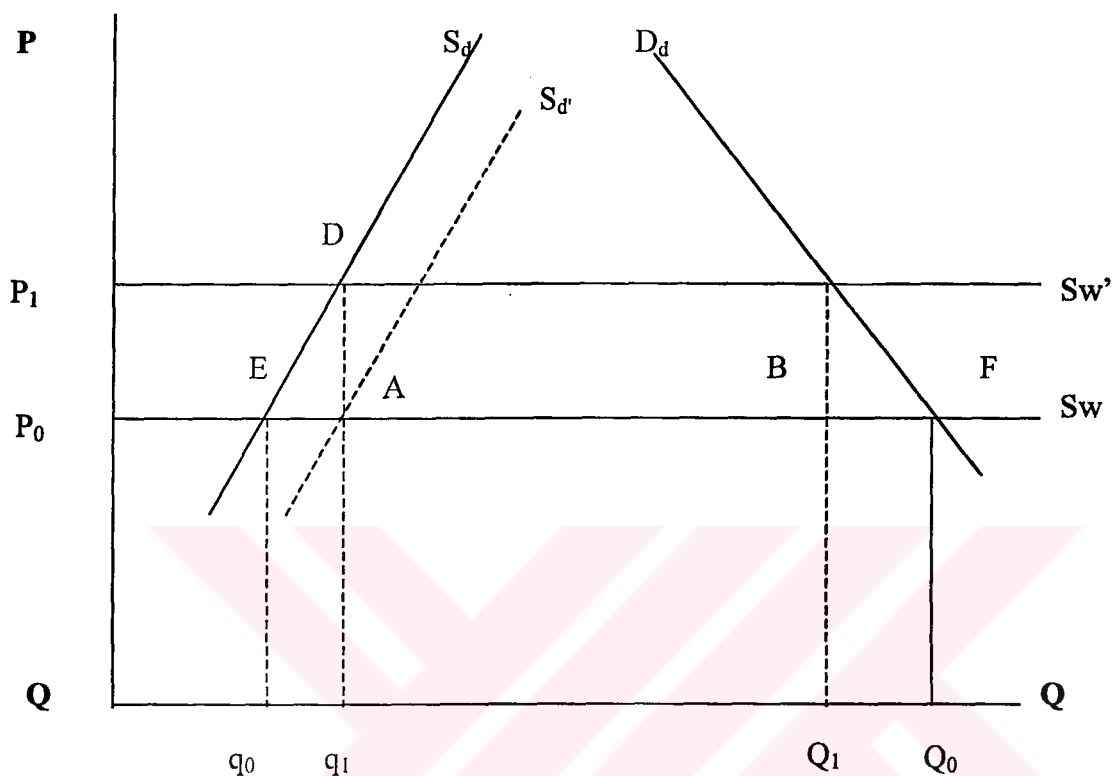
Trade measures have various different effects. Their effects are mainly on the production, employment, price level and on the welfare with different degrees. In looking at all protection measures when applied by a government, what they all have in common is the favourable effect on the *profitability of the domestic producer and loss to the consumer*. The effects to the rest of the national economy (i.e. other domestic producers or the government) or the world economy (i.e. foreign producers) may change depending on which measure is implemented.

Figure 1.1 illustrates a partial equilibrium trade diagram where D_d and S_d shows domestic demand and domestic supply respectively. Assuming the world supply (S_w) infinitely elastic, and the initial price level as OP_0 , the supply level of domestic producers equals to

²³ NTBs are generally distortions to trade, obstacles to imports, or governmental incentives to exports. The GATT Secretariat has compiled an inventory of more than 800 NTBs submitted to it by countries and broken into five main groups; namely, government participation in trade; customs and administrative entry procedures; standards; specific limitations to trade and charges on imports. There are alternative groupings of NTBs by various other studies. UNCTAD categorisation of trade protection measures are divided into 8 groups: tariff measures; para-tariff measures; price control measures; finance measures; automatic licensing measures; quantity control measures; monopolistic measures and technical measures (see ANNEX 2).

Q_0 and the domestic demand Q_0 . The difference q_0Q_0 between the two indicates the level of imports under free trade (no trade protection).

Figure 1.1 Price and Quantity Effects of a Tariff



1.2.2.1 Tariff

In case of the imposition of a *tariff*, the imports decline. The domestic producers can produce more and the government collects tax revenue, while the consumers pay a higher price than they used to under free trade. Thus the domestic consumption reduces to Q_1 level. The import supply curve and the new price level for the consumers go up to S_w' and P_1 ($P_0(1+t)$), respectively. This standard diagram proves that tariff has a positive effect on the domestic production and hence on the employment level as the area P_1DEP_0 denotes, while the trade level decreased from q_0Q_0 to only q_1Q_1 . The resulting net welfare loss is the total of areas DAE and CBF representing the additional cost of producing the extra output domestically (deadweight production loss) and the loss for

consumer surplus, respectively. However, this is not the only cost to consumers as they have to bear the entire burden of P1CFP0, of which P1DEP0 is a transferred rent to protected sector and DCBA is a tax paid to government.

There are other non-tariff barriers (NTBs) having a *price increasing impact*. The most notable of these are anti-dumping duties and countervailing duties, additional taxes and charges on imports, minimum import or reference prices and labeling requirements. Analytically, they operate just like the tariffs pushing up the Sw.

1.2.2.2 Tariff quota

It is also possible for a government to intervene in trade by means of a *tariff quota*. Unlike an ordinary quota it sets no absolute maximum to the quantity of imports permitted into the country during a specified period. Instead it provides that a stipulated quantity or value of import of a product may be allowed during the said period into that country either free of any tariff or with a lower rate. For the rest of the imports above the limits a higher duty is applied. M. Rom (1979, p.141) states that “the tariff quota behaves like an ordinary quota as long as the tariff quota is ineffective and then starts to behave like a tariff once the quota has become affective and demand substantially exceeds the quota limits. It thus has the advantages of both, if a less restrictive measure is considered an advantage”.

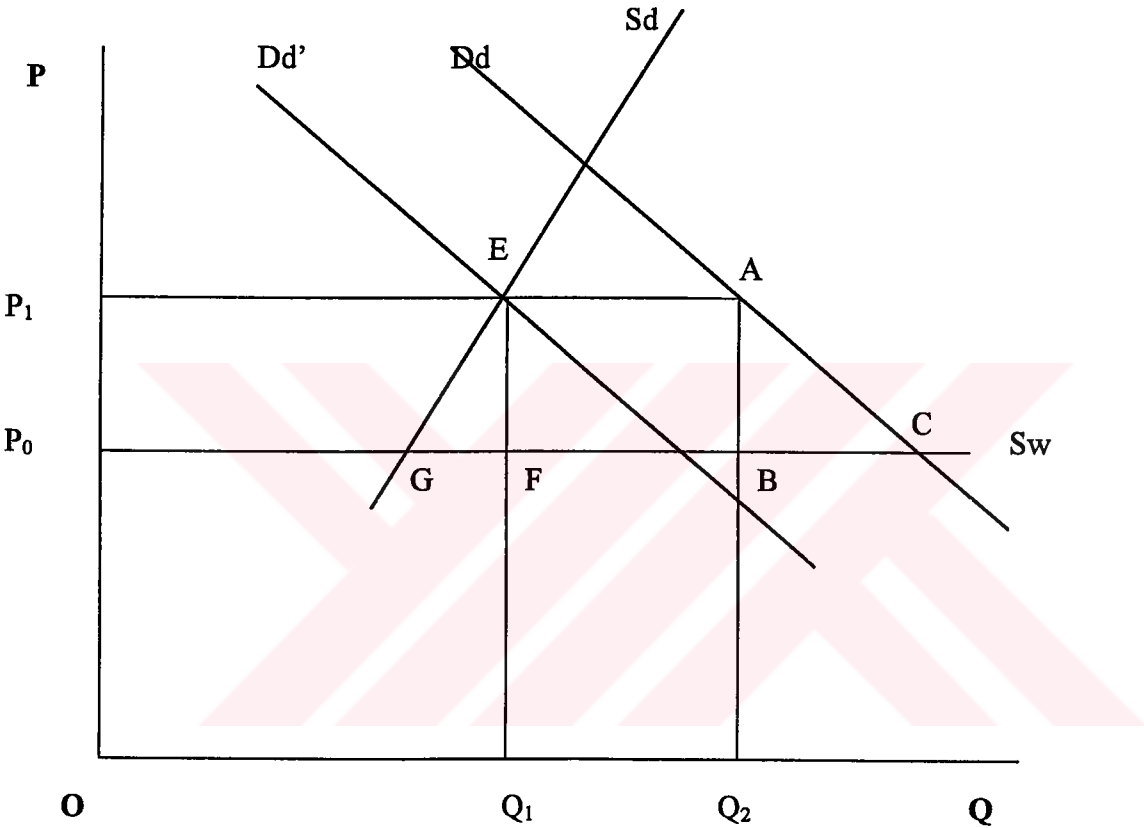
1.2.2.3 Quota

A quota is an imposed upper limit on an imported commodity. It can be expressed in volume or value terms. The imposition of a quota under the condition of absence or insufficient production to meet domestic demand for the commodity in question creates a shortage on the domestic market, thereby causing the domestic price to increase.

Figure 1.2 helps to explain *quota* where Dd denotes total domestic demand for the importable product. Under free trade the domestic price is equal to P0 where Dd intersects with world supply (Sw). The imposition of a quota restricts imports enabling the derivation of a new demand curve Dd'. This will increase the price to P1 at the new intersection point E for Dd' and Sd. The domestic supply is Q1 and domestic demand is

Q_2 , thus leading the usual deadweight loss denoted by area $EFG+ABC$. Actually, the real cost of protection to consumers, similar to the case of tariffs, are higher than just the deadweight losses (area P_1ACP_0). The domestic producers will have an unjustifiable gain -a rent transfer- by the area P_1EGP_0 which they can not under free trade (no quota) condition. Area $EABF$, on the other hand is a transfer of rents from the consumers to quota holders.

Figure 1.2 Price and Quantity Effects of a Quota



Recall that this was the total of tax revenue accrued if the government prefers the tariff as the protectionist instrument. In the case of a quota this rent goes to someone (that is quota-holders) rather than the government²⁴.

²⁴ This explains why a tariff is to be preferred to a quota if we consider that the tariff revenue may be used for governmental purposes. In the case of a quota the entire rent is captured by the quota holders having import licenses. What a government should do is to sell these quotas by auctioning (auction quotas) rather than allocating them free of charge.

1.2.2.4 *The non-equivalence of tariffs and quotas*

The tariff or a quota have similarities. Regardless of the distribution of quota rents, it is clear that a quota on imports is equivalent in all important respects to a tariff. A quota like a tariff raises the price by POP_1 per unit of imports and presents same deadweight loss and rent to domestic producers. Accordingly, it should not matter for the government or the domestic industry seeking protection, to have a tariff or a quota to be applied. The condition when the imposition of a tariff or a quota on the importable products brings an equal level of protection effect on the domestic producer can be referred to as the “equivalence of quotas”.

The quota, due to its limiting effect on imports is more restrictive. A tariff is rather a flexible measure because it leaves the consumers free to pay higher prices for imports if they wish. Another main difference between a tariff and a quota is that tariff affects the price directly and the quota indirectly. The imposition of a quota, unlike a tariff, affects price through creating a shortage in the domestic supply below the level of demand. This makes it more difficult for the government to monitor the level of protection and to achieve the required protection limit under a quota. This equivalence is also broken apart under different conditions²⁵.

1.2.2.5 *Voluntary export restraints*

Similarly, a *voluntary export restraint* (VER) is analytically indistinguishable from a *quota*, since they both lower exports from one country to the other. However, there are crucial differences both administrative or sometimes political as well as economical. Bergsten (1975) brought the following description for a VER:

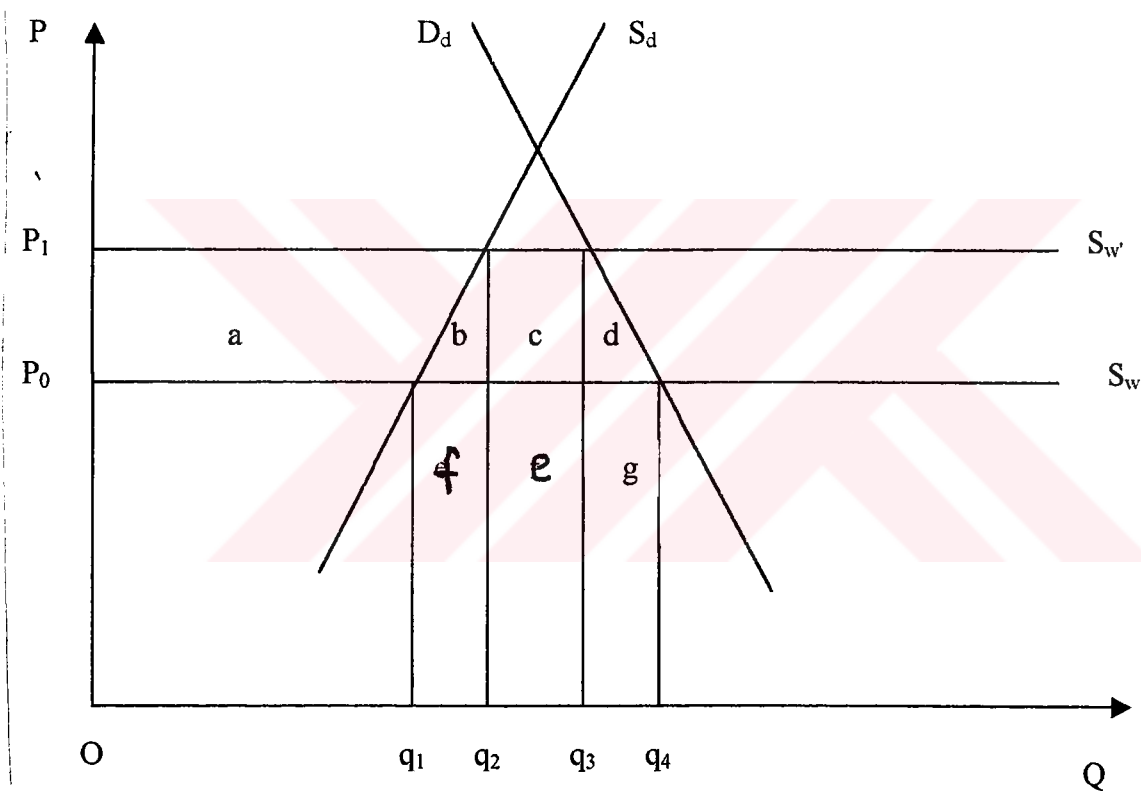
“ VERs are limitations on export sales (i) administered by one or more exporting countries or industries, (ii) on the volume or value of their sales, (iii) to a single foreign market or several markets, or (rarely) the world as a whole, (iv) triggered by pressure from the government or industry in the importing country or countries, (v) carried out either

²⁵ Several theoretical studies have proved that there are various aspects, beyond simple revenue effects, for the examination of the equivalency. Bhagwati (1965) demonstrated the possibility of non-equivalence in the case of imperfections such as “monopoly”. This is also the case under “uncertainty” (Vousden, 1990) and under the possibility of a “foreign retaliation” (Rodriguez, 1974).

bilaterally or within a multilateral framework, (vi) sometimes explicitly authorised or guided by domestic law, or sometimes not” (p.240).

The economic effects of a VER can be depicted by using a partial equilibrium analysis. Consider Figure 1.3 where P_0S_w is the world’s elastic supply curve. Thus a consumer can buy any number of the import product at price P_0 . S_d and D_d are the domestic supply and demand curves, respectively. Under free trade conditions, consumers will buy Oq_4 amount of goods. The demand will be provided by Oq_1 amount of domestic production and q_1q_4 of imports at a total cost of areas $f+e+g$ (that is the number of imports, q_1q_4 multiplied by the world price of imports, OP_0).

Figure 1.3 Price and Quantity Effects of a VER



Assume that the importing country asks the exporting country to limit the number of imports and suppose that the VER asked is equal to q_2q_3 . It follows that the exporters will start to raise their price to P_1 . Hence, the consumers in the importing country will pay areas $c+e$ to the exporters instead of just area e .

1.2.2.6 The non-equivalence of a quota and a VER

The basic economic difference between a quota and a VER is relevant to the capture of “rents”. In the case of a *quota*, this goes to domestic importers or to foreign suppliers, depending on to whom the government of the importing country had allocated the quotas. The situation is different in case of a *VER* which provides the foreign suppliers with the whole rent²⁶. The governments in the importing and the exporting countries auction VER quotas. This difference is essential especially from the political point of view. For the consumer, paying a higher price (P1) due to a quota or a VER, it does not make sense who captures the quota rent. However, for the national economy a VER is an extra cost because the rents (P1ACPO in Figure 1.4) go to foreigners²⁷.

At this point, the difference between quotas and VERs concerns their respective effects on the country’s balance of payments (BOP) and terms of trade. For the importing country, a VER will cause an increase in the unit price of imports, hence *ceterus paribus* the deterioration of the terms of trade. As far as the BOP is concerned, a quota helps a recovery as it restricts the imports. In the case of the VER, on the other hand, the importing country’s need for foreign exchange may increase depending on the demand elasticity (for example, the relative reduction in demand for importables may be less than the increase in the import prices).

However, it is important to note that VERs are not necessarily equivalent to quotas regarding the level of protection *at all times*. A VER may become a more restrictive measure, hence attracting the attention of interest groups seeking protection. Takacs (1978) argued that a VER leads to higher import prices than a tariff or a quota in cases where the markets are competitive and the domestic production is monopolised or when

²⁶ However, the government by using a tariff in conjunction with the VER can capture part of the rent. This is a “tariff-cum-quota”. This, in practice, is available in the case of Multi-fiber Arrangements (MFA) restricting the textile exports of many developing countries into the markets of EU and the US. MFA is a very typical VER of which import coverage includes many products which also bear tariffs.

²⁷ A VER is not different than penalising your consumers in order to protect domestic producers by means of rewarding foreigners. This is an anti-competitive situation which reduces the amount of products available in the market. Its economic effect is same with a cartelisation, this time between domestic and foreigners producers.

scheme. In the event that export license holders are free to sell them and these licenses can be monopolized - which is often the case - A VER is more restrictive (see Figure 1.4). This restrictiveness will increase when more than many goods are covered under a single VER or an OMA (Murray et.al., 1978).

Figure 1.4 Difference between a Quota and a VER

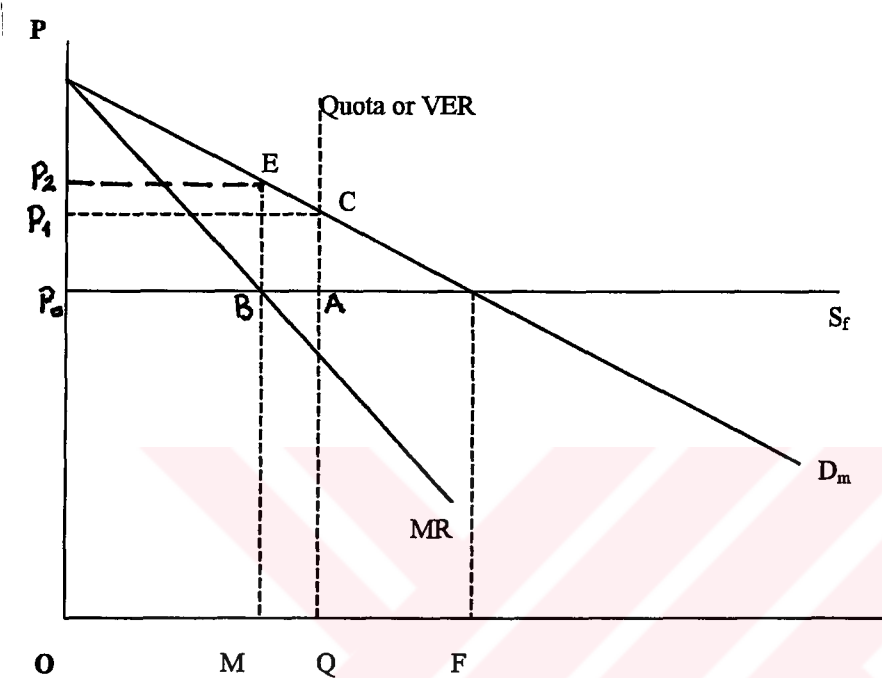


Figure 1.4 helps to illustrate that under a partial equilibrium analysis, a VER or an OMA may cause more protection than an import quota. Accordingly, an import-equivalent VER or a quota (whichever is put) will increase the import price from P_0 to P_1 . This will give rise to a “quota profit” shown by the rectangle P_1CAP_0 . If a single foreign exporter manages to capture all licenses, this may help him maximise his profits by pulling the exports to OM level (it is a normal behaviour that a monopolist will choose a supply level at which his $MC=MR$) and raise the price to P_2 . This will help him obtain a larger quota profit of P_2EBP_0 .

1.2.3 The Empirical Case for Costs of Protection

A better understanding of the principles for free trade or protection requires experimental evidences. As Greenaway (1983, p.115) suggests “trade policy prescriptions should be guided by empirical findings rather than any blind faith in free trade or protectionism”. The economic effects and the costs of trade protection measures have been tested by several studies. Most of these studies revealed that the costs of US import protection has been tremendous.

The immediate effect of protection is on *consumers*. Anderson (1997) reported that a simple elimination of all tariffs and quantitative restrictions on imports in US would bring a \$15.5 billion to net welfare gain of consumers. Feenstra (1992) evaluated the cost in heavily protected industries such as car, steel, sugar, textiles and clothing for the US economy in mid-1980s²⁸. According to estimates, he concluded that merely the total *deadweight loss* to the economy has been \$ 8-12 billion. Additionally, the total cost of quota rents is as high as \$ 7-17 billion, raising the total cost (together with deadweight loss) to the US to \$15-30 billion.

Tariffs are not the only instrument of protection examined in empirical studies. Anti-dumping duties (ADD) and countervailing duties (CVD) have been subject to different researches so far as the economic cost they incur is concerned. The welfare effects of the imposition, by the US authorities, of ADD and CVD on flat-rolled steel products following the termination of VER in 1992 have been examined by Hufbauer and Elliot (1994). The tariff equivalent of ADD and CVD was 13.8 percent. They noted an efficiency loss of \$ 59 million with an import contraction by 27 percent from 6.81 to 4.97 million tons while the rate of increase in import price, domestic price and the domestic output being 13.7 ; 3.9 and 2.6 percent respectively²⁹.

²⁸ In his analysis Feenstra referred to the results of various studies previously held by different economists including de Melo and Tarr (1990); Hufbauer, Berliner and Elliot (1986); Bergsten et.al. (1987); Feenstra (1988) and Trela and Whalley (1991).

²⁹ These figures do not take into account a normal tariff of 5.2 percent that remains intact even after the elimination of ADD and CVD.

Greenaway and Hindley (1985) calculated the cost to consumers of VERs in Britain. Accordingly, the cost is £ 80 million in video-cassette recorders (VCRs); £ 175 million in motor cars; £ 52 million in woven trousers, blouses and shirts and £ 28 million in non-leather footwear. More recent studies had similar conclusions. Hufbauer and Elliot (1994), in their analysis for 21 protected industries in US, estimated the total loss of consumers due to import protection via tariffs and quantitative restrictions as \$ 70 billion - equivalent to about 1.3 percent of US GDP- in 1990. Another research investigated the welfare loss of VERs on Japanese car sales in EC. Digby et.al. (1988) considered the net loss for EC amount to £ 333.3 million. A more striking figure is the 13,864 percent increase in Italy of the Japanese car sales in case of the removal of VER with a lowered car price by over 52 percent.

In addition to its effect on consumers, protection reduces *national income* by changing the direction of the patterns of production and consumption inefficiently. As the protection is a boost for protected domestic industries, the resources shift away from more efficient export industries into former. This leads a decline in the national income when the income is transferred from non-protected sectors of the economy to those who obtain protection. Thus the income loss of the society exceeds the gain of the protected industry, the difference being a cost of inefficient production generated by protection³⁰ (Clements and Sjaastad, 1984).

Secondly, there are *employment* effects of protection. As Hufbauer and Elliot noted, trade barriers applied in the protected industries helped many domestic workers to preserve their jobs. For example, the domestic firms in these sectors employed 1.8 million workers - or a 1.5 percent of the total employment in US- in that year. However, the cost to the economy and to US consumers of preserving these jobs has been very high. On average, the consumer loss per job saved has been almost \$ 170,000 annually. This amount has gone up to \$ 600,000 in sectors like polyethylene resins and sugar and \$ almost \$1 billion in certain chemicals and luggage. As they assert:

³⁰ For theoretical aspects of the efficiency costs of protection see Johnson (1960) and Corden (1971).

“ In other words, consumers pay over six times the average annual compensation of manufacturing workers to preserve jobs through import restraints...In terms of net national welfare, the cost per protected job is about \$ 54,000. This figure far exceeds the cost per worker of even a “gold-plated” adjustment program entailing income maintenance, retraining, and relocation” (p.11).

Greenaway and Hindley (1985) reached comparable figures for the cost of job saving through protection in UK being £ 31,500 in motor cars and over £ 80,000 in VCRs annually.

Destler and Odell (1987), in a previous study revealed that protection of the domestic textile industry helped almost 36,000 workers not to lose their jobs. The protection, on the other hand, had an adverse affect on the jobs of some 58,000 workers in the textile retailing sector linked to imports. Thus, the import protection has caused the job loss of 1.6 workers in order to protect every one worker. Morkre and Tarr (1980) estimated the total economic cost of tariffs in clothing industry equal to \$ 10,150 million in US in 1977. The economic benefit of protection for the government would be \$ 1,255 million because it would now have the possibility to avoid any adjustment cost. Thus the net loss would have been \$ 8,895 million which is almost \$77,000 per job saved or twelve times the annual wage of a worker in the clothing sector. Thus, the economy wastes \$77,000 in order to avoid a net adjustment cost of \$5,600 (only 7 percent) for each worker.

In a similar study, Denzau (1987) analysed the effect of a VER on the employment in domestic steel industry in US, the result being the preservation of 16,900 jobs vis-à-vis the loss of 52,400 in industries using steel as a raw material in their production. This is an unavoidable consequence for such streamline industries (i.e. the car industry dependent on the use of imported steel protected by means of a tariff, a quota or any other price-increasing measure) which face with higher prices of inputs after protection. Nonetheless, the economic difficulties and job losses in such industries are generally ignored in the calculation of the costs of protection. It is true that some jobs are saved via import protection, however it is at the expense of some others. The reason for such negligence

stems firstly from the general fallacy of people that “import causes job losses” and secondly, their difficulty of understanding the real connection between import protection and adverse employment effects thereof. However, many empirical studies attempted to prove it incorrect. Wolf et. al. (1984), for example, claimed that job losses in domestic industries are to be attributed to other factors than liberalisation of trade. Their analysis on job losses in the clothing industry in six EC member countries, the US and Japan held that combined employment in the industry fell by 443,000 during the decade of 1970s. The examination revealed that it is the increase in productivity rather than in imports that caused job losses in that industry. In conclusion, they expressed that;

“...the effect of labour productivity growth to have lowered it (employment) by 27 percent and the effect of trade to have lowered it by 10 percent. In Italy the effect of trade was to raise employment. In each of the other cases, trade had negative effects, but productivity growth was, nevertheless, a more important negative factor for employment than trade” (p.77).

On the other hand, trade liberalisation seems to be a more important factor in the eyes of the public as it is more practical to blame outsiders for any difficulty. A coalition of directly affected domestic producers may encourage both policy makers and the voters not to think otherwise³¹. It can be concluded that import protection measures are inefficient instruments for preserving employment.

1.3 Trade Protection and the Cost of Rent-seeking

All these empirical studies reflects only a part of the total loss due to protection. While the economic theory usually discusses the welfare losses to consumers and gain for the producers a more in depth analysis assures other aspects of protectionism which require close scrutiny so far as the political economy of protection is concerned. There is an

³¹ Actually, a true economic relationship between the level of productivity and free trade is not altogether neglected. It is clearly explained by many economists for years. F. Bastiat, when considering the proposal of the French Ministry to raise the duty on imported cloth, asserted that;

“Pass a law to this effect...No one shall henceforth be permitted to employ any beams or rafters but such as are produced and fashioned by blunt hatchets...Whereas at present we give a hundred blows, we shall then give three hundred. The work which we now do in an hour will then require three hours. What a powerful encouragement to labour?...Whoever shall henceforth desire to have a roof to cover him must comply with our exactions, just as at present whoever desires clothes to his back must comply with yours.” (cited in Heilbroner, 1986, p.182).

extraordinary cost of protection as a result of the attempts to secure it. This can be called as 'rent-seeking'³² costs to the economy. As Feenstra (1992) denotes:

“This estimate should be treated as a lower bound to the actual loss, since we have ignored many factors that could lead to additional costs... For example, the increase in producer surpluses as a result of... protection is many times greater than the deadweight losses, and we might expect some waste of resources as firms attempt to secure this increase in surplus. This waste could occur through lobbying and other 'rent-seeking' activities, or more subtly, as firms neglect to modernize their capital equipment to demonstrate the need for continued protection” (p. 164).

Similarly, Krueger (1974) concluded that the cost of protection is understated by the usual “triangles” calculation;

“Each of these and other interventions lead people to compete for the rents although the competitors often do not perceive themselves as such. In each case there is a deadweight loss associated with that competition over and above the traditional triangle” (p.302).

A domestic industry facing a competitive pressure from imports may adjust its situation only by innovating its production structure unless it can obtain the intervention of the government in the market. It may abandon certain lines of production and concentrate on improving others and works to provide better quality or service to establish a competitive position on imports (Banks and Tumlir, 1986). When it comes to the idea that it may secure a trade protection as a result of its lobbying to the government and that the lobbying activity really costs less than the expected gains of protection or it is in fact being

³² In trade literature, it was Krueger (1974) who invented the term 'rent-seeking'. In her analysis concerning the lobbying activities which are triggered by different licensing practices of governments, she argued that competition to capture these rents leads to resource misallocations. Nonetheless, a clear understanding of rent-seeking requires, first of all, what is meant by “rent”. Tollison (1982) defines rent as “a payment to a resource owner above the amount his resources could command in their next best alternative use. An economic rent is a receipt in excess of the opportunity cost of a resource” (p.577). He asserts that “rents emanate from two sources. They arise *naturally* in the price system by shifts in demand and supply curves...Rents can also be contrived *artificially* through, for example, government action” (p.575). Accordingly, the pursuit of rent under the former situation is quite normal and should rather be referred to as “profit-seeking”. These kind of rents has productive implications and dissipate in time. The notion of rent in 'rent-seeking', however refers to the latter. In this case the rent is “created” by a governmental action. For example, if the government wants to lower the quantity of a good produced and sold in the market, it then leads to the creation of rent to be allocated to competitive producers in that market (Flowers, 1987, p. 434). For a clear distinction between “rent creation” and “rent allocation” see also Browning (1974).

insured against import competition, then the industry will face a 'moral hazard' hence will not necessarily insist on making innovations or modernising its capital equipment. This, in turn, will cause the diversion of resources from productive activities (waste of resources in Feenstra's statement) into lobbying government.

Indeed the interest of such domestic groups endogenously act to influence the government to intervene in the market and distort free trade via import protection measures for their benefit. This intervention-seeking is actually striving for trade protection. Krueger's (1974) "rent-seeking behaviour" and Bhagwati's (1982) "directly unproductive profit seeking activities" or "DUP" initiated a streamline of research which assess the impact of such lobbying activities as wasteful diversion of resources on the economy³³.

Despite her listing of various activities that triggers rent-seeking, Krueger does not propose a clear definition of it. Buchanan (1980, p.4) describes 'rent-seeking' as "behaviour in institutional settings where individual efforts to maximise value generate social waste rather than social output". Bhagwati's definition of 'DUP activities' has similar connotations;

"They [DUP activities] represent ways of making profit (i.e. income) by undertaking activities which are directly unproductive; that is, they yield pecuniary returns but do not produce goods or services that enter a utility function directly or indirectly via increased production or availability to the economy of goods that enter a utility function. Insofar as such activities use real resources, they result in a contraction of the availability set open to the economy" (p.989).

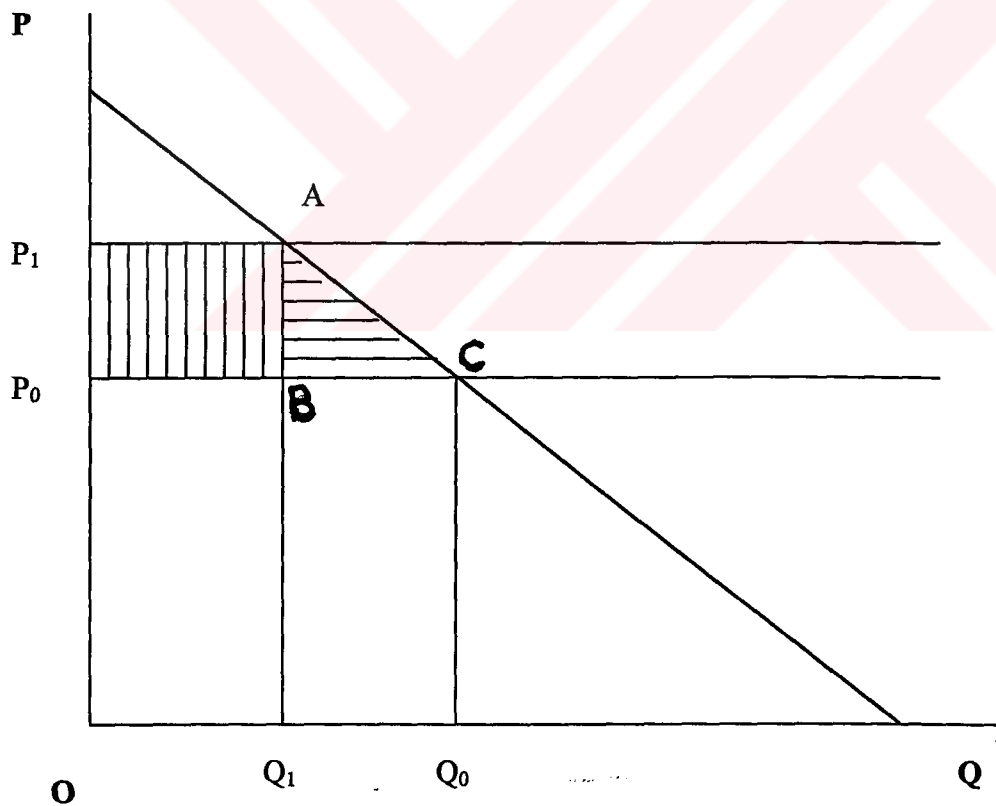
The rent-seeking activity seems perfectly rationale for domestic industries operating in an institutional environment where there is the possibility of "rent creation" by government. The latter may artificially create rent (*a la Tollisonian*) by means of trade measures like a tariff or a quota. As long as this rent exists the lobbying activity continues³⁴. For the

³³ Although they more or less define the same thing, Krueger's "rent-seeking activities relates to a subset of the broad class of what are defined as DUP activities" according to Bhagwati (1982, p. 990).

³⁴ The rent-seekers will continue to the point where the expected return of this activity declines to the level derivable from alternative activities such as innovation in the production structure or modernising the capital equipment to become competitive and pursue their operation under free trade. Thus the cost of

domestic industry the source of the rent does not make any difference because it is profitable. However, from society's point of view, it matters a great deal, because the lobbying activity, in comparison to alternative uses for the firm to employ its resources, brings no social product. The total loss due to rent-seeking can be illustrated in theory. Starting with the welfare implications of tariffs in Figure 1.5, it is possible to estimate the cost to consumers due to the price increase. This is shown by the triangle ABC. It is not surprising that a government does not impose a tariff or any other trade protection measure unless there is a demand for it. The demand for the measure is successful if those asking for it -usually the uncompetitive domestic industry- makes some investment. This may totally be legal activity but has a cost. For example, the industry, in order to be entitled with a tariff or a quota protection, must have his situation appreciated by trade bureaucracy as well as the politicians.

figure 1.5 The Cost of Rent-seeking in a Competitive Industry Converted into a Monopoly by a Government Intervention



protection becomes larger, the greater the expected returns from it. This relates to the expected transfers due to created rents by the government.

Any tariff-seeking or protection-seeking interest group, must employ *able* managers, preferably former politicians and bureaucrats having good relations in the capitals like Washington or Brussels, that can *persuade* policy-makers and the society to vote for their case. This requires the firms in the industry to bear the burden of making all the necessary expenditures. However, during their lobbying for protection, be them finally successful or not, they divert their resources into such “directly unproductive activities” (as Bhagwati stated). The resources, i.e. money spent, time, manforce etc. could instead have been allocated to more productive uses (rectangle P1ABP0 denotes these costs in Figure 1.5). As seen in the diagram, this area is much larger than the triangle ABC which shows the cost to consumers). Furthermore, this only represents one side of the loss. Once such activities manage to institutionalise trade protection, then there will be other groups which will try to overturn it in their favour³⁵. Any existing tariff or a quota will encourage interest groups seeking free trade to lobby for the elimination of the protectionist measure in question. This can be possible in two main ways: “direct lobbying” to phase out tariffs or enlarge quotas etc. to liberalise trade or “tariff evasion or smuggling³⁶”. Similar costs apply in the former as in the case of lobbying for protection. The latter is more pervasive and leaves existing protection intact (i.e. no liberalisation at the end). Tullock (1967) has argued in this context that;

“Generally governments do not impose protective tariffs on their own. They have to be lobbied or pressured into doing so. by the expenditure of resources in political activity. One would anticipate that the domestic producers would invest resources in lobbying for the tariff until the marginal return on the last dollar so spent was equal to its likely return producing the transfer. There might also be other interests trying to prevent the transfer

³⁵ Some studies consider only rent-seeking activities which follow a particular policy, i.e. imposition of tariff; a quota; or a VER; or enactment of a protectionist anti-dumping legislation and neglect those that precede the introduction of that policy for the reason that “they would have occurred anyway -whether or not the policy was adopted- so should not be counted as a cost of the policy” (see, Vousden, 1990, p.74). However, this approach is misleading since the preceding lobbying usually accounts for a misuse of resources and may become a habit to influence the government for non-market decisions.

³⁶ Tariff evasion and smuggling refer to cases where importers illegally manage escape their obligations to pay duties or not to import goods for which the pre-determined quotas are filled. Bhagwati (1982) claims that evasion or smuggling “will be beneficial rather than immiserizing...even though they used up real resources since they confer production and consumption gains” (p.995). However, this does not prevent them from being considered as DUP activities. For more on smuggling see Bhagwati and Srinivasan (1973); Johnson (1972); Sheikh (1974) and Kemp (1976).

and putting resources into influencing the government in the other direction. These expenditures, which may simply offset each other to some extent, are purely wasteful from the standpoint of society as a whole; they are spent not in increasing wealth” (p.228).

Massey (1998) in his discussion on how special interest groups and companies can get governmental help to erect trade barriers or surmount them. Accordingly, they try to make the government regard their case to promote their policy interests. Therefore they do not sacrifice for the costs and efforts to accomplish their aims. This may even include to employ high-level people to present their case to trade bureaucracy and legislature, to cover expenditures of organising a collective action with other interest groups and companies and the public relations such as press conferences etc. where they manage to obtain public sympathy for their case;

“Because this is a complex and important task it is a good idea to appoint a senior executive with special responsibility for it...Today’s emerging best practice is to have a senior executive at headquarters specifically charged with global government affairs, with a separate budget and staff” (p.5).

These executives are normally expected to be chosen among high-rank bureaucrats who served in European Commission in the case of EU, or ITC or Department of Commerce or similar bodies in the US as these people are potentially good lobbyists and have a good experience about the complex structure of access to required levels of government and good relations with bureaucratic circles.

The resources are also misallocated in similar vein when domestic industries lobby for *anti-dumping and countervailing duties*. Considering that dumping and subsidy cases have a legal character apart from economic, firms asking for imposition of such duties have to hire expensive legal firms or employ lawyers specialised on this subject. The economic effect of these duties for the domestic producer is like tariffs. However, ADD or a CVD level may differ from one case to the other depending on how large is the dumping or the subsidy “margin”. Many cases have proved that it is at the administrative discretion to come up with a largest possible margin and an ultimately higher duty on imports. A

successful lobbying by the firm may provide it with a high definitive duty. However, the firm now has to devote much of its productive resources into such administrative and legal pursuits ending up with less actual production.

1.3.1 Rent Transfer, Domestic Income Redistribution and Quotas

The explanation, so far, pretends to have an implicit assumption that the domestic producers and labour unions are the only interest groupings asking for protection. In fact, once it is institutionalised, the protection will have a large assembly of supporters. This is utterly related to the income transferring aspects of trade protection. This is manifest, for example, in the case of quantitative limitations to trade that lead to creating “monopoly” rents.

Economic theory proves that protection measures produce an *income redistribution* effect in different ways which does not necessarily confer an advantage on domestic producers. In a great number of cases protection measures are applied because of their income distributing effects in response to diversified ‘special interest groups’. For instance, the quota rights are normally allotted through a ‘quota license’ system. However, the way this system serves for the redistribution of income depends heavily on the mechanism by which import licenses are awarded. The bestowal of these rights may be for domestic individual importers or foreign trade firms or enterprises, or be auctioned to the public.

An unfavourable redistribution occur if the quota awarding is applied on the basis of any subjective decision. Under such circumstances whoever manages to capture the quota licenses will be able to obtain the import premiums. As opposed to the beneficiaries of tariff protection, the beneficiaries in the case of quota licenses could be anyone not necessarily related to the production activity. Thus there will be other actors in the process to utilize the license system. Consequently, the segments in the society seeking or even lobbying for a protectionist trade policy be larger compared to the case of a tariff. This proves that different protection measures have different supporters depending on their redistribution effects. In fact imposing a quota has some disadvantages in this respect. Corden (1980) commenting on this point claimed that;

“The [quota] licenses will have a scarcity value, yielding potential profits. These are really a form of monopoly profits, the profits being reaped through the sale of the licenses. Alternatively, the first recipients of the licenses may be able to sell the imported goods directly to customers well above what they cost to import. It must be stressed that these profits can be hidden in the sales prices of the imported goods so that they do not depend on the existence of a market for licenses. They can also be reflected in high prices of final goods that embody imported inputs in those cases where the producers of the final goods obtained the licenses to import the goods” (p.85).

Thus the monopoly profits [rents] may go to those who obtained licenses to import goods be them domestic importers or producers or foreigners³⁷. For our analysis it is apparent that these licenses generally benefit those having a political influence in trade policy decision process.

As emphasised earlier, under ‘welfare effects of protection’ studies the import profits captured in this way may be regarded as a gain to some parts of the society and hence deducted from total efficiency loss. Nevertheless, there is the disguised cost of lobbying for such licenses which should be considered for a true estimation of the total cost of protection. Accordingly, because the quota licenses constitute a value for their holders, those who would like to capture them will not sacrifice any expenses incurred unless their total expenditure exceeds the expected gain from licenses. Similarly the bureaucracy in charge of awarding quotas should not be expected to display objectivity at all times. It might be possible for quota license seekers to bribe or persuade them in various ways in their favour. Thus the quota awarding mechanism may easily be corrupted and country’s real resources will be allocated for unproductive activities.

1.3.2 Rent Transfer, Foreign Interests and Voluntary Export Restraints

In some cases, these rents may be collected by foreign exporters. This is a typical situation when imports are limited by VERs. Indeed, this is nothing but a mechanism to transfer

³⁷ The trade measure selected determines who will capture these rents. Therefore governments, while deciding which instrument to be applied, consider which *privileged* interest groups should be favoured.

domestic consumers' income to foreigners who can not obtain it under free trade policy³⁸. It is even possible to say that if the goal of the protection-seeking industries is to maximise the expected value of rents from trade restriction VER provides the most effective framework for rent-seeking strategy. Jones (1994) comments that;

“ Export restraint agreements involve a large social cost to the importing country, due particularly to the massive transfer of VER quota rents to exporters... The empirical studies of the cost of VERs also imply a potentially large rent-seeking cost linked with lobbying efforts to internalize the gains from protection, not only among domestic import-competing producers, but also among exporting countries with established VER quota shares and accompanying rent transfers. This coalition for protection among domestic and foreign firms tend to harm competition in the affected industries and threatens the trading system as a whole” (p.50).

Like import quotas, there are no rents, in the case of VERs, immediately available to domestic taxpayers, or to the secondary rent seekers who ask for governmental revenues. Unlike import quotas, however, VERs offer no secondary rents to domestic import firms, thus rendering the latter not to be able to dominate the protection market by themselves. Thus, a VER is an instrument bringing the foreign actors into the domestic play of trade policy making. Foreign exporters start to lobby their own government to negotiate a restraint arrangement, if they appreciate the economic value of rents derivable from a VER.

The rent-seeking through VER institutionalises an uncompetitive structure in the market and to continue the system of rent transfer, it promotes the corruption that retards efficiency and economic growth.

1.4 Ethical Aspects of Free Trade: A 'Humanitarian' vs. 'Utilitarian' Approach

Most studies in orthodox international trade theory *usually* treats free trade as something that benefits both national economy and the world economy³⁹. However, none of these

³⁸ See, Figure 1.3 above. For more discussion on VERs see Jones (1984); Harris (1985); Greenaway and Hindley (1985); Hindley (1980 and 1987) and Pomfret (1989).

³⁹ As denoted in the earlier parts of this study, free trade benefits the society and all nations. However, it should not be understood, in any case, that “free trade is the policy that economic theory tells us is always

benefits, be them for the economic prosperity or for the international peace as described earlier, are sufficient enough, though they are necessary, to be able to help us acknowledge the exact meaning of free trade for an individual. There is also the 'ethical' dimension that we should recall. Therefore any study concerning the dynamics of protection should bear in mind the fact that economic evaluation requires also a moral discussion. This is especially true if we consider that protection involves a governmental intervention in the economy and that any such intervention should be justified on moral grounds as well as economic. Any negligence of this point will make the case of state unwarranted in the minds of its citizens. In their policy decisions, the governments, most of the time and in most of the cases, consider policy outcomes rather than their ethical justification.

The support for free trade comes usually from economic and political considerations basically possessing a 'utilitarian' thinking. In fact, while the 'positive' theory of international trade gives an idea about the likely impacts of various trade barriers such as tariffs, quotas, anti-dumping duties or voluntary export restraints on different segments of the society, it does not go so far to make any value judgment about the ethical dimension of them. The 'normative' theory of international trade, which is related to making welfare judgments about policies and economic events, is also within the domain of a utilitarian approach because of the fact that, the latter is simply concerned with whether and how far does protection changes welfare rather than whether it is morally true or not. In other words, in modern economics, the virtues of free trade are expressed *only* in terms of their economic and social benefit to the society (utilitarian approach), but not as a natural right

the right" (see arguments of Krugman, 1987 pp. 131-132 in this direction). Actually, this will be the misinterpretation of the orthodox international trade theory itself. What the theory *usually* says is that, given certain assumptions, free trade is optimal. In other words, the theory only goes so far as to claim that free trade is a superior policy to protection except certain circumstances. This axiom is best illustrated by Corden (1974, p.4);

"The point is simply that intervention in trade (trade protection measures such as tariff or NTBs) may not be the best way of dealing with the various problems since they are all essentially caused by "domestic distortions". The best way may be to deal with them in some direct "first-best" way, and at the same time allow trade to flow freely" (parenthesis added).

This is a discussion developed in the post-war trade theory under the title of "the theory of domestic distortions". The following represents the masterpieces of the literature concerning the said theory: Meade (1955); Hagen (1958); H. Johnson (1965); Bhagwati and Ramaswami (1969); Bhagwati (1971); Corden (1957 and 1974) and Chacholiades (1978, ch.20).

(humanitarian approach) as described by J. Locke, the famous philosopher of the seventeenth century. The ethical case for free trade is useful for its supporters since it renders the attempts to prove the economic and social benefits of protection unnecessary. It is true that a utilitarian approach considers free trade as the best policy that a government shall apply. However it reaches this conclusion for a wrong reason since it does not consider the true reason of rights' violation but only deals with material benefits to be accrued.

1.4.1 The 'Utilitarian' Approach

The utilitarianism, first advocated by thinkers like Beccaria and Helvetius, is a concept based on the idea of "greatest happiness of the greatest number" which was later popularised successfully by J. Bentham and his followers⁴⁰. According to this line of thinking, the correctness of a policy (i.e. to protect the domestic industry via tariffs on imported goods) is directly correlated with the outnumbering of people whose utility increased as opposed to those who lose as a result of that policy. In this case the 'optimal' policy is the one that brings about the maximum utility for the society. Considering that the main objective of the government is to maximise the total welfare, then any policy which assures it will be the preferred. Nevertheless, an underlying assumption of the utilitarian approach is the belief that government has some inherent right to intervene in order to reach its objective.

However, the innocence of this approach can easily turn to be dangerous one in the hands of a government which uses every opportunity to behave as it likes and starts to intervene in almost all areas of the economy for the 'common good' of society. This becomes especially true when people have an emergent belief that the government has a right to claim such a competence. It is not possible that the government is always run by benevolent people. Therefore, any government having such unlimited competence will become inclined to corrupt its power with the ultimate risk of becoming a more totalitarian one. Even the assumption of the existence of good faith is not adequate unless it is coupled

⁴⁰ This philosophy was supported as a clear and reasonable slogan of Utilitarians after Bentham's *Introduction to Principles of Morals and Legislation*..

with a masterly statesmanship having the permanent ability to predict everything and know what is good or not. This is something beyond the capability of human reasoning and therefore seems unpractical⁴¹. A more elaborate examination is necessary for a clear understanding of 'utilitarianism'.

There are different forms of utilitarian approach. If the ultimate aim is the 'happiness' or 'welfare' of as more people as possible, then this leads one to defend the benefit of the majority. In practice, this seems to be attractive for any government on the eve of determining which policy to choose. Indeed, the more people the preferred policy satisfies the more likely that the government will have the chance for re-election. Nevertheless, as a wise and an experienced politician knows there are many cases in which the utility of the majority as a result of this policy may rise less than a decline in the loss of the minority. This brings, for a utilitarian, the obligation to calculate the utility quantitatively. The economic theory treats it as 'util's.

The Bentham's theory of utilitarianism requires the measurement of the pains and pleasures of the individual. The approach in the theory is simplistic in that it assumes an unreal homogeneity of human beings in their sensitivity to pains and pleasures and that they (the utils) are measurable. In their attack to the philosophy of 'natural rights' with a claim that the latter causes anarchy, many utilitarians accept the law as the source of rights. Accordingly, the rights are created by law; hence a non-legal right is a contradictory notion (Hart, 1982, p.82). Therefore, Bentham's theory claims that if the natural rights do not provide any theory to guide social choice, utility offers such guidance (Welch, 1989, p.258). This form of thinking within the utilitarian tradition may be referred to as *act utilitarianism* and assesses the rightness of an action depending on its consequences⁴². For example, if the aggregate pleasure provided by the policy of A is

⁴¹ This is a point of start for Hume's 'non-rationalism' as opposed to the approach of 'constructivist rationalism' represented by Bacon and Hobbes. According to Hume, the human reason is the slave of passions and although men do have a capacity for benevolence, this is too fragile a sentiment on which to found a social order (see, Barry, 1986). The latter defends otherwise and gives the government a discretionary power. Nevertheless, this will finally turn it to become 'Leviathan'.

⁴² Act utilitarianism is intrinsically a Machiavellian approach giving priority to the interests of the society rather than the individual. This flaw in Bentham's approach is remedied partially by *rule utilitarianism*. As maintained by Hume and his followers, it assesses the rightness of an action or policy not directly by its

greater than those of the policies of B,C,D...,then according to act utilitarians, policy A should be followed.

There are three points to criticise with act utilitarianism each concentrating on different aspects of the theory namely; *homogeneity*, *measurability* and *morality*. The first relates to the assumption of utilitarians that the human beings are homogenous in their pleasure as if the whole society acts like a single entity. This criticism comes especially from Kantian liberals accusing utilitarianism for failing to take seriously the distinction between persons and not considering the fact that the degree of pleasure and suffering may change from one individual to the other in the same action or policy.

Second criticism relates to the idea that utility is cardinally measurable. Indeed, Bentham's theory does not suggest how to add all individuals' pleasure to be able to reach the aggregate utility. Corden's (1984, pp. 66-67) example can be imported here. Assume that, in Figure 1.6 both axes indicates the levels of utility for persons X and Y and that the national welfare depends on their utilities.

The measures of utility are ordinal; that is they can be ranked but not measured. Any governmental policy bringing the position from A, to B, D or E is a Pareto-improvement, which makes at least one individual in the society better-off without making the utility of the others worse-off⁴³. In this case it is possible to say that the state of affairs D and E represent higher welfare levels as they locate on a comparatively higher utility possibility curve (curve 1).

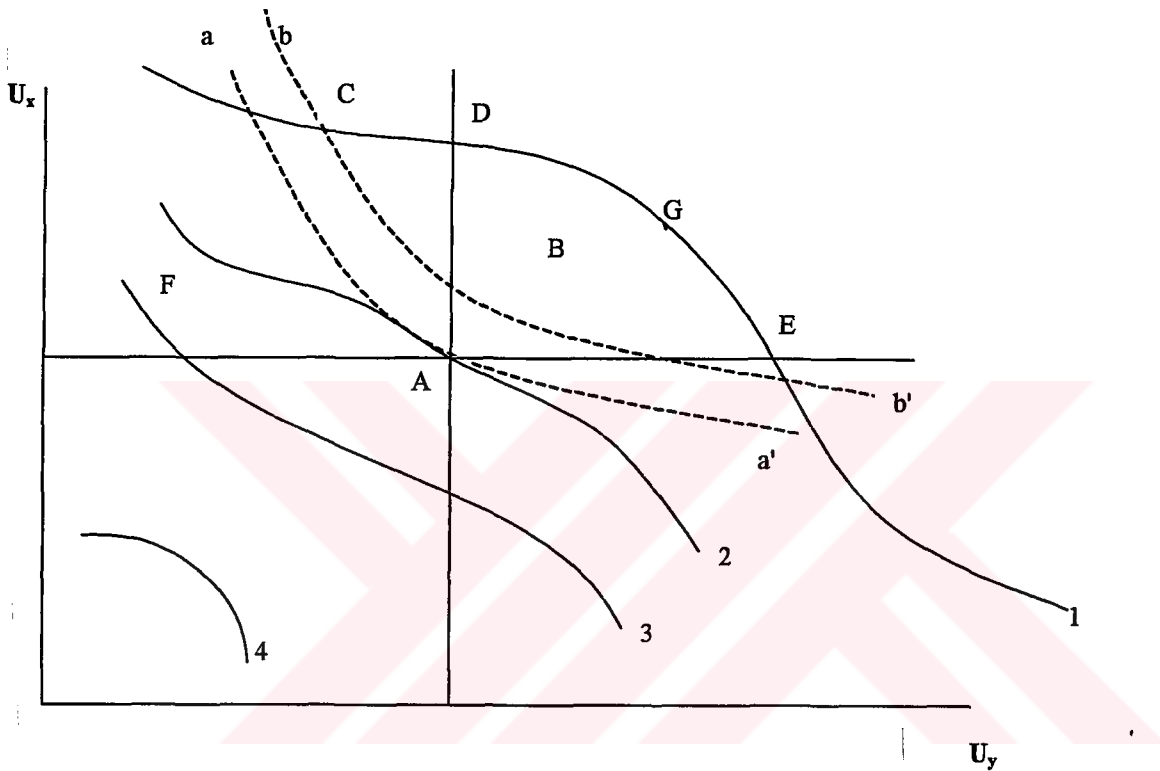
However, it is not possible to say which one brings a higher level because utils can not be add up cardinally to make a social choice. Similarly, we can only rank options D or E first

outcomes but by the universal utility brought about as a result of the observance of certain rules. Hayek distinguishes utilitarian approaches into two groups: 'particularistic' (as proposed by Bentham) and 'generic' (as defended by Hume). In the latter, everyone is expected to follow general and abstract rules.

⁴³ Not the same thing can be said for C. Any movement, as a result of a policy change, from A to C will make the latter Pareto-optimal; that is it is not possible to make one person better-off without other becoming worse-off.

and A second but can not say the former are so many times as good as the position A. The situation is worse in case of a Pareto-optimality (i.e. a comparison between A and C) as it is not easy to understand which one represents a higher welfare level without comparing the utilities.

Figure 1.6 Comparison of Alternative Policies Affecting Individual's Utility



This makes Bentham's theory more difficult especially when we consider that most economic theories are based on the narrow principle of Pareto-comparability and that most real world choices are between Pareto-incomparable options; that is options which make some parts of the society better-off while making the rest worse-off.

The final criticism asserts that utilitarians misinterpret the moral side of the state. Kantians reject utilitarian approach in favour of an ethic that takes the concept of rights more

seriously. As Sandel (1984, p.3) stipulates “certain rights are so fundamental that even the general welfare can not override them”. Rawls (1971, pp. 3-4) had a similar statement: “Each person possesses an inviolability founded on justice that even the welfare of society can not override...the rights secured by justice are not subject to political bargaining or to the calculus of social interests”. This means that certain rights of an individual are inalienable and come prior to the common good. Accordingly;

“what justifies rights is not that they maximise the general welfare or otherwise promote the good, but rather that they comprise a fair framework within which individuals and groups can choose their own values and ends, consistent with a similar liberty for others” (Sandel, p.4).

1.4.2 'Natural Rights': A Humanitarian Approach

The ‘natural rights’ approach overcomes the fatal flaw of utilitarianism. It does not consider to measure the gains and losses of a policy such as protection or free trade. In this approach the gains and losses are irrelevant. If someone’s certain rights are violated, the policy is a bad one, without regard to the extent that others might benefit.

What are these *certain* rights that a government should consider before taking a step. According to Locke these are mainly the rights to life, liberty and property⁴⁴. What makes these rights essential and distinctive, is that their source is the ‘Law of Nature’ and makes them divine. Therefore, these rights should not be restricted or intervened by any governmental policy at all. On the contrary, the state is expected to follow policies to protect these rights. Any governmental action beyond these limited role, according to this approach, will induce a state unnecessarily intervene in the lives of its citizens. The State can not give these rights to people which already inherited them from the Nature, but can only add additional ones to guarantee the former. Nevertheless, these secondary rights shall not be bestowed in a manner to distort the natural ones. The prime reason for the establishment of the state is and indeed should be to protect the natural rights because

⁴⁴ In his *Second Treatise of Government*, Locke states that “no one ought to harm another in his Life, Health, Liberty or Possessions” (see, Locke, 1988 ed. P. Laslett p.271). Locke in this way claims that these rights are intertwined. When Thomas Jefferson wrote US Declaration of Independence in 1776, he used Locke’s wording in a slightly different way that all men have the right to life, liberty and the pursuit of happiness.

these are the only rights that benefit everyone. One example leading to inefficiency is the state of action where the State undertakes a redistributive role and engages in rent shifting activities in the economic life. This is actually a consequence of a utilitarian State mentality where it transfers wealth from one individual to the other for the sake of increasing welfare.

A protectionist trade policy, like many other economic policies ignorant to the fundamentals of the 'natural rights' approach, become an instrument of wealth transfer. Any such government will become an interventionist one, thus finally end up with individuals having a stronger incentive to invest their resources in political activity and try to use the state machine to supply them with goods on favoured terms⁴⁵. When the State expands beyond the minimalist model it starts to distribute the resources to some special interest groups or a subset of the whole society. Then, the society will be intervention-seeking. This will cause the government to forget its basic obligation to guard the *Life, Liberty and Property* of the individuals but to engage in activities finally distorting their situation. Even an economic policy transferring the wealth from a minority of people to an overwhelming majority, does not qualitatively change this fact⁴⁶. In reality, the situation is usually the opposite. Many small but efficient rent-seeking interest groups manage to affect the orientation of governmental policies to be able to derive some rights for themselves at the expense of the natural rights those in the majority. For example, let us assume for a while that a protective tariff policy increase the wealth of a nation⁴⁷ with the ultimate result that the rise in the total wealth of the gainers are far more than the total loss of the losers (i.e. consumers). In this case, a utilitarian approach appraising only the total gain for the society, would very much favour the tariff policy. However, for a natural rights defender, what is important, is the distortion of the rights of the losers rather than a gain for the society. The latter is concerned not with the commensurable benefits, but with

⁴⁵ As stated in earlier parts, Bhagwati's (1982) "Directly Unproductive Profit-Seeking Activities" (DUP) illustrates this paradoxical posture of nicely.

⁴⁶ Nonetheless, the governments generally do not care for their fundamental duty to protect the natural rights but to please a maximum number of people so that they increase their chance of winning the elections, as described elsewhere in this study.

⁴⁷ This is theoretically possible under "optimum tariff argument". This point will be discussed in the following parts.

ethical sentiments. Unfortunately, in the real economic life this point is mostly ignored and policy makers do care for the 'greater happiness of the greatest number'. At this point, the most remarkable side of this problem is that, such utilitarian policies somehow secured a general social acceptance and even became lawful.

How can a protectionist trade policy intervenes in the natural rights of an individual? This point may be elaborated better by drawing the distinction in the nature of the rights.

1.4.3 Negative and Positive Rights

The rights can be divided into two. Natural rights have a 'negative' character. The right to life, for example, is the right not to be killed by anybody. The right to liberty, stated negatively, is the right not to be forced to behave against your free will. The right to property is the right not to have your belongings be taken from you without your consent. The basic feature of them is that they can not conflict. For example, one person's right to life does not violate the same right of another person or one's right to choose does not prevent the other to use his right. Similarly one person's right to liberty⁴⁸ does not prohibit another to own it. Therefore, negative rights produce positive sum. These rights are also inherent, meaning that a person is born with them and not bestowed by others afterwards.

Positive rights, on the other hand are not inherent but are provided by the State. One person's positive right is derived from the sacrifice of the negative right of another person in the society. If the aim is to provide a right to education or healthcare somebody else has to finance it. This requires the allocation of taxes for that purpose. If the farmers have the right to governmental purchases, this is possible only through the sacrifice of property right of the taxpayers⁴⁹. Hence, positive rights have negative sum results. The aim may be

⁴⁸ In this context, the concept of liberty should not be confused to prosperity. The latter is of course, an aim for all societies but one has to be careful about the trap of utilitarian approach. To give an example, the prosperity of the owner of a slave may increase slave's standard of life but never changes his status. The slave of a well-off person was not freer than a poor farmer.

⁴⁹ Think of the politicians promising everything before the elections to persuade the electors to vote for them. It is possible to call them as "heedless" politicians. Actually they do not have to worry to keep their promise since it is possible to create positive rights by stealing the negative rights of some others. In the real life most politicians -not surprisingly- are heedless as long as the voters do ask only for the positive rights without being aware of the fact that, while doing so they actually sacrifice their negative rights.

to increase the welfare but the result may prove otherwise due mainly to the fact that in a country where for example the tax rates are high, people are less inclined to invest and produce. In countries with high levels of unemployment allowances, jobless people are normally discouraged to work.

An essential negative right is the right to *property*. A. Smith claims that property is rather a derived right. However, he does not mean that it is granted by a supreme authority like the State. It could only be that the right to property is derived from another natural right. For example, the liberty to own a property. Indeed, Kant establishing a link between the two concepts, emphasised the fact that different rights may be derived from Liberty (Yayla, 1992, p.181). From the point of view of liberty, what matters most in the economy is property and its use. Marx was right when he stated that those who owned property were free and those who did not were unfree⁵⁰. In his *Human Action*, L. von Mises emphasised the unseparability of liberty and economic freedoms. In this perspective, it is reasonable to agree with Locke and Jefferson that owning property strengthens the freedom of the individual.

The right to *choice* is another negative right. N. Barry (1986) in referring to the expression of Hospers recalls that;

“...the liberty of each person to live according to his own choices, provided that he does not attempt to coerce others, and prevent them from living according to their choices.

Libertarians hold this to be an inalienable right to man; thus, libertarianism represents a total commitment to the concept of individual rights” (p.10).

1.4.4 Trade Laws and the Rights

Turning back to the concept of morality, the idea that any legal action by the government is also legitimate in terms of its ethics is a common fallacy. The law is a set of rules which tells us only what to do and what not to do in a specific issue. However, it does not necessarily mean that the existing law is the one that suits the needs of the society best. In

⁵⁰ From this proposition he deduced, illogically, that great freedom would be achieved through the abolition of private ownership of property.

order to understand whether the existing law is also morally a good one, we must distinguish between the 'authority', 'power' and the 'right'. All governments have the power, i.e. to regulate trade⁵¹. They may also have the authority⁵², but it does not mean that they have the rights to do so⁵³. In other words, any government may have the power and the authority derived from the Law to restrict trade by means of miscellaneous instruments for whatever reason. However, whether the government has any right to restrict trade let say to protect a domestic industry or to collect tax revenue, is open to discussion.

F. Bastiat, French philosopher and economist, regarding the distinction between a 'bad' and a 'good' law asserts that:

“See if the law takes from some persons what belongs to them, and gives it to other persons to whom it does not belong. See if the law benefits one citizen at the expense of another by doing what the citizen himself cannot do without committing a crime. Then abolish this law without delay... If such a law...is not abolished immediately, it will spread, multiply, and develop into a system” [1968, p.21].

Take the case of a law or a regulation granting the protection to a domestic industry against imports. This is one way to provide it with profits (naturally from the pockets of other persons) well above the level than it could obtain under market conditions. This law, without regard to its Paretian benefits - if any- must be abolished. Protection leads an increase in relative prices and induce consumers to pay more. Consequently, all trade laws and regulations restricting trade and increasing the prices are bad laws. This includes all national tariff and anti-dumping laws and other trade regulations.

⁵¹ The US Constitution states in Art. 1, Section that “The Congress shall have the power...to regulate Commerce with foreign nations”.

⁵² In Turkey, Law 2976 concerning “the regulation of Foreign Trade”, authorises the Board of Ministers to impose charges additional to customs duties on imports and exports if it deems necessary.

⁵³ As an extreme example, think that Serbian soldiers have the power to kill civilians in Bosnia and even have the authority from a supreme body like a legally constituted government seeking an ethnic cleansing. This in no way gives them any right to kill civilians, because they have the right to life. Many people may ask the following question? “What is the relevance between killing civilians and restricting trade?” The latter does not cause anybody’s death, however, it distorts his or her eternal rights which are discussed subsequently.

As for the international trade agreement like the General Agreement on Tariffs and Trade, North American Free Trade Agreement (NAFTA), free trade agreements between the EU and other European countries or US-Israel Free Trade Agreement containing several hundred pages do not provide *free trade*-contrary to what their names imply- but provide various protectionist exceptions for special interest groups. They merely constitute an attempt towards *freer trade*⁵⁴. Despite their objectives to promote trade among the contracting parties, all go into details describing which sectors of the domestic industry shall be protected or excluded from the liberalisation schemes. The Preamble of GATT dictates the “substantial reduction of tariffs and other barriers to trade” -if not to eliminate them totally-while the rest of the Agreement are full of provisions explaining the conditions under which countries could intervene in free trade.

1.4.5 Trade Protection as an Attack on the ‘Negative Rights’ to Property and Choice

Any restrictive governmental action on the free (not intervened) exchange of goods constitutes a violation of peoples’ rights. It is quite normal for a shoe manufacturer to have the liberty to sell his manufactured products anywhere within the boundaries of his home country. Indeed, there is nothing more unusual than requesting from him to sell his products within a specified territory such as merely in the town where the premises of manufacturing locate. Imagine for a while that the government has passed a domestic law stipulating that certain products are allowed to be sold only in the towns they are produced as well as a few neighbouring ones and not to be sold or to be sold only in limited amounts in some other parts of the country. Alternatively the law may lay down provisions asking for an extra duty if the product is sold in certain towns. This will preclude many people from consuming the mentioned goods unless they pay an extra duty or even to buy them unless they are willing to go to other places where they are marketed or find other ways to obtain.

⁵⁴ However, because such international agreements ultimately seek to liberalise trade they may not be abolished totally. Nevertheless, this does not relieve them from the camp of ‘bad laws’ as long as they permit trade restrictions.

Naturally, any sensible person in the country will object to this law and require its abolishment. No rational politician can endure such pressures under normal conditions. Nevertheless, when it comes to international trade it is rare to face a similar objection. People are mostly not sensible as far as restrictions are put on imports even though the situation is not different economically for them as consumers⁵⁵.

Therefore, there is no qualitative difference between the previous domestic law and any foreign trade law or regulation that brings let say, a quota limitation or a tariff on the import of Chinese, Argentinean or Malaysian shoes. As Glassman (1998) puts it;

“ People should have the right to exchange the sweat of their brows, the products of their hands and minds, with whomever they wish. I should be free to trade with my corner dry cleaner, a Balinese shirt maker, A Cuban cigar roller, a Japanese lap-top manufacturer. The right to trade is, I believe, one of our inalienable rights, along with life, liberty, and the pursuit of happiness that the Declaration of Independence talks about. The government should be able to get between me and the person I want to trade with only if that threatens the interest of national security-if we are at war, or close to it” (p.4).

Free trade provides people with an opportunity to buy what they like at the lowest possible price. The reputable judgment of the European Court of Justice (ECJ) in “Cassis de Dijon” case⁵⁶, which stipulates that in principle any good legally manufactured and marketed in one Member State (of the EU) should be able to be sold in another, is meaningful.

The aim should be to make this judgment a universally acceptable ruling that *all nations* could follow. If free trade is to survive all must focus the debate from the cold-war

⁵⁵ It may even be worse as many non-tariff barriers have more detrimental effects. In case of trade protection there is always the possibility of retaliation from countries whose products faced a restricted entry into the domestic market. This is a pressure on the exporting industries of the home country.

⁵⁶ The case 120/78 *Rewe-Zentrale AG vs. Bundesmonopolverwaltung für Branntwein* (1979) ECR (normally referred to as “*Cassis de Dijon*”) has been a turning point for the liberalisation of trade within the EC. The ECJ, in this case ruled that:

“There is... no valid reason why, provided that they have been lawfully produced and marketed in one of the Member State, (the goods) should not be introduced into any other Member State...”.

For a detailed comment on this case see Kapteyn and Van Themaat (1989, pp. 378-396) and P. Oliver (1988, pp. Ch.6).

economic understanding to the defense of consumer's, or more succinctly human's, right to purchase what he or she wants at the best possible price. Lepage (1989) is very clear in extending the argument to all nations in the world;

“Why should we discriminate among the rights individuals have according to their national origin? Rights are, by definition, universal claims. If we take human rights seriously, any citizen of a free country has an equal right to purchase goods and services, legally made, from any provider, *foreign or domestic*. Any government restrictions, whether they be tariffs, quotas, or anything else, are a violation of this right. Any denial of it implies a belief that collective state rights should be superior to individual rights. Individual rights are thus undermined and can be superseded by superior decrees. It also implies a belief in the superior knowledge of the state about what is common good of the nation; this revives the holistic philosophy on which any sort of protectionism, whether hard or soft, is necessarily founded. One cannot consistently proclaim the justice of individual liberty and at the same time uphold the right of the state to infringe upon each individual's freedom of economic *choice*” (p.31).

It is hard to deny that there is a case for natural rights or humanitarian interests in free trade. Any restriction or prohibition of trade is an infringement of one's *rights to choose; property; associate and make contracts*⁵⁷.

Take the example of *tariffs*. The expressed reasons may be miscellaneous: i.e. to protect domestic senile industries; to collect revenue for governmental purposes; macroeconomic such as correcting the trade deficits or balance of payments; or a combination of all these. The economic impact of protection will be the rising prices for consumers. This is nothing but to confiscate an extra portion of a person's budget as he has to divert more of his income for the purchase of the same amount of imports compared to state of free trade. This is an open assault to his *property* right, because he could have allocated the sacrificed portion for other consumption purposes such as buying other products or services. Alternatively, he will have to sacrifice by consuming less of the imported product, thus it is an offense on his right to *choose*.

⁵⁷ See, McGee (1993 and 1996) on the moral case for trade and the case against protectionism and their effect on these rights.

The *quantitative import restrictions* (i.e. quotas) is an obstruction to one's attainment of his first choice as a consumer acting freely. Quotas also have an economic effect of causing the property rights to be impaired by rising the relative prices of imports. Limiting imports through quotas also violates his *contract* right as he can not buy whatever he wants from whomever he desires and the *property* right as he must pay a price that is higher than would be the case in the absence of protection. As discussed above, a portion of their property is being taken from them either by domestic producers or by the government acting as the agent or collaborator of domestic producers.

Voluntary export restraints (VERs) represent another commonly applied type of quotas. They also cause the same violations that quotas entail. However, the degree of the effect of these violations are even higher since in the case of VERs you have to please not only the domestic producers but also foreign ones. This is true when one considers the fact that VER is a measure that raises prices, under certain cases, more seriously (See Figure 1.4).

Anti-dumping duty (ADD) precludes foreign suppliers from offering their products on the domestic market, thus making it impossible for consumers to purchase the goods they want at the free market price. ADD is an open violation of individual's rights to property, choose and contract. Some empirical studies tested that ADD hit competitive imports higher than the tariffs because the tariff equivalent of ADD is higher in many cases making its effect even larger⁵⁸.

Therefore trade protection, whatever the used instrument, can not be justified on humanitarian grounds⁵⁹. Thus, a government has no right to protection at the expense of the general public.

⁵⁸ Messerlin (1989, p.586) in his appraisal of the ADD applications by EC in 1980's concludes that the average ad valorem duty equivalent of an ADD is 23 percent or three times of the post-Tokyo Round tariffs.

⁵⁹ It can not be justified even on utilitarian grounds due to the fact that the empirical economic costs of protectionism exceed their gain for the society (see, part 1.1) and there is a net welfare loss for the country (see, part 1.2).

1.4.6 The Government: A Defender of the Rights or a Facilitator of the Robbery

A redistributive role for the government has detrimental consequences. The money which shall stay within the pockets of consumers in a free market economy is transferred by the involvement of the government, into those of some groups who have a larger pressure on the government. This is nothing but just to award their rent-seeking activities at the expense of less people who have limited or no effect on the government. What is worse is that, the government sometimes involves in this rent shifting with the opinion that it is an assistance for those in unfortunate conditions. Recall the situation of diminishing domestic firms vis-à-vis relentless foreign producers and workers facing the threat of losing their jobs. The government and the society mostly think that trade protection is a proper way of helping them. Contrarily, because it is a governmental intervention in the economy and the operation of the market, protection constitutes a wealth transfer. This makes the government a collaborator of those who earns more than they could do under *honest* market conditions. This rent shifting is a legalised, temperate and a socially more accepted way of stealing from others. Thus, the government is not different than the partner of a robber.

This transfer activity⁶⁰, operates not from the wealthy into that of those who are unfortunate but the other way round. The following helps to exemplify this argument. Some industries like textiles and clothing, steel, car, shoes etc. are those of the ones for which the protection is quite common. The average tariff level in these industries are well above average level for the whole industry. Most free trade agreements are full of exclusions and exception provisions for them. Heavy protection raises the prices of these products domestically. When one considers that the marginal propensity to consume these 'heavily protected' products is relatively higher for those groups of the society with less than an average per capita income, that means they have to devote more of their income compared to - if not in actual- well-off segments of the society. This is to say that the less income groups are expected to stand for more sacrifice for their property rights. The

⁶⁰ In fact, this transfer -as Tullock (1967) named it- is a way of *theft*.

government eventually takes from the pockets of these less prosperous people and transfers it into affluent groups such as richer capitalist entrepreneurs of the protected domestic industry.

For example, in his estimation for the income distribution effects of textile and apparel protection via VERs in the United States by identifying the gains and losses to five different income groups, Cline (1987) concluded that the benefits of protection are concentrated in a small number of workers in the third and fourth groups in an ascending line from higher to lower income, and among owners of the protected firms -in the highest income group-whose profits rise. This transfer to producers has the most regressive effect on the lower income groups. The losses were in the form of higher prices to consumers in each group, and calculated to be \$250 on average per consumer annually. As a percentage of income, according to Cline, the greatest losses are accrued to the lowest income group, which suffers a 3.64 percent drop in income as a result of VERs. On the other hand, relative losses of higher income groups were lower. The highest income group actually benefited from protection with a 0.32 percent of its income.

Another point of discussion in protectionism debate is that free trade may be harmful for some. These are the losers of market conditions and its economic impact may be socially undesirable⁶¹. For example, the removal of a tariff or another trade protection measure will normally hurt those who contribute to the production of import-competing products (the lost producer surplus area, DAE in Figure 1.1). Under the assumption of the absence of a regular adjustment policy, free trade is Pareto-optimal. The fact that the total number of those that will gain as a result of the free trade policy will be much higher than those of the losers does not change it. The number of bankruptcies and lost jobs are not prevented. However, explanation of the merits of free trade and its supremacy over protection does

⁶¹ Social undesirability has three reasons. First, relates to the altruistic sentiments of the people. According to this, no one in the society should be left to suffer. The second relates to politics. Leaving these effective groups into the hands of harsh market conditions adds a negative mark for the credibility of the government. Finally, the economic consideration that we may need these industries in the future, is another reason to protect them today.

not in any case necessitate a utilitarian help such that the gainers are outnumbering the losers.

For a humanitarian approach what is essential is whether the rights of those that suffer from free trade are violated or not. In other words, whether non-protection of the domestic industries infringes their any right to property, choose etc. There is no such a case since there is no ‘right to protection’. The suffering of some people is pity but there can be no right to *job* or to *profit maximisation* via restricting trade and obstructing competition. At least these are not the kind of rights⁶² that we can accommodate in the ‘negative rights’ perspective. There is no relationship between taking advantage of rights and rent shifting. Unfortunately, this point is generally disregarded by many and helps the institutionalisation of the idea that uncompetitive *domestic industries* have the right to be protected. For instance, a public poll held in the European Union provided an indication for the misunderstanding of the primacy of rights among the people (Commission 1993a, p.21).

Table 1.1 Europeans views on and knowledge of the rights

	Whether the rights should be respected <i>at all times</i> or <i>depends</i> on the situation			Total
	Always	depends	No reply	
The right to education and training	94	4	2	100
The right to work	90	8	2	100
Freedom of information	82	15	3	100
The right to own property	80	17	3	100
Freedom of speech	77	21	2	100
Freedom of association	60	33	7	100

As Table 1.1 reveals, it was interesting that the basic rights (i.e.negative rights), such as freedom of speech or association, or the right to property were preceded by some positive

⁶² They can only be called as ‘positive rights’ with zero-sum (no positive sum).

rights. Most important rights, according to the people interviewed, were those that directly concern access to work (i.e. right to training or right to work).

Notwithstanding the fact that economic theory refutes protection for it being a welfare reducing activity and promotes the freedom for trade, the practice brings the opposite.

1.5 Rent-seeking Motivated Trade Protection: A Public Choice Perspective

The cost of protection associated with rent-seeking can be very high. Krueger's study revealed that the quota rents were very large indeed. Accordingly, the total rents amounted to 7.3 percent of GNP in India in 1964 and 15 percent of GNP in Turkey in 1968 (p.294). The magnitude of the cost of rent-seeking depends to a large extent on the magnitude of the expected transfers. In circumstances where there is a competition for these rents among various interest groups, the cost of transfers could amount to a multiples of the simple deadweight losses. Whatever the cost is, there is reason to believe that rent-seeking and transfer expectations stimulate interest groups to lobby to the government in order to direct the latter's policy of income distribution in their favour. Krueger has a right in her comment that;

“The existence of rent-seeking surely affects people's perception of the economic system. If income distribution is viewed as the outcome of a lottery where wealthy individuals are successful (or lucky) rent-seekers, whereas the poor are those precluded from or unsuccessful in rent-seeking, the market mechanism is bound to be suspect....If [so], the inevitable temptation is to resort to greater and greater intervention, thereby increasing the amount of economic activity devoted to rent seeking. As such, a political “vicious circle” may develop. People perceive that the market mechanism does not function in a way compatible with socially approved goals because of competitive rent seeking. A political consensus therefore emerges to intervene in the market, rent seeking increases, and further intervention results...In such a system, entrepreneurs would devote all their time and resources to capturing windfall rents” (p.302).

It is manifest that societies having a disposition of widespread monopoly and wasteful rent-seeking will have less wealth than those that are not. Therefore it is necessary to

restrict the rent-seeking behaviour in the society. This is the original role that a state (government) is expected to play. Hence, the government must function in order to guarantee the rights of its individuals and help increase their wealth in an equitable and “humanitarian” or “ethical” manner and should not deal with activities generating rent transfer by means of artificially created monopoly rights. The ethical considerations for free trade reiterates that consumers have certain unseparable inherent rights that even the economic difficulties of domestic industries can not overturn. Therefore protectionist claims are not only sub-optimal *for economic reasons* but also unacceptable on *moral grounds*. Trade protection, as a non-humanitarian action, causes an infringement of negative rights and can lead to an activity of theft. Recalling Bastiat, trade protection laws are “bad” laws. Consequently, the policies a government prefers to apply should be far from bestowing rents to politically active interest groups at the expense of weaker ones and should not cause the squander of resources in the economy⁶³.

If this is so, what then makes the adoption of a protectionist policy so attractive? The answer to this question is directly related to “political economy of protection”, a matter of discussion best analysed within the purview of *public choice* - what is generally classified in *constitutional economics*. This requires the acknowledgment of alternative approaches which explain the trade policy formation in different ways.

⁶³ The fact that these resources, if misallocated due to rent-seeking or unproductive (DUP) activities, do not cause any immiserisation or that the rents obtained by rent-seekers are injected into the economy again (i.e. lobbying expenditures encourage the establishment of lobby or law firms and help further employment) is not important. No one can justify the existence of a mafia organisation just because they help poor people (to justify themselves) and increase their wealth or they invest the money they have stolen, in more productive activities. It should be the ethical considerations that govern the economic life in a society and renders governmental policies, not the mere utilitarian result-oriented mentality. If trade protection is a way of transferring rents to those who can not achieve them without a governmental intervention -an artificial (that is non-market) way-, it is not different than the activity of theft (as quoted by Tullock), this time in a more elegant, disguised and even legal (assuming no bribery or similar illegal conducts during lobbying) track.

CHAPTER 2. THE UNDERSTANDING OF TRADE POLICY MAKING: A POLITICAL ECONOMY EXPLANATION

We have tariffs and other economic policy distortions because they are efficient-that is, they are politically efficient... We have lobbies giving funds to parties because that is politically efficient...For decades, economists have been stuck on the concept of economic efficiency, but this concept is too narrow to provide a proper understanding of economic policy formation.
S. Magee, *Black Hole Tariffs and Endogenous Policy Theory*, 1989.

Economists divide notoriously because they look at different facts, or interpret the same facts differently in viewing reality with contrasting theoretical models...The problem of sorting through a multiplicity of opinions is therefore bad enough in economics...Trade policy issues have not been immune from these problems.
J. Bhagwati, *The World Trading System at Risk*, 1991.

The standard international trade theory alone, does not provide sufficient or accurate answers to the questions such as “why does protectionism appear?”; “why do we have protection in the trade policy?” or “why is a particular trade policy is adopted?”. In order to be able to get a more satisfactory explanation, it is better to analyse the *actors* -involved in decision-making process- as a level and the *processes* in the political system. This requires an understanding of social, political and economic consideration. The political economy explanation can be characterised by an investigation paying an attention to both political and economic conditions and their interaction. Therefore, it is an inevitable approach to the understanding of the process of trade policy formation and its dynamics.

The growth of this form of methodology is itself a consequence of the limitations of the international trade theory based on the neoclassical orthodoxy⁶⁴. Indeed, for many

⁶⁴ These limitations are meant in a descriptive sense and are relevant to the factors central for the determination of the trade patterns and the policy choices.

scholars⁶⁵, the incompatibilities between the assumptions and the prospects of the trade theory on the one hand and the daily realities in the practical life, is the outcome of the false assumptions based on idealised conditions of the liberal trade theory which has its roots from the Ricardian model of comparative advantages and the Heckscher-Ohlin theorem. In these approaches the criticisms generally focus on the assumption of the perfect competition in product and factor markets, identical production function among countries and constant returns to scale. Among these critics, Barry Jones (1983) for example, claims that;

“the corpus of the liberal theory rests not upon sound simplifying assumptions about reality but upon simplifications which require evasions of reality... or a priori assumptions which are quite simply unwarranted” (p.175).

Similarly Kuttner (1983, p.16) argues that (liberal) trade theory “does not fit a world of learning curves, economies of scale and the floating (exchange) rates. It is even possible to see matching views among the economists, concerning the deficiencies of the trade theory. Models such as the “product cycle” or “intra-industry” and more profoundly the “strategic trade policy” based on the well-known study of Spencer and Brander (1983) and shaped into a theory by Krugman and others⁶⁶ have, nevertheless, not been successful in bringing an alternative and a stronger conception of trade theory.

On the other hand, many economists started to produce new theories as a response. Of these, public choice theory (i.e. Baldwin, 1985) and endogenous trade theory (i.e. Magee and Young, 1987) hold an economic analysis leading to a political-economic explanation. This is to say that the economic analysis of the effects of alternative trade policies and the economic impact of these policies on various segments of the society are to be considered. Nevertheless, even this consideration may not be enough to explain the political economy of trade policies. In this respect we should take into account that broader macro

⁶⁵ This is especially true for those from the political science who are in difficulty of drawing a clear distinction of the concepts. Dillon, Lehman and Willett (1990) explain this misunderstanding lucidly. See also Bhagwati (1989) for a counter argument to these critics.

⁶⁶ For a good start for the “strategic trade theory” see Krugman ed. (1986) and Krugman (1994). Richardson (1990) provides a useful overview.

explanation of the protectionist demands in a country also have a value, though limited⁶⁷. Macro-economic hypotheses confirm that macro conditions influence the demand for protectionism to a considerable extent. This is especially true with sectoral imbalances, declining trade balances and pressures of exchange and interest rate movements⁶⁸ as contributors to such demands. Some economists also emphasise the fact that protectionist sentiments often rise at times when the macro-economic conditions are going downward. They also attract attention to the degree of concentration or multinationalisation in the industries for an explanation as to why some of the industries manage to organise to lobby and some do not. Takasc (1981) notes that among economists:

“it is generally agreed that in a modern industrial economy, the cyclical state of the economy and the country’s competitive position internationally are the principal determinants of the degree of protectionist pressure” (p.687).

Nevertheless, because of the underdeveloped political-economic analysis and narrow assumptions, these attempts seem to be far from constructing a theory of foreign economic policy formation in general and trade policy formation in particular. Therefore, a well-articulated understanding of trade politics and commercial policy formulation ultimately requires a political economy explanation explicitly addressing societal, institutional and ideological variables. This does not mean that the economic variables should be disregarded or useful elements of the economic analysis should be neglected. However, a true political economy analysis clearly involves a clear-cut attention much beyond the limited world of the economic analysis.

⁶⁷ For macro-economic explanation of the protectionist trade policies see Ray (1981); Grilli (1988); Grilli and Sassoon eds. (1990); Grimwade (1989, especially ch. 7);

⁶⁸ “Exchange rate” arguments were widely used in the explanation of rising US protectionism in the 1980s. See, for example, Bergsten and Williamson (1983) and Bergsten and Cline (1983) which claim that the cycles of protectionist pressures in the US since the late 1960s coincided with large dollar overvaluation periods. Similarly, McKinnon and Fung (1993) in 1990s followed the same proposition with the view that the large fluctuations and volatility in exchange rates have been an important reason for the spread of the new protectionism.

2.1 Levels of Political Economy Explanations: The Methodological Choice

Political economy explanation of the trade policy formation is not unique. These are, on the contrary, diverse each identifying a wide range of political and social variables at different levels of analysis. The choice of it is a methodological issue. The field of the analysis of foreign economic policy or international political economy has in the early years been under the dominance of a methodology based on a “trilogy” (see Table 2.1). This is a treatment of three contending theories of thought namely: *realism* (or the so-called mercantilist, nationalist or statist views); *Marxism* (and its new version of dependency theories) and *liberalism* (also embodying interdependency theory). This division has been the preferred methodology in the IPE literature especially after the influential work of Gilpin (1987). Gilpin has constructed his method on this trilogy claiming that “over the past century and a half, the ideologies⁶⁹ of liberalism, nationalism, and Marxism have divided humanity”(p. 25). He further argues that nearly all scholars follow such a trilogical approach:

“Although many positions can be identified, *almost everyone* tends to fall into one of the three contrasting perspectives, ideologies or schools of thought (liberalism, nationalism and Marxism). These three are fundamentally different in their conception of the relationships among society, state and market⁷⁰ (*italics added*).

Table 2.1 The Trilogy Matrix of Alternative Methodological Explanations in IPE

	<u>Realism</u>	<u>Marxism</u>	<u>Liberalism</u>
Level of Analysis	“nation” in international setting	“class” in national setting	“individual” in national setting
Trade policy/ interests	country’s interests	class interests	special interests (individual’s)
Prisoner’s dilemma (PD) *	inter-national	intra-national	intra-national

* In Marxism the PD is between capitalists and workers and in liberalism between free traders and protectionists.

⁶⁹ Gilpin used the term “ideology” by making a citation from Heilbroner (1985), to refer to “systems of thought and belief by which individuals and groups explain how their social systems operates”. However, for our study we treat Gilpin’s division as a “methodology” rather than an “ideology”.

⁷⁰ Indeed, Gilpin was not incorrect in his argument. Most of the IPE literature followed this older methodology. Among these, Strange (1988) and Frieden and Lake (1991); Crane and Amawi (1991) are the most popular ones.

However, this method has a serious deficiency in the explanation of the formation trade policy⁷¹. Studies based on it fail to create a systematic distinction between the positive and normative aspects. For instance, as an examination of the issue of positive political economy i.e. an attempt to explain why governments adopt particular policies or why they do prefer certain policies to others rather than what policies they should take up, the trilogy method seems insufficient. Therefore, it provides an approach but does not keep us from investigating alternative explanatory methods.

2.2 Alternative Analytical and Theoretical Methods to the Formation of Trade Policy

Today most analysts of foreign economic policy are generally in agreement that international as well as domestic factors are fundamental in the explanation. However, most of the analyses give a primacy to different levels which we can describe simply as *systemic; unitary* or *individualist*. Approaches studying on the same level or intersection of levels continue to emphasise different variables and policy influences. This causes the prevention of the establishment of a single body of a widely accepted theory⁷². This is generally a correct observation for the whole realm of international political economy (IPE). The novel classification technic can be roughly divided into three: *systemic or internationalist; statist or institutionalist* and *societal* levels.

2.2.1 Systemic-level (internationalist) Analysis

This analysis involves a focus upon the position of sovereign states as the basic unit of study. It treats the state as a rational and unitary actor. It assumes the international system as anarchic in which the power of states provides the opportunities and imposes constraints for their relationships. The methodology of the systemic-level analyses emphasise that it is the international forces which determine the state action i.e. state chooses this or that policy in accordance with what the international interactions dictate. In this way it applies the fundamentals of the realist paradigm. Krasner (1976), follows a

⁷¹ This proposition is also valid for the foreign economic policy in general.

⁷² The political economy of international trade literature is very rich especially as far as the cases of US and EU trade policies are concerned. Nevertheless, most of the studies can be grouped in one of the following bodies of models.

realist approach and argues that the state sets its foreign economic policy in order to raise its economic power in accordance with its priorities and the “national interest”. According to this approach the state acts to maximise its national goals. Therefore, whether a state will prefer a protectionist or free trade policy is very much dependent on which of the policies are serving to the so-called “national interest” or “goals”.

However, this method seems to be flawed in the explanation of the reasons for the existence of protectionist policies. For simplicity, much of the international trade theory defined in the standard international economics textbooks assumes states as unitary actors as is done in the systemic-level analysis. As we all know most of them regard international trade theory in the neoclassical sense based upon the assumption that states act to maximise their aggregate economic utility. This leads to the conclusion that maximum global welfare and Pareto-optimality are achieved under free trade. If this is the case, the state should apply a protectionist policy only if it really serves for its national aims or interests. As H. Johnson (1965) clearly advocated three decades ago this is only so in case of the “optimum tariffs” or national security reasons. Nevertheless, it is not easy to claim that all the neo-protectionist policies followed or protectionist instruments applied serve to these aims.

An important theory applying a systemic-level analysis is the “theory of hegemonic stability”. It starts with a basic argument that the position of a state in the international economy is decisive in shaping its foreign economic policy. Accordingly, nations having a dominant power hold an interest in pursuing liberal trade policy reflecting an international contour of power. Dominant and hegemonic states have the power and intention to create and maintain liberal trade regimes and will be ready to carry the costs of imposing the order. When they feel a diminishing capacity they may change their intention and follow an opposite policy.

This argument, advanced as a theoretical explanation of the British hegemony in the nineteenth century and of the US hegemony in the mid of twentieth century is also open to

serious empirical challenges⁷³. Keohane in his influential *After Hegemony* claims that the erosion of hegemony does not necessarily lead to the adoption of opposite policies thanks to the “international regimes”. On the other hand critics such as Goldstein (1986) argue that even the refinements of the theory is not adequate to form a developed analysis. According to Goldstein, hegemonic stability theory can not explain the dispute between the free or fair trade policy choice in US.

The limitations and weaknesses of the hegemonic stability theory in the explanation of the modern trade policy formation process are almost same with those of the systemic-level analysis in general. While attention is directed towards the constraints and the pressures of the international system, the state is treated as if it were a single entity in which the interests and wants of all domestic actors are assumed to be the same. Because this type of analysis is based very much on the precepts of the realist approach. As Willett (1995) rightly observes “it corresponds in a sense to the Leviathan model since the state (the government) is assumed to be independent from the domestic societal pressures”. Furthermore, this approach does not help us understand why particular policy outcomes emerge among many in the policy bundle. It does not consider the domestic policy making process at all or only in a very limited degree⁷⁴. This is not to say that international system has no role in the formulation of a state’s trade policy at all, but the extent to which they are penetrate into the actual policy is very much dependent on the strength of the executive bodies responsible for the trade policy, in the domestic arena.

⁷³ We should also consider the refinements in the theory beside the challenges. As Keohane (1984, p.34-35) notes “unlike the crude basic model, a refined version of hegemonic stability theory does not assert an automatic link between power and leadership. Hegemony is defined as a situation in which one state is powerful enough to maintain the essential rules governing interstate relations and willing to do so (Keohane and Nye, 1977, p.44). This interpretative framework retains an emphasis on power but looks more seriously than the crude power theory.....It does not assume that strength automatically creates incentives to project one’s power abroad. Domestic attitudes and decision making processes are also important”.

⁷⁴ There are however, studies in the systemic-level camp but considering the domestic aspects. Lake (1988) for example recognises the fundamental need to examine domestic sphere and shows the contest between the executive (seeking to adopt policies reflecting the national interest) and the legislative forces (representing the societal demands).

Systemic-level approach has another shortage. It leads to the marginalisation of the values and more importantly the ideas. Beliefs, opinions and expectancies also play a role in the behaviour of humans and they help the shaping of state actions. The systemic-level approach do not calculate such values. Therefore it has a limited value in the study of IPE and provides only a simplified perception of state action in a specific case such as why certain industries obtain more protection than others or why certain policy instruments (i.e. antidumping duties or voluntary export restraints instead of tariff) are preferred. It is not possible to explain the complex domestic-level motivating factors. A methodological approach based on a theory of domestic determinants is necessary. This can more cogently examine the effect of human (individual's) interaction on the policy outcomes.

There are now more studies using an *individualist* analysis exhibiting a lesser emphasis on the international (systemic) sources but rather focusing on the domestic actors and processes below the “unitary state as rational actor” level. The domestic approach may be characterised as “state-centred” or “society-centred” (Ikenberry et.al.,1988). However, as most of the studies reveal this distinction is not always clear-cut.

2.2.2 “State-centred” - institutionalist Analysis

The assertion that state matters as the level of analysis in the systemic and *realpolitik* approaches has been the central point of much of the critics. It has then became necessary and very common to relax this assumption and launch a new avenue to the way of thinking. This newer alternative method is a “state-centred or institutionalist” analysis which brought a completely different viewpoint to the explanation to the formation of trade policy. The main difference is pertinent to its structure. The primary interest in this kind of analysis is its focus “on state’s relation to other actors *within its own society* as distinct from its relations with other states in the international system” (Odell and Willett, 1990, p.13). Because this is more interested in the state structure within the country itself rather than its power interaction in the international arena (i.e. the role of politicians, economic bureaucracy and domestic institutions), it has a domestic-oriented approach. Therefore some scholars like Frieden and Lake (1995, p.9) call it as a “domestic statist”

perspective with a starting assumption that the international system and the domestic societal effects are absent or limited. This is to claim that the role of national policymakers are essential in the trade policy setting.

However, this approach does not in itself yield a single approach to the state. It can be sub-grouped into two: The *statist* assertion of scholars like Krasner (1978) and Katzenstein (1978) are quite varied and may clearly be differentiated from an alternative version of *institutionalist* approach. The latter is apparent in the works of Goldstein (1986, 1988 and 1993); Destler (1986). Again the division is not very obvious and sometimes is blurred. What makes the main distinction is latter's strong emphasis on the significance and eminent role of the ideas and values.

2.2.2.1 The "statist" approach

This approach move forward from the systemic (internationalist) realism to analyse how the politicians and state officials, under both international and domestic constraints, may be determinant figures in the shaping of policy outcomes. This, so far as the trade policy is concerned, means how and to what extent may these actors play a role in achieving liberal or protectionist outcomes or adoption of this or that policy instrument. This approach view them as playing a intensive and pivotal role in the determination of the "national interest" in the complex cosmos where international and societal pressures exist. While proposing this role to the state institutions and politicians this approach admit them as central pillars of the domestic policy web. Krasner (1978) suggests, for example, that high-level executive officials/statesmen possess the duty of protecting and promoting broad national security interests and are accepted as developing preferences independent from the pressures and they do favour the national good from the narrow economic interests of various groups⁷⁵. The resistance of top US officials and EC Commission to protectionist demands are perceived as an evidence to this. Nevertheless, this approach is open to fierce criticism considering the rise of new protectionism starting from the early 1970s in the trade policies of both the US and the EU (then the EC). It is not very clear

⁷⁵ See Ikenberry et. al. (1988) in this point.

today whether the state officials i.e. executives and bureaucrats are really effective in promoting the national interests like maintaining a liberal trade policy outcomes or enjoy their authority against the domestic groups demanding protectionist policies. This revival of the state approach seems, therefore, misleading as it overemphasise the influence of state officials.

On the other hand, other variants of this approach proposes that the capacity of the state officials as decision-makers to resist private interest pressures in the lines of autonomous preferences, may differ from one country to the other. This capacity is lessened in countries where domestic structure is more skewed towards the influence of private actors and where state officials are more constrained by domestic demands. Katzenstein gives the situation in the US as an example of it (Ikenberry et.al.1988, p.10). Contrarily, in the case of countries having a more centralised and stronger domestic structure (like France and Japan according to him) a national-goal driven officials and executives are less prone to the demands of interest groups and the legislature and have a greater range of policy instruments to conduct the policy in accordance with their own purpose. Haggard and Moon (1995) come to a similar conclusion in the case of South Korea. They argue that the state manages to insulate itself from the influence of domestic interests and it was the authoritarian structure that permitted the government to pursue a strategy of development and an integration into the international economy. Nonetheless, this approach seems to be ignoring the fact that there are large industrial and agrarian interest groups seeking for protectionist policy outcomes and actually turn out to be successful⁷⁶.

Though the *statist* approach usually concentrates on the goal-driven behaviours of the state officials, this analysis does not totally ignore the view that institutions have a major effect on the trade policy formation. However, contrary to the *institutionalist* version of

⁷⁶ France, for example, is traditionally famous for its protectionist agricultural trade policy. It is also known as one of the members of the EC which favours a more protection-biased commercial policy. It is not a coincidence that it is the most notable user of trade protective trade policy instruments with a share of 40 percent for Article 115 applications and antidumping measures (for more detail see Schuknecht, 1992 chs. 5 and 7). Milner (1988) shows that private interests can retain even strongly centralised states like France. This view is also valid for Japan especially if the position of country is considered in its resistance to open up its rice market in Uruguay Round trade negotiations.

the analysis the starting point for the former is the capacity of the state officials and the relationship between their autonomous capacity and the external (i.e. international and market) forces.

We should admit that such analysis is an improvement of the systemic-level studies in the fact that they realise a linkage between international and domestic forces. Its inner analytical capacity, however, is limited for the reasons cited above. The autonomy of state officials is exaggerated. As Frieden (1988, p.88) puts “it [national interest] is internally determined by the socio-economic evolution of the nation in question”. Equally, while this approach centralises the role of state officials, they often do not take fully into account the role of the bureaucratic side of the structure. In other words, the concentration on the executive (governmental) officials and their purpose-driven behaviours does not encompass an equal understanding of the position of bureaucracy and its aims in commercial policy making and negotiations. In the case of the US and the EU, trade bureaucracy may influence the broad policy objectives and strategies and intervene in the negotiation process within the system of GATT/WTO. The European Commission, MITI in Japan and the US International Trade Commission (ITC) are efficacious “institutional actors” in the trade policy process. The limits of the statist approach and the significance of the bureaucracy in policy development provide a case for a deeper institutionalist approach for trade policy understanding.

2.2.2.2 *The “institutionalist” approach*

This approach depends on the proposition that a state as an organisational structure consists of various institutions and a series of laws and rules. The focus is centred essentially around the institutions, their constraining effects upon the state officials and the interaction between the institutional structure and external pressures.

Several scholars⁷⁷ came to agreement that a closer examination of the institutional structure and the relationship between these institutions and their power as constraints is vital. According to these, what affects the potent of political actors and help them shape their preferences and resist to various interests are the prescriptions and proscriptions of the institutional structure and the trade policy rules. This approach explicitly confirms the status of institutions as organisms which filter the pressures of domestic and international forces rather than simply reflecting their effects on the policy formation process. It may be possible to draw an analogy between them and the role of traffic rules and police maintaining the order in the daily rush of the traffic.

While it is assumed under this approach that the policy making is taking place in an institutional setting, some arguments go even further in proposing that the institutional structures, once established, are difficult to eliminate even when the simultaneously existing social and economic forces change. As J.Buchanan once stated correctly, “the institutions do matter-over the long run perhaps far more than the adoption of this or that policy option or the election of this or that politician or party”. This seems to be a true statement when we think that each institution embraces particular ideas or set of beliefs⁷⁸ at its foundation and continue to affect the policy making process even after the faith to this ideology starts to erode due to changing circumstances or by the advancement of contradictory ideas. Destler (1986), for example, claims that an increase in the level of protectionism in US industrial and trade policy since the early 1980s, is not merely a consequence of the societal pressures but also a product of the erosion of relevant governmental institutions and their decreasing capacity to resist protectionist calls. Destler emphasises the changing in the responsiveness of the legislature to such pressures from domestic industries having import-oriented difficulties and the increase in the domestic

⁷⁷ Of these, the studies by Goldstein (1986, 1988, 1989 and 1993) and Destler (1986) are notable for the institutionalist understanding of the US trade policy. In the case of the European Community, the literature using this method is not extensive.

⁷⁸ To clarify what these concepts may mean Goldstein and Keohane (1993) mentioned that *ideas are shared beliefs*. Goldstein (1993, pp.11-12) went further saying that these are *shared causal beliefs*. According to her “causal ideas are road maps showing actors how to maximise interests, whether those interests are material or ideational”.

political burden on the executive branch, mainly the President and the US Trade Representative (USTR).

The embeddedness of ideas in the institutional setting is the key point in the studies of Goldstein who argues that despite the mercantilist pressures generated by a relative economic decline since the late 1960s, the trade policy in the US has remained faithful if not perfectly to the free trade principle. This is a result of the dominance of belief in the liberal trading order in the US organisational system. Thus, while it starts examining the trade policy with the institutional structures and intercourse within that setting this approach attempts to demonstrate how the predominant ideas together with the complex institutionalised relations influence the possibilities of access for the interests of domestic forces and the abilities of government officials to carry out policy.

One common point in the institutionalist analysis embracing the prominence of ideas, beliefs and values is that they implicitly or explicitly accept the role of societal or interest group pressures in the policy making process. Henderson (1986) wrote;

“However, the activity of pressure groups is not the *only* factor involved.....It is when pressure groups can draw support from widely accepted economic ideas, which as I have stressed need not be those of economists, that their campaigns are most likely to achieve results”(Capie, 1994, p.22).

Goldstein (1993, p.12) perceives ideas serve as glue holding a group coalition together around a vision of common interests or for their justification. This combines the approach with an assertion of the importance of interests. This leads us to the third alternative analysis bringing a domestic societal approach to the understanding of trade policy process.

2.2.3 Society-centred Interest Group (Public Choice) Analysis

The society-centred or societal analysis radically differs from the systemic-level. It relaxes the assumption that nation-state should be the unitary actor and moves the focus away from international or statist constraints and opportunities to the importance of domestic

political-economic interactions. The unit of analysis is not the *state* but the *societal* (or *individualist*) preferences. Therefore studies applying such analysis concentrates on the demands placed on government by various segments of the society and their relationship among themselves and with the policy makers including mainly the politicians and the bureaucrats. The layers of the society are private actors ranging from firms in specific sectors, associations of industries, trade unions, consumer groups to private lobbying groups. In this analysis “interests” of the group of individuals is the convergence point. Therefore, it may be regarded as *interest group* approach. Because the interest group approach is mainly applied in the studies of academics advancing *public choice*, the societal analysis largely overlaps with it⁷⁹. Thus, we may regard the public choice analysis as a cogent alternative to systemic-level or state-centred analyses.

Two general points may be identified for the society-centred analysis at this point. *Firstly*, it can be said that, this perspective attempts to explain government behaviour and its responsiveness to “societal pressures” . This accepts the government as receptive and reflecting the needs and demands of the society especially in terms of the organised social coalitions. Governmental policy is seen as constructed so as to meet the requirements of the said coalitions. From this we deduce that the government or state officialdom has no or very limited authority or independence vis-à-vis the societal forces (thus a *receptive government*). In other words the government’s all endeavor will be to adopt policies satisfying these forces. Thus the state or government will have no power but to serve to the interests of those who are effective on them. Furthermore, as Gourevitch (1986) highlights, many studies applying this approach assume that government receptivity to private interests is very much dependent on the changes in the social coalitions and related to the temporal dimension. The basic argument is that “there seem to be no characteristic of state structures that can stand independently of social factors in explaining policy outcomes” (p.20).

⁷⁹ Not all “interest group studies are classified overtly by their writers as “public choice”, but it is not easy to make a clear-cut distinction as many of them apply the methodology of the latter. Historically, however, the interest group studies precede the public choice. Odell and Willett (1990) emphasise the intersection “overlapping with this public choice school is the even older tradition of interest group studies which dates from the early twentieth century”(p.11).

When we accommodate this approach to the trade policy it means overall that, the trade policy outcome, say a protectionist policy such as reaching a voluntary export restraint arrangement; a safeguard measure or a protectionist amendment to the anti-dumping regulation is a direct consequence of the activity of those who demand it and no intervening mechanism such as the existing institutions or personal choices of policy makers are effective to overturn it.

Second point relates to the empirical case of a widely adopted *interest group* study. This point is not totally distinct from the *receptive government* perspective defined above but provides a more in depth and micro analysis to societal interests and their political effects. Schattschneider's (1935) analysis of the Smoot-Hawley Tariff Act has been a pioneering study in this field.

A voluminous literature in trade policy has followed his work concentrating on the endogenous (domestic) protection seeking. Indeed, many economists have long expressed interest in actions taken by agents which endogenously act to influence prospective state activity for their benefit⁸⁰.

The basic argument in these studies has been, as identified previously, to reject the assumption that the state is the unitary actor but to accept that varied interests of particular private industries in shaping trade policies. At the methodological level, the unit of analysis has been changed from the *state* to the *individual*. This method brings a deeper and more fertile prospects of analysis as it warns us to stop focusing only on the national interests like aggregate economic efficiency or to increase the overall utility⁸¹. This seems to be

⁸⁰ As has been mentioned before, the literature concerning state intervention-seeking goes back to Tullock's (1967) famous study on the social costs of tariffs and monopoly. Both Krueger and Bhagwati in their subsequent studies, cogently explained that such endogenous rent-seeking activities in the national economy had caused wasteful diversion of resources into unproductive activities (see, Chapter 1).

⁸¹ This is not to say that notion of *national interest* or *aggregate figures* are totally disregarded. Contrarily, what we claim here, is to remind that not everything under the rubric of national interest may reflect its exact meaning and sometimes this concept may even be abused by some parts of the nation to maximise their own narrow interests. A very good example of it in the trade field is "fair trade" cases which helps those seeking for protectionist rents to claim that what foreigners are doing is against the

more objective and faithful approach when one considers that governments adopt policies not leading optimal outcomes in most of the areas of economic activity including trade policy at most of the times almost in all countries. In this sense, the studies following *society-centred interest group* approach are released from the wrong premise of the *systemic* or *realist* paradigms which “accept an optimal policy approach of standard international trade theory” and assume “that all domestic distributional conflicts within a society have been resolved”. It does not provide a deeper understanding if one believes that international trade problems and negotiations are really taking place among the nations. They are actually a complex web of interaction whereby different interests of individuals or groups of individuals clash with each other. In this web the governments and institutions are solely the intermediaries. However, this does not and in fact should not necessarily mean that their role is to be neglected altogether.

The interest group-focused analysis has been the working field of economists which we can classify as *public choice theorists* and *endogenous trade theorists*⁸². Both of these approaches following a societal approach helped us understand how interests are translated into policy outcomes. The main question they focus is *why countries prefer protection to free trade if the latter is expected in trade theory to bring more efficiency and benefit everyone*. Frey (1984) puts the question in a more direct and simple way as “the main task of public choice analysis of international trade policy is to explain *why we have protectionism*”. However, these approaches are not only limited to this question but aim to explain a series of related questions that the other methodic approaches and realist perspective can not. It is these interest group-studies that first provided a formulation for us to conceive as to *why the level of protection changes from one country to the other or from one industry to the other within the same country or from one time period to the other within the same industry of the same country*.

interests of the country. Thereby they open access for themselves to reach trade protection instruments. The concept of fair trade will be evaluated for the cases of the EU and US trade policies separately and in more detail in later parts of this study.

⁸² Magee, Brock and Young have been the initiators of endogenous analysis and applied it in the trade policy setting in the US in many of their studies. For a selection of literature on endogenous trade policy see, Brock and Magee (1978); Magee (1980 and 1984); Magee and Young (1987); Magee, Brock and Young (1989); Findlay and Wellisz (1982). For a critical survey of the endogenous tariff theory setting see, Nelson (1988).

Analytical studies such as Baldwin (1985 and 1989), Anderson and Baldwin (1987), Pincus (1975), Magee and Young (1987) and Hughes (1986) have extended the research of interest (pressure)-group activity to indicate how a *political market for protection* function and how market conditions drive the behaviours of societal actors. In this respect, public choice brings a useful course of methodology with its one of presuppositions that there are also *political markets* and that the protection has a kind of market where *demand* for it intersects with the *supply* under certain conditions. Thus the demand for protection of the industries to shelter themselves against the imports are reciprocated by the supply of it by government and politicians. If a political market for protection is established all the actors in this market should undoubtedly be expected to maximise their utility just like the firms behave in the product markets in traditional economics. This is a reflection of another presupposition in the public choice approach which is generally referred to as *homo economicus*. The approach assumes that all actors involved in the policy process including the voters, taxpayers, lobbies, bureaucrats and politicians are self-interested utility maximisers. D. Muller (1979, p.2) argues that “the basic behavioural postulate of public choice, as for economics, is that man is an egoistic, rational-choice maximiser”. As Buchanan, the distinguished scholar of public choice approach, revealed (1987) “there is at least a strong presumption that individuals do not undergo character transformation when they shift from roles as buyers or sellers in the market place to roles as voters, taxpayers, interest groups such as lobbies, politicians or bureaucrats in the political process”. The first task of the analysts following this approach, therefore, is to identify a variable within the choice set of both those who are demanding protection, and those who are supplying it. This helps to understand what determines the supply and demand elasticities of protectionism and how these in turn affect the working of the “market for protection”.

Thus, all individuals including those acting in the name of domestic industries or trade unions, politicians and bureaucrats behave in a rational way to be able to maximise their interests. In the market for protection, under this assumption, as indicated above, the politicians as “rational utility maximisers” themselves will have a self-interest in satisfying

the protectionist sentiments of organised private interests. This will help them seek “rents” of votes and revenue⁸³ just like domestic industries and individuals seek tariff, quota, licence or subsidy rents⁸⁴. Also in the supply side there are bureaucrats who look for ways of maximising their utility. Public choice theorists following the cogent works of Tullock (1965), Downs (1967) and Niskanen (1971) assume that bureaucrats have several private motives such as retaining their jobs or having a promotion. When there is a demand then there is a supply, when there is a demand for protection then there is the supply of it despite its adverse effects in the economy or at least in large parts of the society. It is helpful to examine the tenets put forward by the “pure” public choice theoreticians.

2.3 The “Pure” Public Choice Theory and Political Markets in Trade Policy Process

The theory of public choice developed as an attempt to explain why the outcome of interaction between politicians, bureaucrats, pressure groups and voters turn out to be economically inefficient and welfare reducing. It applied the general economic theory tools to the political decision-making or more specifically the policy choice process. In the words of Mueller (1979, p.1) it is the “economic study of non-market decision-making”. Public choice theorists, by relaxing the narrow confines of traditional neoclassical economics, analysed the aims and motivations of different individual or group actors within the domestic setting and the problems that stem from the interaction among themselves and with the policy makers. Thus, the domain of public choice study provided more comprehensive and worthwhile insights in understanding the large gap between what the neoclassical economic theory dictates and how the outcome comes out in practice⁸⁵.

⁸³ By revenue, we mean not only financial contributions to the political parties they represent, but also valuable information on protection-seeking sectors of the economy and about the position and sentiments of voters, to the parties, in exchange for favour. Moreover, the protectionist lobbies are able to exert pressure or threat through strikes and boycotts.

⁸⁴ For rent-seeking refer to Ch. 1.

⁸⁵ James M. Buchanan’s studies are pioneering in this field, though he himself accepts that the roots of the theory goes back to the works of K. Wicksell. *The Center for the Study of Public Choice* at George Mason University helped the early institutionalisation of the Public Choice studies. The basic literature of public choice is: Buchanan and Tullock (1962); Olson (1965); Buchanan (1975; 1990); Buchanan and Wagner (1977) and Niskanen (1971). Various theoreticians including Tullock; Tollison; Vanberg; Peacock; Wagner; Vaubel; Odell, Frey, Mueller et. al. write extensively in this field.

Public choice is a radical refutation of the assumption that “the market fails”. Contrarily, its endeavor has been to dismiss the mistrust about and skepticism for the market-oriented approaches and to prove that what constitutes inefficient economic outcomes and the decline in welfare should not necessarily be related to the working of the “markets” but the “political markets”⁸⁶. In the words of its founder, Buchanan (1990);

“Given the legal order of the protective state, we know that under some conditions ‘markets fail’ when evaluated against idealized criteria, whether these be ‘efficiency’, ‘justice’ or other abstract norms. We also know that ‘politics fails’ when evaluated by the same criteria” (p.81).

Hence, the public choice assumes ‘politics as an exchange mechanism’ (catallactics) whereby the policy makers sell their policies for votes or other benefits⁸⁷. Accordingly, politics is a complex process where the individuals involve under their self-interest motivations. In this process the individuals may seek to maximise their interests ‘collectively’. Buchanan (1987b) purports that;

“Politics is a structure of complex exchange among individuals, a structure within which persons seek to secure collectively their own privately defined objectives that cannot be efficiently secured through simple market exchanges” (p.246).

Thus, politics becomes the locus of balancing the interests of various groups in the society- such as domestic industrialists, trade unions and workers, exporters, farmers or consumers. However, political balance can be quite different than what the market balance provides. As Brittan (1988) describes;

⁸⁶ In this respect, the public choice approach can be classified in the ‘liberal’ tradition. The reasons are clear: First, the analytical methods applied are in the liberal tradition (for example, *methodological individualism* that rests on the individual choice as the basic unit of analysis and *homo economicus* that assume individuals to seek their own interests). Secondly, Public choice theorists are well aware of the fact that governments- (the state) is open to delusions. Thus, not all policies adopted by the state serve for the benefit of *all* citizens. Indeed the state may become a mechanism captured by privileged groups which maximise their interests while the rights of others are violated instead of protected. Therefore, public choice theoreticians decisively support a *minimal* and a non-interventionist government. For more detail see, Buchanan (1987a and 1990) and Savas (1989).

⁸⁷ Peacock (1992, p.13) subdivides political markets into three: First, is the *primary political markets* in which politicians sell their policies in return for the votes of the individuals. Secondly, there is the *policy supply* market in which bureaucrats offer alternative policy packages to promote the policy aims of the elected government. Third market relates to *policy execution* as an exchange between the bureaucracy and the individuals and/or interest groups.

“Politics is essentially about accommodating interest groups and that political wisdom consists in finding the right compromise between them....(However), horse trading between interest groups does not produce a healthy compromise. Each party is likely to be given some *concession*, the cost of which is spread over the whole Community, and thus seems only mildly damaging to the individual citizen. One group may be granted a tariff on foreign imports, another protection from the threat of new domestic entrants...But the harm done by the sum total of these practices and *special deals* is very far from mild. Each of us suffers from the concession to the groups to which we do not belong” (pp.260-261).
(*italics added*).

The term ‘concessions’ referred to under ‘special deals’ represent the *rents* that are only available if the government intervenes in the market. Trade protection measures are typical outcome of rent-seeking activities that special interest groups involve. The lobbying in political market in order to extract rents⁸⁸ is a substantial danger for the proper functioning of the economy and the costs are paid by those who have little or no power to change the balance to their favour in the “political” market.

Public choice analysis provides that in their goals or, motivations as driving forces of behaviour, all actors in the market -be them in the demand or the supply side- possess the characteristics of *homo economicus*; thus, the groups of politicians, bureaucrats, domestic producers and voters are naturally composed of individuals each of which aims to increase his own benefit. So far as the trade policy is concerned the operation of the political market is not different.

Domestic producers demand for trade protection and influence the agenda for trade policy issues. They can increase their pressure if they can act in a group collectivity (i.e. pressure group). For this, the groups do not hesitate to contribute financially for the organisation and effective lobbying. Anderson and Baldwin (1987) purports that:

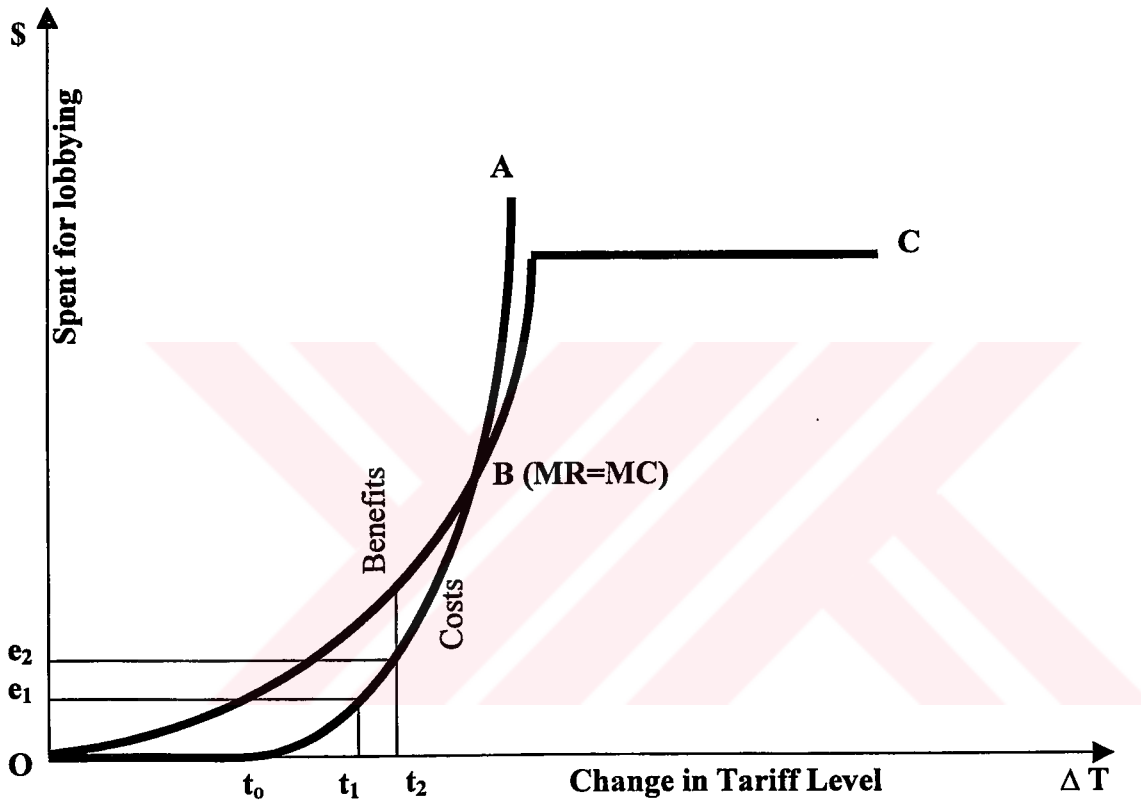
“If an industry is able to secure sufficient lobbying funds from its members, it will select the level of lobbying expenditures which yields the degree of protection that maximises the

⁸⁸ The rents referred to here are *artificially* contrived rents (see, Tollison, 1982).

difference between its gains and the costs of lobbying. Thus, an industry seeking protection tends to invest in lobbying activities up to the point where the marginal cost of further lobbying equals the marginal gains from influencing policies in its favour” (pp.21-22).

Figure 2.1 indicates that the industry spends OC_2 to be able to maximise its benefits from trade protection.

Figure 2.1 Costs and Benefits of Lobbying for Tariff Protection



However, the mere political self-interest motives of the group is not enough to manipulate the decisions of politicians and bureaucrats though essential in the decision-making process. The characteristics of the group are vital determinants for the level of protection and the type of the trade measure selected. Indeed, not all groups can exert the same pressure.

Table 2.2 Interest Group Strategy Matrix (à la Olson)

TYPE OF GROUP	GROUP CHARACTERISTICS							
	Free Riding Risk	Cost of Co-ordination and Monitoring	Main Difficulty	Lobbying Effect on Government	Benefit from Prevailing Ideas	Influence of Social Values and Motives	Benefits Expected to be Accrued	Trade Policy Measure Targeted
LARGE vast number of members with lesser degree of common interests)	high	generally high	interest divergence	weak	usually lower	high or low (social altruism)	evenly shared with a small portion	any measure (usually tariff; quota or a subsidy)
SMALL few number of firms and a high degree of market concentration)	low	generally low	high cost of lobbying	strong	may be used though not necessary		unevenly distributed (larger gains)	measures that yield higher protection (higher tariff; quota; ADD or a VER)

Olson (1965) has noticed that smaller interest groups can have larger pressure effects on policy outcomes and obtain larger gains⁸⁹. As Table 2.2 explains, the large groups have the risk of 'free-riding' and 'interest divergence' as well as the 'high cost of co-ordination'⁹⁰. Therefore, it is likely that smaller but more concentrated pressure groups can obtain trade measures that yield highest protection (such as higher tariffs; ADDs or VERs).

The Olson's group theory can be extended to the case where gainers and losers from protection seek to influence the trade policy. The interests of an individual consumer rests on the adoption of free trade policy rather than protection. Therefore, s/he is expected to support policies which contribute to maximise his/her interests. In practice, nonetheless, many governments prefer protection and most restrictive measures in most of the cases. This has some major reasons: First, the losers (free trade supporters) are large in number, however each individual is a potential free-rider in the 'free trade coalition' wherein the activity directed in securing the policy they favour has the nature of a 'public good. Accordingly, the members of a large group have the tendency not to make any contribution for the public good as they assume that they are going to benefit from the policy anyway (Stigler, 1974). Secondly, the benefit accruing from a free trade policy is relatively small while gainers from protection secure larger stakes. A protectionist policy is chosen because it gives a large beneficial effect on the protected groups like domestic producers or trade unions, while the cost of such a policy is spread thinly over larger

⁸⁹ The size (small or large) depicts the number of individual members of the group. According to Olson (1965), the larger the number of members in the group, the smaller the fraction it can get from collective good will be and the more individuals take part in the group the more serious the suboptimality in providing collective goods (ie. to pay for the 'lobbying expenditures'). He explains the reasons as to why these groups work more efficiently;

"...there are members who would be better off if the collective good were provided, even if they had to pay the entire cost of providing it themselves, than they would be if it were not provided...In smaller groups...there is the greater likelihood that a collective good will be provided; for the greater the interest in the collective good of any single member will get such a significant proportion of the total benefit from the collective good that he will gain from seeing that the good is provided, even if he has to pay all of the cost himself" (p.34).

Hence, this approach to the group theory suggests that it is not a necessity to have large numbers of supporters of trade protection, but a smaller group may suffice to obtain higher levels of protection. The "adding machine" model forwarded by Caves (1976) requiring larger industries employing too many workers and representing a sizable number of firms cannot be generalised in all cases as a determinant of the level of trade protection.

⁹⁰ The latter point was drawn by Pincus (1975) .

group of consumers (Baldwin, 1988)⁹¹. The protectionist decisions are usually made in the context of 'representative democracy', but not in a political process where they can *directly* express their choice. As Hillman (1989a) claims;

"Under representative democracy individuals do not have the opportunity of using their vote to influence trade policy directly... Voters are in general obliged to vote for candidates on the basis of the stand taken on a bundle of issues, rather than a single issue such as protection for one particular industry...(so) the probability of being the decisive median voter in any election is small. It may therefore be rational for individual voters to be ignorant about candidates' policy positions. The consequence is that policy choices under representative democracy need not duplicate the outcomes that would obtain under direct democracy... Since the expected benefit from voting is small, rational individuals whose value of time is positive have little incentive to participate by voting in political contests" (pp.43-44).

The policy package of the politicians may include such issues highly crucial for the future of certain groups that it worths for the latter to bear the expenditures of lobbying. In the case of a declining domestic industry it is not uncommon that the industrialists, trade unions and the voters in the region where most of the firms in the mentioned import-competing industry locate, allocate their resources and time for a protectionist policy and support politically the parties and/or politicians that include such measures in their election package. Industry-specific interests always dominate general interests of voters who allocate his/her resources into a wide spectrum of policy bundle under representative democracy⁹².

⁹¹ Empirical studies reveal that the total cost of protection can be considerably high as explained in earlier parts of this study. However, it does not change the policy choice since *either* the consumers are not usually aware of the fact, *or* that they know but have no incentive to influence the decision. The former is relevant to the *information asymmetry*. An individual is normally uninterested or unable to invest substantial time and resources in capturing information in the political process (see, Brock and Magee, 1978 and Teutemann, 1990). The latter is relevant to *ignorance* of the consumer as individual. Although s/he has the necessary information it may be irrational or economically costly to make lobbying on the decision-making process.

⁹² Weck-Hannemann (1990) states that trade protection is also possible under 'direct democracy'. She argues that "even when citizens have the possibility of deciding on trade barriers in direct democracy, tariffs are still maintained or even increased".

Politicians are central in the decision-making process. The way they maximise their interests is to get into power or to increase and keep it. They try to obtain the support of influential groups by giving them (or promising if they are not in power yet) special privileges (such as subsidy, quota rent or high tariffs) to be financed by less influential groups. McLean (1987) suggests that a Downsian politician should be close to the median voter⁹³. In single-issue policy choice case, like free 'trade vs. protection' or the choice of the means of protection, the politician will go in the same way. If those supporting free trade policy or a less restrictive trade barrier show little probability to represent the median voter (Hillman's approach above), it is rational for the politician to take part in the protectionist camp. This provides the politician to win more votes by giving more favours to protectionist groups than they lose by imposing costs on consumers. Thus, a political support public choice approach assumes that the politician is inclined to raise the protection level up to the point where the additional unit of increase start to reduce the political support. Brock and Magee (1978) argue that "the politician will raise his tariff until the positive of increased funds on his probability of election is just offset by the negative general voter effect

Bureaucracy is another important component of the supply side of the political markets. It is sensible to assume with the same logic that bureaucrats are utility maximisers and their behavioural character resembles to all other decision makers⁹⁴. Downs (1967, p.262) claimed that "every bureaucrat is significantly motivated by his own self-interest even when acting in purely official capacity". Public choice studies emphasise their ambition to retain as much autonomy and information as possible. What the bureaucracy is keen to maximise its budget and the space of activity. Their self-interest has a large spectrum including the maximisation of social position and authority areas, pride in good work, good furnished offices or being seen to do something. Niskanen (1971) describes it clearly;

⁹³ Following Downs (1957), most studies based on society-centred interest group (political support motive) approach assume that politicians pursue their own interest in the political market just like they do in the economic markets.

⁹⁴ Peacock (1992, p.68-73) establishes the linkage between 'utility maximisation' and the 'human nature' by referring to the writings of both D. Hume and A. Smith, and explains that human nature of the bureaucrat.

“Among the several arguments that may enter the bureaucrat’s utility function are the following: salary, perquisites, public reputation, power, patronage, output of the bureau...All of these variables...are a positive monotonic function of the total *budget* of the bureau during the bureaucrat’s tenure in the office” (p.38).

Broad discretionary powers delegated help bureaucrats in magnifying their position. In the case of trade, for example, certain trade protection measures like anti-dumping require specialised bureaucratic divisions which in turn like to exaggerate the need for such trade measures in order to explain the vitality of their existence. The sub-directorates C, D or E in DG-I in the European Commission and International Trade Commission in the US, for example, have central roles and wide discretion in the administrative procedures that lead to trade protection. Messerlin (1981) found that the larger the scope of the bureau in charge of protection is, the more likely it moves away from free trade.

2.4 Towards a Synthesis in Understanding the Trade Policy: A “Revised” Public Choice Approach Broadened with Values, Ideas and the Institutions

In understanding the political economy of trade policy we normally confront a complexity and a multiplicity of factors that makes any single method of analysis inadequate on its own. What is emerging is a synthesis. In this study, we accept the methodology of society-centred interest group analysis -public choice in particular- while acknowledging, at the same time, the influential role of some other factors (social values, institutions and ideas mainly) without which the complexities of the political economy of trade policy are difficult to grasp. These factors seem to be influential and complementary for a more concise and comprehensive *public choice* investigation.

The society-centred analysis perceives the state officials and politicians that they do behave in accordance with their own interests rather than the overall national ones. Nevertheless, this assumption of society-centred analysis seem to imply a state of affairs where trade policy lie outside the control of policy-makers. This is especially so in the “receptive government” approach. We may rename it as “the state or government as a mirror of interests of the society”. That is the domestic politics is imbalanced, the policy-maker is

seen as an auctioneer in a product market balancing supply and demand (Magee and Young, 1987, p.145). Their own preferences are regarded to be negligent and that they possess no ideas or values as to what is good for the economy and what is not.

The “receptive government” or “government as a mirror” approach is very helpful in the explanation of the domestic interactions of protectionism. Therefore, a public choice analysis dealing with the domestic rent-seeking activities seems more pragmatic and effective compared to systemic level or state-centred analysis. When analysing the trade policy, Schuknecht (1990, p.39) distinguishes the distinctive role of the domestic special interest lobbying and claims rightly that protection results from an *intra* rather than an *international* conflict. This domestic conflict of groups is a kind of Prisoners’ Dilemma. Thus, the public choice analysis as a societal approach, which assumes the receptive government reflecting the demands of special interest groups as an intermediary is a powerful explanation. This is to regard the government (or state including the economic bureaucracy) simply the reflector of political pressures from various groups whose members are attempting to maximise their short-run gains from trade by influencing public policy.

However the practical results of the receptive government argument will bring into our minds the fact that only those having a political influence or power will be able to determine the direction of the policy choice. Thus, if the domestic industry having no lobbying power enough to demand for protection will not be able to obtain it. Similarly, trade liberalisation policy will be available in a sector if the industry in this sector is having an extensive pressure on the government. Then, *how can we explain the situations in which weak industries⁹⁵ can get protection or how a country accepts liberalisation in tariff negotiations in a sector where protectionist pressures are high.*

⁹⁵ By weak industry, we mean those having no or limited *capacity to make a pressure* on the government officials to lead them to adopt policies they demand, not the industries having no or lesser *economic strength*, although in many cases these two may overlap.

This will necessarily require little relaxation of the receptive government approach in the public choice analysis. Therefore, a second set of models consistent with the view that individual voters and governments are motivated either by some *social considerations* and affected by certain *ideas* and *institutional settings* or government officials are regarded as having a certain level of capacity to follow their own public policy preferences. This means they are not simply the intermediaries of interests but may, depending on some other factors, pursue what they know best, though in a limited way. Let us analyse each of these main factors.

2.4.1 Social Concerns and Values

One important point in the trade policy analysis (and especially the understanding of the genesis of protection) is to evaluate the role of social concerns conditioning the societal interests. Many theorists today prefer to consider the interaction between the interests and the societal values or perceptions.

Baldwin (1989) cogently illustrates that social values or concerns also play a role in trade policy besides the self-interests. This requires a certain degree of autonomous behaviour by government officials where social values are introduced in the framework of trade policy. Two different but very related concepts are important to understand how the social values are involved in it.

First, the governments discovered that, sometimes it is much easier for them to find practical solutions with less visible short-run costs for economic problems they are expected to solve. The best way to do this may be to transfer the burden on to those who have no possibility to vote in the elections or those who have but are not able to see a correlation between the harmful effects of governmental policies and their political choice in the elections. The first group are foreigners on whom the government imposes the costs of protection. Because the foreign exporters or producers whose products' entry is restricted have nothing to say in the elections of the protectionist country, the government

will have no direct reaction from them⁹⁶. The second group are mainly the consumers who economically lose from protectionist policies. However, for certain reasons they may stay silent. These reasons can be divided into two. The first reason is very much related to the high costs of organisation and free riding as Olson (1971) explains it for larger groups like consumers who expect only a little benefit from acting as a coherent group. This will be explained in more detail in later parts of the study. Nonetheless, it is not this type of group-characteristic type of reason that we should assume when we try to understand their silence. It is actually related to *altruism* of the individuals and it is this reason that governments may sometimes use or abuse while adopting a protectionist policy.

Grasping the meaning and the role of altruism seems to be essential in the understanding of the economic policy formation such as trade policy. Individuals do not always behave directly in the way that their narrow interests dictate. They also have values that they consider humanistic i.e to help others. Contrary to the Bergson-Samuelson social welfare function, it is not only the individuals own consumption that determine his preference. K. Arrow (1975) advocates that altruism appears simply for two main reasons: The first is that an individual's welfare is not only depending on what he consumes directly but also the economic welfare of the others. Secondly, the individuals' own satisfaction may increase from the fact that he has contributed to the raise of the satisfaction of others⁹⁷.

This brings us to the second concept to understand the role of social values in the trade policy preferences. Just like the attitude that people give blood to others that they personally do not know, individuals may think that protection granted today any industry may be the one to be granted to their own industries tomorrow once the protection is

⁹⁶ There will of course be certain repercussions of a protectionist policy abroad where foreign exporters will complain about it to their own governments to do something. However, for the matter of simplicity, let us assume that the foreign reaction is very limited in the elections of the importing country.

⁹⁷ This should not be taken as an irony in studies preferring a "public choice" approach. As mentioned before, one of the basic assumptions in the Public Choice analysis is *homo economicus*. According to this assumption, the individual gives priority to his own self-interest and aim to maximise his utility. Nevertheless, it is also possible to expect that a satisfaction from an altruistic behaviour may also add to the total utility of this rational utility maximiser. This is especially so when altruism appears in a "reciprocal" manner. Following Trivers (1971), we may say that people help each other or give mercy with the hope that they may need it themselves in the future.

assumed to be a life-jacket. When this habit turns out to be a normal attitude then *protection* (i.e. tariffs or quotas) is seen *as an insurance policy*.

Hillman (1989a and 1989b) is among theorists who considers this situation as the “social insurance policy motive”. According to him, people view trade policy as having a role of insurance in protecting their incomes against unforeseen changes in the world markets (p.286). This point is first named by Lavergne (1983) as the “status quo model” in evaluating the trade policy through social values and concerns. Accordingly, protectionist policy is regarded as a response to the uncertainty of the market mechanism to be able to preserve the welfare level. Nevertheless, this requires a strict intervention of the government to the economy and cause further distortions. Most governments use tariffs or other restrictions indeed as an insurance for their domestic producers having competitive problems, especially if they wish to avoid large adjustment costs. Hillman is actually right when he regards that the “social insurance argument” has a market failure or efficiency basis. A similar approach is apparent in Corden’s (1974) “conservative social welfare function”. Corden (p.107) argues that governments prefer policies that avoid “any significant absolute reduction in real incomes of any significant section of the community” and this concept is helpful in explaining the “income maintenance” motivation of tariffs. This explanation is not contrary to the societal analysis of the trade policy especially when we consider the Olsonian group structure. Those that gain from protection may be less in number but well-organised to represent themselves at the governmental level. Therefore, it will not be unrealistic to conceive them as a significant section of the community⁹⁸.

Cheh’s (1974) analysis also highlights the same notion. It is also instrumental in emphasising the argument that the governments are not only receptive but also preserve their own interests. According to Cheh, when protecting the domestic industries, they aim at minimising short-run labor adjustment costs. They lower tariff cuts in trade negotiations so that they prevent significant reductions in the real income of labour.

⁹⁸ Indeed, what makes sense in the eyes of politicians is not the simple majority of voters but the qualified majority. The latter refers to the maximum number of voters who are able to determine the political future of the politician. Therefore the politicians only aim target groups who will be able to help them win the elections.

Some analysts consider the social insurance and societal rent-seeking models as alternatives in the explanation of trade protection⁹⁹. However, it seems more convincing to assume these two different motives to be complementary rather than substitutes. Willett (1989) even goes further claiming that “to obtain major protection it appears that direct political clout (interest motive) by the industry in question and a plausible basis for public interest (social motive) appeals are both typically necessary conditions and neither by itself is typically sufficient”¹⁰⁰.

2.4.2 The Functions of Institutions

Equally, some society-centred analyses do not appraise the role of the *institutions* at all. This is a missing point. The institutionalised structures may help shaping the definitions of interests. They may at least lessen, by limiting the accession into immediate instruments, the effect of organised interests transform into policy outcomes. For example, if the antidumping legislation makes the complaining procedure more difficult for petitioners, it would be more difficult for them to attain the antidumping duty protection whenever they wish. This will reduce the abuse of the antidumping as a protectionist instrument by the domestic producers. In the US, the transfer of authority in tariff negotiations from the Congress to the President in 1934, restricted the access of domestic industries to obtain protection due primarily to the fact that the Presidential Office was more difficult to capture and more ideologically oriented towards free trade than the Congress. This suggests that the roles of the executive (the President’s office) and Congress (vote maximising politicians) beside the societal interests are all important.

Similarly, while it is true that institutions are important in the policy outcomes; they are in turn affected by the interests. This is essential for the interests to institutionalise their claims and reach results they desire. The composition of the International Trade

⁹⁹ See for example, Hillman (1989).

¹⁰⁰ Parenthesis added.

Commission (ITC) is an important determinant in the direction of trade policy¹⁰¹. Until the second half of 1960's, the appointments for the ITC were mainly chosen among those who had been previously employed in the executive branch or academics. However, the role of the Congress increased after 1968. The total number of the appointees representing free trade interests decreased significantly (from 10 to 1) and the total number of appointees from Congress and domestic industries increased from 3 to 15. The new composition was a result of the raising protectionist pressures and ultimately helped them reach their aims (Baldwin, 1985; p. 96-97). In fact, the injury findings increased afterwards and the ratio of antidumping and safeguard investigations with definitive duties at the end went up.

Indeed the institutional approach provides a better understanding of the supply side of protection and brings a manifest explanation for the whole trade policy making process. Therefore, we can and should regard the role of institutions as a companion to, not an alternative for the public choice. Lake (1993) succinctly illustrates this point;

“the institutions are the filter through which societal demands must pass before becoming a public policy....The institutional approaches, assert that the structure and processes of government decision-making, while not substitute for other approaches, are consequential and integral to any accurate accounting of the pattern of protection” (p.xvi).

However, it is also important to draw the distinction, at this point, between the role of the institutions in the public choice explanation of the trade policy and the pure institutionalist approach under state-centred analysis. Our revised public choice approach starts from the demand side of the protection; that is the interests, while giving a posture for the institutions. The pure institutionalist approach, on the other hand, comes to the conclusion that policy is determined to a large extent by the state's central decision makers, whose attitudes and beliefs restrain their actions. Most studies¹⁰² in this latter group

¹⁰¹ The role of the ITC is important as it has a large responsibility in the trade policy making process in the US. For example, it is the responsibility of ITC to investigate the existence of an injury in the case of antidumping and safeguard actions.

¹⁰² Finger, Hall and Nelson (1982); Goldstein (1986); Takacs (1981) and Rogowski (1987) are to name but a few.

(institutionalist-state centred) have the common characteristic of granting a negligible attention for the demands for protection and little curiosity for the calculus of individual interests. Lenway (1985), for example, comes to a point that pressure groups have little influence in trade policy and argues that GATT is a constraining factor for the US trade policy. It is logical to assume the role of GATT as a discipline over national trade policies, but this approach is not enough to understand why we had experienced a new protectionist movement in 1970s and 1980s when GATT was existing. The main reason lies in the fact that this approach does not consider the domestic interests enough.

2.4.3 The Impact of the Ideas

Though it gives a considerable attention, the public choice approach do not in fact consider the interests as the sole determinant of the policy outcomes. The political and economic ideology of the policymakers also play a role in the direction of the trade policy. This does not mean that these ideas are totally exempt from the pressures of the interests over time. Both seem to affect each other and they both have the main impact on the institutional structure leading towards a liberal or a protectionist policy outcome or more or less protection granted to the domestic industries. However, which one (interests or ideas) have a more dictating effect over the other is not thoroughly unambiguous. For D. Hume, for example, ‘though men may be much governed by interests, yet even interest itself, and all human affairs, are entirely governed by opinion (ideas)’. Henderson (1991), claims a pivotal role for ideas beside interests. Accordingly;

“If it is held that the protectionist instruments of the 1980’s were the natural resort of governments which were prisoners of interest groups,... how is it that these same governments took effective measures to restrain public expenditure, to privatise public enterprises, and to reduce the scope of official regulation of domestic transactions? In order to account for the recent dualism....it is necessary to bring another factor, namely the power of *ideas*. It is the body of economic ideas, *as well as* the impact of the pressure groups, which lends impetus to trade interventionism.” (pp.28-29)¹⁰³.

¹⁰³ Quoted from Capie (1994) pp.23-24.

Two significant and inter-related ideas, namely *reciprocity* and *fairness in trade* (or more commonly known as “unfair trade”) have been apparently influential notions in both the US and Europe, that nurtured protectionists interests. The first has its roots from the mercantilist ideology which considers the exports as something favourable and imports as something to be avoided as much as possible. The societal beliefs that promote “to buy domestic products” or “to prefer domestic over foreign goods” implicitly guide ordinary citizens to approve domestic industries seeking for protection. Fairness is also another noteworthy embedded idea especially in the US trade policy¹⁰⁴. This is especially observable in domestic discussions over trade policy. Many politicians, in supporting the interests of their electorate, use or abuse the concept of “fairness” in such a way as to lead the public to think that it is really to their overall interests. The arguments like “our markets are more open to the exports of others than theirs to us” have been serious and prominent ideas that helped protectionist interests rise.

Nevertheless, the concepts of fairness and reciprocity, are alien to free market system and have no proper place in the liberal economic thinking. An outstanding example of the institutionalisation of these ideas has been the Gephardt amendment to the US trade acts. According to this, the countries having “excessive trade surpluses” in their trade with the US, would have been taken under scrutiny to determine whether they cause unjustifiable, unreasonable or discriminatory trade practices (Pearson and Riedel, 1990). The increasing number of antidumping investigations and duty impositions are a natural result of the concept of unfair trade (i.e. foreigners behave unfairly by dumping their products into our market with amusingly low prices). It is therefore too easy to obtain protection by

¹⁰⁴ The term “fair trade” has been a twin sister of free trade in the history of US trade policy, though they are conflicting concepts with each other. For example, the Trade Act of 1974 states its objectives as “to promote the development of an open, nondiscriminatory, and *fair* world economic system, to stimulate *fair* and *free* competition...”. The current Omnibus Trade and Competitiveness Act of 1988 also defines the trade negotiating objective as “more open, equitable, and *reciprocal* market access” (Sec. 101) and give special emphasis on the “*unfair* trade practices” of trading partners (Sec. 301). This is not surprising, if we consider the fact that the mercantilist ideas have never disappeared completely in the public eye, even during the heydays of the liberal trade periods such as the postwar era. This is one reason why “reciprocity” has been one of the basic principles of the US dominated GATT trading system and “fairness in trade” as the complementary part of “free trade” in most of the trade legislation. These concepts will be referred to in more detail in the following parts.

domestic interest groups, if they blame foreigners and hit them with strong ideas like unfairness.

The classical economic theory tells us that free trade is conducive to better allocation of resources and a higher level of employment. On the other hand, many politicians almost managed to change this idea by claiming that free trade is detrimental to employment in the domestic industries. This being the case, for a very long time period any trade liberalisation movement has been reciprocated by a reaction that it is not to the interests of the domestic economy. Many politicians played a pioneering role, either in order to promote the interests of the groups for which they act or for their personal belief, in persuading the large segments of the society to accept the malign effects of free trade. A prominent example is the argument advocated by J. Goldsmith (1994), a member of the European Parliament who concludes that “it must be a mistake to adopt an economic policy which makes you rich if you eliminate your national workforce and transfer production abroad” (p.18). Similar arguments were raised by politicians in the US for similar concerns.

However, what is more surprising is to see that these ideas were also shared by economists. Dornbusch, for example, claims that the US trade problems stem from formal and informal trade barriers in third country markets, especially Japan (1990). In this way, he explicitly claims the “unfairness” by others. Prestowitz et. al. (1991) argues that the postwar trading system is breaking down as its basic assumptions about free trade prove inadequate and a more realistic approach is necessary for both US and world economy. For him, the “reciprocity” should become the basis of future trade policy. Morici (1994) also supports a similar idea claiming that the position of US is disadvantaged vis-à-vis Japan for the fact that the latter is not as open as the US and the EC. Therefore he suggests that “United States should seek to redress the imbalance in trade, either by negotiating improved market access in Japan for American companies or by creating comparable benefits for them at home”. H. Daly and Goodland (1992), in their study asks “ if a country has managed to provide social insurance, high wages, reasonable working hours and other benefits to its working class, should it allow these benefits to be competed

down to the world average by unregulated trade?” By “unregulated trade” they imply that if government does not intervene in the free market i.e. continue to pursue a free trade policy, the foreign competition will pose a danger to the country’s economic well-being¹⁰⁵.

These beliefs either as ideological doctrines by politicians or doubtful economic ideas from some of the economists are important complements for the interests of those seeking protection domestically. This does not, of course, mean that ideas are always in the protectionist camp. The opposing liberal ideas and values do help the policymakers to resist the protectionist interests. This also helps us to understand why protectionism is not always high or why all protectionist proposals are not legislated. The protective effect of liberal ideas depends largely on how persuasive they are. The strenuous objections of the group of 1028 economists supporting free trade did not preclude President Hoover to prevent the Smoot-Hawley bill to pass in the US Senate (Dobson, 1976). On the other hand, the liberal views of the administration in 1981 managed to block the proposal of protectionist and discriminatory domestic content legislation by Congressman Ottinger, obliging the use of domestic contents up to 90 percent if the sales in the US market are larger (Low, 1993, p.116).

All these points, however, do not diminish the quality and advantages of the societal approaches and especially the public choice perspective. On the contrary, compared to the receptive government- based public choice approach, a “revised” public choice analysis enriched with ideological considerations, alternative institutional arrangements and social motives seem to a more satisfactory treatment of the political economy of trade policy. What we should consider is the changing importance and the relative degree of effectiveness of these considerations in terms of time, industry and the choice of policy instruments.

¹⁰⁵ Bhagwati (1991) explains these protectionist ideas by denouncing them in a very lucid way.

There are studies in the public choice school which do not underestimate the role of the ideas, social concerns and the role of the institutional structure in the understanding of trade policy¹⁰⁶. Amongst them, for example Baldwin (1985) recognises that as far as the behavioural patterns are concerned in the trade policy arena, the governmental pursuit of public policy goals follows not simply a self-interested calculation but also values and social perceptions. Marks and McArthur (1990), while accepting the public choice premises also consider the role of institutions. In their analysis of the determinants of protection in the US, they pay attention to the ideologies of the members of the Congress. In contrast to the perception that politicians vote on trade policy issues in harmony with the economic interests of their constituents, they conclude that their own beliefs and ideologies also affect their behaviour. In a mathematical analysis based on public choice Weck-Hannemann (1992) concludes that discretionary power of political agents and their own ideas are also important in protectionist policies beside the influence of private interest groups. According to her “the economic, political and institutional setting which determines demand and supply and their interaction in the political market for protection also determines equilibrium, i.e. the aggregate level of protection” (p.740).

This bridging is also apparent in studies focusing on trade policy issues beyond the political economy aspect. Bhagwati in his seminal *Protectionism* (1988) starts with the proposition that “profound commitments to policies are generally due to a mix of ideological factors in the form of ideas, interests and institutions” (p.17)¹⁰⁷. Such a mix is useful to be able to explain the varying degree of protection in different countries at the same time period and

¹⁰⁶ We have to reveal that the institutional structure and the idealistic notions do not emerge per se. They are formed out of a need. The societal interests and interactions create a demand for the establishment of as well as the modifications in the institutional structure. The prevailing ideas, on the other hand are not totally abstract and distinct from the human want. For example, there are deep-rooted pre-economic ideas which play an influential role in the formation of the policy. Though these ideas do not appear simultaneously with the interests, they may affect them in the succeeding periods of time. Similarly the institutional structural changes will certainly affect the policy formation in the country. But these changes of course, do not appear all of a sudden but a result of societal demands. Therefore we can accept a “spontaneous order” in which the interests motivate the ideas and institutions which may in turn change the structure of societal interests as incentives or constraints. It will be easier to understand this point when we consider the past examples of the US and EU trade policy settings in more detail.

¹⁰⁷ In this way, Bhagwati agrees that the role of ‘ideas’ and ‘institutions’ are very much mingled with the ‘interests’.

different levels of protection in the same country in two different times. A pure society-centred analysis may claim that this is mainly a result of the differences in the level of protectionist demands for economic reasons, but it may partly be a consequence of the non-identical setting of the institutions or differences in the prevailing ideas and beliefs between various countries or time periods.



CHAPTER 3. TRADE POLICY PROCESS IN THE EUROPEAN UNION: A “REVISED” PUBLIC CHOICE VIEWPOINT

Its (European Union) historic approach to international trade has been an uneasy compromise between liberalism and protection which might be called ‘managed liberalism’.
M. Wolf, The Resistible Appeal of Fortress Europe, 1994

The single market must first offer an advantage to ‘European companies’.
This is a message we must insist on without hesitation.
Signor Agnelli of Fiat.

The single market will be open but it will not be given away.
Jacques Delors (in D.G. Mayes, 1993).

We are not building a Single Market in order to turn it over to hungry foreigners.
W. de Clerq, Former EC Commissioner (quoted in Hamilton, 1991,p.378)

Those responsible for framing Commission policy are perfectly ready, as a matter of policy, to hear what the lobbies have to say.
L. Armstrong, 1973.

The ‘revised’ approach is illustrative in the case of trade policy processes within the European Union and the United States. In quantitative terms both the EU and the US play a major role in world economy¹⁰⁸. Any significant change or revisions in the trade policy orientation of such giant actors closely affect the trends in world trade. For a comprehensive investigation of the public choice approach, it would be helpful, empirically to view the directions and the principles embedded in their trade policies during the last few decades. In this part we deal with that of the EU.

¹⁰⁸ The EU (15) is the largest exporter in world trade with a total share of 20.2 percent and is followed by the US with a share of 15.8 percent (a total of 36 percent). The total shares of the US and the EU (15) in the whole world imports amount to 37.9 percent (19.9 and 18 respectively) which positions them in the first and second in world ranking (WTO b, 1997).

3.1 The Basic Characteristics of the EU's Trade Policy

As in other industrial countries, the EU has lowered tariffs on a wide range of manufactured goods in accordance with successive multilateral trade negotiations (MTNs) under GATT. However the liberal stance of the EU has been challenged due to the extensive use of the non-tariff barriers that has been apparent in various sectors having a downward competitive position vis-à-vis the goods of NICs. A World Bank (1991, p.104) report confirmed the increased resort to NTBs by the EU as an indication of the trend called "new protectionism". Accordingly, non-tariff protection has been increasing in the EU much faster than in other industrialised countries and the share of the imports affected by NTBs increased by 160 percent in two decades [1966 to 1986]¹⁰⁹. In terms of trade protection instruments, the EC had a strong preference for mainly the voluntary export restraints (VERs) and anti-dumping duties (ADD). The GATT *Trade Policy Review* for the EU in 1991 reported the existence of several VERs negotiated by the Commission for the EC as a whole, by individual member governments or by industry associations apart from the massive number of restraint agreements with a large number of textile and clothing exporting countries under Multi-fiber Arrangements (MFA). As Table 3.1 reveals, the EU has been the largest negotiator for the VERs in world trade notably in 1980's. In more than 50 percent of the VER arrangements negotiated in the world, the EU (then the EC) or one of the Member States have been involved (138 out of 261). This is especially high in sectors such as electronics, footwear, vehicles and car and agro-industries which the Community considered 'sensitive'¹¹⁰. Following the increase in the unfair trade allegations, anti-dumping duties had a solid ground in EU's trade policy especially for declining industries.

¹⁰⁹ Laird and Yeats (1990) estimated that the average of total EU imports affected by NTBs were only 20.8 percent in 1966 but it went up to 54.1 percent in 1986 (see especially Table 6, p.316). The figure was even higher in some Member States like France (81.6 percent) or the Netherlands (78.6 percent). Although these figures shall not be assumed as an evidence of the 'restrictiveness' of European markets, they nonetheless, constitute a good indication of the rising trend of protectionist measures that actual trade encounters.

¹¹⁰ The fact that the figure is relatively lower in sectors like textile/clothing or steel or that no VERs exist for chemicals, does not mean that there were no severe protection in them. In textile/clothing, the MFAs, the most striking organised protectionist arrangement ever negotiated, are not included in the figure. The textile sector has also been a regular applicant for protection under Article 115 of the Treaty of Rome. As for the steel and chemical industries, *anti-dumping duties* have been the most significant measure to protect the domestic industries.

Table 3.1 Voluntary Export Restraints operating worldwide and in the EU in 1988

Product group	Worldwide	EC		EC/W. (%)
		EC-wide	National	
Electronic products	19	5	11	84
Footwear	14	1	10	78.5
Vehicles/trans. equip.	17	2	11	76
Agriculture/food	55	36	4	73
Machine tools	7	2	1	43
Textile/clothing	72	18	3	29
Steel	52	14	1	29
Other	25	10	9	76
Total	261	87	51	53

Source : Adopted from McDonald and Dearden, eds. (1992).

The major aspects of EU's trade policy in the last few decades include the following:

3.1.1 The Habit of Trade Discrimination and Regionalism

The late 1970's onwards witnessed a resurgence of interests in the European Union in the direction of 'regionalism', bringing about an essential aspect of its trade policy, namely, the preferential trade relations. This practice of the EU is inherently based on discriminatory treatment towards many of its trading partners which is, in principle if not legally altogether, opposed to the 'most-favoured nation treatment' (MFN) of GATT. Indeed, it became an essential feature of its commercial policy. By its own words, the EU has expressed its basic attitude;

“For the Community there is no contradiction between these two positions [multilateralism and *regionalism*]. We have always believed that regional trade arrangements complement the multilateral system and represent an intermediate step towards the ideal of trade that is free of all customs duties and import restrictions among all nations” (GATT, 1991, p.16).

This tendency led the Union to sign a series of *regional trading arrangements* (RTAs) with many non-EU countries¹¹¹. However, these countries with which the EU had established such links were not those of an arbitrary selection. As Tsoukalis (1997) stated;

“The attitude adopted by the EC towards preferential agreements, and the actual contents of those agreements, used to be influenced mostly by two main variables, namely the level of economic development of the EC partner and its eligibility as a future member of the Community”. In most cases, the two conveniently coincided, since countries with a higher level of economic development were also, with very few exceptions, those which were considered as potential members. For the latter group of countries, preferential agreements were characterised by *reciprocal* concessions...For the others, who may be considered as the Community’s privileged partners in the developing world, there used to be limited or no reciprocity at all, although things have now begun to change” (pp. 241-242).

The discrimination is a typical nature of the EU’s trade policy choice where it diverges from that of the United States most. Two general motivations seem compelling in its orientation towards a regional approach¹¹²: First, is the increasing wisdom that countries should find ways for easier and quicker access to others markets than relying solely on multilateral negotiations of GATT. Bhagwati’s (1992) argument is applicable to the case of the EU;

“just as public choice theory *à la* Olson tell us in regard to the diffusion of consumer losses and concentration of producer gains that favour protectionist outcomes, the proponents of regionalism tend to be better focused and mobilised whereas the support for multilateralism is often more diffused and less politically effective and therefore takes second place when regionalism is on the political scene” (p.551).

¹¹¹ These are the agreements establishing *free trade areas* (known as ‘Europe’ agreements) with most of the countries in Central and Eastern Europe; a *European Economic Area* (EEA) with EFTA states; a *customs union* with Turkey and other preferential market access agreements with southern Mediterranean and many developing or less-developed ACP (Africa, Caribbean and Pacific) countries with which the EU Member States had traditional links. For an overall approach to EU’s trade relations based on regionalism, see Hine (1985); Winters (1993) and Baldwin (1994). For more detail on EU-EFTA trade relations under EEA see, Norberg (1992); for EU-Eastern Europe relations, see (Winters and Wang (1994) and Rollo and Smith (1993); for EU-Turkey trade relations and the customs union, see Kabaalioglu (1997).

¹¹² The following are comprehensive in understanding the factors driving trade policies into regionalist track; Bhagwati (1992); Anderson and Blackhurst (1997) and de Melo and Panagariya (1992). See also Akman and Dartan (1998) for a concise summary.

Because RIAs provides a privileged position for EU export industries and business in the neighbouring countries markets, many multinational corporations viewed them as promoting their interests. Second, RTAs were considered as proper ways for achieving sectoral interests. Both motives reveals that private *interests* have an outstanding role in 'regional' inclinations in EU's trade policy. The argument may be put as follows; *the domestic interest groups take a significant part in forming the shape of trade liberalisation under RTAs, more than they do under the multilateral negotiations.* These interests may be of free trade or protection oriented. From economic point of view, it is not surprising that the large firms in rising industries will prefer larger markets to benefit from economies of scale. Therefore the principal supporters of RTAs are business sectors in favour of opening trade. Private foreign investors also call covering investment issues and lobby to their governments and the Commission to start negotiations for a RTA with targeted countries.

Liberalising nature of regional trade arrangements does not deprive them of being captured by protection-seeking interest. These groups may become highly effective in accommodating diverse means and obtaining concessions to protect trade in RTAs. The EU manufacturers in "sensitive" industries such as textiles, clothing, chemicals, foodstuff and steel have always been effective in keeping the level of protection higher against like imports from Central and Eastern Europe and Turkey¹¹³. As Hoekman and Kostecki (1995) argue, protection-seeking lobbies benefit from large returns under RTAs as they have a 'bigger size of the protected market' at a regional level.

3.1.2 Reliance on the 'Contingent Protection' and the Attention to 'Sensitive' Industries

The institutional structure of the EU brings an administrative mechanism providing 'protection' to any organised industry, especially once the industry is assumed to be "sensitive". The fact that the EP's role is limited and the Parliamentary check and balance is rudimentary, helped special interests make a pressure on policy makers and especially

¹¹³ Hoekman and Leidy (1992) explains the 'holes and loopholes' inserted as a result of lobbying by protectionist interests during the negotiation stage, in such arrangements.

the Commission to supply desired measures. The restrictiveness of these measures are correlated to the organisational power of the industry in question. The trade regulations permitted domestic industries to petition for protection *contingent* upon the injury caused by either unfair trade practices of exporting countries (e.g. subsidised or dumped imports); or increased imports. The latter gave rise to 'safeguard' measures. The number of successful applications under 'contingent protection' have been significant, thus encouraging the industries use this track even for the industries in traditionally known as the most liberal Member States. As Wolf (1994) emphasised;

"Almost any industry is sensitive in at least one country. Important, in this context, is the ability of major firms to dominate policy debate in the Brussels bureaucracy. The inevitable result of log-rolling is that such sensitivities are reflected in policy. There are cases where policy of the most protectionist countries are liberalised, but the trade policy of liberal countries also often becomes more restrictive. This usually happens where separate policies turned into common policies (i.e. common rules for imports to protect trade), examples being steel in the early 1950s, agriculture in the 1960s, textiles and clothing in the 1970s and, arguably, automobiles in the early 1990s" (p.21). (Paranthesis added).

Thus, the commitment of EU to free trade has largely been under the influence of 'special interests' which seek ways of accession to the policy process in the complex institutionalised structure. The heavy reliance on legal regulation in trade matters in the EU provided the special interests with channels to reach protection. Two main channels were apparent: First was the lobbying directly at the Commission (European level) and the use of the legal track which allowed to petition for trade protection. The second channel was possible through national involvement in the Council of Ministers. Accordingly, special interests that managed to transform into 'national interests' disguised under the argument of national difficulties or circumstances, had been effective. This is not surprising because the EU policy should secure the delicate balance between the Member States having protectionist tendencies against those which favour free trade. Therefore, as Wolf defines, the EU trade policy has been a compromise between the interests and ideas

of free traders and protectionists; a rigid compromise between liberalism and protection. Nugent (1994) summarises the approach in the EU as follows;

“It is a liberal trading policy, however, which is not always pursued with complete consistency and uniformity. Protectionism is never far from the surface as the governments of the member states seek to cope with ‘special’ national economic circumstances and accompanying political pressures. EU trade policy is thus concerned not only with promoting the general liberalisation of trade, but also with ensuring that the consequences of this are not damaging. The result in trade policy being much taken up with matters such as the seeking of ‘special exemptions’ from general trade agreements, the negotiation of ‘orderly marketing’ agreements and voluntary export restrictions with more competitive countries, and the imposition of anti-dumping duties (p.387).

3.2 The Political Economy of Trade Policy Decision Making Process in the EU

The European Union’s system of taking decisions in the area of trade policy is a highly complex one having counter balances. At the critical points of deciding to draft a trade legislation serving the protection of a domestic industry; to apply a safeguard measure; to modify the provisions of the antidumping regulation; to bring a retaliatory action against another country or to formulate the draft of a regional trade agreement (free trade area or a customs union) with a third country, there are opposing interests each insisting on maximising their own benefits. Therefore, widely divergent and sometimes conflicting views compete to reach their ultimate objectives. Consequently the decisions are mostly the result of internal struggles and a final domestic compromise (EC Commission, 1993b). In other words, the decisions in trade policy arena in the EU requires an understanding of several domestic processes of reconciling divergent interests¹¹⁴.

In the domestic arena there are different actors representing different preferences. These are mainly the domestic producers and their associations sometimes organised around interest groups; exporters; consumer bodies; politicians and bureaucracies at both the ‘national’ as well as the ‘European’ level. All these create a complex nature of the process within the Union. Nevertheless, however complex the organisational structure and

¹¹⁴ For an idea on how the decisions are generally made in the EU under a complex institutional structure, See, Annex 3.

however distinctive the nature of the European Union is, in comparison to a nation-state system as a policy-maker in international trade, the existence of legally governed trade policy system and the set of trade policy interests enables us to construct an effectively 'society-centred' political economy approach. This approach shall, of course, need to consider the special role of the institutionalised structure and the trade policy ideas and objectives as conducive to protectionist measures. Therefore, it seems convenient to organise the discussion of trade protection policy in the EU around the concept of a "political market for protection" within a "revised public choice" approach where special interest groups seek to pressure policy makers to supply the desired measures (i.e. protective tariffs; antidumping and countervailing duties; quotas or voluntary export restraints)¹¹⁵ under a complicated institutional structure. Moreover, this system is not only composed of domestic institutions but also international bodies (like GATT/WTO) which have a certain degree of effect over the trade policy in the EU.

Decision making in the EU is not solely in the hands of single government, but in the hands of a *multi-level structure* with differing degree of control by voters in general and various interest groupings in particular. The EU is not a state in terms of a unitary government with absolute sovereignty. However, in many fields, and especially in the domain of trade policy, the EU enjoys a range of policy-making powers like the governments of the US, Japan or Canada etc. It has an "exclusive" competence¹¹⁶ in the conduct of external trade relations on behalf of all fifteen member states and implements a

¹¹⁵ The usual studies concerning the trade policy in the EU can roughly be classified into two groups. The first consists of studies with a systemic approach. This is a very frequent one where the interests of the Union are taken as granted and only the negotiations with the trading partners are focused. This intrinsically assumes an international prisoners dilemma and therefore flaws the existence of domestic conflicts in trade policy formulation within the EU itself. The second group is rare but manages to go into deeper analysis of the intra-EU realm of trade policy making (a societal-oriented approach). However, most of the studies in this group mentions divergent interests and the channels of their influence into the institutions of the EU superficially. They are most of the time quite vague about the strength of interests as demanders of protection and the role of institutions and European politicians and bureaucracy as suppliers. There are, of course, exceptional studies. Schuknecht (1992); Verreydt and Waelbroeck (1982) and Vaubel (1994) are to name but three.

¹¹⁶ This is a matter of legal discussion. Therefore it might seem negligible for political economists. However, this is an important point to appreciate the exact roles of the institutions in the EU over trade policy. For a clear understanding of the concept of 'exclusivity' in commercial policy of the EU and the division of powers between the Community institutions, see Bourgeois in Völker (1987; 2nd.ed) ; Neuwahl (1991) and Mc Goldrick (1997; chs.3 and 4).

“common commercial policy”¹¹⁷. Additionally, the issue becomes a framework open to a set of ideas which are also apparent at the national level. These ideas are an amalgam of values and perceptions which are similar to those embedded in the US trade policy. Take for example, the role of “level playing field” (commercial and social fairness) implemented through instruments like antidumping legislation supposed to bring *fairness* against harsh foreign competitors from NICs possessing lower cost structures and different industrial laws and regulations.

The case for an analytical framework based principally on an interplay of domestic interests, social values and policy ideas, is actually compelling for a true understanding of the pressures for protection and the reactions thereof. On the other hand, the institutional basis of the EU system does also require a scrutiny for a clear investigation of the edifice allowing the supply of trade protection.

3.2.1 The Trade Policy Setting in the EU: Is it All Different than in the US?

The basic motive underlying the determination of the protectionist policy instruments in the trade policy of the European Union is the self-interests of domestic producers converged around interest groups, politicians and bureaucrats who aim to maximise their utilities. The appraisal of protection in the EU trade policy in this way is akin to Buchanan’s *homo economicus* postulation. This approach is also valid for the US. The EU system, like that of the US, is very much dominated by domestic rather than international interactions. The only *difference* that we should consider in analysing the

¹¹⁷ Article 113 of the Treaty of Rome stipulates a *common* commercial policy (CCP) which shall be based on *uniform* principles. Many authors have argued that the Community has the power to conduct its own commercial policy. However the division of power over trade policy between the EC and the Member States has always been a controversial issue. Nonetheless, the interpretations stressing the Community’s power to conduct its “common” commercial policy on a Community level appears to be conforming to the system of the Treaty as a whole. Since all goods admitted to free circulation in one of the Member States are simultaneously entitled to free circulation in the Community, trade distortions would arise, unless the commercial relations between the EC and third countries were handled on a unitary basis. This argument is supported by the fact that the Treaty of Rome refers to a “common” commercial policy rather than to several or “harmonised” commercial policies of the Member States. In reality, on the other hand, the CCP is far from being complete as there are current applications which distort the *commonality* of the commercial policy within the EC. Article 115 is the most distinctive of these. For the “uncommon” character of CCP see especially, O’Cleireacain (1990) and Cremona (1990). Furthermore, the Commission has for long been unable to achieve a common import regime for certain sectors like textiles and cars (Hayes, 1993).

case of the EU is its complex 'supranational' structure and the degree of the role of the EU institutions in trade matters. Thus, the demand side of the protection market seems structurally the same as in the case of the US, though the influence of buyers (i.e. protectionist rent-seekers) might differ from one case to the other, whereas not exactly the same can be said for the institutional structural aspects of the supply side. Therefore, the level of protection as well as the instruments preferred may change. For example, while one industry in the US is protected by voluntary export restraints, the device might be the antidumping policy in the case of the EU. The differences might originate from various parameters including;

- the economic situation in the industry protected; such as the market entry barriers, the mobility of labour, demand elasticity of the product they produce. These are important for the influence of the demands for protection;

- the organisational structure of the industry as an interest group, i.e. how well the industry is in reflecting its pressures on the government through various ways such as lobbying; the use of information channels or economic muscles;

- the structure of the EU as a new form of 'supranational' authority. The structure in the EU is entirely different than a nation state. It also differs from the truly federal state structure of the US. The European Commission plays the role of the government with some shared executive competencies with the Council. The role of the European Parliament as a legislative organ is very low. It is generally the bureaucracy in the Commission that faces the special interests during its daily activities at the European level (Andersen and Eliassen, 1996, p.53);

- the institutional design and the permissiveness of bureaucracy for the protectionist demands. The case for antidumping actions is illustrative. In the EU, the system is based on a delicate balance between the European Commission representing the EU as a whole and the member states through the Council of Ministers (shortly referred to as the Council). The system allows a 'discretionary power' in dumping charges. In the US,

the checks and balances in the system are different. The responsibility is split between the Department of Commerce and ITC with no intervention of the Congress in the process. The discretionary powers of the ITC and the Commerce Department is lower, though still substantial, compared to those of the European Commission;

- the general statehood perception. For example, the number of countervailing duty applications was 30 times larger (332 to 11) than in the European Union between 1980-88 (see, Boltuck and Litan, 1991, p.5). The main reason for this is the difference of understanding for the position of state in the market in both sides. The Anglo-Saxon market-oriented approach in the US requires a state as less interventionist in the market as possible, compared to a more dirigiste and regulatory Continental European state approach. This is indeed a compelling reason to explain the high reaction to subsidised foreign exports into the American market¹¹⁸ and the frequent use of CVD by the US;

- the general feeling within the minds of people in the United States that the hegemonic power of their country over the world economy is diminishing and their country ends up with relatively more open market for the goods of other countries whose markets are closed to American goods. Thus, unfairness or reciprocity concepts turn into concrete policy applications like Section 301 requirements or 'voluntary import expansion' (VIE) measures. Because such a feeling is not in comparable highness in the EU as in the US, the counterpart of Section 301 in the EU (Regulation concerning New Commercial Policy Instrument) is not widely referred to.

¹¹⁸ The European countries, with some exceptions, had been more inclined to welfare state policies historically. Although the role of state in the economy may differ from one European country to the other, there is an overlapping. The only significant divergence is the British model. Edye and Lintner (1996), in classifying different approaches to the economic organisation in Europe, claim that;

“most European countries naturally retain their own emphases, preferences and diversity, but the adoption of German leadership in key aspects of macroeconomic management has led to the emergence of what increasingly resembles a ‘European model’. The only ‘alternative’, if this is the right word, is represented by the British neo-liberal approach which emphasises the market over the social” (p.183).

Accordingly, the “European social market” model is more bureaucracy committed, corporatist and encompassing than British capitalism with a marketised organisational approach to economic activities.

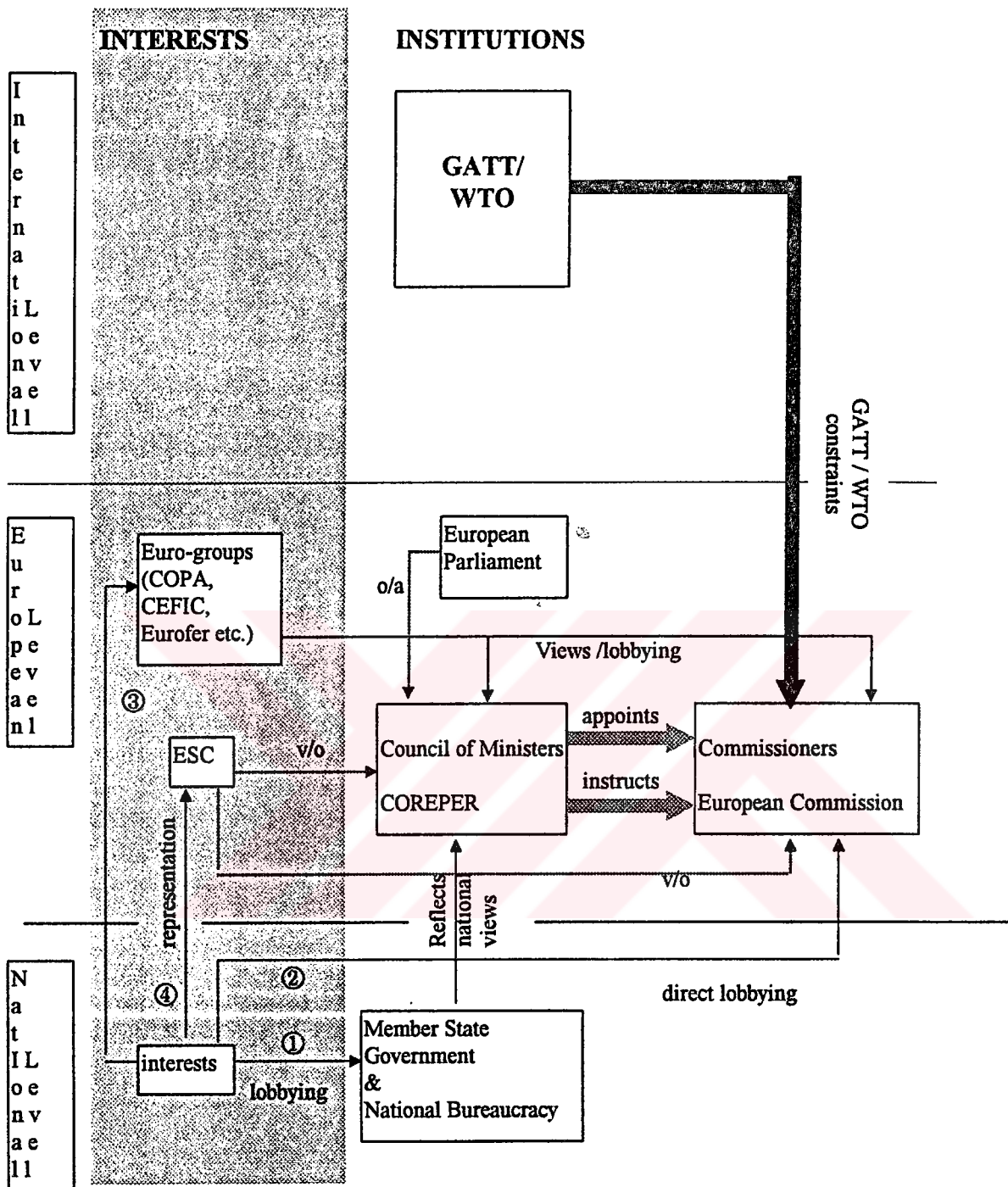
3.2.2 Trade Policy-Making Process and Access to Decisions in the EU

In all political systems, the organised interests search for ways of influencing the policy-making process to their own benefit (Mazey and Richardson, 1996, p.200). As the representation of private interests plays a crucial role in the functioning of the EU, it is necessary to scrutinise the 'process' of interest representation to be able to understand how the protectionist policies emerge and are shaped. However, it suffices to say that there are *multiple ways of access* for interests in the long and a multi-layered nature of the EU process (see, Figure 3.1). They use the opportunities in these process to keep themselves fully aware of the developments concerning their position and to press their cases and opinions on those making and implementing trade policy decisions (Nugent, 1994, p.258).

The boundaries of trade policy process covers the whole area of the 'common commercial policy' of the EU. The development of this policy required the establishment of a common customs tariff; uniform application of tariff rules such as how to classify goods for customs purposes; customs valuation and rules of origin; common trade rules including the trade protection measures to be taken in the case of dumped and subsidised imports and other safeguard measures; joint negotiation of trade agreements and other agreements covering trade matters, with individual or group of non-member countries as well as the tariff and trade negotiations under the auspices of GATT/WTO (Hine, 1985, p.75). The external trade policy of the EU is generally advocated to be liberal in the sense that the general level of tariffs are low¹¹⁹ and the EU has a wide range of bilateral and regional agreements with other countries to liberalise trade. Nevertheless, all these developments do not detain the EU to have a protectionist stance as far as the non-tariff barriers are concerned. This is especially the case in sectors having strong lobbies representing their cases both in their own capitals and in Brussels. The bureaucratic as well as *multi-layered* structure of the EU allows this.

¹¹⁹ The weighted average tariff level in CCT is only 3.6 percent in the aftermath of Uruguay Round.

Figure 3.1 Interests access in trade policy decision-making process in EU



v/o: views and opinions

o/a: opinion and assent

ESC: Economic and Social Committee

① ② ③ ④ : Alternative ways of representing the views and lobbying

The policy making process in the EU has two main layers: The 'European level' and the 'national level'¹²⁰. The powers and values of each of these levels (in reaching the supply of protection) within the decision making process are important for the interests to direct their attention. As the European Union represents a unique character of supranationality, the governance of trade policy like in other policies, is split among the EU institutions and the national governments of member states.

The European level of government in the EU, and especially considering the powers of the Commission in commercial policy, is vital for most private interests to have their voices heard before a final decision is reached. As Mazey and Richardson (1996) say;

“if the power has shifted to a new level of government, any sensible interest group is bound to attempt to influence policy-making at the new level. As one American interest group official put it you need to shoot where the ducks are!” (p.200).

A similar assertion is made by Andersen and Eliassen (1996) who claims that “key political actors in Europe, such as companies, interest groups and local authorities, increasingly direct their attention towards the EU” (p.45). According to them, most people now regard the Commission as the most important institution to lobby (*the location of ducks*).

Verreydt and Waelbroeck, on the other hand, claims that “the main channel through which both lobbies and general voters influence the Community (*EU*) is the governments of member states, via the Council of Ministers. They are themselves politicians” (p.377).

The roles of the institutions are mingled and needs further clarification. The tripolar division of powers in the EU is different than in the usual systems of ordinary states. The

¹²⁰ Verreydt and Waelbroeck (1982), following a similar approach, suggests a four-tier approach of decision making in the EC. They note that the “decision making with respect to the trade policy making is not concentrated in the hands of one government...Reality is a good deal more complex”(p.374-75). According to them, the four layers are *national bureaus; elected politicians; EC level and the GATT*. Greenwood (1997) classifies the dimensions as follows: “The multi-level character of the European policy process means that actors seeking to participate in European public affairs have a number of so-called routes of influence. At its most simple level, the ‘national route’ refers to the use of national governments to influence Brussels, whereas the ‘European route’, also known as the Brussels strategy, involves seeking to exert influence by representation direct to the European institutions themselves” (p.31).

Council and the Commission shares the legislative powers. On the other hand, the role of the European Parliament in legislative process is very low albeit some revisions and upgradings after the Maastricht Treaty¹²¹. Therefore, the interest groups will prefer the channels of influence leading to the Commission and the Council. For policy agenda setting i.e. at the stage of legislation of a new antidumping regulation, it would be better to save their energy for lobbying in these institutions. In the case of a new trade agreement with non-EU countries, the assent of the Parliament is not required. This makes the latter relatively less important in the eyes of the interests groups. At this point, a wider look at the institutional mechanism concerning the trade policy in the EU will be helpful.

3.2.3 Institutional Structure of the EU Trade Policy Process

The institutions in the EU have different roles over trade policy matters as stipulated in the Treaties. Their involvement is possible in *three broad areas* which are essential parts of the trade policy process. These are:

- 1- *Legislative process*, e.g. the enactment of legislation concerning trade policy measures. These are various legal means such as regulations, directives or decisions to implement trade protection, customs procedures etc.;
- 2- *Negotiation of agreements*, with non-EU countries. These include agreements at the multilateral level such as those under the auspices of GATT (i.e. Uruguay Round negotiations); trade agreements and all other agreements having a trade component¹²²;
- 3- *Executive role*. This is basic to the administrative role of the Commission concerning investigations of safeguard actions; unfair trade practices (imposition of ADD, requirement of price undertaking and CVD) or Article 115 measures.

¹²¹ As Nugent (1994) observes rightly;

“ the European Parliament (EP) is still commonly regarded as being a rather special sort of advisory body rather than a proper parliament. The main reason for this is that its constitutional powers remain considerably weaker than those of national parliaments. It does not have full legislative powers...” (p.206).

This indicates that as far as trade policy is concerned the EP does fall short of serving as a proper place to balance the interests of various groups, especially for free trade groups who have limited access to administrative bodies like the European Commission where protectionist groups are better represented.

¹²² Note that all association agreements, Europe Agreements etc. previously mentioned under the rubric of RTAs are not trade agreements but have a broader scope which encompass trade matters as well.

3.2.3.1 *The European Commission (The 'Commission')*

The Commission is an active agent in all of the three areas of EU's trade policy process. First, it is the 'executive body' of the EU having a wide discretionary power in trade policy practices (see, Table 3.2). All major trade protection measures are applied following the affirmative signs from the Commission as it is the main body to decide upon the existence of any alleged dumping or subsidy or any other situation that cause or threaten to cause an injury to the Community industry concerned. Thus, for practical interests such as affecting the dumping or safeguard investigations, it would be the suitable 'pool of ducks'. It is also responsible for the negotiation of voluntary export restraints¹²³. Secondly, the Commission's role in trade policy 'legislative' process should also be considered. The legislation concerning the trade policy measures requires the initiation by the Commission. It serves as the administrative mechanism which makes proposals for the enactment, revision or modification of any legal means. Finally, it is also the responsible body to propose a trade agreement or any other agreement having a trade chapter with non-member states and conduct 'negotiations' upon the authorisation from the Council.

The Commission is a highly open institution to pressures from different interest groups which seek to influence the agenda to their own favour in the EU. This is especially the case for better organised ones with a smaller free-riding problem such as domestic industries seeking the 'protection rents'. The organisational structure of as well as the powers assigned to the Commission provides this outcome for the following main reasons:

-firstly, the Commission has a wide latitude of powers in trade policy area which requires an extensive EU involvement compared to other fields¹²⁴. Take the case of dumping actions which serve for trade restriction purposes. The Commission has a great discretionary power so far as the calculation of dumping margins are concerned. This led

¹²³ Though VERs are normally GATT-illegal actions, the Commission officially takes part in the negotiation of such arrangements with the governments and firms of other countries. For Commission's role in these actions see, Schuknecht (1992, ch. 6).

¹²⁴ It is indeed not surprising that interest groups have a large pressure effect in areas where the involvement of the Commission is highest. Agriculture is another of such fields where a Common Agricultural Policy (CAP) is extremely protectionist. This is a result of the direct influence of farming society on the Commission bureaucracy. This in no way denies the effect of pressure groups on politicians (the Council) but a reflection of interests on the bureaucracy should not be underestimated. See, Messerlin (1981) for more on this argument.

Table 3.2. The roles and the involvement of EU institutions in trade policy process

	Legislative	Negotiation	Executive
Institution	Legal means for trade policy implementation	Trade agreements with non-EU states and GATT negotiations	Administration of trade protection measures
Commission	(agenda setting and initiation) makes proposals for trade legislation ; prepares drafts, re-examine and amend them initiates contacts with interest groups and get their opinions	drafts proposal of a new agreement ; presents recommendations to Council conducts negotiations on behalf of the EU; sets agenda for multilateral (GATT) negotiations	central body to administer procedures (opens and implements dumping; subsidy and safeguard investigations; calculates dumping and subsidy margins; searches for injury; imposes provisional measures proposes definitive measures) verifies 'Community interest' decides for actions under Art. 115 negotiates VERs
Council of Ministers (and COREPER)	takes decisive action (adopts <i>or</i> does not approve proposals)	approves the negotiation mandate and authorises Commission to start negot. COREPER discusses Commission's recommendation and places it on agenda; gives directives and guidelines to Comm. Council approves the final agreement to be ratified and signed	takes definitive action (i.e. imposes definitive ADD or CVD; a safeguard measure) considerable (especially through lobbying at the national level)

table 3.2 (cont.)

Institution	Legislative		Negotiation		Executive	
	Legal means for trade policy implementation	Trade agreements with non-EU states and GATT negotiations	Administration of trade protection measures	Trade agreements with non-EU states and GATT negotiations	Administration of trade protection measures	Openness to protectionist lobbying
European Parliament	<i>(pre-Maastricht)</i> advisory has rights to hearings in the Council and the Commission; proposes amendments	consultative support by means of reports and resolutions; much greater powers in regard to cooperation and association agreements under Art. 228 and 238) for its assent is required than they are in regard to trade agreements under Art. 113.	_____	_____	less due to its minor role more symmetrical representation for groups favouring <i>free trade</i> and <i>protection</i>	_____
Article 113 Committee	_____	gives consultation to the Commission for negotiations; reviews, discusses and takes decisions on trade agreements within the scope of Art. 113 plays a major role in establishing the Council mandates	_____	_____	less open than the Council	_____
European Court of Justice	applies, interprets and develops EU law helps shape EU trade law	applies, interprets and develops EU law helps shape EU trade law	provides legal redress	_____	not open as the judges are normally immune from direct pressures	_____
Economic and Social Committee	provides views and opinions	_____	_____	_____	not much lobbied due to its negligible influence	_____

many domestic EC producers to lodge complaints against allegedly dumped imports, thus the proliferation of protection by means of legal instruments ('contingency' or 'administered' protection).

-secondly, the Commission has a strong vested interest in EU centralisation. The Commission's bureaucracy is attracted to the largest budget (Vaubel, 1994). Thus, the complex structure of the Commission has separate units each specialising on particular sectors or issues 'sensitive' for these sectors. There are, for example, separate sub-Directorates with specific mandates such as Directorate C on 'anti-dumping strategy' (dumping aspects and investigations); Directorate E on 'anti-dumping strategy' (injury and EC interest) and Directorate D on 'sectoral commercial questions' including textile; footwear; steel; coal; motor vehicles; chemicals and shipbuilding, all under DG-I. It is noteworthy that these are the sectors that obtain the highest trade protection and trade measures that are most frequently applied. This should not be surprising as these sectors struggle for the establishment of such units that will specifically be responsible for their specific problems and the economic difficulties they faced. Therefore, the protectionist lobbying activities often associated with the Commission's staff damage their commitment to Community interests in general, but become more interested in their situation in particular¹²⁵.

3.2.3.2 *The Council*

The Council is composed of the national ministers of the Member States in charge of the issue under discussion. It represents the 'national' interests within the EU rather than 'sectoral' or 'special' ones. The Council members are politicians and it is an institution

¹²⁵ It is of course not only the "interests" and the "legal and institutional powers" that play a role in the formulation of policies by the Commission bureaucracy. The role of ideas should also be incorporated as identified in the "revised" public choice approach. The posture of the Commissioner and his/her personal *cabinets* (usually from the same country) and their commitment to free trade are also relevant factors for Commission's approach. The task of trade policy is under Directorate-General I which is directly responsible to the Commissioner in charge of External Trade Relations. It is encouraging that the Commissioner in question is generally from a country traditionally more in favour of free trade. No matter how important it is for the EU to take a less protectionist position, however other factors are immediate. The policy-making is open to outside assistance including sectional interests such as ETUC, COPA, CEFIC, CCMAC (described below) which favour protectionism. Furthermore, as Nugent (1994) claims officials in the Commission "can sometimes be less than wholly and completely EU-minded" and may reflect the protectionist concerns in their native countries.

which is naturally 'political'. It is the body that takes final decisions in the legislation process; approves and signs trade agreements and takes definitive action as protective measures (i.e. ADD) and becomes the final resort (i.e. safeguard measures) (see, Table 3.2). Like politicians everywhere, the Council members have a rationale to maximise their own interests in the name of national interests. As Vaubel (1994) defines it clearly;

“In a public choice framework, national politicians assembled in the Council must be assumed to maximise their power and prestige, their ideological objectives and amenities- all subject to national reelection constraint” (p.231).

The Council is the main 'legislative' body taking the final decision to adopt the Commission proposals or not. In taking decisions on trade policy matters the Council votes by qualified majority. Almost a quarter of the meetings of the Council in early 1980s were concerned with trade topics.

The decision-making process in the Council also brings the involvement of COREPER (the Committee of Permanent Representatives), national delegations of Member States based in Brussels. Many times, the meetings in the Council are held below the ministerial level with the participation of COREPER. Agreements concerning policy issues in COREPER are submitted to the Council as 'A' points for ratification without any further discussion in the Council of Ministers (Hayes, 1993). The role of the Council is not as significant as the Commission in administered protection. Although it is the body which decides for ADDs, CVDs and safeguard measures, it acts so under the guidance of the Commission.

3.2.3.3 *The European Parliament*

The European Parliament (EP) had a restricted role in the decision-making process in trade policy issues due mainly to its smaller role in legislative process. Especially in pre-Maastricht period, it served in its advisory capacity without having a strong influence on the Commission and the Council. It had no formal power to overturn any trade agreement concluded by the EC under Article 113 and its approval is not required except the consultative support. This actually creates a 'democratic deficit' within the EU in the case

of minority groups and/or groups representing large but loosely combined segments of the society, i.e. consumers.

3.2.3.4 *Article 113 Committee*

Article 113 (3) of Treaty of Rome stipulates that where trade agreements with third countries need to be negotiated:

The Commission shall conduct these negotiations in consultation with a special committee appointed by the Council to assist the Commission in the task and within the framework of such directives as the Council may issue to it.

This committee plays an important role in making of the trade policy. Its role is consultative in the negotiations but helps the Council establishing mandates. The Committee is composed of members appointed by the Member States and who have a great deal of experience in providing the delicate balance of interests among the Member States. Gray (1985) observes that the Committee members;

“...have a close knowledge of domestic political situations that are always important in international trade negotiations or disputes. And they have a knowledge of the broad limits of what is tolerable for the Minister and what is not. Second, [they] do not change that often. They know each other pretty well and sometimes very well” (p.24).

The Committee is the main contact point between the Commission and the views of the member states in trade negotiations. The smooth and a harmonious operation of this process is essential. During the Uruguay Round negotiations, for example, the consultation worked well the Committee approved most of the proposals of the Commission without referring it to the Council (Murphy, 1990)¹²⁶.

3.2.3.5 *European Court of Justice (ECJ)*

ECJ as the judicial body is the least open to special interest pressures. The only restriction that the judges may face is the possibility that they may not be re-appointed. Its role is to

¹²⁶ For an embracing analysis of Article 113 Committee, see Johnson (1998).

interpret and develop the EU law and provide the legal redress. Its decisions helped the liberalisation of trade substantially. Schuknecht (1992) goes further and claims that;

“the Court makes decisions which the Council is not able to make because of *national special interests* but which member governments would like to make. From this perspective, the Council “delegates” trade liberalization to the Court” (p.50). [*italics added*].

3.2.4 The Role of the Interests Groups in Trade Policy Setting and Formulation in the European Union

The EU gives a strong position to the interest groups in policy making. Since policy-makers at every level of government, need policy advice and further technical information, they also seek it at the European level in Brussels. For officials sitting in their bureaux in Brussels, this consultation is a useful source of collecting data and gathering knowledge; and is essential for balancing various views and establishing a consensus of interests. For these reasons, the assistance of interest groups representing the various segments of the society is an essential link for them to set agendas¹²⁷. However, this requires a formal and a regular way of integration of the interest groups in policy making process. The Commission, in this context, prefers to contact interest groups organised at the European level (Euro-groups) as much as possible (see, Figure 3.1). The Commission itself is the institution in the EU which initiates a legislation. It prepares the drafts of regulations or directives to be submitted to the Council¹²⁸. These drafts and policy initiatives are also circulated to the relevant interest groups (i.e. Euro-groups) to learn their opinion. For example, before the proposal concerning a new regulation on safeguard measures against sudden surge of imports, is submitted to the Council to be adopted, the

¹²⁷ For Nugent (1994), there are negative as well as positive aspects of the involvement of interests in the EU decision and policy-making processes. While it provides a more democratic structure by means of a broadened participation of all views and ensures that policy and decision making is not completely controlled by politicians and officials, it nevertheless may give way to some interest which are more powerful and influential than others to change the balance in their favour. This distorts the democratic structure by forcing the EU policy go into a protectionist direction.

¹²⁸ Article 113 (2) of the Treaty of Rome stipulates that the Commission shall submit proposals to the Council for the implementation of the common commercial policy. The definition of the process in the Treaty brings to our minds an implicit assumption that, it is the Commission where everything starts. However, in reality the things are not such formalistic. As Cini (1996) argues that aside from the formal requests “policy ideas emerge from a variety of sources...from national governments individually or jointly; interest groups...”(p.144).

views of the representatives of domestic producer groups are considered (European-level influence). Furthermore, the latter have also the chance of lobbying through the Council of Ministers (national-level influence).

The channels of influence at the European level, increases the importance of the establishment of Euro-wide organisations just like at the national level. Therefore, a rapid acceleration of Euro-interest group formation is evident (Mazey and Richardson, 1996, p.205). According to Butt Philip (1985) “pressure groups have come to recognise the importance of protecting and promoting their interests in the European Community by means of suitable Community wide organisations” (p.8). A Commission study (1992) reveals that the total number of interest groups seeking to affect the policy process in Brussels is over 3000¹²⁹.

Various business associations and lobbying bodies organised at the European level are specialised in different industrial sectors representing the European producers. Good examples of these are Eurofer for steel; CEFIC for chemicals; COPA for farmers; CCMAC for the car industry. As far as the imports are concerned their interests may converge and encourage them to take a united action in Brussels¹³⁰. Since they have a good information on the routes of access to the policy process of the EU, some of them know how to use policy choices. Schuknecht (1992, p.52) alleges that these groups have been specialised in seizing certain trade policy instruments like CEFIC (antidumping measures), the textile association (Article 115) or CCMAC (voluntary export restraints).

¹²⁹ Quoted from Greenwood (1997, p.3). There are more than 500 EU-wide federations representing business sectors, trade unions, consumers et. al. Some groups have a broad membership. Of those, the Union of Industrial and Employers' Confederations of Europe (UNICE); the European Trade Union Confederation (ETUC); the European Bureau of Consumers' Association (BEUC); European Environmental Bureau (EEB) and the Committee of Professional Agricultural Organisations of the EC (COPA) are important so far as trade policy matters are concerned.

¹³⁰ We should also mention bodies representing the interests of various giant companies from different industries and the Member States and having common benefits. The European Roundtable, for example, is an effective lobbying group for major European firms such as Philips (electronics/NL), Volvo (vehicles/Sweden), Hoechst (pharmaceutical/Germany) and Saint Gobain (France).

These groups also take an effective role in influencing the trade negotiations of the EU with non-member countries. The level of trade protection are largely determined under their influence. It is, therefore, not a coincidence that almost all regional trade arrangements of the EU contain sectoral exclusions and exceptions to free trade similar to those in GATT. They may be highly effective in inserting diverse means to protect trade. Many EU producers threatens contingent protection against the producers of the countries with which the EU has regional links. Many sectoral Euro-lobbies representing the interests of European producers become active during trade negotiations to obtain relief for their sectors. Textile and clothing is one which is treated as a special exception in almost all agreements of the EU. Special safeguards are also bestowed to iron and steel, thanks to the vigorous pressures of Eurofer, the European steel producers organisation. As Winters and Wang (1994) describe, for example the vigilant lobbying of European steel lobby as “always in the next door” to negotiations of the Europe Agreement to be finalised between EU and Romania.

Similar approaches of the pressure groups were also apparent during multilateral trade negotiations under GATT. For instance, both the European Textiles Bureau (ETB) and CEFIC acted on behalf of their affiliates and had consultations with the Commission on the Uruguay Round. The effectiveness and the intensity of these contacts are very much dependent upon the strenght of the organisation and the sensitivity of the issue in question (Murphy, 1990, pp. 126-127).

The presence of interest groups at the policy setting and formulation may cause the Commission to be ‘captured’. This suggests that while the Commission is claiming that it is objective and impartial in its decisions and representing the interests of the whole Community, it is in fact acting for the sectional and sometimes even marginal interests. This is normal under a public choice assumption that the politicians and the bureaucrats aim to maximise their own utility in the EU as elsewhere in the world. Some large but unorganised interests such as consumers may easily be excluded from the process (Cini, 1996). Indeed, the interest involvement is intrinsically biased leading to an uneven representation due to the fact that not all interests have the same power of influence or

pressure. Only some interest groups are real pressure groups¹³¹. Nugent (1994, p.427) claims that the success of the interest groups depend either on their apt to persuade the decision-makers that their interest are not all different than the national or general interests, or their power and information are enough to lead the EU decision-makers to listen to them.

Once these groups capture the Commission and the Council and have their views taken into consideration, this relationship may transform into a 'symbiotic' nature. This is inherently dangerous, as it can lead to an bureaucratic and political advocacy of protection (i.e. *administered protection*). As domestic producers are better organised and represented in the process than the consumers and foreign producers, the trade policy possesses a protectionist character. It is precisely this critical point that lead many public choice theorists and followers of Buchanan's advocacy of 'constitutional economics' to search for ways of constraining the 'political and bureaucratic capture' of government by narrow interests.

3.3 Trade Policy Instruments: Alternative Measures to Protect Trade in the EU

Each industry naturally demands for the most effective trade protection measure (i.e. yielding the highest rate of protection). Although each trade policy instrument is accommodated for achieving certain purposes like penalising the dumped or subsidised imports; relieving the injury caused by imports or confronting the economic difficulties, the EU in practice employed all these instruments as alternatives. The domestic interests search for ways of obtaining the most restrictive instrument so far as the institutional structure and external dynamics (like GATT obligations) allow them.

¹³¹ Interests are important but their degree of 'capture' depends to a large extent on certain parameters determining their pressuring power.

Table 3.3 The protectionist effect of EU trade policy measures

Trade policy measure	Protective effects-actual	Future role in post-UR period	Importance in the US trade policy
<i>GATT-compatible measures :</i>			
Tariffs (GATT bound)	moderate (high in sensitive sectors)	minor	minor
Anti-dumping duty (ADD)	high	considerable	considerable
Countervailing duty (CVD)	negligible	negligible	moderate
Safeguards	negligible	moderate (?)	moderate (?)
NCPI*	negligible	negligible	considerable (Sect. 301)
<i>GATT-incompatible measures :</i>			
Quotas (include. Art.115)	considerable	moderate	moderate
VERs	high	moderate (?)	high
Article 115	considerable	minor (?)	not applicable

Source : Adopted from Schuknecht (1992, p. 55).

As Table 3.3 indicates, certain measures had more protective effect than the others. Two outcomes are observable; first, EU resorted to GATT-incompatible measures, thus causing the disparage of the GATT system and secondly, it did not prefer the use of GATT-compatible measures frequently with the exception of ADD. (for principal EU trade protection instruments see Table 3.4).

3.3.1 Protection Against Unfair Trade Practices: ADD and Politicisation of Protection

The antidumping measure (ADD) has been one of the most esteemed trade instrument among the special interest groups as they realised its protective nature. As Table 3.3 reveals, its protective dimension has been considerably high. The European Community's antidumping measures found their basis in Article 113(1) of the Treaty of Rome. This Article provided for the adoption of uniform legislation to govern common commercial policy including measures of commercial protection against dumped or subsidised imports. The Regulation 2423/88 preceded by the Regulations in 1984 and 1968 gave rise to the

Table 3.4 Principal EU trade protection instruments*

<i>Legal base pre-UR</i>	<i>Legal base post-UR</i>	<i>Applicable cases</i>	<i>Remedy used</i>	<i>Investigative agencies</i>	<i>Decision-making institution</i>	<i>Final resort</i>
Reg. 288/82	Reg. 3285/94	Increase of imports that deemed to cause or threaten to cause serious injury to domestic industry (Community producers)	import surveillance; imports permitted under authorisations; quota limitations; negotiated restraints (not legal)	Commission	Commission	Council may confirm, amend or revoke Comm. decision if a Member State refers it.
Reg. 2423/88	Reg. 384/96	<i>dumped</i> imports whose release causes or threatens injury or materially retards the establishment of a Community industry	ADD to offset the margin of dumping or negotiated adjustment (price undertaking)	Commission	<i>Commission</i> (provisional duty and undertakings) <i>Council</i> (definitive duty)	None
Reg. 2423/88	Reg. 3284/94	<i>subsidised</i> imports whose release causes or threatens injury or materially retards the establishment of a Community industry	CVD to offset the margin of subsidy or negotiated adjustment (elimination or limit. of subsidy)	Commission	<i>Commission</i> (provisional duty) <i>Council</i> (definitive duty)	None
Reg. 2641/84	Reg. 8286/94	protection against illicit commercial practices of third countries that cause, i.e. tariff or quota; threaten to cause material injury to EC industry safeguard EC exports in third country markets	New commercial policy instrument (NCPI)	Commission (both for investigation and negot. of solution with countries concerned)	Council	Council has the final word

* The provisions in the pre-Uruguay Round Regulations are taken into consideration. Article 115 measures are not included in the Table.

initiation of proceedings following the lodging of complaints by any company, or any association acting on behalf of a Community industry which considered itself injured or threatened by dumped or subsidised imports. The protectionist nature embedded in the antidumping actions makes it necessary to explain why they are accepted as a legal tool. The GATT itself provided the opportunity for the adoption of legislation against unfair trade practices such as dumping (Article VI). Therefore, it is quite natural that the EU has a mechanism to combat against *unfair* imports. Indeed the mere existence of a regulation in order to prevent such practices is understandable when one considers it for a pure economic rationale. As many economists put it clearly, there is always the possibility of “unfairness” in the case of imports which are dumped or subsidised at the expense of the domestic production. The economic approach to dumping is relevant to its effect on the competitive structure of the market (Ethier, 1982). The Community’s definition of dumping is based on the relevant provisions of the GATT. Accordingly, dumping occurs in cases when a product is sold in the export market with a price (export price=EP) lower than its “normal value” (NV). The mere definition does not give rise to any unfairness allegation, because a price discrimination between two markets is something that a rationale exporter could do when he considers different market conditions¹³². Hindley’s (1991, p.25) comment illustrates the dilemma for an economist in the dumping case. He writes that “even trade policy officials who dislike the current use of antidumping policy are convinced that there is a sound economic justification for some form of antidumping policy”. The idea is that dumping will help some exporters to lower the prices to levels which are difficult for the already existing domestic producers to cope with and eventually

¹³² To establish the “normal value”, the Commission looks first for the price actually paid in the ordinary course of trade for the alleged dumped products intended for consumption in the exporting country. Where prices vary, a *weighted average* method is used. If there are no such prices actually paid, the following are used:

- i) price for the product in the country of origin; or if none
- ii) price of the like product in the market of the exporting country, or sales to a third country; if not available
- iii) constructed value: total cost of production + a reasonable margin of profit.

The existence of “dumping” is necessary but not enough to initiate an antidumping action. There must be 1) “material” injury or a threat of material injury to the relevant Community industry, or material retardation of the establishment of such an industry; 2) a “causal” relationship between the dumping practice and the injury thereof. A third condition is the existence of a “Community interest” in the antidumping action. For more detail concerning the procedure of antidumping action in the EC, see Bael and Bellis (1985); Beseler and Williams (1986); Vermulst (1987) and Bellis (1989).

force the latter to leave the market. The exporter causing dumping will attempt to achieve a monopoly and raise the prices in the market. This is a predatory action which is incompatible with the market mechanism.

However, this assumption is open to challenge by many economists who claim that such “predatory” intentions are difficult to achieve and they fear that “dumping” concept is open to abuse in the political market for protectionist purposes. Hindley (1991) claims predatory pricing is theoretically possible in an industry between two firms, one being better financed and more powerful than the other. This situation, however, has fundamental obstacles. According to him,

“The first question is that why the two firms do not collude over pricing. That is potentially cheaper means of obtaining monopoly profits than for one to try to drive the other out of business by charging low prices. The second is why one firm does not buy control of the other, which, again, is a potentially cheaper means of creating a monopoly than attempting to destroy the competitor through a low price strategy.....*and* as the number of firms in the world industry increases above two, and as the fraction of the world industry controlled by the dumping firm(s) falls, the plausibility of predatory pricing as the explanation of dumping rapidly declines” (p.29).

M. Davenport (1990) also claims that *not* all dumping practices are predatory. He comments that,

“Dumping could reflect the difficulties of forecasting demand and costs of storage or it may be a response to the costs of varying factor inputs and output with cyclical swings in demand. Either approach can generate non-predatory dumping at below marginal cost... There is no obligation in antidumping cases to establish predatory intent” (p.271).

However, the problem with the antidumping practice in the EU has been that the Commission authorised action against a wide range of behaviour that is not “predatory”,

and in cases in which such dumping is inconceivable¹³³. Table 3.5 based on GATT's review, shows that almost 62 percent (279/449) of the dumping complaints during 1980s ended with some form of antidumping measure. The antidumping has been one of most favorite trade defense instrument preferred by some of the Community industries in the EU. Chemicals, steel and steel products, office and computing equipment, non- electric and electrical machinery and consumer electronics are the leading sectors in antidumping cases. The EU's antidumping laws and practice helped them to ask for measures against imports of countries which were lower costs competitors with no unfairness at work. Take the case of the chemical industry which is not only notorious in its complaint against unfairly dumped imports, but also successful in reaching protection. Nicolaides (1990) emphasised the low rate of no-dumping findings in that industry in relation to the high rate of incidence of antidumping actions. His argument seems to be convincing;

“This may mean that the chemical industry is especially vulnerable to dumping or that it is more effective in its complaints. Given the evidence on the cartelized structure of the industry it is more likely that the latter possibility is closer to the truth (p.277).

The EU antidumping measures hit the imports of many developing countries involving steel products, basic chemicals and synthetic fibers to protect the cartelised structure in the first two of these sectors and to complement the protection in the textiles by means of MFA (Eymann and Schuknecht, 1993). However, protection through antidumping became a tool to prevent the main exporting countries to the EU from benefiting their comparative advantage rather than to defend the domestic market from unfair competitive practices¹³⁴. Thus, initially it was designed to strive against unfair trade, antidumping transformed into a mechanism which is itself unfair. The reason is relevant to its

¹³³ Actually the misuse of anti-dumping measures to protect domestic industry from any competitive import rather than a mere “unfair” practice has become very common in other industrialised countries such as the US, Canada and Australia especially during the “new protectionist” era. The ADD took the place of already lowered and bound tariffs in previous GATT negotiations and started to be applied as a new protective duty. This caused a circumvention for many domestic industries who claim they are exposed to unfair practices of importers, to lobby for the protection via ADDs and CVDs. These claims are, doubtlessly, reciprocated by the policy makers and bureaucracy in the supply side of the political market for the protection.

¹³⁴ This was apparent in the case of textiles from Turkey, chemicals and mechanical equipment from Eastern Europe, electronics and mechanical devices from Far Eastern countries and chemicals from the US and Canada.

politicisation due to technical and administrative patterns. These patterns are various and very much related to the great latitude of *discretionary power* within the hands of the Community bureaucracy in determining the criteria as far as the technical matters are concerned in antidumping actions. This is especially considerable in dumping and injury findings; in the implementation of 'Community interest' clause and in the selection of the instrument in positive findings. The administrative discretion makes it open to political pressures. This makes it easier for high value-added, large and tightly associated industries with extensive employment to abuse the case by means of a social advertisement that they face an unfair competition of foreigners who attempt to drive them out of business and that they have no choice but to be protected. As emphasised earlier, the necessary criteria to implement a protective anti-dumping duty were the existence of dumping; material injury or a threat thereof; a causal relationship between them and the existence of a Community interest. Consequently, the Commission's role in dumping investigation procedure is crucial for the final decision. Thus, a positive finding of the dumping and the injury helps domestic industries to support their case. Therefore the extent to which procedure applied by the Commission gives rise to positive finding is a clear indication for the inclination in the ECU in favour of high number of anti-dumping measures. The following propositions helps us to think that the EU approach to dumping actions had a protectionist nature:

a) The Commission is biased in finding the existence and high margins of dumping: Many studies highly criticise the EU procedures to calculate margins of dumping. At many points during the investigations, the requirements are set in such a manner to exaggerate the margins, and therefore to impose higher duties. Indeed, the abuse of anti-dumping legislation is possible in the technical details. There are many "tricks" that the Commission could employ. One common trick refers to the biased methodology that helps to find the mere existence of dumping and to calculate the "normal value" as high as possible¹³⁵. As Nicolaidis (1990) indicated:

¹³⁵ See, Tharakan (1993) and Hindley (1988) on the arbitrary calculation of the existence of dumping by the Commission.

“The nature of anti-dumping proceedings (in the EC) is such that an exporter cannot merely dispute the validity of the evidence against him but he must also prove that dumping has not occurred. This is intrinsically unfair because it may be impossible to prove that there has been no dumping. For example, there are often many ways in which fixed costs may be allocated over a multiproduct company’s operations or production runs. Accounting systems cannot give a unique picture of a company in all possible market contingencies. Nor they can indicate a product’s normal price (value) when the determination of such a price depends on expectations of future market trends, investor’s commitment to a particular company and the management’s investment horizon. The belief that normal prices can be derived examining company accounts is a myth” (pp.275-76).

Another important trick refers to the technique known as “averaging”, that the EU authorities preferred to apply in computing the dumping margin. Accordingly, to obtain a dumping margin, the authorities in the Commission must subtract the “export price” from the home market price of the exporter. In this case, assuming that both prices are ECU 100, then there would be no dumping at all when the EU accepts a “transaction-to-transaction” method.. Nevertheless the ingenuity of the Commission can derive a high dumping margin under this example by means of the “averaging” method. The system works as follows: The Commission does not consider a single transaction but a number of those with different prices for different sales for the same commodity. It eliminates low-priced sales in the home market of the exporter claiming that they are unprofitable. The home price, therefore is automatically a higher average of prices of the exporter’s sales in his home market. Secondly, the Commission treats all export prices above that average as inestimable. This helps the export price to be as low as possible and the margin highest ¹³⁶.

¹³⁶ The following numerical example will simplify the complexity. Assume that there are three unrelated sales of the same commodity. Each pair of the prices are determined as:

Normal value	Export price
15	15
12	12
9	9

If each transaction is taken on its own there will be no dumping necessitating an ADD at all. However, under the “average” method, the calculation is different. For normal value (NV), 9 is disregarded and an average of $15+12/2= 13.5$ is obtained. For the export price (EP), 15 is thrown out and an EC average of

b) The Commission has the discretion to find the material injury with ease: It is clear that not all dumping practices cause an injury to the rival domestic industry of the importing country. However, an injury must be related to it if the aim is to protect the said industry. This imposes the requirement that there is indeed an injury due to dumped imports. For the EU legislation, following the dictates of the relevant GATT article (VI), there is no need for a “serious” or a ‘substantial’ injury but a ‘material’ injury or a threat thereof suffices. Though it is indicated what constitutes a material injury, this does not eliminate altogether the ambiguity in the injury determination. Actually, in the EU the injury determination was based on an investigation of the volume of dumped imports; the level of prices of dumped imports compared to the prices of the EC industry and the impact of dumped imports on that industry. The Commission has applied two methods; ‘price undercutting’ (if the prices of the dumped imports significantly undercut the prices charged by the Community producers for the like product) or ‘price underselling’ (if the prices of the dumped imports have depressed prices). According to Tharakan (1993) “both methods are open to serious criticism” and “lack a sound economic basis”. His remarks about EU’s injury determination is disparaging¹³⁷ :

“The EC’s injury determination process is riddled with a number of shortcomings. In general it is rather ad hoc and unpredictable....Different methodologies could lead to radically different injury margins. This leaves open the possibility that the methodology used might be selected on the basis of the desired results” (p.585).

c) The “Community interest” clause not properly considered: The EU anti-dumping legislation expressly provided that an ADD could be imposed only in cases where the authorities decide that this action serves “to the interests of the Community”. This was an

13.5+12+9/3= 11.5 is reached. The NV (13.5) - EP (11.5) = 2 is the “margin”. This is 2/11.5 = 18% ADD which should actually be nil. I should thank to Dr. Hindley for explaining this detail to me. His article (1992) is illustrative for such tricks in the EU.

¹³⁷ See, also Vermulst and Waer (1991) for similar concerns. Another critical point for the injury determination refers to the practice of ‘cumulation’. According to this, before determining the injury the imports from the producers of several countries are cumulated. This makes a foreign exporter with a marginal share of EU market guilty of causing material injury to the Community industry when its share is added to those of others. Such cumulation, leads to unfair penalisation of exporters and face anti-dumping measures. This is an *unfair* characteristic of EU’s “unfair trade” legislation against outsiders!

additional requirement on the Commission before they impose the duty where they have established the existence of dumping and injury (Bellis, 1989). However, this test has not been used extensively, nor its exact boundary has ever been clearly defined. Under normal circumstances, it is expected that the clause serves for the interests of all parties beside the domestic producers. Eymann and Schuknecht (1993) noted that “in none of the 904 cases considered during the 1980s did the Commission rule against the imposition of antidumping measures on the basis of injury to users and consumers” (p.230). In other words, the Commission has used its discretionary power always in favour of domestic producers of the like products just as it did in the determination of dumping margins and injury. This is not surprising when one considers that the Commission (DG-I Directorates C and E) has an easy access for domestic industries who are in favour of some form of antidumping measures than other interest groups favouring totally unrestricted trade. This proposition is compatible with the assumptions laid down in our ‘revised public choice’ approach. As Tharakan (1999) puts forward:

“The theoretical and empirical work on the political economy of contingent protection, as well as several enforcement studies have given us considerable insight about the link between the lobbying activities of interest groups and the tenacity of anti-dumping practice” (p.189).

It is also relevant to the assumptions of the public choice approach about the rationale of bureaucracy. Thus, in support of the claims Messerlin (1981) made earlier, bureaus such as Commission may favour protectionist interests in order to maximise their own interests. Therefore, they prefer instruments; methods and procedures with less transparency and technically with a greater degree of complexity that will downplay the influence of free trade pressures.

The ADD compared to safeguard (explained below) is politically more easier (because it provides a higher protective effect) and ideologically more persuasive (because there is nothing to be ashamed of if one is protected against an ‘unfair’ action of others) and technically more practical (because it is in the hands of the EU authorities to apply), though it is not an economically impeccable weapon.

Table 3.5 Anti-dumping actions by the EU, 1980-1989

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	Total 1980-89
Complaints	20	29	24	27	71	62	46	75	57	38	449
Initiations	25	47	55	36	49	36	24	39	40	27	378
Measures taken thereof:	53	16	42	47	32	12	29	16	18	14	279
definitive duties	7	10	7	20	5	8	4	8	18	9	96
price undertakings	46	6	35	27	27	4	25	8	0	5	183
Findings of no dumping	7	7	3	3	4	2	4	4	0	0	34
Findings of no injury	1	6	6	8	6	15	7	4	5	5	63
Measures in force	53	69	111	156	188	166	187	169	133	120	--

Source : GATT, *Trade Policy Review, EC*, Vol.1, June 1991.

3.3.2 Article 115: A Forceful Weapon for Trade Protection

Article 115 is the main legal instrument that is applied to prevent the free circulation of goods which enter the Union from abroad. It is a typical safeguard mechanism whereby any Member State concerned, after having obtained the necessary authorisation from the Commission, could employ a protective action to block the targeted goods from a non-member country which come via another Member State in the EU (O’Cleireacain, 1990)¹³⁸. It is possible to invoke this safeguard clause with respect to two situations: First, the case in which the execution of the national regime risks being *obstructed by deflection of trade*, i.e. the relevant product is not imported directly to the Member State taking action, but through another Member State. Second, Article 115 permits for protective measures *where differences, still existing between the national regimes lead to economic difficulties in one or more of the Member States*¹³⁹.

The real reason for the introduction of such a clause in the Treaty was apparent. The drafters were aware that a safeguard mechanism would serve as a ‘safety valve’ in the early days of the Community between member countries with different trade policy regimes, some of which were more protectionist than the others, and which were required to liberalise trade among themselves. Because some of them traditionally had more severe quantitative restrictions, the Community did not require them to face competitive difficulties against products of third countries, once they open their customs to other members in the EC. However, the Article 115 was introduced for a mere transitional period until the completion of the commercial policy and elimination of differences of

¹³⁸ Note that Article 10 of the Treaty of Rome allows the free circulation (within the Community) of goods which are imported from any third country once “the import formalities have been complied with and any customs duties or charges having equivalent effect which are payable have been levied in that Member State, and if they have not benefited from a total or partial drawback of such duties or charges” (Article 10, para.1). Thus, Article 115 provides a derogation for any Member State to be able to protect the industry it deems necessary upon the application of that industry. For a detailed legal analysis of Article 115, see Oliver (1988; pp.184-199) and Timmermans (1987).

¹³⁹ A “deflection of trade” according to Smit and Herzog (1976), possesses an economic beside a geographic content and furthermore justifies a safeguard measure within the meaning of Article 115 only if it “obstructs” a measure of commercial policy. However, the degree of the seriousness of obstruction is not clear and therefore is open to the abuse by domestic lobbies. Another gap in the Article is related to the definition of the “economic difficulties”. The Treaty does not go into detail as to indicate what kind of difficulties can be deemed necessary to invoke the safeguard clause. Any avoidance of the statement may lead to application of the Article even under less serious difficulties. This being the case, it becomes very practical for industries in trouble to refer to this protective measure.

application among the members (see, supra footnote 118). Nonetheless, this safeguard clause remained applicable even after the end of the transitional period and introduction of a 'single market'¹⁴⁰.

Article 115 has been one of the most referred methods of trade protection in the Community. As we can traced in Table 3.6, there have been more than 3000 applications during the 1970s and 1980s. Almost every 3 out of 4 applications managed to obtain the approval from the Commission. It became a very common tool of protection especially towards the end of 1970s that the Commission considered to tighten up the procedural constraints for the application of the Article 115 by bringing Decision 80/47 in 1979¹⁴¹. Following the Decision the number of applications started to decline although the rate of approval remained steady. Some factors needs further scrutiny in order to understand the wider application of Article 115 mechanism as a safeguard to protect trade. These factors provide a good understanding for the public choice approach.

First, Article 115 brings a good mechanism for Member States to prevent the circumvention of their national quotas or other restraint arrangements through trade deflection. Indeed it helps the domestic industries continue to benefit the status quo of protection. This has especially been the case for textiles¹⁴², footwear, automobiles and agricultural goods and even smaller industries such as umbrellas and espadrilles (Schuknecht, 1991). Some of the Member States which are more inclined to trade protection have unsurprisingly been the most regular customers of it. For instance, almost 86 percent of the total applications during the 1980s were made by southern countries like France, Italy, Ireland and Spain.

¹⁴⁰ The Maastricht Treaty, which entered into force in 1993, did not invalidate Article 115. It, on the contrary, brought amendments to institutionalise the clause. The repeal of the words 'in case of urgency during the *transitional period*', and its replacement by 'in case of urgency' in the second paragraph of the Article reveals that the Article is prolonged for all.

¹⁴¹ The Decision 80/47 (OJ 1980, L16) provided a considerable power to the Commission. The Decision defined the scope (art.1) and types of measures (art.2) to be taken and stipulated the information that a Member State must provide to the Commission to be able to obtain its authorisation (art.3(2)). The Decision states that the Commission must be fully aware of the objectives of removing internal EC frontiers when authorising measures pursuant to this Article (p.26).

¹⁴² For Article 115 in textile sector, see van Dartel (1987).

Table 3.6. Article 115 applications within the EU, 1971-1988

Year	No. of applications						
	Total	Textiles	Other	Approved		Rejected	
				Total	%	Total	%
1971	33	5	28	30	91	3	9
1972	63	11	52	59	94	4	6
1973	51	6	45	47	92	4	8
1974	36	12	24	33	92	3	8
1975	78	40	38	64	81	14	19
1976	110	72	38	74	67	36	33
1977	121	75	46	79	65	42	35
1978	317	258	59	197	62	120	38
1979	347	269	78	260	75	87	25
1980	356	273	83	222	62	134	38
1981	255	184	71	166	65	89	35
1982	241	156	85	174	72	67	28
1983	253	176	77	188	74	65	26
1984	215	155	60	165	77	50	23
1985	211	143	68	176	83	35	17
1986	184	131	53	141	77	43	23
1987	182	122	60	157	86	25	14
1988	153	84	69	128	84	25	16
(1971-88)							
Total	3206	2172	1034	2360	74	846	26

Source : Schuknecht (1991, p.41)

Secondly, Article 115 allows the 'domestic producers' a better avenue to acquire trade protection due to its relatively low lobbying costs and opaque structure. The Article 115 procedure is more convenient for trade protection lobbies than some other alternative measures. As Schuknecht (1992) states,

“ Industries can lobby their own national governments. This facilitates protection seeking by small industries limited to national markets who would have difficulties in forming EC-wide organisations... Secondly, Article 115 protection can be obtained “low key” because the procedure is intransparent and not subject to GATT or other international scrutiny. This is abused by industries and policy makers who fear the publicity of antidumping and the popular mistrust towards EC-wide voluntary export restraints” (p.95).

Thus, Article 115 creates an access to protection market for weaker industries and while allowing the authorisation, the Commission is not afraid of international repercussions of Article 115 actions, because such internal barriers attract less attention of outsiders.

Finally, the trade protection in the EU under Article 115 is completely in the hands of the Commission which has a wide discretionary power to grant it or not. The maximisation of self-interests of industries, politicians and bureaucrats as underlying motives for trade protection, as set out in public choice approach is highly visible in the case of Article 115. The Commission as a bureaucracy presented a high approval rate (even more than under anti-dumping actions) validating Niskanen's (1971) and Messerlin's (1981) arguments that bureaucrats, in the long run try to expand their own interests. Schuknecht (1992), therefore considers the trade protection through Article 115 from a pure public choice perspective without even involving the concept of 'social concerns and values' by claiming that;

“ It is the self-interest of pressure groups, politicians and bureaucrats and not the political altruism (for instance social welfare, social insurance and fairness argument) which determines decisions under Article 115 by means of political and bureaucratic discretion” (p.96).

This argument makes sense when we consider that under more disguised tools, social concerns are not necessary. This facilitates for the Commission (under Article 115) and the

Council to provide trade protection measures much easier under certain trade policy measures.

3.3.3 Safeguards and VERs: From GATT-Legal to Illegal Measures

Another trade policy instrument in the EU has been the “safeguard” measure in compliance with the general escape clause (Article XIX) in GATT¹⁴³. It permits the Commission to impose ‘emergency protection’ in order to protect domestic industries that are seriously injured. However, the EU resorted to this special measure very rarely (not more than ten cases during 1980s). It is a fact that the protectionist interests in the EU had various alternative measures that could secure greater level of protection. A VER, for example, provided stronger and more effective relief from import competition. Its protective effect, as suggested in Table 3.3, has been higher than many other tools available.

Despite its economic costs, the VERs had particular advantages which rendered them politically more feasible. The superiority of VERs over safeguards are administrative as well as procedural. It is essential to emphasise that a VER is a suitable tool to circumscribe the requirement of non-discriminatory application of a safeguard measure. Thus, it has a ‘selective’ nature¹⁴⁴. This provides the administrative authorities to negotiate only with the most prominent exporters and escape the GATT obligation to compensate everybody affected thereof. The VER, however, intrinsically possesses a “compensation” mechanism for the foreign firms who are required to restrict their exports. The prominent

¹⁴³ The term ‘safeguard’ used here refers solely to measures resorted to by the Commission under Reg. 288/82 (replaced by Reg. 3285/94) and assumed to form an alternative policy instrument applicable under specific circumstances, unless otherwise stated. Safeguard measures usually consist of surveillance of imports or quotas. In many studies, on the other hand, this term was employed interchangeably to include other measures of trade policy like anti-dumping or countervailing duty etc. (see, for example, Hoekman and Kostecki, 1995 in Ch.7; Robertson, 1992 in Ch.3).

¹⁴⁴ According to GATT rules any country, including the EU, has to make a formal notification before it applies a safeguard measure to protect one of its industries from foreign rivals in emergency cases. However, this obliges the country in question to “compensate” all other countries that are affected consequently. This is a long and burdensome mechanism which may render the supply of protection difficult. The EU, on the other hand, always insisted on a ‘selective’ application of such measures bilaterally, by-passing Article XIX of GATT. The selective approach targeted imports mainly from the developing countries with increasing competitive power. Therefore, criticisms towards ‘selective’ EU policy were natural (see, for example Patterson, 1993 and Koulen, 1983). For arguments supporting selective practices, see especially Bronckers (1985).

characteristic of a VER reveals its perceived advantage in yielding higher protection rents. It became a preferred method of protection for the EU, as in the US, for the main reason that it involves a coalition of diverse interests which benefit from a protectionist trade policy. As the economic analysis proves (see Chapter 1), the VER is *politically* conceivable since it urges the foreign exporters to seek rents and search for rent-sharing mechanisms together with the domestic producers¹⁴⁵. Compared to ADD which provides no compensation for the loss of exporters, it is possible for the latter to change the case in their favour. Many foreign rivals who are threatened with high ADDs in European markets opted for a large “*voluntary* export restraint” (VER) in which they can get a satisfactory portion of the quota rent. Anderson (1993, p.133) claims that exporting firms accelerate in dumping to obtain more export licences in the future when there is a positive probability of a future VER. In this way, these firms with no lobbying power within the EU circles start to benefit from protection. The opposite is also true. That is, the domestic firms, by increasing their applications for AD investigations, may indirectly induce the Commission to start negotiations for a VER (Jones, 1994). Rosendorff (1996) claims that;

“Many of these VERs are the outcome of negotiations that originated as antidumping actions or other forms of administered protection” (p.544).

Although an ADD is contingent upon unfair practices, an interchangeable use of ADD and VER is actual. This is not surprising considering the fact that what motivates protection is the political influence of special interests. As Schuknecht (1992, p.120) claims the “*the fairness or unfairness of foreign trade practices is merely rhetoric*”.

It is clear that political market for protection allowed special interests gain from protection but the biggest losers are the household consumers that were forced to pay more or to

¹⁴⁵ Rosendorff (1996) asserts that:

“The VER has successfully facilitated collusion between the domestic and foreign firms-levels of output under the VER are lower abroad and higher at home than would have been the case without a VER” (p.552).

Indeed, in a VER, domestic firms take up some share of the market by the withdrawal of the exporting firms from the domestic market. They expand their output as foreigners contract theirs but the expansion is smaller than the contraction. Hence, the total production is lower than before, resulting in higher prices and profits for both sides. This is actually, nothing but rent created through negotiated market sharing agreement under a term “VER”. The Commission and politicians favour these privileged interest groups to appropriate these rents which will be impossible to obtain under free market conditions.

consume less. The loss is higher, the less transparent is the mechanism. Indeed, most of the VERs manage to escape from the 'public scrutiny'. They are mostly negotiated between the producers many times under the knowledge and involvement of authorities with no information delivered to the public. It is always difficult for the consumers to identify the exact cost of protection under a VER despite the fact that it is much higher than formal tariffs¹⁴⁶. Thus, VERs has been the most favourable protectionist device in the EU for firms with lobbying power both in their capitals and in Brussels and a mechanism of robbery with the help of the Commission and the politicians (the Council and Member State governments. See, *supra*, 1.4.6).

Another major superiority of the VER provides protection for longer periods and there is no concrete requirement like in the safeguard that it must be limited to the duration and extent necessary to remedy the injury. This is so, because the main objective of a VER is nothing but to institutionalise the protection.

3.3.4 New Commercial Policy Instrument: A Measure Relegated to Oblivion

The EC introduced a Regulation¹⁴⁷ in 1984 in order to strengthen its common commercial policy in areas not covered by the existing instruments. This new instrument was modelled on the notion lodged by the US in its Section 301 (though with differences as to its GATT-compatibility) and proposed to respond to any 'illicit commercial practice' of non-EC countries with a view to removing the injury resulting therefrom (Art. 1(a)); and to ensure 'full exercise of the Community's rights with regard to the commercial practices of third countries' (Art. 1(b))¹⁴⁸.

¹⁴⁶ Actually, it makes little difference even when a VER is declared openly to the public, as long as general free trade interests have difficulty in a collective political action in resisting it.

¹⁴⁷ Regulation 2641/84, OJ 1984, L 201/1.

¹⁴⁸ An "illicit commercial practice" within the meaning of the said Regulation means "any international trade practice attributable to third countries (non-EC) which are incompatible with international law or with generally accepted rules". Such practices also include the rights of the Community that it derives from GATT (such as the violation of GATT rules by non-EC countries at EC's expense) and justify the Community measures (i.e. a tariff or a quota; or suspension or withdrawal of concessions that the EC previously granted to the country concerned during GATT negotiations, see Table 3.4) where they cause or threaten to cause material injury to EC industry. For a comprehensive analysis and a discussion for the reasons of enactment of Reg. 2641/84 (nicknamed as NCPI) see, Bronckers (1985) and Steenbergen (1985).

In practice, the NCPI is formulated to protect the rights of EC industries in export markets against unfair practices and allows an EC industry to initiate a complaint to the Commission in prescribed cases. However, the Commission has no obligation to act (for instance, to impose a measure) even if the injury to the domestic industry could be proved. This instrument has not been in use except in a few cases¹⁴⁹, the reasons being compatible with the 'revised public choice approach'.

First of all, the EC industries have not been aware of the existence of such a measure to protect their rights in third country markets; or even if they have, they did not consider it applicable due to its lengthy procedure. Therefore, the demand for protection under this Regulation has been rudimentary (Murphy, 1990). Second, the supply side of protection was not permissive because the Community, before taking any action have to comply with its international obligations such as GATT requirements, and the discretionary power of the Commission was not expansive contrary to other trade protection instruments under CCP. Third, the EC has been reluctant to follow an aggressive trade policy (compared to the US) and the idea embedded in the minds of US policy makers that 'others markets are not open enough for our goods' was not compelling in the EC. Fourth, the NCPI had no social perspective or concern within the Community may be due to the reason that 'injury' concept in the export protection has never been as prominent as in import protection cases.

Nonetheless, the EU seems to be more concerned with the ideas of "unfair practices of others" and to "promote its export opportunities abroad. The new Regulation (3286/94, OJ 1994, L 349/71 "to ensure the exercise of Community's rights under international trade rules" known as "Trade Barriers Regulation - TBR) replacing NCPI is a result of the rising

¹⁴⁹ The NCPI is not a common trade protection measure in the EC. The first case was brought by the Dutch chemical company (AKZO) in 1985 where the complainant argued that the US procedures for appeal in its case discriminated against foreigners. In FEDIOL case (Case 191/82) 1983, ECR 2913), the EC Federation of Oil Industries brought a complaint against unfair pricing of exports of soya beans by Argentinean government. In another case, the complaint was lodged against Indonesia which was accused of failing to grant adequate protection to EC producers against unauthorised copying of their recordings (1987, 3 CMLR 547).

belief in the EU that the previous application did “not prove to be entirely effective” and “it is necessary to establish new and improved” procedures. This brings a concern that this measure will become a replica of the US Section 301 by-passing the GATT dispute settlement process and cause trade conflicts between the EU and its trading partners. The words of Bronckers (1996) put it clearly;

“Since, contrary to Section 301, the NCPI remained within the GATT framework, the NCPI’s effectiveness depended in large part on the threat of GATT-authorized retaliation. That was virtually non-existent...In this connection the decision-making machinery of the TBR becomes quite important, and is conducive to effective enforcement of the Community’s rights. This is due to the Commission’s leading role. In essence, the Commission can take all decisions throughout a TBR procedure until the very end. All of these decisions, except initiation, the Council can only overturn by special qualified majority. That is quite difficult for the Council...The fact that the threat of retaliation by the Community has become much more real than in the past, is likely to make the TBR a *more effective weapon* for European industries to remove foreign obstacles to trade” (pp. 317-318).

A “more effective weapon” may easily become “a more protectionist” one within the bureaucratic procedures of the Commission working under the pressure from lobbying groups.

CHAPTER 4. THE POLITICAL ECONOMY OF THE US TRADE POLICY

The history of American tariff is the story of a dubious economic policy turned into a great political success.
Schattschneider in Politics, Pressures and the Tariff, 1935.

What constitutes unfair, unreasonable, unacceptable trade can be invented in unending improvisations.
J. Bhagwati, The World Trading System at Risk, 1991.

Americans' freedom and prosperity are being sacrificed on the altar of fair trade... Fair trade is a moral delusion that could be leading to an economic catastrophe.
James Bovard, The Myth of Fair Trade, Cato Institute, 1991.

Two mainstream theoretical methods to explain the US trade policy dominate the literature. The first refers to analysis applying either *systemic* or *unitary* models which consider the US trade policy within the international setting where the state organism is treated as the basic unitary actor and it is assumed that any domestic conflict on which the policy should be adopted or particular trade policy tool that should be utilised have already been settled. Most studies can be categorised in these approaches which we titled as the “systemic-level” and “state-centred” models in the previous parts. Nonetheless, these models cannot provide satisfactory answers to such questions as to *why particular policies are preferred at a particular time in a particular sector* or *what factors influence the formation of the trade agenda of the US in its international trade negotiations* or; *what makes the difference between the ability of various industries in the US to acquire protection*. The main difficulty with these studies have been their underestimation of the “part of the iceberg below the sea level”. That is they have been negligent on the domestic interplay of actors that dominate the formation of the US trade policy before it comes to the international arena. They only considered the dominance of state officials (domestic statist) in the trade policy-making, thus omitting the interests of non-state characters and

domestic societal effects (i.e. the relationship between the politicians and the electors or; bureaucracy and lobbying groups)¹⁵⁰ .

An alternative group of studies devoted their interest substantially on the domestic conflicts within the American society following the need for more adequate answer to above questions and in order to be able to explain the simultaneous existence of the trends in the US trade policy for the liberalisation on the one hand and the gradual increase of the protectionist practices on the other. Thus, the model is based on the “political economy of trade policy” research that focus on the role of the societal interactions (*society-centred-public choice*) in the analysis of the trade policy decision-making within the US. Accordingly, most of the trade disputes between the US and other countries that seem at first sight to reflect or possess an *inter-national conflict* character, are infact having an *intra-national conflict* nature that includes the clashes of interests among various parts of the society (Schuknecht, 1990). Therefore, a public choice approach is a more suitable approach as an analytical framework for the US trade policy considering its realistic assumption that every individual -including the politicians and the bureaucrats- shall seek to maximise their own welfare levels which depends on the goods s/he consumes directly (Baldwin, 1985). Despite its incomplete nature, this assumption is a correct point to start for the US trade policy.

A pure public choice approach, as discussed previously, considers the public officials (the supply side of trade protection) do not act autonomously and have only limited ability to follow their own ideological beliefs or what economic rationality dictates on an impartial administrator. If it has been so there would not be any trade liberalisation policy and free trade would not be apparent in the US at all. In the words of Frank (1989);

“It would be a mistake to ascribe protectionist acts of government mainly to a failure to appreciate the intellectual case for free trade. By and large they are a reaction to pressures from special domestic groups acting rationally in their own interests” (p.55).

¹⁵⁰ A more detailed criticism of the “systemic-level” and “state-centred” models were discussed in Chapter 2.

Therefore, public choice is intrinsically a more persuading method to understand why the economic theory and social merits are disregarded in the policy-formulation process. Nevertheless, a “pure” public choice theory has always the risk of impossibility to explain why a government may *sometimes* follow policies that serve for domestically less active or dormant groups. The latter requires that complementary motives may be necessary to explain the trend in trade policy. Thus, an interest-based political support motive, albeit its fundamental role, must be coupled with other elements for a more concise grasp of the US trade policy. Denouncing a complete “receptive government” approach adopted in pure public choice theory will not decompose the premise of public choice approach but actually strenghtens it. This makes it easier to comprehend why and how “factors” like *social motives* such as altruism, social concerns, patriotism or equity; *embedded ideas and arguments* like free markets; fairness or reciprocity and the *composition of the trade institutions* such as the USTR; International Trade Commission or the Department of Commerce may help shaping the policy outcome. As Baldwin (1985) asserted;

“The introduction of social and interpersonal concerns into a public choice framework not only helps to explain why certain politically weak sectors receive import protection but to account for why legislation is passed that involves significant cuts in US tariffs” (p.25).

This brings us to a *revised public choice* approach which is also aplicable in the analysis of the US trade policy in recent decades¹⁵¹.

The ‘revised’ approach has the assumption that these factors may influence the ways the specific interests take in reaching their aims. Thus the existence of social concerns for altruistic or nationalist factors will help several domestic industries seek protectionist policies to enhance their interests in Washington D.C. when the state officials perceive such factors that they provide a social support for protection. Take the idea that foreign governments have unfair trade acts or foreign firms unfairly dump their products into American domestic market. This will help many domestic industries to ask for protection

¹⁵¹ The ‘revised’ approach does not take these factors into account as alternative tools of explanation but just complementary to the self-interest motives. However, there are several studies that have considered these factors as the sole or main motives to explain trade policy formation as an alternative to public choice approach. See, *supra* 2.4

against such allegations of unfairness. All these does not reject that these factors may be the outcome of interest motives but they in time turn to influence the interests (supra Chapter 2, footnote 43).

The US trade policy, today, rests on controversial ideas that have resulted in a capture and a protectionist misuse by spacial interests groups. These groups have the required resources, skills and lobbying power to manipulate the legislature to adopt protectionist and interventionist laws, and to guide executive and the trade bureaucracy to have an administrative discretion when the US industries have competitive difficulties both in the domestic market and abroad. This policy has two main legs. First, is the “protection against imports” for American industries who cannot, or are not willing to compete with imports under “fairly” competitive market conditions (Section 201) and protecting the US market against “unfair imports” (ADDs and CVDs). Second relates to “export protectionism”, a new element introduced in the trade policy aimed at promoting US exports and was directed at the policies of foreign governments which are considered as not providing a fair access to US products in their markets (Section 301). This assertion needs a further clarification for the role of fairness and its relevance to free trade.

4.1 The Changing Nature of the US Trade Policy: “Free Trade” and “Fair Trade”: An Uncompromised Coupling

On the eve of 1980s, B. Conally, the former American secretary of treasury stated that; *“it is time we said to Japan: If we cannot come into your markets with equal openness and fairness as you come into ours, you had better be prepared to sit on the docks of Yokohama in your little Datsuns...while you stare at your own little TV sets because we have had all we are going to take”* (quoted in Nivola, 1993, p.57). In 1990s Presiden Clinton’s words are on the same track as he promised to retaliate *“when imports unlawfully flood our nation...I have already informed the government of Japan that if the nation’s sudden surge of steel imports into our country is not reversed, America will respond”* (in, *Economist*, January 30, 1999). These are the statements from top US officials. However, it is not easy to understand what is *unlawful* or not *fair* in foreigners’ actions. In 1985 Senator R. Gephardt introduced a bill that would have imposed a 25

percent tariff surcharge against countries with “excessive” trade surpluses in their trade with the US (Bayard and Elliot, 1994). These statements and attempts were actually stemming from the ongoing concern of special interest lobbies in the US, which confess that foreigners’ competitiveness should be stopped to provide more market opportunities for the US companies. At the same time, such calls are consequences of the simultaneous existence in the US trade policy of two different and practically opposing views: On the one hand the US administration is favouring a trade liberalisation under multilateral forum of GATT while it welcomes a rising level of protectionist demands by means of the *administered protection* mechanisms based substantially on the *executive discretion*. The novel structure of the US trade perception starting in early 1970s permitted the mutual occurrence of protectionist trade bills enacted by Congress and the executive dominance of trade policy. Thus, the US trade policy has become more politicised under the pressure of domestic interests than ever before. Economic and political self-interests have always been principal motives stimulating trade protection policies in the US. This time, especially following early 1970s, they continued to play their significant role in the domestic trade policy decision-making process by the help of a more robust argument”: “*Foreigners are trading unfairly*”. It is understandable why some domestic actors hide their ultimate aim (i.e. to obtain rents in à la Tollisonian), behind such arguments when one considers that these arguments inspire altruistic and social perceptions and provide the nationalist enthusiasm for national industries in the public. This can be a complementary factor in rent-seeking activities, as argued in *revised public choice* approach, because it curtails the lobbying power of free traders and strengthen the position of domestic protection lobbies on the policy suppliers.

The rhetoric of *fair trade* goes back to earlier period. The starting point of modern version of the policy in the US is *reciprocity* in similar or related markets. For a long time the US has maintained a protectionist high-tariff policy until it reached its peak level by Smoot-Hawley Tariff Act of 1930. With the Reciprocal Trade Agreements Act (RTAA) in 1934, the US changed this course and admitted a gradual liberalisation policy based on

“reciprocal” commitments by the US and its trading partners¹⁵². This policy of relative openness of the American markets continued for a couple of decades. However, the US commitment to multilateral GATT system based on reciprocity and non-discrimination was not forever. Several factors in the changing *conditions* of the world economy started to ignite a general idea that the US is being cheated by its trading partners who benefit the openness in the US market for their exports whereas they do not reciprocate by opening theirs for the American goods¹⁵³. According to the proponents of this idea, free trade is acceptable only as long as it is *fair* trade.

Concerns over the insufficiency of GATT-reciprocity and market access abroad intensified in 1980s, when the US started to face large trade deficits to several countries, most notably Japan. This generated intensive political pressures and lobbying by industrialists and trade unions supported by politicians and even by distinguished economists to take measures and apply unfair trade laws such as anti-dumping, countervailing duty and Section 301 measures; or voluntary export restraints to alleviate the severe import competition that affected many domestic industries. In practice, the use of fair trade has been popular in both the import and export policies of the US and *unfair trade actions* to protect trade constituted almost 98 percent of all the legislated trade measures in the decade of 1980s. Table 4.1 reveals that protection of domestic industries against fair competition (Section 201) has only marginally been applied. Additionally, export-oriented voluntary import expansion (VIEs) measures preferred to GATT negotiations. In 1981, for example, Japan a notoriously-trade surplus country was persuaded (!) to adopt a VER on its car exports to the US market. The Reagan administration negotiated similar bilateral VERs with many countries covering miscellaneous product categories (See, Annex 4). In 1985, however, the US administration began to shift its attention towards measures that helped to open up foreign markets to American goods by means of VIEs (Irwin, 1994a).

¹⁵² For a detailed analysis of the change in the US policy following RTAA, see Dobson (1976); Pearson (1990); Destler (1992, Ch. 2); Goldstein (1993, Ch. 4) and Low (1993).

¹⁵³ The modern version of “reciprocity” referred to here is protectionist-oriented “aggressive reciprocity” and different from what the drafters of GATT intended to institutionalise, but took an altogether divergent form. Bhagwati and Irwin (1987) calls it “reciprocitarianism” to differentiate it from free trade friendly GATT-reciprocity.

The US trade laws delegated to the President and his trade representative (USTR) the necessary power to enter into bilateral dealings with any country which has trade practice that may be deemed “unfair” by the US. The unfairness is a flexible notion which can be expanded indefinitely covering matters to equalise trade balance through non-market dealings or differences in wage levels, working conditions, governmental policies and institutional structure concerning the daily economic life. However, this is a dangerous attack on free trade and the very notion of comparative advantages. As Bhagwati (1991) observes rightly;

“The problem with trying to include such things, and indeed all policies and institutions, as the natural target for objections that they affect trade and must therefore be scrutinized and changed to suit one’s advantage if free trade is to be allowed, is simply that one is opening up a Pandora’s box. Those who seek this wider mandate in looking for policy and institutional differences as sources of unfair trade are essentially arguing that everything affects trade, that policy on virtually everything will affect trade, and therefore that every policy can be put on the line in discussing what is ‘fair trade’ and hence a prerequisite for legitimate free trade...In going down this unwise route, the American trade policymakers put the world trading system at risk: If *everything* becomes a question of fair trade, the likely outcome will be to diminish greatly the possibility of agreeing to a rules-oriented trading system. ‘Managed trade’ will then be the outcome, with bureaucrats allocating trade according to what domestic lobbying pressures and foreign political muscle dictate” (pp.21-22).

But, has *everything* become a concern for fair trade? Once the door is open to a result-oriented approach the political structure allows any foreign measure taken within this sphere. The notorious Section 301 provided the President with a discretionary authority to retaliate against ‘unjustifiable and unreasonable’ foreign barriers. What constituted “unjustifiable” or “unreasonable have been a wide range of activities from border measures against American exports to domestic marketing systems¹⁵⁴. A list of the principal types of

¹⁵⁴ One significant example has been the *keiretsu* system in Japan. This is a special vertical relationship among many Japanese firms whereby a grouping of hundreds of component manufacturers do their business with a giant firm. For example, in the car industry, Toyota owns shares in many of its components suppliers and buys the bulk of its parts from them. These suppliers work with the manufacturing firm, Toyota to develop parts for new models from the earliest stage and even shares the costs. This complex organisational system provides the main firm to have a competitive power. Many

informal import barriers that American negotiators brought on the table in their talks to their Japanese counterparts in the 1980s included product standards; testing and certification processes; customs procedures; intellectual property right protection; government procurement practices; administrative guidance and governmental regulations allegedly inhibiting the use of foreign goods (Lincoln, 1990).

4.2 The Reasons of Change in US Trade Policy: Domestic Interests in the Pursuit of Fairness

Several factors underlying the shift in the US trade policy towards a *managed trade* have been purported. The fundamental one is relevant to the America's diminishing economic position. The US economy has constituted almost 60 percent of the world manufacturing production. The liberal trade policy has been a consequence of its competitive position coupled with the foreign policy reasons. Its pioneering role, however, has been initially challenged with the recovery of Europe and Japan and other NICs afterwards. It began to lose its economic superiority in manufacturing. Its share, for example, in world manufactures trade declined from 15.4 percent in 1965 to 11.1 percent in 1986 making it only the third largest exporter in the world (Grilli and Sassoon, 1990). In 1971 the overvalued dollar caused the first trade deficit the US ever faced in the last fifty years. The deficit persistently continued during 1980s and accompanied by current account deficit (CAD) in 1982. The CAD raised to a top level of \$ 172 billion in 1987. The realignment of dollar for orderly depreciations following the Plaza Accord failed to reduce the deficit as well as the demand for imports. The growth rate of the US imports have been faster than in any other country (Baldwin, 1988). These macroeconomic problems expectedly activated the policy makers to apply strict measures in trade in order to achieve acceptable results¹⁵⁵. This was possible to achieve larger exports as well as finding ways to restrict

American firms argued that the *keiretsu* system was fundamentally anti-competitive and gave Japanese firms an "unfair" advantage. This was a strange argument because, if Japanese manufacturers were limiting their purchases only a small number of suppliers they would have no chance to reduce their prices under market conditions. For more on the operation of *keiretsu* system see, Fukuyama (1998).

¹⁵⁵ Bhagwati (1990) considers it as the 'diminishing giant syndrome'. Accordingly, when people witnessed the erosion of their country's predominant status in the world economy it began to stimulate a national attitude in them to re-gain the eminence it lost.

imports. Although this argument could be a useful starting point, it does not explain, for example, why trade measures change from one industry to the other or change in time.

The governments restrict imports because policy actors -large segments in the society that benefit from a free trade policy- are not informative or are not politically effective; or they have been persuaded by the case for intervened trade. All of these cases seem to be valid in the case of the US trade protection largely resting on the “fairness” and “reciprocity” arguments and possess political and bureaucratic factors. As the import competition became more severe in the domestic market the local industries started to declare that they faced injury. However, it did not take too long for them to understand that it would be much easier to defend their case at the political and bureaucratic levels had the distortion in the market been a result of *unfair* (i.e. dumped or subsidised) imports of foreigners. This led the proliferation of anti-dumping and anti-subsidy petitions (see, Table 4.1) and represented almost 73 percent of the contingent protection.

There is also the complementary policy that the US forced the opening of foreign markets through Section 301 actions and VIEs. This focus on exports is new compared to import protection¹⁵⁶. Thus, as Lindsey (1998) claimed the shift to export politics was a tactic employed by free traders. According to Lindsey;

“Free traders determined that they could not win a head-on domestic political fight to reduce US trade barriers (in imports). So they changed the subject and fought instead over promoting exports. Rather than try to defeat protectionist claims, free traders simply diverted attention from them...It is therefore not an accident that supporters of trade liberalisation today make little or no mention of low US trade barriers. Their silence may be conscious or it may be a conditioned reflex, but in any event it reflects a longheld strategy of diverting attention from US import markets. According to that strategy, any emphasis on the benefits of free trade at home amounts to leading with your chin” (p.7).

¹⁵⁶ The US pressure on its trading partners that they must import more American goods has a trade liberalising character. However, it is discriminatory and illeberal to force others to make their imports from a specified source of supply or to buy products more than the demand in their markets.

Table 4.1 Trade protection cases initiated in the US, 1980-1990

Type of trade protection	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1980-1990
<i>Escape clause (fair):</i> Section 201	2	1	3	0	7	4	1	0	1	0	1	20
<i>Unfair trade actions:</i> Section 301 (trade barriers)	0	5	6	7	2	5	6	5	7	10	4	57
Section 337 (Unlawful marketing)	18	18	23	43	33	25	24	18	11	19	13	245
Section 701 (unfairly subsidised imports /CVD)	14	22	140	22	51	43	27	8	11	7	7	352
Section 731 (dumped imports /Anti-dumping duty-ADD)	21	15	65	46	74	66	71	15	42	23	43	481
Total unfair trade cases	53	60	234	118	160	139	128	46	71	59	67	1135
Total protection cases	55	61	237	118	167	143	129	46	72	59	68	1155
Unfair trade cases/total (%) 96	98	99	99	100	96	97	99	100	99	100	98.5	98

Sources : Destler (1992, p.166) and Nivola (1993, p.24).

This creates a covert coalition between the domestic interests seeking protection in the domestic market against imports and exporters, who are traditionally in the free trade camp, aiming to sell their products abroad. The free-trade interest alliance in domestic trade policy process was weakened and the level of protectionism increased in that period. Thus the fair trade argument helped pro-protectionist lobbies to achieve their objectives.

For the policy suppliers the concept of fairness is like a blanket under which they can veil inefficient policy choice from the public eye. It becomes much blurred now to appreciate the distinction as to whether the government applies trade protection to serve the interests of protection lobbies or to penalise the aggressive foreigners trying to capture our markets at the expense of our nation. Therefore politicians have always been eager to call for fairness. Bovard (1991a) explains the delusive argument very well;

“When politicians call for *fair* trade with foreigners, they routinely use a concept that is diametrically opposed to the word’s normal meaning. In exchanges between individuals -in contract law- the traditional test of fairness is the voluntary consent of each party to the bargain: ‘the free will which constitutes fair exchanges’. When modern politicians speak of *unfair trade*, they do not mean that buyers and sellers did not voluntarily agree but that officials disapprove of bargains American citizens choose to make. Fair trade now means government intervention to direct, control, or restrict trade...In practice, fair trade means protectionism” (pp. 1-2).

Fair trade is misused and abused to create a public acceptance for the protection of the anti-competitive and economically weak domestic industries and the export industries which have limited access to world markets not mainly because foreigners have restrictions but that they themselves are unable to sell their goods for competitive reasons. In any case, the producer oriented strategy and choice in the US trade policy is apparent. Bovard (1991a) notes it ;

“Fair trade is based on the doctrine that producers have rights and consumers have duties. Fair trade argument means that consumer’s freedom of choice is an injustice to the producer” (p. 18).

Table 4.2 Principal US trade protection instruments

<i>Legal Base</i>	<i>Applicable cases</i>	<i>Remedy used</i>	<i>Investigative agencies</i>	<i>Decision-making institution</i>	<i>Reputation</i>
Section 201 Escape clause	Increase of fairly traded imports deemed to cause or threaten serious injury to US industry	Temporary tariffs; quotas, negotiated restraints, and/or trade adjustment assistance (TAA)	International Trade Commission (ITC) determines extent of injury and recommends to President for action	US President decides what action to take	Congress can override in 90 days if President rejects an affirmative ITC recommendation
Section 301 Trade barriers	Foreign practices deemed violating US trade agreements; unjustifiable, unreasonable or discriminatory practices deemed to burden US commerce	Negotiated settlement, backed by retaliatory action (e.g. suspension of trade concessions) unless a satisfactory agreement is reached	Office of the USTR (US Trade Representative)	USTR	President can waive remedial action in case of harmful effects to national economy
Section 701 Unfairly subsidised imports	Subsidised imports deemed to cause or threaten material injury to a US industry	Countervailing duties (CVDs) to offset margin of subsidy or negotiated adjustments	ITC determines the extent of injury, ITC of Commerce Dept. calculates subsidy margin and determines remedy	ITA (Int'l. Trade Admin.) of Comm. Dept. administers remedies	None
Section 731 Dumped imports	Dumped imports deemed to cause or threaten material injury to a US industry	Anti-dumping duties (ADD) to offset margin of unfair pricing or negotiated adjustment (e.g. price undertakings)	ITC determines extent of injury, ITC calculates margin of dumping and determines remedy	ITA administers remedies	None

4.3 Section 301 : The Political Economy of 1988 Trade Act

Section 301 is arguably the single most influential piece of US trade legislation that allows governmental intervention in trade. Although some of the intent behind Section 301 was reflected in earlier trade laws, the Trade Act of 1974 introduced for the first time, along with anti-dumping and countervailing duty provisions and Section 337, the legislative and executive backbone of unfair trade remedies (Table 4.2). The basic idea behind Section 301, as noted above, was to confer on the President, a broad authority to retaliate against other countries' *unreasonable* and *unjustifiable* trade practices affecting commercial interests of the United States.

This measure has been an unchanged part of the following US trade legislation and it represented a good example of the incremental shift of power from Congress towards the President¹⁵⁷. It is not surprising that the severe measure of Section 301 was invented and included in trade legislation subsequent to macroeconomic imbalances in the United States' economy. For instance, 1974 Act followed early trade-deficit period in the beginning of 1970s and 1988 Trade Act has been accepted just after the current account deficit had reached its peak in 1987. Section 301 Trade and Competitiveness Act of 1988 (1988 Trade Act) provided more aggressive retaliation under the misleading rhetoric of free but fair trade. It induced significant changes and an increased discretionary power of the Administration which would have been captured by protectionist lobbies.

4.3.1 The Transfer of Authority from the President to the USTR

The status of the United States Trade Representative (USTR), under pre-1988 trade laws was only confined to recommend to the President as to what kind of actions to be taken.

¹⁵⁷ As illustrated in Table 4.3, Trade Agreements Act of 1979 gave the President the authority to enforce trade agreements. Trade and Tariff Act of 1984 provided that the USTR with an authority to initiate investigations. It institutionalised, for the first time, the submission of National Trade Estimates Report in which the unreasonable and unjustifiable actions of foreign countries enumerated. Congress had the fear that Administration was not pursuing an active (interventionist) policy under the existing Section 301 in 1974 Act despite the amendments in 1979 and 1984. Congressmen complained that President's political position disallowed him to use his power properly against unfair practices of foreigners. Therefore, Omnibus Trade and Competitiveness Act of 1988 (1988 Trade Act) passed in both the House and the Senate which shifted the authority to retaliate from the President to USTR. Gephardt Amendment enhanced the discretionary power of USTR to include the identification of countries with excessive trade surpluses. See, Bayard and Elliott (1994).

The President was the ultimate decision-making unit to decide whether any measure was necessary or not and which action to take. The idea was that the President's role as a supreme organ, would prevent him applying his wide discretionary power for the reason that he had to consider the interests of everybody but not just the special interests groups¹⁵⁸. Therefore a delegation of mandate to the President, just like the case in RTAA in 1934, was a necessary constraint on the US Congress which had a considerable elasticity for any protectionist pressures. It was the original intention that an authority delegation to make the President an ultimate decision-maker would diminish the asymmetrical power of protectionist lobbies on policy suppliers. Nonetheless, the practice proved that it was a mistaken belief especially when small but efficient special interests groups (à la Olsonian) were considered. These groups always managed to include their special concerns within the trade agenda of the Administration. It was not surprising that, for example, President Reagan, in his official visits abroad such as Japan used to bring a VER (as an import protection tool) or a VIE (as an export protection tool) offer to the Japanese government. Oppenheim's (1992) comment emphasises the same point;

“it was under President Reagan that post-war American protectionism really took-off. For this leading champion of the free market first conceded to further pressure from the textile and steel industries, and then added automobiles to the long run list of foreign products which were denied free access to the American market, ushering in an era when almost any industry threatened by foreign competition knew that it had good friends in Washington” (p. 55).

Industries seeking a wider market access abroad followed the same route and started to knock the door of executives. This was intensified when the authority shifted to the USTR in 1988 Act. The USTR became the sole responsible for investigation and decision-making

¹⁵⁸ For the same reason the transfer of authority to negotiate international agreements liberalising trade (i.e. tariff negotiations) passed from the Congress to the President in RTAA in 1934. This helped the US administration to relieve from the pressures of protectionist lobbies and open the way to freeing trade. Low (1993) defines it as follows;

“The Smoot-Hawley tariff considerably worsened the already disastrous economic circumstances of the early 1930s. The beginning of a historic policy reversal occurred with the enactment of RTAA which.... marked the end of the many decades of congressional tariff setting right down. From 1934 onward, the main responsibility for setting tariffs fell to the “executive” branch. Congress legislated itself out of a process so imbued with log-rolling and pressure-group sensitivities as to make a coherent international trade policy impossible” (pp. 53-54).

under Section 301 complaints of the US industries. Accordingly, the USTR within 30 days of determination to take retaliatory action, must implement it subject to the President's waiver if he considers the action having harmful effects on the national economy (Phillips 1989, pp. 508-510). However, the President could not bloc the USTR to take retaliatory actions against foreign imports except in a few cases. Further steps in 1988 Act deteriorated the case for free trade. These are the *mandatory retaliation* and *Super 301* as a weapon for protection.

4.3.2 *The Mandatory Retaliation*

Under Section 301 if the USTR determines that a “foreign act, policy or practice violates or is inconsistent with a trade agreement or is *unjustifiable* and burdens or restrict US commerce”, then an action as retaliatory measure, by the USTR to enforce the trade agreement rights or to obtain the elimination of the act, policy or practice is *mandatory*¹⁵⁹. This “unjustifiable” group of unfair acts or practices that require a mandatory retaliation are generally the infringement of US rights in international agreements such as denial of national or most-favoured nation treatment, right of establishment, or protection of intellectual property rights (see, Bhagwati 1991, pp. 126-130).

The mandatory retaliation provided the US negotiators with an additional opportunity to enforce their rights under international agreements such as GATT on the trading partners. However, this is a power-oriented approach that violates GATT itself. It is not different than breaching the law in order to enforce it (Bhagwati and Hudec 1990). Hudec (1990) described this disputable trade act as a “justified” disobedience;

“The notion ...is based on the simple judgment that there are cases where the damage to the legal system caused by inaction in the face of deadlock will exceed the damage caused by some disobedient act trying to force a correction” (p. 127).

¹⁵⁹ If, on the other hand, the USTR considers that the said act, policy or practice is *unreasonable* or *discriminatory*, then s/he has “discretionary” authority to take all appropriate and feasible action. These constitute acts or practices that are not necessarily in violation of or inconsistent with US international legal rights, but are otherwise unfair and inadequate.

Table 4.3 Evolution of the Executive Authority over Section 301 in the US Trade Acts

Trade Act	Presidential authority	Change from the previous Act
Trade Expansion Act of 1962 (section 252)	broad discretion to retaliate against “unjustifiable” agricultural barriers but limited authority to retaliate against other barriers	
Trade Act of 1974 (sections 301-302)	expanded discretionary authority to retaliate against “unjustifiable and unreasonable” foreign barriers, with no distinction made between agricultural and non-agricultural goods	replaced Section 252; extended coverage to services “assoc. with int.l. trade”; authorised action against foreign export subsidies; required USTR to submit reports to Congress every six months
Trade Agreements Act of 1979 (sections 301-306)	specified that President should use authority to enforce trade agreements	established more detailed investigation procedures including time deadlines for action; required consultations with foreign trade partners and use of available dispute settlement proc.
Trade and Tariff Act of 1984 (sections 301-307)	discretionary authority unchanged; but USTR now permitted to initiate investigations and recommend action to the President	explicitly authorised retaliation in the services sector; explicitly included for the first time coverage of intellectual property and foreign direct investment; section 181 required submission to Congress of National Trade Estimates Report
Omnibus Trade and Competitiveness Act of 1988 (sections 301-310)	authority to retaliate shifted from President to USTR, subject to specific presidential direction, if any; retaliation against unjustifiable practices made mandatory, but with many loopholes permitting considerable discretion	established Super 301, requiring USTR to identify trade priorities, including designating “priority countries and practices” to be investigated under Section 301; established Special 301 to promote more aggressive assertion of intellectual property rights; established new deadlines for action in cases involving GATT dispute settlement
Gephardt Amendment to Super 301	enhanced discretionary authority to USTR to label countries as unfair traders; put annual deadlines for USTR to name “excessive and unwarranted surplus countries”	allowed determination of countries with “excessive” trade surpluses by a mathematical formula

Source: Bayard and Elliot (1994); p. 24

The power conferred on the USTR promoted the surge of requests from export lobbies that they face unfair practices abroad which should be remedied by diplomacy rather than the principles of economic theory. The potentially influential role of these specific interest groups somehow managed to capture the USTR's mandate and to change trade policy direction on their own behalf.

4.3.3 Super 301: A "Super" Weapon for Protection

Super 301 section can be considered as the most disputed part of US trade policy and a vital threat for a liberal world trading system. Under Super 301 the USTR *must* identify "priority practices" including major trade barriers that have the "most significant potential to increase US exports". According to this new instrument all obstacles for US exports in foreign markets must be identified under the headings of "priority countries" and "priority trade practices" in annual National Trade Estimates (NTE) Report. It passed as a result of a "result-oriented" amendment proposed by Congressman Gephardt (Bayard and Elliott, 1994), a devoted protectionist, who required that "excessive trade surpluses" of trading partners of the US under market conditions should be penalised because their surpluses were unfair since they do not open their markets properly¹⁶⁰.

Super 301 have been an interventionist weapon within the hands of the arbitrary authority devoted to the USTR against many countries including mainly Japan, Korea, Taiwan, India and Brazil (see, Bayard and Elliott, 1994 for specific case studies). This weapon is based on a political compromise that permits a belief that fair access to markets should be judged on the basis of results under a managed trade policy. In other words, it presumes that for the running trade deficits, the *unfair* practices of other countries are responsible rather than the poor competitiveness of many American goods abroad. This is a fallacious assumption, nevertheless, it constituted the principal leg of the US trade policy as a result of its abuse by domestic lobbies.

¹⁶⁰ There were two alternative approaches to Super 301. The first was based on Gephardt's proposal based on trade balances, the second was Senate's approach focusing on unfair trade barriers, not trade balances. Super 301, as stipulated in the Act, required a dollar-for-dollar retaliation for unfair trade practices though it did not take an extra step of mandating a ten percent reduction of foreign countries' trade surplus, as did the Gephardt amendment. For more detail in these approaches and legislative history of it see, Phillips, 1989.

4.4 Administered Discretion and Trade Protection in the United States

Political economy of protection models based on the public choice approach explain well the situation in both the demand for and the supply of protection in the United States. The shift of power in the supply side from the politicians (Congress) toward the executive-bureaucratic circles (the President's office and trade bureaucracy) did not properly serve as a constraint on the domestic protectionist lobbies. It simply enhanced the arbitrary actions of these supply-side policy actors in the form of trade protection measures. Thus, the shift showed a "bumerang" effect that hit free trade itself. Politicians intentions to maximise their utilities by means of their mutual relationship with various rent-seeking groups in the domestic policy arena was coupled with an *administered protection* in imports. The result was an increasing resort to unfair trade measures such as ADDs and CVDs and GATT-illegal fair trade measures like VERs. Section 201 escape clause lost its attraction simply because it has retaliatory repercussions under GATT mechanism (Article XIX); it is based on the shameful argument that domestic industries are too weak to compete against fair competition of foreign goods; and alternative trade measures are more easily captured under the existing administrative discretion by protectionist lobbies.

4.4.1 ADDs and CVDs: Protection against "Unfair" Imports

Trade laws in the US were designed in accordance with the sensitivity of domestic lobbies who allege that unfair foreign pricing and subsidisation cause an injury in the domestic industry. The number of petitions for anti-dumping (ADD) or anti-subsidy (CVD) remedies proliferated in the last two or three decades. The protectionist bias in the trade policy formulation process in the United States enables most of these complaints to be successful. From an economic point of view the ADD must be confined to cases where there is a *predatory* intention of the exporting firm to lower its price for some time to be able to drive its competitors out of the market and obtain the monopolistic power. In this respect, anti-dumping duty is an effective *anti-trust* instrument to protect the consumers.

Nonetheless, ADD lost its innocence as a tool to *protect free operation of the market* but turned out to be a *misused weapon of protection for rent-seeking activities*. Its definition

has been broadened in such a way, needless to say under protectionist pressures of domestic industries, that all differential pricing between the home country and the export price in the US, of a foreign seller were labeled as “unfair”. The term “less than a fair value” for sales in the US market were potentially deemed to cause an injury that required an ADD.

The standard requirements for the existence of “dumping” and “injury” had been defined so vaguely that they were most of the time and in almost all investigations interpreted by the US authorities to be used for protectionist purposes (Tharakan, 1993). The investigation is split between two agencies of US trade bureaucracy (see, Table 4.2). Accordingly, the International Trade Administration of the Department of Commerce (the Commerce Department) which is responsible to calculate dumping and administer the remedy, and International Trade Commission (ITC) in charge of finding the injury¹⁶¹. In practice, the Department of Commerce has only a limited time to decide for the existence of any dumping and traditionally the complaints in the US contain little or no evidence of injury. The Department usually assumes that complaints are serious unless a majority of producers express their opposition. It has a wide discretion to decide for an affirmative finding of dumping. Finger and Murray (1993, p. 241) confirms the politicisation in the process that;

“when the US government turns down a petition for an import restriction, it is almost always because the injury test is negative-the government finds that the imports in question are not causing serious harm to domestic producers. These findings suggest that the definition of dumping (and subsidy) are broad enough that the economics of unfair trade remedies is effectively the same as the economics of the escape clause” *-that is valid in the case of protection against fair import competition- (italics added)*.

Therefore many economists¹⁶² are highly critical of the procedures used by the Department of Commerce to calculate the margins of dumping and subsidy and claim that there is a bias toward higher margins and therefore higher ADDs or CVDs.

¹⁶¹ Same practice is applied in cases of subsidised import investigations and the administration of CVDs.

¹⁶² See, for example, separate articles by Murray, Baldwin and Palmetier in Boltuck and Litan (1991) and Finger (1993).

The injury finding in the ITC usually operates in favour of complainant domestic industries too for the reason that its composition is protectionist. A significant majority of Commissioners are selected among the nominees of Congress and private sector organisations who are ideologically more committed to protect domestic industries (Baldwin, 1985)¹⁶³. In unfair trade cases there is no intervention of the Congress but the laws are drafted in a protectionist way¹⁶⁴. The role of the politicians in AD cases is also important in their relations with the administration. Baldwin and Moore (1991) offers that;

“Besides seeking changes in the fair trade laws, protectionist interests may try to influence the administration of existing laws, particularly if those interests have not been organized into effective legislative coalitions...the pressure for changing the administration of CVD and AD laws is best routed through Congress. Protection-seeking industries can complain to their representatives and senators, who will subsequently communicate their constituents’ concerns to administration. As expected, the legislators...have argued that the Department of Commerce should act as an ‘advocate’ for US producer interests” (p.263-64).

The functioning of AD laws is therefore more producer oriented and is largely abused under an “administered protection” mechanism. Extreme cases were not infrequent. Bovard (1991a) reveals that a price difference as small as 0.5 percent between its US and foreign prices can be a matter of investigation. The success of ADD lobbies can also be attributed to the misunderstanding in public about the notion “dumping” as if it is something that harms the individuals in the importing country though it is the opposite in most cases in the form of reduced prices and an opportunity to consume more quantities

¹⁶³ For example, 3 of the members of the Commission (ITC) in charge of injury determination in a textile import case were the representatives of the US labour union in the relevant sector; American Textiles Manufacturing Association and the chief US textile negotiator all having protectionist tendencies. In case of a 3 to 3 voting the case is considered affirmative for injury. Thus, it needs to persuade at least 4 Commissioners to reject the case and to prevent an ADD. It might be argued that the members are selected for a term of nine-year which is a barrier against political pressures coming from the executive or legislative organs but Congress shall still play a role on the Commission and influence its members’ decisions because of its budgetary powers (Baldwin and Steagall, 1994).

¹⁶⁴ A study by Griswold (*Few free traders in Congress*) of the Cato Institute (www.cato.org) revealed that more than 90 percent of the senators and representatives tended to favour trade barriers and governmental involvement including trade subsidies in their votes and only a 6 percent of members in the House of Representatives voted consistently in favour of free trade.

while it creates recoverable injury to the domestic industries for a short time period that does not cause their disappearance in the market.

4.4.2 The Political Economy of Voluntary Export Restraints

The use of VERs as politically negotiated trade obstacles by the US has surged dramatically since mid-1970s. The VER policy exploited a loophole in GATT discipline and became a popular protectionist device. This popularity can be attributed to a bundle of reasons. First is related to its *voluntary* character. As noted previously, a restraint arrangement will lead to the creation of an economic rent transferred to the restraining exporters. This makes the VER more favourable in the eyes of the exporting country because it will improve its terms of trade by raising the prices its exporters charge for lesser quantities of goods. This is a “bribe” to the exporters¹⁶⁵. Second, VERs are discriminatory in nature. Thus a VER brings a more extensive protection because it lowers the import share of the most competitive suppliers reducing the fierce rivalry in politically efficient but economically less-efficient sectors. Third and perhaps the most important reason is embedded in the politicisation of the VER process. It is not a legislative trade barrier contingent upon certain requirements. As Savage and Horlick (1985) put forward;

“ Because any VRA (voluntary restraint arrangement) is a creature of political forces, its substantive terms are likely to be determined less by legal considerations than by the political and economic significance of the affected industry...It is not surprising, therefore, that VRAs have been most prominent in industries such as textiles, steel and automobiles, which, because of their size, enjoy great political power in both importing and exporting industries. The circumstances leading to the adoption of such significant VRAs vividly demonstrate their fundamentally *political* nature” (p.284).

Such industries having a political pressure capacity are at the same time, experienced in receiving protection by other means previously. Rosendorff (1996, p.544) claims that in

¹⁶⁵ VER is an arrangement whereby domestic producers form a special “cartel” with the exporters to share the market and obtain the rent of protection. On the voluntariness of VERs see especially Greenaway and Hindley (1985) and Harris (1985). Such practices are illegal in domestic anti-trust law of the US but they are, on the contrary, being encouraged by the US government which negotiates them on behalf of its own producers at the expense of its own consumers. For the economics of VERs see, Pomfret (1989); Hindley (1980). On the non-equivalence of VERs and quotas see, Bergsten (1975); Takacs (1978) and on the comparison between VERs and tariffs see, Moore and Suranovic (1993).

most cases, the VERs are the outcome of negotiations that originated as anti-dumping or other administered protection. In other words the proliferation of the number of several anti-dumping petitions in an industry is a precursor of a large VER in the coming years (Prusa, 1992 and Finger and Murray, 1993). K. Jones (1994) thinks in the same vein and calls this sequence as leading to a pattern of “induced” export restraint;

“...A similar means of structured restraint is available through provisions of the anti-dumping (AD) and countervailing duty (CVD) laws, which allow the president to authorize an export limitation in order to terminate an unfair trade practice investigation. A negotiated quantitative export restraint of this sort was used in steel pact of 1982 with the EC, which limited EC exports in several specific steel products” (p. 70).

Most of the industries that managed to receive the highly politicised, domestically non-transparent and internationally discriminatory protection by means of VERs, have been those facing structural adjustment difficulties. Therefore, these industries looked for ways that could make the protection more stable and permanent than contingent protection. The discretionary powers conferred upon the executive branch (for example, the President’s negotiation authority was enhanced in 1984 and 1988 Acts) provided the political atmosphere necessary to lobby for more strict quantitative limitations in such agreements. The VERs have been common in textiles, steel, automobiles, footwear and machinery industries (See, Annex 4) during the new protectionist era¹⁶⁶.

¹⁶⁶ For additional and analytical studies about VERs in US trade policy on textiles, see Aggarwal (1985); on automobiles, see Collins and Dunaway (1987) and Feenstra (1988); on steel, see Walter (1979) and McKinney and Rowley (1989); on footwear, see Hamilton (1989); on machinery, see Dinoapoulos and Kreinin (1990).

CHAPTER 5. PROTECTIONISM IN WORLD TRADE: A PUBLIC CHOICE APPROACH TO THE WORLD TRADE ORGANIZATION

It was the original purpose of the GATT...to strengthen governments against the particularistic pressures emanating from national economies. This purpose has almost been lost; a new joint initiative is needed to retrieve it.
International Trade 1982-83, GATT Secretariat, 1983.

A major reasons why things gone wrong with the trading system is that trade-policy actions have often escaped scrutiny and discussion at the national level. Clearer analysis and greater openness in the making of trade policy are badly needed, along with greater public knowledge of how the multilateral system works.
F. Leutwiler et.al., Trade Policies for a Better Future, 1985.

In its fundamental form, the answer to rising protectionist pressures lies in efforts that combine vigorous education with strong persuasion..
M.L. Weidenbaum, Challenge, 1983.

5.1 The Constitutional Aspects of GATT/WTO in Domestic Policy Process

The society centred - interests group models based on public choice approach explain trade policy process to produce protectionist policies as a function of the political effectiveness of small but well-organised groups compared to large unorganised ones. The political market does provide little *domestic* supervision and checks on the interaction of its actors. Economically inefficient and suboptimal policies like “managed trade” or “fair trade” are the consequences. Such policies are inevitable when the policy choice is restricted under given set of *rules and institutions* that govern the market. The neo-classical economic prescriptions supporting the superiority of free trade do not find sufficient ground at governmental level where interventionist policies attract more attention. One compelling reason to this is the complex policy-making process in which

the choices are made *within* the specified *constraints*. Buchanan (1990) claims that these constraints have an *exogenous* character¹⁶⁷. According to him;

“The constraints that restrict the set of feasible choice options may be imposed by nature, by history, by a sequence of past choices, by other persons, by laws and institutional arrangements, or even by custom and convention” (p. 3).

As it is not an easy task to change the rational utility maximising character of individual actors (interests groups such as domestic industries or trade unions seeking protection; politicians or bureaucrats supplying it) in the domestic trade policy process, a better alternative to the suggestions of the neo-classical trade theory will be to change the rules and institutions within which the actors interact in order to achieve a free trade choice. Therefore, Buchanan asserts a broader approach where attention is directed to the choices *among* constraints i.e. to change the circumstances of exogenous factors. Hence, the policy process may be re-designed if *domestic set of rules, laws or institutions* are subject to alterations. This means that the society can, in fact, choose its own constraints. These constraints are not solely composed of domestic institutions but can be inter- or supranational as well. Accordingly, institutional restraints that are provided internationally can be *internalised* within the domestic policy choice setting.

Internationally agreed policy commitments can help govern the interactions among not only international but also *domestic* societal actors. International regimes in trade policy is an example. These, according to Moser (1990);

“... can limit the range of domestic collective choices. If effectively enforced, these rules change the outcome of domestic political process... In this sense, international agreements have a function similar to national *constitutional* rules. They provide a framework of self-imposed restraints on policy options that reduce governments’ discretion to intervene in private autonomy. The restricted ability of governments to interfere in international

¹⁶⁷ The “exogenous” character denoted here is making GATT an “endogenous” element to restrain the discretionary power of policy-makers in instituting trade protection. Therefore, what Buchanan and other public choice economists argue by “exogene” here is different than what many international political scientists consider GATT as an external force to liberalise trade. The latter group are called “institutionalists” in this study to denote the distinction with “constitutionalists” following the teachings of Buchanan. Sally (1999) defines internationalist approach as *liberalism from above* and constitutionalist approach as *liberalism from below*. See, Table 5.1 for detail.

exchange does not only strengthen the property rights of foreign exporting firms but, most importantly, the rights of domestic groups. Consumers and importers can buy to a large extent from their individually preferred suppliers. Therefore, international commitments can reinforce the constitutional property rights within each nation” (p.27).

This formulation can be stated as follows: GATT system may provide a constraint, in the domestic political markets, a set of rules that prevent -at least to a certain extent- rent-seeking and to limit the ability of protectionist interest/pressure groups to achieve their objectives. It also helps to curb the discretionary powers of the government in supplying a protectionist policy. As Tumlir (1987) described;

“In this respect, the international commitments that constitute a trade regime ultimately appear intended to protect governments against internal political pressures. These governments could, in principle, satisfy the demands (e.g. for protection or subsidies) of any particular interest group but not those of all” (p. 9).

Thus, GATT constitutes a system whereby the member governments agree to abide themselves by a set of rules, norms or principles which describe the limits of acceptable behaviour and thereby govern the ‘domestic bargaining frontiers’ in trade policy decision-making process¹⁶⁸.

The whole process of the establishment of GATT was not, of course, painless. National policies affected by the internal pressure groups have always managed to exert a great influence in the formulation of policies and the rule-making in GATT. However, the relationship has a two-way structure. These forces that dominate the national position in GATT negotiations are, in turn, affected by GATT’s prescriptions and proscriptions. For

¹⁶⁸ Despite growing number of literature concerning the application of “public choice” analysis and reference to “constitutional economics” in various economic policies including trade, only some of them attempted to test them in the field of international political economy. Vaubel and Willett (1991) and Frey (1991) are useful to start. The internalisation of international constraints in domestic trade policy choice set has, on the other hand, been a subject in only limited studies. Tumlir’s (1983b; 1985; 1987) studies have a pioneering role in attracting the attention into “constraints that are created internationally” to restrict the behaviours of actors in the domestic realm. He also clearly indicated that a regime like GATT may help the ‘protection of (natural) rights’ of individuals like property, choice and freedom of contract, as discussed in Part 1.4. Moser (1990) is the most extensive study that applied public choice for the GATT. See, also Schuknecht (1992); Finger (1991) and Goldstein (1998) that note the role of international institutions and rules as a discipline over trade protection in domestic policy choice.

that reason GATT can be assumed to supply a ‘constitutional function’ in the domestic trade policy arena. On the other hand, GATT in reality could only partly fulfilled this function as confessed in one study (*International Trade, 1982-83*) published by its own Secretariat. This, in no way means that GATT’s achievements can be underestimated in the liberalisation of world trade. It has successfully provided a mechanism whereby trade relations are governed in a “rule-based” system with norms that helped governments to enter into market opening commitments. Nevertheless, all the “success” GATT achieved was overshadowed by its weaknesses that caused difficulties to fully attain its “constitutional” function. GATT’s history tells us that half of the glass is full but the rest of it still waits to be filled. Let us illustrate two faces of GATT in more detail.

5.2 A Brief History and Characteristics of GATT System: Norms and Achievements

The central role played by GATT in shaping the post-war trade policy is widely accepted. Through eight rounds of trade negotiations that have followed its inception since 1947, average and ad valorem tariffs on most of the industrial goods have fallen significantly from almost 50 percent to less than 4 percent. Its core body of “tariff bindings” enforced significant reductions in tariff protection. During the same period, its membership (also considering its successor, the World Trade Organisation-WTO) increased by six times and has risen from 23 countries to over 135¹⁶⁹. The main intention in GATT was to bring about a “rule-based” system of network whereby all participant countries obey previously determined and agreed set of rules and standards of behaviour. Transparency was another basic purpose in GATT. It is an important character eliminating “uncertainty” and creating predictability in commercial relations because countries can no longer increase tariff levels by themselves as they wish but any changes must be authorised or negotiated within GATT or that the country wanting to raise its tariffs have to compensate it by further liberalisation commitments in other goods¹⁷⁰. This was a vital development that

¹⁶⁹ Jackson (1969) is a seminal study for a detailed analysis of and the developments in the GATT system as well as its legal status and role in the post-war trade policy. See also, Curzon (1965); Gardner (1969); Dam (1970); Hudec (1975); Long (1987) and Jackson (1989).

¹⁷⁰ GATT, for example, brought the obligation of ‘notification’ that member countries (the ‘Contracting Parties’ in the GATT terminology) must consider before they act in specified issues. There are 16 of such instances stipulated in GATT’s articles. These include matters such as the imposition of ADDs and CVDs

GATT system provided in order to protect the value of previous liberalisation steps. Accordingly, the countries had to make a choice; either to enter into the GATT system and play by the rules of the game or to stay outside it and play by power politics¹⁷¹. It is, doubtlessly, possible to interpret GATT as a major attempt to create a confidence among players for a broad trade liberalisation. It is common to accept that two main pillars in the GATT approach are the “norms” of *non-discrimination* and *reciprocity*:

1. *Non-discrimination*: is generally assumed to be the cornerstone of the GATT regime embedded in the commitments of “most-favoured-nation-MFN” (Article I) and “national treatment” (Article III)¹⁷². The norm is based on the economic rationale that each country will satisfy its needs from the most efficient sources of supply. The MFN helped the liberalisation of world trade in two ways. First, the “unconditional” requirement in MFN clause provided third parties with benefits of bilateral trade concessions such as tariff reductions between any two countries. This is possible through *multilateral* structure of GATT system. Hence, *multilateralism* is a basic characteristic of GATT. It has to be distinguished from MFN though both are complementary for trade liberalisation. While it is interpreted as an “approach” within the GATT trade regime by some scholars (Baldwin,

in certain cases (Art. VI); the balance of payment (BOP) restrictions (Art. XII:4 and XVIII:B12); revisions in tariff concessions in order to protect infant industries (Art. XVIII:A); emergency protection to domestic industries (Art. XIX:2); withdrawal of concessions (Art. XXVII); modification of tariff schedules (Art. XXVIII:1 and 4) etc.

¹⁷¹ The “rule-based” system, in this context, is an opposite to “power-oriented” diplomacy as put forward by Jackson (1989, pp.85-89 and 1990, pp. 54). He describes that, in international trade, there are two ways for countries to manage their trade relations and solve the disputes among themselves. He explains that;

“In broad perspective one can roughly divide the various techniques for the peaceful settlement of international (trade) disputes into two types: settlement by negotiation and agreement with reference to relative power status of the parties; or settlement by negotiation or decision with reference to norms or rules to which parties have previously agreed” (p.85) (*parenthesis added*).

GATT’s history reveals that, in practice, governments found a third type; to stay in the system and pretend to show their loyalty to the rules, but apply their powerful arms on others. The aggressive nature of the US trade policy (i.e. Section 301; VIEs) against Japan and other NICs or EU’s anti-dumping laws are examples. This final type is a direct consequence of the flaws in the GATT system as described in following part.

¹⁷² Accordingly, the most-favoured-nation clause provides an equal treatment among the imported goods of all GATT members. Article I stipulates that “...*any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties*”. National treatment, on the other hand, prohibits discrimination between domestic and imported goods, as far as domestic taxes or similar measures; laws and regulations are concerned.

1988 and Jackson, 1989), others consider it to constitute a “norm” by itself. Finlayson and Zacher (1982), for example, assume it a “procedural norm” which;

“signifies the willingness of governments to participate in rule-making conferences and to allow multilateral surveillance of, and even a degree of control over, their trade policy. It symbolises regime members’ acceptance of the proposition that they have a legitimate interest in each other’s policies and behavior” (pp.297-98).

Secondly, any country wishing to increase its bound tariff is expected to do this in a non-discriminatory way against the goods originating from *all* GATT members. Nevertheless, this necessitates re-negotiation of balancing concessions (i.e. compensatory tariff reductions for other goods) with all these countries, thus making protection more difficult.

2. *Reciprocity*: is a norm under which one country agrees to reduce its level of trade protection in return for a “reciprocal concession” from its trading partners. In principle, the norm is a reflection of the pragmatic approach in GATT obliging all participants to make “equitable” though not “equivalent” sacrifices such as reduction in their tariff levels. It is instrumental in minimising the risk of “free-riding” by countries that benefit by exporting to others’ markets liberalised in GATT negotiations but do not provide similar concessions for foreign goods in their domestic markets. Therefore, it is a “fee” that all members of GATT club have to pay in accordance with their development stage (Hoekman and Kostecki, 1995, pp.27-29 and Winters, 1990, pp.1290-91). The essence of original GATT reciprocity was to provide a balanced package of concessions with no attempt to define expected outcome sector by sector or indicated trade amounts in a multilateral system (Curzon and Curzon, 1989).

The *success of GATT system* in minimising tariff protection has various reasons: The first reason rests on its flexible organisational structure developed largely through a pattern of customary relations converged around its practice of “consensus” in decision-making (Winham, 1998, p.359). This encouraged the participating countries to enter into a network of obligations reached by consensus without giving substantial concessions in return. Second, the trade liberalisation commitments are not entirely irrevocable but there

are different ways to erect tariff protection against unforeseen developments. Dam (1970) considers it a “safety valve” approach and Robertson (1992) claims that it is better if invocation of such commitments are made within the limits of GATT;

“Governments adhering to an agreement may decide in subsequent, and in different, circumstances that their international commitments prevent, impede or inhibit them from pursuing a desirable policy. If the new circumstances demand immediate action, the government may have to derogate from the agreement...It is better that this should be done under specified rules, within the agreement, rather than arbitrarily” (p.26).

Third, and may be the most compelling was that GATT has been a compromise of balanced societal *interests*. It was a trade-off by desire of exporting industries seeking wider market access and resistance of import-competing producers to domestic market liberalisation. GATT was a result of the need for multilateralisation of bilateral liberalisation dealings with the US and its trading partners based on Reciprocal Trade Agreements Act (RTAA) of 1934. The dominant ideas of American officials coupled with free trade interests in special interest groups helped the establishment of GATT with reservations, on the other hand, from other interest groups which never lost their adherence to mercantilist principles and protectionist policies¹⁷³.

5.3 What Went Wrong with GATT? The Deficiencies and Fallacies in the System

The happy days of early liberalisation within GATT framework passed quickly followed by new protectionism and a dense governmental intervention in trade. Actually, GATT's success has been limited in fulfilling its objectives¹⁷⁴. In bringing a rule-based regime for the world trade, it neither formed a truly liberal understanding, nor it managed to remove neo-mercantilist ambitions in the domestic policy process in member states. Indeed, these

¹⁷³ The latter include protectionist groups (several business associations and trade unions) with familiar arguments warning the detrimental effects on the national economy of free trade policies. These groups have also been active in resistance to International Trade Organization (ITO). Nonetheless, they did not prevent the establishment of GATT because according to Diebold the “commitments in the latter are less binding” and it “covered a narrower sphere of policy”. Diebold (1952) considered this character of GATT as a “source of both weakness and strength” (p.28).

¹⁷⁴ The “objectives”, in this context, are economic such as to “raise standards of living, ensure full employment, large and steadily growing volume of real income and effective demand, develop the full use of world resources and expand the production and exchange of goods” as set out in the preamble of the Agreement.

were intrinsically embedded in the GATT system. The basic norms of *non-discrimination*, *reciprocity* and *multilateralism* have been subject to serious erosion as a consequence of GATT's institutionally limited responsiveness capacity against transformations in the world economy. The GATT system have been subject to various protectionist challenges from the US and the EC. Since 1970s GATT has lost its role of being the principle vehicle through which their trade policies were conducted. "Non-discrimination" had become an exception rather than the rule and the original purpose of "reciprocity" had been blurred. The US trade policy changed its direction from multilateralism to *bilateralism* and from free to *fair* and *managed trade*. In the EC, the tendency towards regional agreements (RTAs) and administrative (bureaucratic) protection have been dominant¹⁷⁵.

As Low (1993, p,27) puts it "there has never been a 'Golden Age' of GATT and many of today's challenges are yesterday's failures or indulgences". The main difficulties with the old GATT system were relevant mainly to the initial weaknesses and deficiencies combined with a doubtful holistic philosophy of mercantilism in its body. The principal "flaws" and "failures" can be summarised as follows:

5.3.1 The Main Flaws in the Old GATT System

Although GATT worked well in the first two decades, the initial constitutional flaws have rendered it ineffective in deterring countries from applying protectionist policies. It did not prevent the protectionist lobbies from leaning on the government in order to obtain protection.

¹⁷⁵ These developments reveal that protectionist policies have seriously impaired GATT regime and endangered its objectives. Krasner (1983) claimed that;

"If the principles, norms, rules and decision-making procedures of a regime becomes less coherent, or if actual practice is increasingly inconsistent with principles, norms, rules, and procedures, then a regime has weakened" (p.5).

The principle of free trade has always been unpopular in actual policies, though not in theory. The norms of GATT crippled due to politically driven trade policies. It is also possible to argue that the rules have not initially been designed to serve liberal aims. Hence, GATT regime needed an extensive revision. This was the prominent objective in Uruguay Round which started in mid 1980s when protectionism was galloping.

5.3.1.1 The 'systemic' level assumptions in GATT

First, and perhaps most important, is that its inception does not consider the domestic level of the story. It only aims to regulate the trading relations among countries with given set of balances. Thus, the GATT system never involves in the ways of restraining the access to protection at the domestic level by rent-seeking interest groups efficiently. It does not consider the intra-prisoners dilemma but strives for an international balancing/trade-off among the interests of countries. This is best illustrated by the norm of *reciprocity*. This stems from the wrongful insistence of countries on the actions of others rather than their own (Bhagwati, 1993). The GATT system is certainly not conceived to inspire freeing trade by a country unilaterally, but upon a mutual or reciprocal step from the trading partners. The norm of reciprocity, of course, brings an improvement in world trade but leaves the existing perceptions such as the notion of fairness intact.

Classical liberal economists normally categorise reciprocity as an anti-liberal practice and potentially dangerous simply because mutual expectations of balanced trade based on fairness are too often and easily abused by protectionist interests. Therefore, the critical views on reciprocity always have the concerns that it provokes retaliation which in turn produces detrimental effects. Reciprocity, for many scholars, leads domestic lobbies to insist on restrictive trade measures as a response to unwillingness of foreigners in opening their markets. This has been one key point in the US trade policy of US-Japan semiconductor agreement or many Section 301 cases that rest on aggressive demands to 'level playing field' and for 'result-oriented' bilateral trade negotiation methods¹⁷⁶. This also helps domestic import-competing lobbies interested in being protected, to argue that their country's markets should be closed to foreigners who deny reciprocal trade liberalisation. As Lindsey of the Cato Institute wrote previously:

“The reciprocity-based free trade strategy helps to frame the whole trade debate in terms that favour the protectionist lobby. The special interests that seek a protectionist

¹⁷⁶ Krueger (1990), for example, argued that; “result-oriented aggressive bilateralism has scope for big disruptions of the international trading system and little potential for enhancing the efficient flow of goods in the international economy” (p.91). Similar worries are shared by others. W. Cline (1983) claimed that reciprocity leads to restrictive trade relations and induce the country to punish 'unfair trade practices' of others.

bailout rarely admit that they were out-competed by their foreign rivals. Rather they claim that they are the victims of ‘unfair competition’... A policy of trade negotiations lends credence to this ploy by focusing attention on the other countries’ import barriers and ‘unfair’ practices.”¹⁷⁷

The systemic level approach in GATT is the result of the intellectual fallacy -the mercantilist belief that exports are the goal of the trade policy, while imports are its cost, thus exports are favourable but imports are to be avoided. This philosophy is common in the minds of proponents of balanced trade with Japan and others in the US¹⁷⁸. This is revealed in GATT’s terminology where liberalisation of trade barriers to imports was not described as a goal to improve consumer living standards in the importing country but as a *concession* necessary to open an access for the exports. Tumlir (1987) described it as a ‘failure (in GATT) to state the case for free trade correctly’;

“From those early days to the present, governments have believed that the benefits of general trade liberalization accrue...in the form of ‘trade concessions’ by trading partners, that is, through other countries’ reducing their barriers to imports. The very notion of ‘concessions’ distorts understanding by assigning positive value to protection. In this way, a mercantilist residue was preserved in the foundations of the post-World War II trade regime” (p. 4).

The export-oriented approach in GATT is co-related with systemic explanation of the trade relations in which the national interests come to forefront. Nevertheless, as societal interest-group view of trade policy formulation rightly proves that segments of the society consider their own interests, a ‘supra-societal’ (systemic) approach in GATT is far from reflecting the intra-national realities.

5.3.1.2 No consideration for the ‘political market imperfections’

The GATT system has never been equipped with a mechanism to cope with the “political market imperfections”. Thus, it did not bring constitutional rules for the regulation of domestic trade policy processes. No proper code of conduct explaining how or how not to

¹⁷⁷ Quoted from Glassman (1998) p. 4.

¹⁷⁸ Dornbusch (1993) and Fallows (1989) are to name but two.

design domestic trade policy institutions have been initiated in the GATT's history. No provisions of GATT or agreements under multilateral trade negotiations (MTNs) managed to limit the discretionary power devoted to the institutions and policy-makers. This is not surprising, as we consider the fact that GATT was formulated to lower the trade barriers with mutual negotiations. It was not, however, designed to intervene in the existing domestic structures of its members with a large scale of protectionist discretion and tendencies. Its constraining structure to help policy-makers resist protectionist pressures was a limited one. Baldwin's (1988) argument, in this context, is rightful;

“The objectives of those who established the organization were mainly political, and they were quite willing to slant the rules in favour of a particular domestic pressure group, producers, to help gain acceptance of their broad trade-liberalizing recommendations”
(p. 145).

The rules and procedures in GATT never properly encouraged national policy-makers to allow politically disadvantaged free trade lobbies represent themselves in domestic policy formulation process¹⁷⁹.

5.3.1.3 *No mechanism to cope with the 'market failures'*

The GATT system did not provide necessary mechanisms to encourage the elimination of “market failures” which were structurally one of the most important sources of protectionist demands. It was not a coincidence that voices from different circles often raised, claiming that there were imperfections in the markets and asked for trade protection as a remedy. GATT therefore did not propose a challenging view against the “infant” industry (Article XVIII:C) or “senile” industry (Article XIX) arguments.

It is true that GATT discouraged the use of trade policy measures like tariffs on imports but it did not significantly elucidated *optimal methods of intervention* to assist the

¹⁷⁹ The text of the General Agreement stipulates specific prescriptions of behaviour for the Contracting Parties, only in their interactions among themselves. In this respect, the obligations like the general elimination of quantitative restrictions or tariff reductions are not enough simply because the domestic decision-making process is politically dominated by protectionist pressure groups that can persuade the government to pursue a policy totally incompatible with a particular GATT obligation. This explains why, for example, VERs are used in the EU and the US.

domestic economies in cases of domestic economic distortions¹⁸⁰. Thus it did not specifically encouraged methods to facilitate the 'adjustment' in industries where trade liberalisation caused immediate job losses and therefore gave way to the acceptance by the public of the social justice considerations¹⁸¹. GATT permitted for emergency protection (e.g.raising tariffs) in cases where domestic industries are exposed to unforeseen developments such as a sudden surge in imports. However, this was assumed to be a temporary measure to be followed by long-run adjustment policies to increase the competitiveness of the industry protected or the smooth transition of the resources into alternative sectors of the economy. Nonetheless, GATT did not bring trade-adjustment mechanisms. This induced governments, under political pressure of of the senile industries in the US and the EC, to institutionalise trade protection with more distortionary and costly instruments such as the MFAs in textiles, ADDs in steel and chemicals, or VERs in steel, machinery or vehicles. Robertson (1992, p.36) claims the opposite that "emergency protection is intended to facilitate adjustment, ameliorating market disruption and allowing time for adjustment to take place". However, once the domestic industries are protected, it shall make them addicted and lobby for more unless coupled with non-trade policy interventions. This has been the case in the US and the EC where powerful pressure groups opted for more hard-core NTBs to compensate their injuries or the market disruption. Robertson (p.37-38), himself confessed that adjustment readily translated into 'managed trade' and therefore "there is little justification for emergency protection".

¹⁸⁰ The theory of 'optimal intervention in the presence of domestic distortions' was first developed thoroughly by H. Johnson (1965) to explain that in the protection of industries at infancy stage, trade policy measure (i.e. a tariff or a quota protection) are not the first-best instruments but that the most efficient policy to counter market distortions is a policy that attacks directly the source of the 'distortion'. Since most market failures and imperfections arise within the national economy, the measures needed to attack the source of such distortions directly are not trade policy measures but domestic policies. Trade measures, on the other hand, create by-product distortions and therefore reduces motivation in the assisted industry to adopt itself into post-trade liberalisation conditions. For an advanced literature on the theory of domestic distortions (divergences) see, Baldwin (1969); Bhagwati and Ramaswami (1969) and Corden (1974). *supra*, footnote 31 in Ch. 1. Theoretical discussion is also applicable in the case of senile industries.

¹⁸¹ See, A. Hillman (1982 and 1989a); Gray (1973 and 1975) and Corden (1974) for the social concerns in the protection of declining industries. Baldwin (1989) provides an overview of it and places these arguments on a social choice theory.

5.3.1.4 *The institutionalisation of 'exceptions' and 'safeguards'*

The GATT, perhaps because of its mercantilist formulation, did help to institutionalise “exceptions” to the elimination of trade barriers and the safeguards for protection contrary to its original objectives. Indeed, as Goldstein (1998, p.147) observes “the trade vision in GATT is not akin to free trade models suggested in the economic textbooks” and formulated not on the principles of classical liberalism but on *embedded liberalism*¹⁸² as defined in Ruggie (1983). The deductive approach in GATT, such as putting the general rule first and omitting it by means of opposing rules- saying free trade should be the rule and bringing too many circumvention for protection - did not help to establish the world trade system as envisaged in the textbooks. Take for example the provisions of GATT which institutionalise the “intervention of governments” to free market in the name of infant industry protection (Article XVIII:C), balance of payment difficulties (Articles XII and XVIII:B), unfair practices of others such as dumping (Article VI), protection of industries facing a sudden competition - emergency protection- (Article XIX). There are also exclusions which are as dangerous as the exceptions in the system like waiving a country’s obligations - waiver clause- (Article XXV:5), non-application of the Agreement *vis-à-vis* certain countries - opt-out clause- (Article XXXV) and the sectoral applications in practice like the agriculture and textiles.

5.3.1.5 *GATT without self-enforcing rules*

The GATT is not a constitution with ‘self-enforcing’ rules. It does not create a ‘direct effect’ for the individuals suffering from the GATT-inconsistent actions of the countries. For example, an American or a European importer shall not have an access for a judicial remedy in their own courts (or in European Court of Justice in the case of EU) even if s/he believes that his/her rights are violated by the actions of their governments contrary to what GATT principles or rules dictate. Ehlermann for the case in the EU (1986, p.137)

¹⁸² Goldstein (1998) describes it as follows;

“Embedded liberalism meant that the formal trade system was expected to accommodate exceptions, explaining why far more details exists on how to renege from an agreement than on how to negotiate the opening of markets...The post-World War II world trade system is characterized both by universal low levels of trade barriers and an increasing number of products regulated by some safeguard or a negotiated agreement that undermines “free” movement of goods” (p. 147).

states “ GATT is not directly effective, individuals cannot invoke it to contest the legality of national or Community (EC) laws” ¹⁸³ .

5.3.2 Political Failures in GATT

GATT trade regime did not institutionalised an ‘ethical’ content and it has never considered trade as a “right” for the individuals. The abstract idea that each domestic industry shall have the right to its domestic market motivated governments to explain why they had to give market opening concessions rather than why they opposed to free exchange of goods. This, of course, constituted a system whereby trade policy process is open to protectionist groups domestically.

5.3.2.1 The disregard for the individual rights: GATT as a ‘utilitarian’ institution

No special priority is given under the GATT arrangements for the protection of individual rights such as property, contract or association (*supra Part 1.4*). GATT rather paid attention to the protection of special interest groups like domestic producers and perceived it as if these groups had the ‘vested right’ for protection. GATT, through trade negotiations, transformed the domestic vested interests of protectionists into the international arena where they somehow managed to maintain the continuity of rent-seeking activities. Long et. al. (1989) emphasised it clearly;

“The relationships that inevitably develop between domestic industry groups and those agencies responsible for them mean that policy initiatives, bearing on foreign trade, arise in a piecemeal fashion, are essentially industry-specific and are biased towards increasing protection. In such circumstances, measures tailored to the demands of particular interests tend to proliferate and to persist long after their original purpose has passed, as *vested interests...*” (p. xix).

¹⁸³ For the relation between the GATT law and the domestic law in the EU, see especially Hilf, Jacobs and Petersmann (1986). Brand (1990) is useful for the US.

This is a dilemma. The protection mechanism worked in the wrong direction. This can be called as the protection of wrong persons (the protection of the *wrongs* rather than *rights*). The wording in the GATT reflects this sensitivity clearly. For example, the word “domestic producers” appear several times in the text whereas the “consumers” does not appear.

5.3.2.2 The politicisation of alternative methods of protection

In spite of the fact that GATT always encouraged tariffs as the instruments of protection and gradual elimination of them in time, it did not offer necessary mechanisms to counter the circumvention of countries resort to alternative methods of protection. A vital and often utilized instrument have been the voluntary export restraints. Another was the frequent dumping investigations mostly finalised with definitive duties. This ignited a sudden surge in the use of such measures having economically more distortional effects than the tariffs themselves. Therefore, the neo-protectionist wave spread from one country to the other. As Anderson (1992) advocated they showed a “*domino effect* in which a protectionist domino in one country or market topples others when it falls” (p.65).

5.3.2.3 Non-state pro-free trade actors have no voice

GATT did never have a proper mechanism where the views and interests of pro-free trade groups are represented effectively. It has always served as an international framework whereby the interests of states (nations) are negotiated and balanced. Due to the fact that national interests are generally skewed towards the positions of protectionist groups, GATT has in practice, served as a forum whereby countries negotiated to capture more liberalisation concessions from others by offering as less commitments as possible. As Hillman and Moser (1995) argued, import-competing industries are assumed to have ‘property rights’ to their home markets as a result of past lobbying and political support of governments. However, the GATT structure has been negligent to the involvement of non-governmental organisations (NGOs) favouring free trade and did not provide the room for their active participation in agenda setting and decision making process¹⁸⁴.

¹⁸⁴ The new WTO system, in this respect, seems to be more developed in allowing the NGOs to express their views. Article V (2) of the WTO Agreement recognises a role, though limited in scope, for the

5.4 GATT/WTO as Constitutional Constraint on Demands for Protection

Tumlir (1985) has correctly observed that international trade policy conflicts and the problem of protectionism arise from 'domestic distributive politics'. Following the tradition of the public choice approach we assumed domestic political process as the starting point for trade policy investigation. Accordingly, individual interests create their own market for protection. The political market for trade protection requires two more factors to be taken into consideration. First relates to the 'ideas and perceptions' inherent in the society and in the political decision-making units about the principle of free trade. The second is the 'institutional constraints' that govern the political interactions. As previously explained, the institutional structure is important in shaping the market conditions. For example, the degree of receptivity of the European Commission or the Department of Commerce and ITC in the case of safeguard demands from the European or American producers or the design of the respective roles of the President and of the Congress in the US are crucial in the determination of trade policy outcomes.

However, the domestic (national) institutional setting is only one side of the matter. In a global economy, the international context is another point to consider. Indeed, a 'revised' public choice approach embracing the functions of the institutional structure should also encompass the potential roles of the international institutions as determinant factors in domestic policy-making procedures. In other words, an institutionally enriched analysis requires the examination of the role of international institutions on trade policy process in a national economy. As Moser (1990, p.2) correctly emphasised the "institutional constraints that are created internationally such as GATT or other internationally agreed policy commitments" should not be taken superficially. It is essential for a comprehensive positive political economy analysis, to explain the extent and the relevance of the present

NGOs: "The General Council may make appropriate arrangements for consultation and cooperation with non-governmental organizations concerned with matters related those of the WTO. This new approach is vital for the 'democratisation' and 'transparency' of the world trading system . The GATT system did not have such instruments and only concerned with inter-state bargaining at the international level. However, the new WTO has an important effect; i.e. to carry the domestic-level discussion in trade policy into international forum as an extension of the former.

GATT/WTO system which helps to shape the political incentive structure and the policy process *at the domestic level*. Therefore, constitutional functions for WTO like assisting countries to establish a system that provides greater public awareness for trade policy issues; a transparency mechanism for trade laws and governmental administrative practices and to help free trade interests become more informed and participatory in the domestic trade policy process are equally important like traditional GATT practices that urge countries to reduce protectionist practices and include a broader list of goods and sectors under liberalisation schemes. This can be illustrated in different forms:

5.4.1 The Resistance to Domestic Pressure Groups

It is substantially important to create a balance between protectionist and free trade interests in favour of the latter. The GATT/WTO system equips the government with necessary tools to resist the protectionist demands and undercut the relative power of the domestic pressure groups. Tumlrir (1985) puts it clearly:

“In reality, there is much political pressure on governments to counteract the results the market tends to bring about...The internationally accepted policy commitments are often the most effective support of governments trying to resist these indigenous pressures. It is therefore true to say that the institutional arrangements constituting the multilateral trade system protect the market against governments.” (p.12).

Tumlrir, here emphasises the constraining role of GATT as an international actor in the domestic field. It may become a weapon for politicians to shield themselves from the selfish interests of various groups and to protect the interests of those having a smaller possibility to be represented at the governmental level. This contributes to the elimination of the asymmetric structure among divergent interests in the domestic policy making arena. The enforcement of international rules in the domestic legal system is indispensably vital in that context. Moser (1990) reiterates that;

“ the direct access to national courts by individuals which are harmed by domestic trade policies strengthens their position and helps to correct asymmetries in the political process” (p.37).

International commitments, if transformed into legal provisions having direct effect, can create private rights for consumers, exporters or others that benefit from free trade which the governments should respect. Hence, it helps the government to resist protectionist demands.

5.4.2 WTO as a Platform for Pro-Free Trade Interests

An international body like GATT/WTO may serve as an institution whereby pro-free trade groups which are underrepresented domestically shall have the opportunity to have their voices heard by the policy makers more effectively during the trade policy formation process. As these groups are normally weaker in organisation, this will help them to decrease the costs of organisation and encounter the difficulties of free-riding¹⁸⁵. Thus, it may be a tool enabling them to unite and establish a common voice in trade discussions. This may improve the results of the domestic policy interaction in favour of free trade and alleviate the impact of pro-protectionist interests on policy outcome. Goldstein (1998) emphasises two lines of support by the WTO for policy makers favouring liberal trade policies.

“ First, the trade organization [like WTO] acts as an agenda setter, undercutting the asymmetric power of pro-protection domestic interest groups at home; second, the WTO facilitates bundled agreements that expand the size of free trade coalition” (p. 150).

Thus WTO may be a catalyst in creating a stronger and more effective free-trade alliance. The trade agenda in WTO negotiations may include several topics that under an “all-or-nothing” approach in which each topic will have its own groups in favour of liberalisation. If the ultimate arrangements under separate topics are united under a single framework agreement, the governments will face a single choice: to approve all or none. This mechanism worked in the Uruguay Round of GATT negotiations where protectionist demands under all topics were finally curtailed in order to save the whole package. Schott (1990) said that this provided a scope for the broadest range of trade-offs among issues.

¹⁸⁵ Similar to *large* group of domestic protectionists in the Olson matrix (Table 2.2), pro-free trade groups face a high costs of group co-ordination and monitoring; a high risk of free-riding because of smaller share of gains from free trade policies (in other words their higher aggregate loss may be negligible if measured individually) and an interest divergence for not having enough concentration on their claim because of the difficulties in reaching their objectives (a weariness effect).

Actually, broader packages of liberalisation work better for free trade interests than single issues like either to protect a senile industry -potentially in danger of shut down because of cheaper imports- in a location where it is the main economic activity, or not to protect.

Additionally, WTO can help all free trade interests establish an 'international pressure group' on their governments by incorporating the foreign interests in the determination of a country's trade policy. Thus, for example, car exporters in Japan can unite in big coalitions with the US consumer associations against the US car producers if such cross-free trade interests are provided with opportunity in WTO negotiations to express their views officially¹⁸⁶. Normally, free trade groups will have a bigger chance of representation at the WTO level than at the domestic level. Scholte et. al. (1999) states that they contribute to global trade talks agenda more than the domestically effective pro-protectionist pressure groups. Free trade business associations such as International Chamber of Commerce or European Round Table had easier access. Thus, for example, they represented 65 percent of the civil society organisations accredited in Singapore Ministerial Conference, the top decision-making body of WTO.

Another way that GATT/WTO can work for the interests of free trade lobbies is to encourage countries to create avenues for these groups to be heard in domestic policy actions. The "Community interest" clause in anti-dumping and subsidised-import investigations should not be taken superficially but must be made more instrumental. This is an important criterion for the European Commission and similarly for the US authorities to take into consideration the detrimental effects and costs of possible ADDs and CVDs on *consumers* and *importers of intermediary goods*. The WTO in this respect took a step in

¹⁸⁶ The *consumers* are normally expected to be favouring a free trade policy since it is economically rationale for them. However, it is not a surprise in some cases if they lobby for the restriction of trade. Many consumer bodies in the US and the European Union advocate that a truly liberal global trade policy will enhance the power of companies which do not care about consumer safety (Scholte, 1999). This is especially the case in foodstuffs trade. Many of the European or American food safety laws obligating minimum standards are enacted under the pressure of consumer organisations like Consumer International and International Organization of Consumer Unions. The case is not different as far as consumers safety is concerned in industrial goods such as chemicals, electronics, machinery, toys etc.

post-Uruguay Round ‘Subsidies and Countervailing Measures’ (SCM) and ‘Dumping’ Agreements by taking into account the rights of *interested parties*¹⁸⁷.

5.4.3 WTO and the Free Trade Ideas in the Domestic Economy

GATT/WTO may help flourishing of free trade ideas in domestic economy. Goldstein (1998, p.145) states that it may legitimise and disseminate ideas and norms. The policy makers will believe in the long term efficacy of the economic doctrine of free trade and be able to dispense with short-termism (i.e. populist protectionist policies enabling vote-hunting) and be more courageous in taking risks against organisational pressures of pro-protectionist groups.

GATT/WTO can help to eliminate the misinformation and provide a better knowledge about the implications of free trade policy as well as to encourage the establishment of a more transparent domestic environment in which the cost of protection is better understood by the public. It is also equally important if it can obligate member governments to add into their trade laws certain requirements that divulge who gains and who loses from trade protection and how much. This may constitute an essential step in changing the perceptions embedded in the society that opening the doors of the country to imports is not a “concession” at the expense of the national economy but quite contrarily that it helps the promotion of national welfare. The reaction of a lower -income American consumer would have been different had this person known that more than 30 percent of his family’s purchasing power was taken away by protection in textiles and foodstuffs or

¹⁸⁷ For instance, Article 12 of the SCM Agreement provides:

“ Interested Members and all *interested parties* in a countervailing duty investigation shall be given notice of the information ...to present in writing all evidence which they (the authorities) consider relevant in respect of the investigation in question.” (12.1) and;

the term ‘interested parties’ include;

“an exporter or foreign producer or the importer of a product subject to investigation, or a trade or business association a majority of the members of which are producers, exporters or importers of such product (12.9 (i)).

More importantly, Article 12.10 brings an obligation for the importing country to consider the views and interests of other domestic societal actors such as “the industrial users of the product under investigation”, and “representative consumer organisations”. Similar measures are also taken in favour of these groups in the “Dumping” Agreement (Article 6.12). For more about the participation of interested parties and non-governmental organisations in such proceedings in WTO Agreements, see Marceau and Pedersen (1999).

that some 240.000 Americans work in semiconductor production, but more than two million work in the industries which buy semiconductors and their jobs have all been put at risk by measures taken against Japanese producers under the Semiconductor Arrangement, which raised the price of these goods in the US market (Oppenheim, 1992). Similarly, British consumers would be in shock had they been aware of an annual £ 175 million cost because of the VER on car imports (Greenaway and Hindley, 1985). Finger (1982) suggested ingenious examples to warn public on how protection affects their daily life. He cited the following;

“The Argentines would buy television time to in Japan to show an Argentine family enjoying a big roast beef and to show Japanese families how much of the roast beef they would have after the Government of Japan took its slice. The United States would buy space in French newspapers to publicise how much the French Government spends to subsidise exports, perhaps under the headline ‘your government gave more money last year to international corporations than to the “x” poorest countries in the world...South Koreans might have sponsored a television spot as follows: the television picture flicks to a scene of happy children dancing their own way down the street to the shoe shop singing, ‘new shoes for school, new shoes for school !’ They gambol one by one into the shop, but as the twelfth one comes to the door, Uncle Sam, in striped trousers and white beard, steps forward and throws the child out, saying, ‘no shoes for you this year, kid’. The voice-over then explains: ‘the US, Korean and Taiwanese governments have just concluded an agreement which will reduce the number of children’s shoes available for sale in the US by one twelfth. That means somebody doesn’t get any” (pp.376-77).

Thus, transparency is a useful method to disseminate more information to disadvantaged parts of the society. Leutwiler Report (1987) proposed that the transparency system should be instituted in the domestic decision-making process;

“ In each country, the making of trade policy should be brought into the open. The costs and benefits of trade policy actions, existing and prospective, should be analysed through a ‘protection balance sheet’. Private and public companies should be required to reveal in their financial statements the amount of any subsidies received. Public support for open trade policies be fostered” (p. 41).

The governments should not decide for trade policy actions behind closed doors and therefore, domestic transparency institutions must be established. A greater public awareness will help the governments to make rational choices in balancing the conflicting interests (Long et. al., 1989, p. xxi). This is an information function of the government which must *educate* its people about rising protectionist demands¹⁸⁸. The role of WTO, in this context, must be to encourage the setting up of such institutions at the domestic level.

5.4.4 WTO and the Protection of Individual Rights: A More Humanitarian Approach

GATT/WTO is potentially a crucial part of a domestic system to prevent government from unpredictable interference with the market mechanism and from violating certain rights of individuals; mainly the *rights to property and contract*. As Hayek (1960) iterates perfectly, the rise of the discretionary protection erodes the legal framework of property rights, distorts cross-border contracts and causes a discrimination among persons before the law. GATT as a constitution may be transformed into national legal system to guarantee the freedom of contract and force governments to respect the individuals rights to have free access to markets. It enables the gradual elimination of the preservation of a large discretionary power in the hands of political authorities over national trade policy. This is relevant to the *constitutional aspects* of an international trading system within the ambit of GATT/WTO.

This strand of approach is a reflection of Buchanan's 'Constitutional Economics'. Buchanan, in his work, *The Limits of Liberty*, explained the necessity for constitutional constraints and demonstrated the benefits of a contractual agreement to respect the *natural rights* of individuals. He stated that the existence of such constitutional device is vital prior to the exchange of goods. However, in international transactions no such mechanism properly existed before. Therefore, GATT/WTO must be re-designed to provide an institutional framework with set of rules that constrain the choices and activities

¹⁸⁸ Banks and Tumlir (1986) proposed a transparency institution with the powers of advising government on the national effects of proposed protection before any decision is taken; publicising this advice; and to survey and appraise economical effects of trade interventions details of which should be regularly documented.

of economic and political agents in domestic policy making (Moser, 1990). In this way GATT/WTO induces the *protection of the freedom to trade* in cross-border commercial relations and discourages *the protection of trade*. Finally, the GATT/WTO system can be a domestic instrument to help reducing the political and administrative corruption (i.e. in the allocation of quotas or in tariff-seeking lobbying with the aid of bribes to politicians) in trade.

As noted above, following Buchanan's thesis GATT/WTO is an external element that can be placed into the domestic trade policy-making. Thus, the public choice approach, as a research line of constitutional economics, emphasises the role of GATT/WTO not as an international arena where the divergent interests of states clash with each other, but as a domestic tool that shape in its capacity, the policy outcomes within the domestic economy of a state before it comes to the international negotiation stage (i.e. MTNs)¹⁸⁹. Therefore, GATT/WTO is "internalised" into an *endogenous* factor to liberalise trade. This makes the 'constitutionalist' approach different from those of 'international institutionalists'¹⁹⁰ who perceive GATT/WTO as an *exogenous* (international) regime around which the *states'* expectations converge. Table 5.1 explains the characteristics of both approaches as well as advantages and disadvantages.

There should be no doubt that GATT system has *not* been very effective in restraining the tendency for protection at the domestic level due to the inherent flaws and failures and its *exogenous* characteristics. Its impact, actually depends on to what extent it fulfills its expected functions of enabling 'self-enforcing rules' for protecting the right of individuals to trade; correcting 'political market imperfections'; restricting the 'discretionary power' of politicians; opening the channels of access for pro-free trade interests to policy-making units or closing the channels to pressures of the pro-protection interests.

¹⁸⁹ It may be necessary to reiterate the words of Röpke "internationalism, like charity begins at home". According to him a progressive liberalisation of international trade is concerned more with the domestic level and GATT as an international regime has only a *supporting* role (Sally 1998, p.141).

¹⁹⁰ 'Internationalist approach' to GATT is apparent in studies of Krasner (1982); Keohane (1984); Ruggie (1982) to name but a few. The 'constitutionalist approach' to GATT/WTO follows a "public choice" theory and is rather limited to a few studies. Tumlrir's researches (1983a; 1983b; 1985 and 1987) have been influential. See also Moser (1990); Finger (1991); Frey (1991); Roessler (1986) and Hauser (1986). R. Sally (1998 and 1999) explains the distinction between these two approaches lucidly.

Table 5.1 GATT/WTO as an Endogenous or an Exogenous Factor of Trade Liberalisation

	<i>Endogenous influence of GATT/WTO</i>	<i>Exogenous influence of GATT/WTO</i>
Definition of the role of GATT/WTO	Liberalisation coming from <i>within</i> the domestic dynamics of a nation, i.e. domestic balancing of the interests in favour of a free trade policy where GATT/WTO is <i>internalised</i> in the system as an influential constraining factor on the domestic trade policy formulation process.	Liberalisation imposed <i>externally</i> where GATT/WTO is assumed to create an international regime in which the countries, not societal actors within the country, balance their interests by mutual concessions in a reciprocal way based on power and diplomacy.
Difficulties	arise concerning questions like how to integrate WTO into domestic policy interplay and how to establish symmetrical representation opportunity for less favoured and less-organised interests within the domestic trade policy process and how to establish procedural devices serving for the minimisation of political failures.	It does not create a confident mechanism to keep the norms and principles of GATT undistorted because it does not aim to cope with mercantilist fallacies such as aggressive reciprocity and sovereign concept of trade “concessions” in which imports are regarded as detrimental to national economy. It ignores the “political market for protection” and the domestic aspects of the trade policy process.
Priority of analysis	is given on the rights of the individual such as the rights to property; choose; contract and association.	is given to national interests and mainly the reactions of interest groups who loses from trade liberalisation such as domestic producers and trade unions but the case of consumers and exporters are taken superficially.
Accepted by	Public choice theoreticians which regard GATT/WTO as a constitutional constraint in the domestic field (constitutionalists)	Neo-liberal “institutionalists” who consider GATT/WTO as an external enforcement on the trade policy of a country.

CONCLUSIONS

*The inner history of every modern protective tariff
is a history of commercial and political corruption.*

Russell Rea, Insular Free Trade, 1908.

*Democracy, if survives, must above all learn how to discipline
and organise such minorities as 'special interest pressure groups'.*

Henry Simons, Economic Policy for a Free Society, 1948.

Academic arguments consider “free trade”, as a general economic proposition that provides an optimal case for all nations, in *almost* all possible circumstances. It enhances the development of the national economy and societal welfare thanks to its characteristics that it allocates the country’s resources efficiently and increases the prosperity of people by raising their consumption possibilities. The thesis that the national industry should be protected in cases when there are *market imperfections* and *market failures* to achieve an optimality has been refuted quite lucidly by “domestic distortions” theoreticians who argued that intervention in trade may not be the first-best way to deal with the problems and that policy intervention, if assumed necessary, must take place at the exact point at which the distortion occurs; that is by means of a domestic policy instrument. Accordingly, the only economic justifications of trade protection shall be in cases where the distortion is a trade-distortion- that is the “optimum tariff argument” as clarified by H. Johnson (1965). Even the last argument is not totally free from a criticism. It is true hypothetically that national welfare will increase if the optimum tariff rate is applied but it cannot be measured how much will an individual’s welfare be increased. Hence, it is not possible to measure the benefit from such a protectionist policy by adding up cardinally the utilities of all individuals to make a social choice.

The same logic applies to the choice of a free trade policy where there will be individuals who are, for sure going to lose. Therefore, the government as the policy supplier faces the same dilemma: Which policy to apply or put it rightly which groups’ interests in the

society should be favoured? The simplistic and pragmatic answer for an economic-rationality government will be to choose the policy that will increase the welfare of as much people as possible. This is politically rationale as well since it helps the government to guarantee as many votes as possible, in a democratic society, that will help to win the next elections. However, more important than the failures in the markets, are the *political market failures* which can alter the choice structure of an economically-rational government. According to this, not all individuals have the necessary information to decide which policy action of the government maximises his/her own utility; or that s/he may be aware of the consequences but have not enough political power to change the policy direction in domestic policy-making process either because s/he is not a member of a pressure group or his/her group is politically less coherent as a coercive force, though crowded in number, on the government compared to other groups favouring alternative policies. Trade policy issues are not immune from this political assumptions where a protectionist policy may be preferable to a free trade policy even though the latter benefits more of the citizens. Taussig's assertion that "the fundamental principle of free trade has been little shaken by all the discussion and all the untoward events of the past half-century. But its application is not so easy and simple" (quoted in Irwin, 1989). This observation of a century ago is also illustrative for the recent protectionist period in world trade -new protectionism- by innumerable examples of import quotas; excessive anti-dumping duties; voluntary export restrictions and so on.

This explanation above brings us to the principal discussion in this study. Many economists looked for the explanation of the fundamental question as to *why is a particular policy is adopted* i.e. *why do we have a protectionist trade policy?* They looked at the discussion from diverging perspectives with different methodologies. In this study, three alternative methodological explanations were analysed.

The first method is a *systemic* approach whereby the trade conflicts such as protectionist policies are considered to be a consequence of national differences and the states are assumed to be the unitary actors in trade discussions. This approach shall have its disadvantages in bringing a satisfactory answer to our fundamental question when it is sub-

divided into questions as to *why, if it applies a trade protection policy, the country has a higher protection than other countries; or why its protection is more in one industry compared to other industries within its domestic economy; or why protection rate differs in the same industry in different time periods, or why certain industries are protected by tariffs and others by quantitative restrictions like VERs within the same period.* Similar concerns are also relevant to second alternative explanation: the *state-centred* analysis. This applies the methodology which expands the investigation from international into domestic level and it focuses on state's relation to other actors *within its own society* as distinct from its relations with other states in the international system. It magnifies the roles of state officialdom or institutional constraints upon their decisive role thus assumes that state is the unitary actor in trade policy formulation. However, this approach is having a serious weakness, for example, as to *why different protectionist tools are applied for the case of different industries at different times.*

The third method of explanation, *society-centred interest group* analysis, to which the hypothesis in this study are based on, is generally referred to -though not limited- the "public choice" approach which comes from a liberal tradition refusing the arguments that markets fail and produces a counter-attack that "the politics fail and political market for protection have imperfections". Thus it brings a more sophisticated explanation whereas standard market failure and neo-classical optimum tariff arguments for trade restrictions explain only a minor portion of actual trade policies. *Public choice theory* has rightly observed that the operation of demand and supply conditions for trade policies is much the same as the conditions in goods markets. Thus, every interest group in the society lobbies on the government (supply side of the trade policy market) to change the direction of latter's policy outcome to serve its own self-economic interests. They seek *rents* - a payment to a resource owner above the amount his resources could command in their next best alternative use; a receipt in excess of the opportunity cost of a resource- in the political market by means of governmental intervention, i.e. trade protection. Import-competing industries, accordingly, could be expected to lobby and exert a pressure on the government for rent-generating protectionist measures, whereas consumers who are more

in number and whose interests rely on free trade, would do nothing -despite tremendous cost of protectionist policies- because political markets operate under imperfections.

This study explores the answers to these questions in the case of industrial trade protection in the European Union (EU) and the United States (US) for the period between 1970s to 1990s. The findings are *fourfold*:

First, the best approach to start the investigation is the *society-centred interest group* analysis on which we built a public choice methodology. It suggests that widespread protection in these countries cannot be explained adequately by an *inter-national* (systemic) setting, but an *intra-national* approach that construes the “domestical” process of decision-making where economic interests of social actors are focused is useful. Hence, a *public choice approach* for trade policy formulation is more successful in figuring out why trade protection is accepted even though it may economically be an inefficient policy. This study recognises that the prime success of protectionist lobbies is a direct function of their organisational structure. As Olsonian hypothesis develops conditions whereby smaller but more co-ordinated interest groups with lesser free-riding problems can better reflect their views at the policy suppliers (i.e. the politicians and trade bureaucracy). Pareto’s observation that individuals will work much harder to achieve a large gain than they will avert a small loss is applicable here. Thus, protectionist groups tend to lobby more intensively and invest more resources as they will extract more incomes as a result of a trade protection measure. They will multiply their gain if they can persuade the policy suppliers to select the most restrictive alternative measure, i.e. a VER quota over a tariff. Similar logic applies when we think of the otherwise. Large but unorganised groups in favour of free trade tend to inert as the cost of protection is spread over a large part of the population with little share of loss per individual.

These general propositions hold true for especially the case of protection for declining industries in both the EU and the US. Nonetheless, this study concludes that differences arise in particular cases between the two. The reasons may be relevant to various parameters that we have to consider. The high level of dependency on contingent

protection (mainly the ADDs and CVDs) measures in the US, is coupled with a series of seriously rent-creating discretionary measures such as Section 301 actions, VERs and voluntary import expansion schemes. The second group of trade obstacles is not frequent though it heavily uses the contingent protection and VERs. The difference can be explained by altogether different orientations of both sides in international political relations. The rising decline of the US economy relative to its previous superiority can provide a good explanation for the insistence on “export protection” measures. Many American industries ardently supported their government’s negotiation with foreign countries to open their markets for more American goods. The public choice view explains this “executive” track of protectionism with the help of the legislative (Congressional) support in two ways; both by the pressure of domestic protection lobbies on the Congress which in turn intervenes in the executive branch of the government to adopt policies that will maximise their constituents’ interests and by passing barely protectionist laws. In the European Union, on the other hand the equivalent legislation for “export protection” has been mute for the reason that the EU, compared to the US, has been more interested in opening markets by means of *regional schemes* such as RIAs with other European and neighbouring countries and more concerned with import protection. The complexities of organisational structures were also determinants for the access for interest groups in the decision-making process.

Second, we also observe that industries which do not have serious competitive difficulties are granted protection or that not all the industries facing hard times are *equally* successful in securing protection. Thus, for example, it will not be easy to appreciate why politically less powerful industries can obtain protection; or how trade liberalisation occur simultaneously with trade protection; or why industries with similar problems obtain different protection measures. This study reveals that the assumptions of a pure public choice approach needs a relaxation of the receptive government approach, which considers the policy suppliers as prisoners of societal demands (a “receptive government” approach), to include certain factors for a better understanding of trade policy outcomes. This suggests that rent-seeking concept based on the assumptions of *homo economicus*, *utility maximising individuals* and *political markets for protection (catallaxy)*-the

principal arguments in public choice approach must be complemented with hypothesis based on *social values and concerns*, and embedded *ideas*. Social motives based on “protection as social insurance policy” or “conservative social welfare function” models and the holistic mercantilist ideas such as “fair trade should be the norm” can help us analyse the elaborated domestic decision-making structure more efficaciously. These factors do not represent an alternative to the public choice approach but broadens its theoretical underpinnings. This is what we name the *revised* public choice approach for explanation for the functioning of EU’s and US trade policies.

Third, in a revised public choice approach, several exogenous factors can be internalised (thus become an endogenous factor) within the complex domestic trade policy formulation process. This is also relevant to the normative structure in public choice theory. As it is not easy to change the rational utility maximising character of domestic policy actors, a better alternative will be to change the rules and institutions within which they interact. Hence, the policy process may be re-designed with different domestic set of rules, laws and institutional structures to be able to reach different policy outcomes. This is a Buchananian assertion of *constitutional economics* that seeks choices be made *among* constraints not *within*. GATT/WTO can be a significant factor that can alter the constraints in the domestic policy formulation. GATT could have been erected as an institutional device that could help to reduce trade protection and obtain free trade policy outcomes. This point was only narrowly touched in the literature of international political economy.

This study aimed to emphasise the potential influential role of GATT system as an *endogenous* variable, not as an *exogenous* factor itself at the systemic level as was discussed in most of the studies. Thus the liberalisation of free trade comes from the internal dynamics of a democratic society and it is not possible to overrule trade protection by means of external elements with limited self-enforcement capacities. For this reason, this study claims that an exogenous factor like GATT needs further internalisation to make it an “endogenous constraint” on policy suppliers. Several initial flaws and failures in the GATT system prevented it constituting such a constraint and eventually rendered it to be unsuccessful in precluding the occurrence of new protectionism. The study explains the

ways to increase the effectiveness of free trade lobbies and restrict the influence of trade protection lobbies as well as to curtail the inactivity of policy suppliers acting like a receptive government.

Fourth, this study attempts to open a discussion concerning the right-violating effects on the individuals of trade policy measures. Bastiat's asserted that "if the law takes from some persons what belongs to them, and gives it to the other persons to whom it does not belong, then it is a bad law". This study claims that trade protection laws operate under the same formula where individual's *negative rights* such as the right to property, choice, contract or association in the *Lockian* sense are being violated through ant-dumping laws, quotas, VER arrangements and similar measures in the existing domestic policy-making process. The government, within this process, facilitates the rent shifting and therefore moves away from its original role to defend the rights of its individuals.



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Annex-1. Overview of computable general equilibrium (CGE) assessments of the Uruguay Round

Study	Base/ Evaluation	Policy Experiments (Coverage)	Model Structure	Income	Trade	Other
Brown, Dearliff, Fox, and Stern (1995) (The Michigan Model)	1990/1990	Four liberalization scenarios based on combinations of the below ingredients Industrial Tariffs: Cut according to schedules. Agricultures: Tariffs incl. NTB-equivalents cut according to the difference between estimated base rate and final offer rate. Services: NTB tariff-equivalents cut by 25%. (The tariff-equivalents are estimated from coverage ratios, see Hoekman 1995). Note: Industrial NTBs, such as the MFA, are not covered. The service liberalization scenario represents hypothetical post-Uruguay Round liberalizations.	The model: Agriculture: Constant Returns to Scale, Perfect Competition. Products differentiated by country of origin (Armington). Manufactures and Services: Increasing Returns to Scale, Monopolistic Competition. Services are treated as tradables. The variety effect on utility and scale economies is dampened by 50% compared to the original Dixit-Stiglitz spec. Labour mobile between sectors, while capital is specified as sector-specific. Aggregations: 29 Sectors (1 Ag., 1 proc. food, 1 Prim. 20 Manuf., 6 Services), 9 Regions. Dynamics: Static model	Disaggregated income effects of Industrial, Service, and full liberalization: (% of GDP). USA 0.3%, 0.7%, 0.9% Canada (0.4%, 1.6%, 2.0%) Europe (0.3%, 0.6%, 0.9%) Japan (0.6%, 0.8%, 1.4%) Australia & New Zealand (1.2%, 2.8%, 3.6%) Asian NICs (2.4%, 1.1%, 3.6%) Mexico (0.1%, 2.7%, 2.8%) Other Major Trading Nat. (0.0%, 1.0%, 1.0%)	Export effects of industrial tariff cuts. USA 2.9% Europe 3.2% Japan 3.3%	Real Wage Effects USA 0.30% Canada 0.70% Europe 0.30% Japan 0.50% Australia & New Zealand 0.60% Asian NICs 2.10% Mexico 0.40% Other Major Trading Nat. 0.50%
Francis, McDonald, and Nordström (1995) (WTO/GATT)	1992/1992 (1992 dollars) (The model is a steady-state model benchmarked to 1992).	Textiles and clothing: MFA quotas are lifted Tariffs cut according to schedules Other Industrial Goods: Tariffs cut according to schedules NTBs (except dumping) are phased out. Non-agricultural primary goods: Tariffs cut according to schedules Agriculture: Export subsidies cut 36 (24)% (Developing countries within parenthesis) Import liberalization is limited to minimum market access commitments note: quotas are modelled as quantity constraints (not as taxes) for MFA and agriculture. Minimum access in agriculture involves expansion of tariff-quotas.	Model 1: Constant Returns to Scale (CRTS). Perfect Competition (PC), Products differentiated by origin (Armington). Model 2: Increasing Returns to Scale (IRTS), Ehliber/Krugman type monopolistic competition. Aggregation: 19 Sectors (3 Ag., 3 Primary, 12 Manufactures, Services), 13 Regions. (Based on augmented GTAP 1992 SAM). Dynamics: (Accumulation Effects) Fixed savings rate (F). Endogenous savings rate (E). (The return to capital must be equal to the rate of time preferences in equilib.).	World: Model 1 (0.29%) F (0.43%) E (0.83%) F (0.94%) E (Medium-run dynamic specification within parenthesis). Disaggregated income effects, model 2: Canada (0.67%) E (0.62%) E (0.18%) E (0.48%) E (0.43%) E (0.40%) E (3.97%) E (1.68%) E (3.15%) E (3.07%) E (1.41%) E (0.42%) E Disaggregated real wage effects, model 2: Canada 0.67-1.12 F-E USA 0.45-0.62 F-E EFTA 0.31-0.44 F-E EU 0.45-0.33 F-E A&NZ 0.42-0.89 F-E Japan 0.23-0.39 F-E China 4.01-1.68 F-E Latin America 0.96-1.86 F-E East Asia 3.27-1.61 F-E South Asia 4.65-2.02 F-E Africa 1.29-1.09 F-E Transition Ec. 0.34-0.43 F-E	World: 3.7-6.3% 13.6% - 14.5%	Decomposition of welfare effects Model 1. (E) Agriculture 9%, Primary 3%, Textiles & clothing 35% Other industry 53% Model 2. (F) Agriculture 3%, Primary 6%, Textiles & clothing 61% Other industry 30% Model 2. (E) Agriculture 3%, Primary 7%, Textiles & clothing 50% Other industry 39% Notes: Economies of scale only in industrial sectors

(-continued-)

Study	Base/ Evaluation	Policy Experiments (Coverage)	Model Structure	Income	Results Trade	Other
Harris, Rutherford, and Turr (1995) (World Bank)	1992/1992 (1992 dollars)	Industrial Tariffs: Cut according to schedules Industrial QRs: VLEs (unspecified) are eliminated. Agriculture: Tariffs incl. NTB-equivalents cut according to schedules. (See Ingo (1994) for details on estimation of ad valorem equivalents of specific tariffs). Export subsidies cut 36 (24) % Domestic support cut 20 (13) % (Developing countries within parentheses) Textiles and clothing: MFA quotas are lifted note: reductions in textile and clothing tariffs are included in "Industrial Tariff" liberalization for decomposition purposes. note: quotas are modelled as taxes, constraints (not as taxes).	The base model: Constant Returns to Scale (CRTS), Perfect Competition (PC), Products differentiated by origin (Armington). Model 2: Hybrid Armington - Monopolistic Competition (AMC) model. Intra-regional monopolistic competition, inter-regional competition between sectoral Armington-composites (cubilia properties of a model with regional external scale effects for production of Armington composites) Aggregation: 22 Sectors (5 Ag., 3 proc. food, 3 Prim., 9 Manuf., 2 Services), 24 Regions. (Based on GTAP 1992 SAM). Dynamics (Accumulation Effects) Endogenous savings rate. (The return to capital must be equal to the rate of time preferences in equilib.).	World:24 Reg Base Model 0.403% (0.712%) World:12 Reg Base Model 0.407% (0.699%) World:24 Reg Hybrid Model 0.418% (N/A) (Steady-state dynamic specification within parentheses). Disaggregated income effects, "long-run" model: (from Table 13) OECD (0.631%) USA (0.449%) EU (0.743%) EFTA (0.733%) Japan (0.638%) LDC (1.199%) China (0.451%) Latin America (1.720%) MEast/Nafica (0.260%) SS Africa (-0.399%) South Asia (2.032%) Transition (0.138%) East Asia (3.120%) World (% of GDP) 0.89%.	N.A.	Decomposition of welfare effects: Base model (Stat.) Agriculture 68%, MFA 15%, Manuf. reform 18% Base model (Dyna.) Agriculture 38%, MFA 12%, Manuf. reform 49% Model 2. (Stat.) Agriculture 61%, MFA 17%, Manuf. reform 23%
Hertel, Martin, Yanagishima, and Dinaraon (1995) (GTAP Model)	1992/2005* (1992 dollars) *(The model is calibrated to 1992. However, the base for the UR-assessment is a projected world economy in 2005).	Industrial Tariffs: Cut according to schedules Agriculture: According to the Agreement on Agriculture. Textiles and clothing: MFA quotas are lifted. note: reductions in textile and clothing tariffs are included in "Industrial Tariff" liberalization for decomposition purposes. note: quotas are modelled as quantity constraints.	The model: Constant Returns to Scale (CRTS), Perfect Competition (PC), Products differentiated by origin (Armington). Aggregation: 10 Sectors (1 Ag., 1 proc. food, 1 Prim., 5 Manuf., 2 Services), 15 Regions. (Based on GTAP 1992 SAM). Dynamics: Using exogenous projections of each regions growth of physical capital, human capital, state of technology, population, labour force and arable land, the world economy is projected with and without the Uruguay Round policy changes from 1992 to 2005.	Disaggregated income effects, base model USA/Canada 0.40% EU 0.72% Japan 1.04% NICs 3.87% China 1.46% Indonesia 2.94% Malaysia 21.38% Philippines 6.63% Thailand 4.54% Latin America -0.08% Sub-Sah. Afr. -0.51% South Asia 1.93% ROW 0.03% note: global results were reported incorrectly as 0.42 percent in the original paper.	Change in exports (based on bilateral effects.) 48.01% 41.91% 22.33% 118.63% 217.35% (ASEAN) 142.72% 63.31% 60.52% 94.00% 34.83% World 58.88%	Decomposition of welfare effects (sum = 100) (Ag., Tariffs, MFA) (18%, 9%, 73%) (5%, 51%, 44%) (1%, 97%, 2%) (0%, 116%, -16%) (-3%, 71%, 29%) (14%, 51%, 35%) (1%, 102%, -3%) (6%, 97%, -3%) (8%, 83%, 7%) (-46%, -195%, 341%) (6%, 43%, 48%) (10%, 73%, 18%) (35%, 99%, -93%) World (5%, 81%, 14%)

(-continued-)

Study	Base/ Evaluation	Policy Experiments (Coverage)	Model Structure	Income	Results Traits	Other
<p>Goldin and van der Mensbrugghe (1995). (RUNS Model)</p>	<p>1985/2002* (1992 dollars) *(The 1985-1993 period is used to validate the model to observable data. Projections are made for the period 1993-2002).</p>	<p>Five scenarios differing with respect to measurement of benchmark protection (1982-93 or 1991-93 averages), whether input subsidies are reduced, and whether unemployment is allowed or not. We report results from scenario II and III: Industrial Tariffs: Scenario II&III: Cut according to schedules Agriculture: Scenario II&III: Tariffs incl. NTB-equivalents cut according to schedules. (See Ingco (1994) for details on base protection, the average for 1991-93 in these scenarios). Scenario III: Input subsidies cut 36% for OECD and 24% for other countries. Note: Industrial NTBs, such as the MFA, are not covered.</p>	<p>Base version of the Rural/Urban-North/South (RUNS) model: Two types of households: Urban manufacturing and Rural farming. Constant Returns to Scale, Perfect Competition. Manufactured products differentiated by origin (Armington). Agricultural products are treated as perfect substitutes. Aggregations: 20 Sectors (15 Ag. Fertilizers, Energy, Equipment, Services, Other Manufact.) 22 Regions. Dynamics: Recursive dynamic structure (with separate static and dynamic relations) using exogenous regional forecasts of population and labour force growth, productivity trends in various sectors, energy prices, and foreign transfers.</p>	<p>Changes in real income (% of benchmark GDP in 2002)</p> <p>Scenarios (II, III) Low. Inc. Asia (0.1%, 0.2%) China (-0.1%, -0.2%) India (0.5%, 0.7%) Up. Inc. Asia (1.3%, 1.3%) Indonesia (0.1%, 0.1%) Other Africa (-0.2%, -0.3%) Nigeria (-0.1%, -0.1%) South Africa (-0.4%, -0.4%) Magreb (-0.1%, -0.3%) Mediterranean (-0.1%, -0.2%) Gulf region (0.0%, -0.2%) Oth. Latin Am. (-0.3%, 0.0%) Brazil (0.4%, 0.3%) Mexico (-0.4%, -0.5%) US (0.0%, 0.1%) Canada (-0.2%, 0.0%) Aust. & N.Z. (0.0%, 0.1%) Japan (0.4%, 0.4%) EU (0.3%, 0.6%) EFTA (1.0%, 1.2%) Former USSR (0.1%, 0.0%) Oth. Eur. trans. (0.1%, 0.1%)</p>	<p>N.A.</p>	<p>Agricultural price increases: Scenario: (II, III) Wheat (3.8%, 6.3%) Rice (-0.9%, 0.8%) Coarse grains (2.3%, 3.2%) Sugar (1.8%, 2.5%) Beef, veal, & sheep (0.6%, 1.4%) Other meats (-0.6%, -0.1%) Coffee (-1.5%, 1.4%) Cocoa (-0.7%, -0.6%) Tea (-1.4%, -1.2%) Oils (-0.3%, 3.9%) Dairy (1.2%, 2.3%) Other food products (-1.4%, -1.5%) Wood (-0.9%, 0.5%) Cotton (-1.2%, -0.3%) Oth. Ag. (0.8%, 0.9%)</p>
<p>Franscois, McDonald, and Nordstrom (1994) (GATT)</p>	<p>1990/2005 (1990 dollars) (The model is a steady-state model benchmarked to 1990. GDP estimates for 2005 are based on application of results to OECD and World Bank Baseline 2005 GDP projections.)</p>	<p>Industrial Tariffs: Cut according to schedules Agriculture: Tariffs incl. NTB-equivalents cut 36 (24%) Export subsidies cut 36 (24%) Domestic support cut 20 (13.3%) (Developing countries within parenthesis) Textiles and clothing: MFA quotas are lifted Others: VERs on Autos in EU phased out Note: MFA quotas modelled as explicit quantity constraints.</p>	<p>Model 1: CRTS, PC, Armington. Model 2: Regional "external" scale economies depending on aggregate production of the sector, PC, Armington. Model 3: "Internal" scale economies, Monopolistic competition. Aggregations: 15 Sectors (2 Ag., 3 Primary, 8 Manufacturing, 2 Services), 9 Regions. (Based on GTAP 1990 SAM). Dynamics: Fixed-saving rate. Savings allocated between sectors so as to equalize the return to capital in each sector.</p>	<p>World: Model 1 (0.31%), Model 2 (0.32%), Model 3 (0.41%) World: Model 3 (0.86%) (Medium-run dynamic specification within parenthesis). Disaggregated income effects, model 3: Canada (1.32%) USA (1.35%) EFTA (2.37%) EU (1.73%) AANZ (1.07%) Japan (0.57%) Dev/Tra (1.29%)</p>	<p>World: 8.6% 9.6% 23.5%</p>	<p>Decomposition of welfare effects: Model 1: Tariffs 30%, Agriculture 31%, MFA + VER 39%, Model 3, Tariffs 26%, Agriculture 10%, MFA + VER 64% Notes: Economes of scale only in industrial sectors.</p>

(-continued-)

Study	Base/ Evaluation	Policy Experiments (Coverage)	Model Structure	Income	Results Trade	Other
Goldin, Knudsen, and van der Mensbrugghe (1993) (RUNS Model)	1985/2002* (1992 dollars) *(The 1985-1990 period is used to validate the model to observable data. Projections are made for the period 1990-2002).	Industrial Tariffs: 30% across-the-board tariff cut. Agriculture: Tariffs incl. NTB-equivalents cut 30% Export subsidies cut 30% Input subsidies cut 30% Note: No distinction in cuts between developed and developing countries, nor between signatories and non-signatories to GATT.	Base version of the Rural/Urban-North/South (RUNS) model: Two types of household: Urban manufacturing and Rural farming. CRTS, PC. Manufactured products differentiated by origin (Armington). Agricultural products are treated as perfect substitutes. Aggregations: 20 Sectors (13 Ag, Fertilizers, Energy, Equipments, Services, Other Manufact.) 23 Regions. Dynamics: Recursive dynamic structure (with separate static and dynamic relations) using exogenous regional forecasts of population and labour force growth, productivity trends in various sectors, energy prices, and foreign transfers.	World 0.7% Africa (net-food imp.) -0.3% Low Income Asia, China plus India 1.7% Latin America 0.3% Other Developing 0.8% OECD 0.8% Other 0.1%	N.A.	Approximately 85% of global welfare gain from agricultural reforms. Full trade liberalization would increase the income gain from \$213bn to \$430 bn by 2002, or from 0.7 to 1.5% of base GDP. Most ag. prices increases with 1-8%, except Coffee, Cocoa, Rice, and some meat products.
Nguyen, Ferroni, and Wagle (1993)	1986/1990 (1986 dollars)	Industrial Tariffs: 30-50% cut depending on product category and region. Industrial NTBs: 40% cut of tariff equivalents of NTBs. Textiles & Clothing: MFA phased out. Agriculture: Boundary measures cut 40 (20)% (developing countries within parenthesis). Domestic support cut 20% (No cuts in centrally planned economies). Services: 40% cut of tariff equivalents of NTBs.	Model structure CRTS, PC, Armington. Aggregations: 9 Sectors (1 Ag., 2 Prim., 3 Manf., 1 Services). 10 Regions. (EU, EFTA, USA, Japan, Australia and New Zealand, Canada, middle income ag. exporters (AGX), middle income ag. importers (AGM), centrally planned economies (CNP), and ROW). Note: Policy-data for Post-Tokyo Round. Dynamics: Static model	World 1.1% EU 1.8% EFTA 2.1% USA 0.8% Japan 2.0% Aus&NZ 1.1% Canada 0.9% AGX 1.9% AGM 0.9% CNP 0.6%	20.2%	Decomposition of welfare effects: Industrial Tariffs and NTBs 12% Text&Cloth 40% Agriculture 34% Service 14%
Brandao and Martin (1993) (RUNS Model)	1985/2002 (1992 Dollars)	Agriculture: Tariffs incl. NTB-equivalents cut 36 (24)% Export subsidies cut 36 (24)% Domestic support cut 20 (13.3)% (Developing countries within parenthesis)	The RUNS model: (See above under Goldin et al, 1993)	World \$88.8 bn OECD \$63.3 bn Non-OECD (by 2002) \$19.8 bn EU 0.6% EFTA 1.2% USA 0.2% Japan 0.6% Low Inc Asia 0.2% Upp. Inc Asia 1.1% China 0.1% India 0.4% Latin America 0.7% Africa -0.1% Mghreb -0.1% Mediterranean -0.3% East Europe 0.4%	N.A.	Agricultural price increases: Wheat 6.3% Rice 4.2% Coarse grains 4.4% Sugar 10.2% Beef, veal, & sheep 6.1% Other meats 3.2% Coffee 0.4% Cocoa 0.1% Tea 2.3% Oilseeds 4.5% Dairy 10.1% Wool 2.0% Cotton 2.2% Other Ag. 2.2%

PC = Perfect Competition, CRTS = Constant Returns To Scale, Armington = Product differentiation based on origin, IRTS = Increasing Returns to Scale, MC = non-pollistic competition.

Abbreviations:

(-continued-)

Study	Base/ Evaluation	Policy Experiments (Coverage)	Model Structure	Results		
				Income	Trade	
<p>Hylland and Tollefsen (1994)</p> <p>(Haaland and Norman Model)</p>	<p>1985/1992* (1985 ECU)</p> <p>*The model is calibrated to 1985. However, the base for the UR-assessment is a simulated "after-1992" equilibrium in which EU and EFTA have formed the EEA.</p>	<p>Industrial Tariffs: 33% across-the-board tariff cut. Industrial NTBs: 33% across-the-board cut of NTBs (tariff equivalents) on non-agricultural goods. Services: 33% cut in NTBs (tariff equivalents) of financial and transportation services.</p> <p>Note: Does not cover agricultural reforms and MFA. (Trade between the OECD and developing countries is held constant).</p>	<p>Model: Cournot competition in market for final demand. Monopolistic competition in market for intermediate demand. Economies of scale. Aggregations: 13 Sectors (12 Manf., 2 Serv., 1 NT), 4 Regions (EU, EFTA, USA, Japan). Note: Developing countries are not covered by the study. Dynamics: Fixed interest rate. Savings and investment are determined by the condition that returns on capital must equal the fixed interest rate in equilibrium.</p>	<p>World (GDP-weighted) 0.17%, (0.21%) EU 0.11% (0.16%) EFTA 0.14% (0.19%) USA 0.05%, (0.11%) Japan 0.62%, (0.61%) (Medium-run dynamic specification within parentheses).</p>	<p>Total 33.3% 18.5% 3.4% 39.9% 39.7%</p>	<p>Other 10% liberalization of services trade instead of 33%: This reduces welfare gain by some 40%. Trade war if IIR falls: Welfare loss of between 0.11% for USA and 1.06% for Japan.</p>
<p>Yang (1994) (GTAP Model)</p>	<p>1992/1992 (1992 dollars)</p>	<p>Industrial Tariffs: Cut according to GATT(1992). Agriculture: Tariffs incl. NTB-equivalents cut 36 (24)% Export subsidies cut 36 (24)% Domestic support cut 20 (13.3)% (Developing countries within parentheses) Textiles and clothing: MFA quotas are lifted</p>	<p>Model 1: CRTS, PC, Armington Model 2: Regional "External" scale economies depending on aggregate export of the sector, PC, Armington. Aggregations: 10 Sectors (1 Ag., 8 Manf., 1 Serv.), 10 Regions. (Based on GTAP 1992 SAM). Dynamics: Statis model</p>	<p>World: \$69 bn (Approximately 0.30% of world GDP 1992). World: \$146 bn (Approximately 0.63% of world GDP 1992).</p>	<p>N.A.</p>	<p>Decomposition of welfare effects model 1: Agriculture 46% MFA 29% Tariff 24% Decomposition of welfare effects model 2: Agriculture 26% MFA 37% Tariff 37%</p>
<p>Francis, McDonald, and Nordström (1993) (GATT)</p>	<p>1990/2005 (1992 dollars)</p>	<p>Industrial Tariffs: Cut according to offers as of 19/11/92. Agriculture: Tariffs incl. NTB-equivalents cut 36 (24)% Export subsidies cut 36 (24)% Domestic support cut 20 (13.3)% (Developing countries within parentheses) Textiles and clothing: MFA quotas are lifted</p>	<p>Model: CRTS, PC, Armington Aggregations: 10 Sectors (1 Ag., 1 Prim., 7 Manufact., 1 Services), 7 Regions. (Based on GTAP 1990 SAM). Exogenous Dynamics: Medium-run dynamics calculated based on aggregate "a" of 1/3. Applying Baldwin (1992) formula, medium-run dynamics add 50% to static income gain.</p>	<p>World: 0.45%, (0.67%) (Medium-run dynamic specification within parentheses).</p>	<p>World: 12.4%</p>	<p>AB. prices: 2.2% increase in agricultural world market prices.</p>

Annex-2 UNCTAD CODING SYSTEM OF TRADE CONTROL MEASURES

Code	Description
1000	TARIFF MEASURES
1100	- STATUTORY CUSTOMS DUTIES
1200	- MFN DUTIES
1300	- GATT CEILING DUTIES
1400	- TARIFF QUOTA DUTIES
1410	- Low duties
1420	- High duties
1500	- SEASONAL DUTIES
1510	- Low duties
1520	- High duties
1600	- TEMPORARY REDUCED DUTIES
1700	- TEMPORARY INCREASED DUTIES
1710	- Retaliatory duties
1720	- Urgency and safeguard duties
1900	- PREFERENTIAL DUTIES UNDER TRADE AGREEMENTS
1910	- Interregional agreements
1920	- Regional and sub-regional agreements
1930	- Bilateral agreements
2000	PARA-TARIFF MEASURES
2100	- CUSTOMS SURCHARGES
2200	- ADDITIONAL TAXES AND CHARGES
2210	- Tax on foreign exchange transactions
2220	- Stamp tax
2230	- Import licence fee
2240	- Consular invoice fee
2250	- Statistical tax
2260	- Tax on transport facilities
2270	- Taxes and charges for sensitive product categories
2290	- Additional charges n.e.s.
2300	- INTERNAL TAXES AND CHARGES LEVIED ON IMPORTS
2310	- General sales taxes
2320	- Excise taxes
2370	- Taxes and charges for sensitive product categories
2390	- Internal taxes and charges levied on imports n.e.s.
2400	- DECREED CUSTOMS VALUATION
2900	- PARA-TARIFF MEASURES N.E.S.
3000	PRICE CONTROL MEASURES
3100	- ADMINISTRATIVE PRICING
3110	- Minimum import prices
3190	- Administrative pricing n.e.s.
3200	- VOLUNTARY EXPORT PRICE RESTRAINT
3300	- VARIABLE CHARGES
3310	- Variable levies
3320	- Variable components
3330	- Compensatory elements
3340	- Flexible import fees
3390	- Variable charges n.e.s.
3400	- ANTI-DUMPING MEASURES
3410	- Anti-dumping investigations
3420	- Anti-dumping duties
3430	- Price undertakings

continued

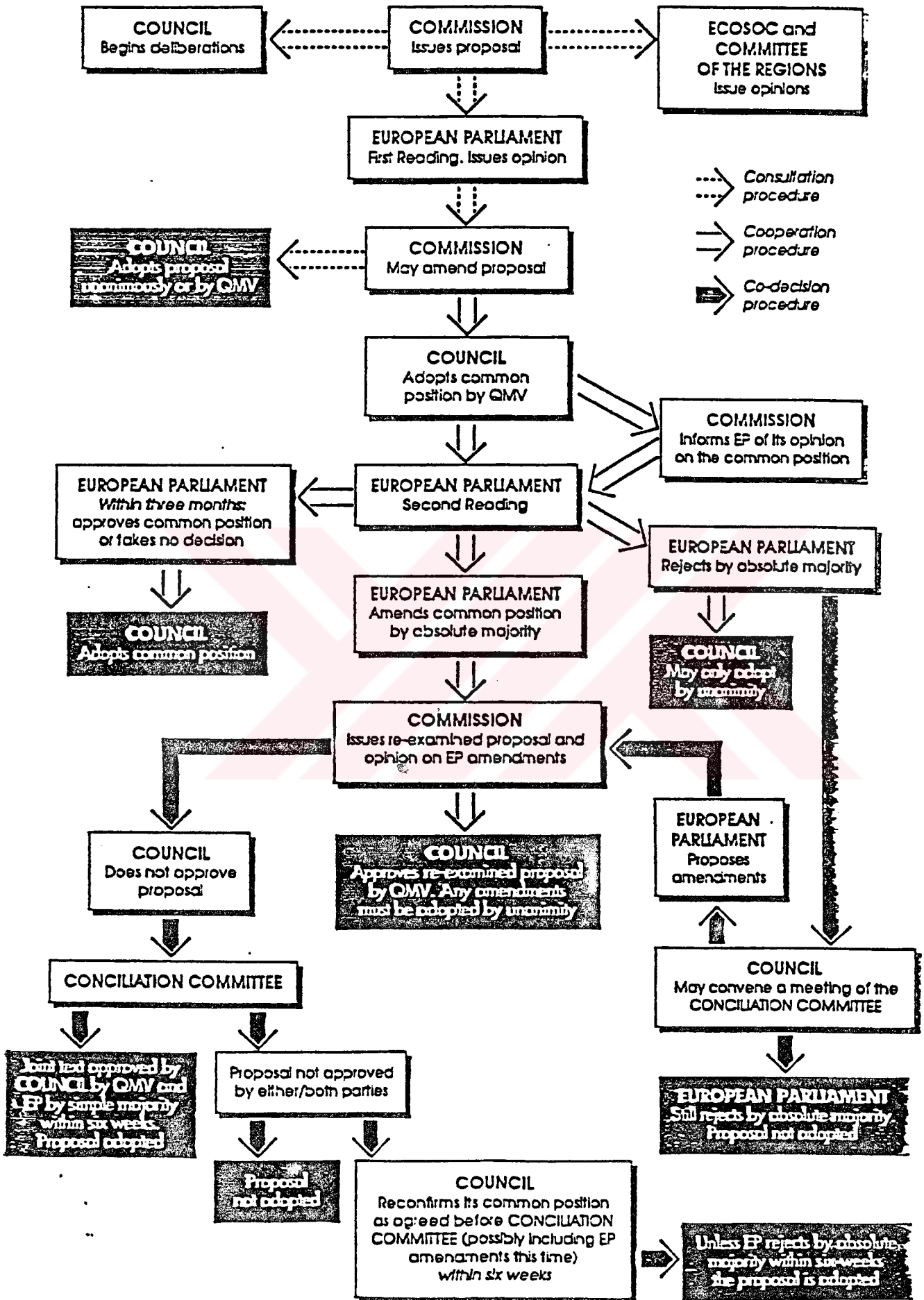
Code	Description
3500	- COUNTERVAILING MEASURES
3510	- Countervailing investigations
3520	- Countervailing duties
3530	- Price undertakings
3900	- PRICE CONTROL MEASURES N.E.S.
4000	FINANCE MEASURES
4100	- ADVANCE PAYMENT REQUIREMENTS
4110	- Advance import deposit
4120	- Cash margin requirement
4130	- Advance payment of customs duties
4170	- Refundable deposits for sensitive product categories
4190	- Advance payment requirements n.e.s.
4200	- MULTIPLE EXCHANGE RATES
4300	- RESTRICTIVE OFFICIAL FOREIGN EXCHANGE ALLOCATION
4310	- Prohibition of foreign exchange allocation
4320	- Bank authorization
4390	- Restrictive official foreign exchange allocation n.e.s.
4500	- REGULATIONS CONCERNING TERMS OF PAYMENT FOR IMPORTS
4600	- TRANSFER DELAYS, QUEUING
4900	- FINANCE MEASURES N.E.S.
5000	AUTOMATIC LICENSING MEASURES
5100	- AUTOMATIC LICENCE
5200	- IMPORT MONITORING
5210	- Retrospective surveillance
5220	- Prior surveillance
5270	- Prior surveillance for sensitive product categories
5700	- SURRENDER REQUIREMENT
5900	- AUTOMATIC LICENSING MEASURES N.E.S.
6000	QUANTITY CONTROL MEASURES
6100	- NON-AUTOMATIC LICENSING
6110	- Licence with no specific ex-ante criteria
6120	- Licence for selected purchasers
6130	- Licence for specified use
6131	- Linked with export trade
6132	- For purposes other than exports
6140	- Licence linked with local production
6141	- Purchase of local goods
6142	- Local content requirement
6143	- Barter or counter trade
6150	- Licence linked with non-official foreign exchange
6151	- External foreign exchange
6152	- Importers own foreign exchange
6160	- Licence combined with or replaced by special import authorization
6170	- Prior authorization for sensitive product categories
6190	- Non-automatic licensing n.e.s.
6200	- QUOTAS
6210	- Global quotas
6211	- Unallocated
6212	- Allocated to exporting countries
6220	- Bilateral quotas
6230	- Seasonal quotas
6240	- Quotas linked with export performance
6250	- Quotas linked with purchase of local goods
6270	- Quotas for sensitive product categories
6290	- Quotas n.e.s.

continued

Code	Description
6300	- PROHIBITIONS
6310	- Total prohibition
6320	- Suspension of issuance of licences
6330	- Seasonal prohibition
6340	- Temporary prohibition
6350	- Import diversification
6360	- Prohibition on the basis of origin (embargo)
6370	- Prohibition for sensitive product categories
6390	- Prohibitions n.e.s.
6600	- EXPORT RESTRAINT ARRANGEMENTS
6610	- Voluntary export restraint arrangements
6620	- Orderly marketing arrangements
6630	- Multi-fibre arrangement (MFA)
6631	- Quota agreement
6632	- Consultation agreement
6633	- Administrative co-operation agreement
6640	- Export restraint arrangements on textiles outside MFA
6641	- Quota agreement
6642	- Consultation agreement
6643	- Administrative co-operation agreement
6690	- Export restraint arrangements n.e.s.
6700	- ENTERPRISE-SPECIFIC RESTRICTIONS
6710	- Selective approval of importers
6720	- Enterprise-specific quota
6790	- Enterprise-specific restrictions n.e.s.
6900	- QUANTITY CONTROL MEASURES N.E.S.
7000	MONOPOLISTIC MEASURES
7100	- SINGLE CHANNEL FOR IMPORTS
7110	- State trading administration
7120	- Sole importing agency
7200	- COMPULSORY NATIONAL SERVICES
7210	- Compulsory national insurance
7220	- Compulsory national transport
7900	- MONOPOLISTIC MEASURES N.E.S.
8000	TECHNICAL MEASURES
8100	- TECHNICAL REGULATIONS
8110	- Product characteristics requirements
8120	- Marking requirements
8130	- Labelling requirements
8140	- Packaging requirements
8150	- Testing, inspection and quarantine requirements
8190	- Technical regulations n.e.s.
8200	- PRE-SHIPMENT INSPECTION
8300	- SPECIAL CUSTOMS FORMALITIES
8900	- TECHNICAL MEASURES N.E.S.

Source: UNCTAD (1994), which contains notes on certain measures as well as a set of working definitions for trade control measures.

Annex-3 HOW THE EUROPEAN UNION WORKS



Annex 4. Voluntary Restraints and similar measures that affect US imports in late 1980s and early 1990s

Exporting country	Product	Measures
Agriculture		
Australia	Beef and veal	VRA on export volume
New Zealand	Beef and veal	VRA on export volume
Footwear		
Korea, Rep. of	Footwear	Autolimitation
Textiles (outside MFA)		
El Salvador	Cotton yarn	Export quotas
Fiji	Cotton, man-made fiber	Export quotas
Haiti	Cotton, man-made fiber	Export quotas
Mauritius	Certain cotton and textile products	Export quotas
Nepal	Certain cotton goods	Export quotas
Nigeria	Cotton goods	Export quotas
Soviet Union (formerly)	Cotton sheeting and printed cotton cloth	Export quotas
Taiwan	Textiles and Apparel	Export quotas
Trinidad&Tobago	Selected textiles/apparel	Guaranteed access levels
United Arab Emirates	Selected textiles/apparel	Export quotas
Bahrain	Cotton, wool, silk blends and fibres	Memorandum of understanding
Bulgaria	Cotton, wool, silk blend and fibres	Memorandum of understanding
Taiwan	Cotton, wool, silk blend and fibres	Memorandum of understanding
Laos	Cotton and man-made fibres	Memorandum of understanding
Lebanon	Certain textiles	Unilateral restraints
Lesotho	Cotton and man-made fibres	Bilateral agreement
Oman	Certain textiles	Unilateral restraint
Steel and steel products^a		
European Community	Steel&steel products	Voluntary restraint arrangements
Australia	Steel&steel products	Voluntary restraint arrangements
Austria	Steel&steel products	Voluntary restraint arrangements
Brazil	Steel&steel products	Voluntary restraint arrangements
China	Steel&steel products	Voluntary restraint arrangements
Czech&Slovak Republics	Steel&steel products	Voluntary restraint arrangements
European Community	Steel&steel products	Voluntary restraint arrangements
Finland	Steel&steel products	Voluntary restraint arrangements
German D.R	Steel&steel products	Voluntary restraint arrangements

^a VRAs (except in the case of Canada) were formally terminated in March 1992; however, ADD and CVD investigations commenced against many steel products shortly thereafter.

Hungary	Steel&steel products	Voluntary restraint arrangements
Japan	Steel&steel products	Voluntary restraint arrangements
Korea. Rep. of	Steel&steel products	Voluntary restraint arrangements
Mexico	Steel&steel products	Voluntary restraint arrangements
Poland	Steel&steel products	Voluntary restraint arrangements
Romania	Steel&steel products	Voluntary restraint arrangements
Trinidad&Tobago	Steel&steel products	Voluntary restraint arrangements
Venezuela	Steel&steel products	Voluntary restraint arrangements
Yugoslavia	Steel&steel products	Voluntary restraint arrangements
Canada ^b	Steel&steel products	Export monitoring/export permits

Car

Japan ^c	Passenger cars and minivans	Company quotas allocated by MITI
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Machinery

Japan	Computer-controlled machine tools	VRA: market share limits for each category
Japan	Ball bearings	Voluntary export restraints
Taiwan	Machine tools	VRA: market share limits for each category
Brazil	Machine tools	US request for restraints
Germany	Machine tools	US request for restraints
Italy	Machine tools	US request for restraints
Korea Rep. of	Machine tools	US request for restraints
Singapore	Machine tools	US request for restraints
Spain	Machine tools	US request for restraints
Sweden	Machine tools	US request for restraints
Switzerland	Machine tools	US request for restraints
United Kingdom	Machine tools	US request for restraints

Electrical and electronic household equipment

Korea Rep. of ^d	Microwave ovens	Export monitoring
Korea Rep. of	Video recorders and TV sets	Export monitoring
Japan	Semiconductors	Bilateral gov'n. arrangement

Other manufactures

China	Tungsten products	Orderly marketing arrangements
Korea Rep. of	Stuffed toys, pianos, leather bags, fishing rods, brassware, some furniture products, travel goods, spectacles and frames	Export monitoring
Japan	Pottery and chinaware	Export monitoring

Source: GATT. Trade Policy Review: United States, 1991 and 1994. Geneva.

^b The US government has denied knowledge of the existence of the Canadian measure

^c The US government is on record as opposing the continuation of Japanese automobile restraint after bilateral VRAs ended in 1985.

^d The US government is not aware of any such measures