

Trade Politics and Reform

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Introduction

In setting contemporary trade policy, Americans confront issues far afield from that imagined by the nation's Founders. The frontier in 1789 was sparsely populated and although the new nation faced a British government willing and able to undermine commercial activity in the colonies, early elected officials worried little about international markets. Instead, they looked west and America grew in isolated splendor. Isolationism, however, proved to be a short-lived policy. By the end of the 19th century, US central decision-makers had to deal with growing demands from constituents for access to foreign markets; by the mid-20th century, US commercial policy had moved center stage as the US orchestrated a widespread globalization in production and trade.

Creating that internationally oriented trade policy, however, was problematic. In 1789, the Founders had given Congress the right to set tariffs; instead of imagining tariffs as a foreign policy tool, tariffs were merely another tax. High tariff barriers became the norm, used both to increase government coffers and to facilitate rapid industrial development. By the end of the Civil War and demise of the Southern voting bloc, tariff setting had become the quintessential example of unfettered congressional logrolling. When the 1930 Smoot-Hawley tariff was making its way through congress, over 1000 economists signed on to a document decrying its content. But as Schattschneider (1935) later wrote in his famous analysis of the Act, congressional behavior was as predictable as it was problematic – in the face of powerful interest groups and the authority to set rates – high tariffs were inevitable.

Yet, post WWII tariff policy followed a path far afield from what would have been thought from a reading of Schattschneider's book. The US systemically changed its trade policy and opened its borders to foreign goods. Instead of being the textbook example of poor public policy, trade politics became increasingly bi-partisan and de-politicized. And although academics and pundits often cite the lack of forward movement in 21st century trade agreements as the first step down in a 'slippery slope' to the protectionism and economic decline associated with the Smoot-Hawley era, there is scant evidence of that happening. Looked at from the long view, the US continues to have one of the most liberal trade policies in the world, and far more open than at any previous moment in US history.

This essay examines the oddity of post-WWII US trade policy. As an empirical matter, America's borders are more open than ever before. Given increased congressional dissent, intense international competition, and public discontent with America's trading partners, this 'good' policy is an anomaly that needs explanation. To unravel the conundrum of good policy and bad politics, this essay is organized around three questions.

Part one asks how the US was able to get around the pro-protection bias found in the Constitution. This section argues that institutional changes dating to the interwar years made it more difficult for protectionist interest groups to effect

policy while a web of international agreements, via both, the WTO, and a large number of preferential trade agreements, made it increasingly difficult to close markets without a significant economic cost.

Part two begins with the current economic consensus, that is, that open trade is the best public policy, and asks to what extent these ideas influence the public policy process. I argue that three themes have repeatedly characterized all debate on legitimate trade policy. On one side are economists who argue uniformly that open markets serve the national interest. While not arguing against the logic, a second line of debate focuses on issues of 'fair' trade, where matters, ranging from other nations' subsidies, to currency manipulation, to the lack of intellectual property protections are cited as leading to an unlevelled "playing field." The Democratic Party was a proponent of the first line of argument until the late 1980s when they adopted the second; the Republicans argued the second, from their creation in the years before the Civil War until 1958, when they adopted the free trade position. For much of the post war years, the parties agreed on the value of open borders; today, both parties worry about 'fair' trade. They differ, however, on the third line of debate, that is, whether or not government should redistribute the gains from trade in order to compensate for job loss that results from opening the US market. The fissures today revolve more around this issue than the other two.

Third, the essay looks ahead and asks whether or not we should expect policy change. Given the inability to close the Doha Round, the rise of anti-Chinese sentiment, and the partisan nature of the passage of the last three preferential trade agreements, the US appears to have lost its commitment to the further opening of its borders. At the same time, both parties support increased use of sanctions for a variety of infractions, from anti-dumping, to patents and copyrights, suggesting a move toward closure. The left of the Democratic Party and the right of the Republican Party are both critical of aspects of the globalization project, splitting a consensus among policy elites that has existed since the 1930s. This shift in domestic politics, opposed by just about every member of the economics community, is a bellwether of what some suggest is America's declining interest in providing international collective goods.

The Institutional Setting

Institutional Reform

All explanations of contemporary US policy begin with events in the interwar years. Previous to the Depression, US trade policy reflected the Article 2 grant of authority to Congress to set the tariff schedule. Given that tariffs are a 'tax', initial authority for tariff bills go to the House of Representatives. Although a co-equal with the Senate in legislative authority, House members answer to smaller constituencies and face significantly shorter electoral cycles. It is well known that as district size increases in a representational system, leaders become more willing to think about the

welfare of society as a whole, a reflection of their ability to make tradeoffs between competing groups with crosscutting interests.¹ Thus, the president who serves the largest constituency in the US has historically been more willing to support free trade than has Congress. Among congressional representatives, the Senate is more free trade oriented than is the House.

With very small districts, House members have the greatest difficulty ignoring organized groups within their constituency; the granting to them of initial trade authority provides a simple explanation for early US protectionism. Even though majorities existed in the US for a more open trade policy, congressional representatives tended to heed the voice of import competing groups. When aggregated together, House votes became log rolls in which all interests were accommodated. The result was trade restrictions. Even with Southern interests squarely in the pro-trade camp, the US tariff schedule in the 19th century remained higher than that found in Europe.

Although Congress supported high tariffs throughout the 19th century, the Smoot-Hawley tariff in 1930 is most cited as the exemplar of deleterious public policy. The 1930 Act was notorious, not only because it raised overall customs duties to over 50% ad valorem (an amount not uncommon in the previous century) but because of its timing. After passage of the income tax in 1913, tariff revenue had diminished in importance; after WWI, the US international footprint grew rapidly and the dollar was increasingly a world currency. Thus, the decision to return to the previous era of high tariffs was met by universal criticism and what many argue, was retaliatory tariffs by trading partners causing, or at least aggravating, what would become the Great Depression. For American scholars, the height of the tariff wall was not the only source of criticism. For the next generation of academics, the process of passage became the epitome of how interest groups involvement and congressional log rolling can undermine the policy process.

High tariffs and the onset of the depression led to new majorities in Congress and the re-legislation of the tariff. The new Act, however, changed the process of setting rates and not the rates themselves. Sidestepping Article 2 of the Constitution, the Reciprocal Trade Agreements Act of 1934 (RTAA) granted the president new authority to lower rates by up to 50%, if he received reciprocal reductions in a partner's tariff. The new treaties required no *ex post* Congressional vote.² Between 1934 and 1947, when the GATT (General Agreement on Tariffs and Trade) came into force, the President used this authority to conclude thirty-two such agreements with twenty-eight countries. This authority required regular congressional renewal and both Democratic and Republican majorities re-authorized the program.³ When the GATT went into force on January 1st 1948, congress continued to grant

¹ The relationship between district size and trade politics has been noted broadly. See McGillivray, 2004; Milner, 1997; Verdier, 1994, Bailey et. al., 1997 as examples.

² Ultimately defended in the courts a generation later.

³ The RTAA program was renewed in, 1937, 1949, 1943, and 1945.

negotiating authority.⁴ By 1962, trade was no longer a partisan issue and both parties had platforms that endorsed the trade liberalization program.⁵

The 1934 Act dictated the form of tariff setting as well as its height, thus becoming the template for all future trade agreements. These early trade treaties were bilateral but their effect extended beyond the two nations. After 1923, the US was bound by Executive Order to grant Most Favored Nation (MFN) privileges to our trading partners and by the end of WWII, the US had agreed to a large web of such MFN agreements. Thus, once the US lowered rates for one nation as part of a bilateral process, others with whom we had a MFN agreement benefited immediately from the lower rate. The treaty process in the GATT was multilateral in essentially the same way. Negotiations occurred between dyads but all members of the organization benefited because of the MFN agreement that accrued from signing onto the GATT itself.⁶ Twenty-three nations, some of whom already had bilateral agreements with the US, participated in the initial GATT negotiation. Thereafter, the organization grew rapidly.⁷

As well as being multilateral because of MFN provisions, the Executive was bound by law to negotiate *reciprocal* agreements, meaning that import access necessitated an immediate and monetarily equal export gain. Importantly, reciprocity extended to parties withdrawing from the treaty. When this occurred the nation that was losing access had the right to demand compensation, either in the form of a changed tariff to another product, or an increase in their own tariff schedule up to the lost revenue. Because of this stricture, these agreements were stable. A nation could, for political reasons, rescind a tariff by substituting an equivalent concession. In practice, however, moving a tariff concession to another product, in the absence of a matching export 'deal' was very difficult and thus rarely occurred.⁸

Congressional concern about what products would be open for reduction led the Roosevelt administration to agree to negotiate only on products to which the

⁴ GATT participation was authorized in 1948, 1949, 1951, 1954, 1955, 1958 and 1962.

⁵ As well as both parties endorsing 'free' trade, open markets were controlled in the House by the chair of the ways and means committee, Wilbur Mills, who "would not let a Democrat on Ways and Means unless he was for the trade program, against cutting the oil depletion allowance and for Medicare." Given that the one example of this recruitment process not working perfectly on trade was that Aime Forand from Rhode Island was on the committee, "it was nearly perfect, as shown by the voting record of the Committee Democrats through the 1957-1967 period." Manley (26). By the time the 1962 Act was signed by Kennedy (10/11/62) he would declare that, "this act is, therefore, an important new weapon to advance the cause of freedom."

⁶ Non-GATT participating nations with whom the US had a bilateral agreement benefited from these changes in the US schedule as well since all the bilateral agreements included MFN provisions. By this time, the US had MFN agreements with XXX nations outside of the GATT.

⁷ New treaty partners in the GATT who did not have agreements with the US via the RTAA process were: Australia, Burma, Ceylon, Chile, India, Pakistan, Lebanon, New Zealand, Norway, Southern Rhodesia, Syria, Union of South Africa.

⁸ The exception to this rule was in Australia where a federal tariff board was able to respond to import surges by moving tariff concession onto other products. No other major trading nation supported such centralized authority.

trading partner was the 'principal supplier'. Thus, to predict who needed to worry about tariff changes, the average congressman needed only to look at the import pattern of products in his or her district.⁹ Nations initiated negotiations by asking for a change in the tariff of only a subset of products, that is, those in which they had a dominant share of the market.¹⁰ Nations would then look at the list of 'demands' and make counter 'offers.' When a deal was struck other nations would 'free ride' on the tariff concession.¹¹ The benefit for small nations was that via MFN, they received a lowered rate without making a concession; the problem was that their small markets meant that they could rarely dictate the products being reduced.

Two caveats are important for contemporary policy. First, a congressional delegation to the President was not a form of abdication, although it has been so argued. From the start, treaties occurred under the watchful eye of Congress. Congress kept the president on a 'short leash' and renewals were a regular part of the trade agreements program, occurring four times before the creation of the GATT, and then regularly thereafter, whenever the President wanted to set up a new trade Round. By the 1970s, Congress re-asserted its centrality by mandating that negotiated agreements return to Congress for final approval. Further, Congress established the Office of the Special Trade Representative in 1962 to increase its oversight of the trade agreements program. That office was renamed the Office of the US Trade Representative or USTR in 1979 and its head became the chief US negotiator. In part, the intent of the office was to balance the power of the State Department and the perception that their civil servants were willing to undermine US economic interests for larger foreign policy goals.¹² USTR joined the Commerce Department and the International Trade Commission as the organizational support for US trade policy setting.

⁹ When congress entertained the original bill sponsored by the State Department that allowed the president to negotiate to open the US market, the members of the Ways and Means committee had balked at treaties, less because it gave the president a new authority (treaties were always in the President's domain) but because the treaties would be shared with others via MFN agreements. The committee worried about free riding on the part of nations who did not give reciprocal access. Hull's response was to explain the notion of a 'chief supplier' and he promised a treaty would only be on a product with a nation that was the low cost producer. Explaining that the world economy was tied into a 'hard knot,' the procedure was at best limited, "operating by singling out a leading commodity we buy from one country and ascertaining whether we can enter into, not hurtful relations in trade arrangements that would be a loss to us, but arrangements that would be equally profitable to us and other countries" See Hearings before the committee on ways and means, reciprocal trade agreements Act, 73rd congress, second session, no. 1, March 8, 1934 (15).

¹⁰ One of the most underappreciated reasons for the stability of the RTAA treaty process was that almost a majority of the most highly protected products in the 1930 Act had Germany as its principal supplier. By the time the US began negotiations under the new Act, US-German relations precluded a treaty to open up the market in those products. As a result, protections remained on the most highly organized product groups. Although unintentional, not having to face these groups allowed early liberalization to succeed and gain more generalized political support.

¹¹ The rule, which meant that the smaller nations rarely got the products they exported onto the negotiations agenda, led to developing world complaints in ensuing years. Even with preferential tariffs, many developing nation products were not granted access via this process.

¹² Irwin (2002): 171.

Second, over time, all these agencies dealt less with tariffs and more with a range of other restrictions on the US market legislated separately by Congress. Increasingly, US policy on 'free trade' was deviating from that on 'fair' trade. On the free trade front the President and Congress continued to endorse multilateral and bilateral agreements to open up markets. The GATT held eight Rounds of trade talks, each begun with authorization from Congress to the President for American participation. Reciprocal reductions in tariffs were the focus of the first five Rounds exclusively; the last three saw reductions in tariffs but more centrally, began to deal with a range of other national regulations that undermined trade flows. The change in focus reflected a changed reality of border regulation. By the close of the last Round, the Uruguay Round, tariffs in the developed world on average, were below 5%; however, a number of 'behind the border' regulations were now the central impediments to the international flow of goods and services.

In the US, behind the border measures were deeply entrenched even before the passage of the Smoot-Hawley tariff. Antidumping law, which protects producers from foreign imports sold at less than their real production costs, appears in its modern form in 1921.¹³ While dumping involves corporations, countervailing duty laws (CVD) protect American producers from unfair practices of foreign governments; Congress has provided such protections as far back as 1909. Similarly, section 337, which provides protections for intellectual property, was born out of legislation in the tariff act of 1922. Thus, although the US has signed onto international rules on dumping, subsidies, and intellectual property protections that have focused on procedural issues, domestic rules remain intact and under the watchful eye of congress.¹⁴

Given this history, it is unsurprising that Congress was reticent in its support of reforms on 'behind the border' regulations. In the Kennedy Round (1964-67), negotiators returned to Congress with enabling legislation that included at least two measures that they felt were not in the president's domain: American Selling Price and Anti-Dumping rules. Neither was enacted. In anticipation of a re-occurrence of what Congress thought was an over zealous negotiating team, the Trade Act of 1974, which authorized the subsequent Tokyo Round (1973-79) pre-stated the need for final congressional approval of all GATT agreements. But, to overcome a return to the same structural problem that led to delegation in 1934, Congress devised a new procedure called "fast track" to provide some commitment to negotiators and America's negotiating partners that congress would not emasculate the initialed agreement. Fast track was no more than a promise that the trade bill would be considered as a whole, and not laden with particularistic amendments.

¹³ The law made its first appearance in Section 5 of the Federal Trade Commission Act of 1914 and was reformed after a 1919 report by the US Tariff Commission that suggested the need for more protections.

¹⁴ Along with section 301 cases, these three laws are the most often used by US producers hurt by trade competition.

Fast track proved to be a successful innovation in Presidential-Congressional trade policymaking, facilitating negotiations on what many now considered essentially domestic legislation. The procedure was used to approve the final Tokyo Round agreement in 1979, as well as the subsequent US-Canada, NAFTA, CAFTA (Central America Free Trade Agreement) and Uruguay Round agreements. Although the procedure was created to preempt congressional logjams, in effect, it brought Congress center stage. Congress was now more central in the negotiating process and mark-up stage, and more resistant to Executive foreign policy claims. By the turn of the century, instead of arguing about the trade agreements themselves, whether or not to give the president fast track approval had become the focus of debate. In 2002, Congress mustered support to renew fast track authority by two votes; the authority was renewed in 2005 but in 2007 that authority, now called Trade Promotion Authority (TPA), expired. Fast track is not needed to either negotiate or pass trade legislation. However, given past congressional resistance, US credibility as a negotiating partner is far weaker in its absence. The three Free Trade Agreements (FTAs) that were signed into law in October of 2011 with Korea, Colombia, and Panama were concluded before TPA expired, and before the Obama administration took office.¹⁵ In the absence of TPA, there are no new agreements on the table.

Mediating Partisan Politics

The US has signed on to numerous international agreements that constrain trade policy today. These agreements mediate potential partisan swings in trade policy preferences, making commercial policy a far slower and more deliberate public policy than others in the congressional domain. Thus, even though representatives have placed thousands of bills into the hopper that would have given tariff hikes to particular industries, they have rarely made it to the floor. The rare individual product bill that is enacted usually lowers a rate in response to a constituent need for some cheaper foreign product input needed in the production process, not the opposite.

The central constraint Congress faces from enacting a change in trade policy is potential punishment through the WTO dispute settlement system. If a nation believes that a trading partner has broken any part of the treaty, they can ask for consultation and failing agreement, the creation of a panel of experts to hear the case. Decisions are binding, in that a nation is supposed to adhere to the decisions. There is an appellate process in place to hear appeals but if that goes against the defendant, a change in policy is expected. If a nation does not adhere, the nation bringing the case has the right to retaliate, up to the amount of lost trade. This too,

¹⁵ There are 17 in force FTAs: Australia, Bahrain, Canada, Chile, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Israel, Jordan, Mexico, Morocco, Nicaragua, Oman, Peru, Singapore. As with WTO agreements, these open trade in many but not all industry categories. Often they extend policy constraints and opportunities to investment access issues areas as well.

however, must be authorized by the WTO. Under the GATT system, a nation could veto the creation of these panels; the WTO removed that right.

Congress was willing to go along with this new system, basically because of a general belief that the US was more often in adherence to WTO rules than were her trading partners. As of this writing, the US was a complainant in 97 cases since the WTO was created, and was a respondent in 113 cases. In addition, the US participated in 86 other panels as a third party. This made the US both the most-likely target as well as the most likely complainant, of any other member of the WTO. In fact, just about half of all cases involved the US on one side or the other.

Few of these cases involved tariff policy. Rather, they mainly dealt with those laws passed by congress that pre-dated delegation of tariff setting authority to the President. Most often, the US is in court because of the administration of an “unfair” trade law, either anti-dumping, countervailing duty or section 301 of the Trade Act of 1974.¹⁶ These ‘fair trade’ laws were politically distinct from tariff regulation in administration as well as intent. Executive agencies are responsible for the technical aspects of determining whether or not a product is sold at less than fair value but once injury is determined, the President has no authority to stop the additional duty.¹⁷ America’s trading partners have had numerous problems with the method used to assess both dumping and injury and in 1994, the US agreed to a clarified although not dissimilar standard. Still, Congress has mandated these standards and the agencies making the calculation are answerable to congressional committees.

Although the discussion of US trade policy often focuses on high tariffs, these ‘unfair’ trade statutes are more longstanding and have become increasingly used as an alternative to tariffs as rates have declined. Starting in the 1970s, they became the most visible part of US commercial policy. When a firm or industry brought a claim forward, presidents could do little other than cajole industry to pull back their petition. Large industries, such as steel, repeatedly filed petitions under these statutes for aid against imports; many of these cases were justified according to the letter of the law although not its underlying intent: these industries were losing market share not because of cheating but because others were more competitive. Given that they qualified for increased tariffs, often up to 100%, more free trade oriented presidents found themselves with limited tools to undercut the tariff hike.

¹⁶ Section 301 is used by the USTR to retaliate against practices felt to undermine US exporters access to foreign markets. The legislation gained majority support as a way to provide ailing US businesses with aid that was otherwise unavailable because of the injury requirements in earlier unfair trade laws. The law first appeared in 1974 and again in 1988 as Super 301 legislation. Super 301s was meant to spur USTR to identify and prosecute unfair trade activities, an attempt by Congress to force the president to be more aggressive. Its use has been challenged in the WTO on the grounds that it is a unilateral action in violation the multilateral provisions in the WTO.

¹⁷ Until 1974, the US Treasury department evaluated whether or not products were being ‘dumped’ onto the US market. Because congress felt that Treasury’s interest had deviated from their own, they moved jurisdiction to Commerce. In both cases, the International Trade Commission (ITC), a congressional agent, ruled on whether or not injury had occurred as a result of a product being dumped into the US market.

Voluntary Export Agreements (VEAs) grew as a response, a largely inefficient but available remedy.¹⁸ It was a poor tool but the President, faced with foreign resistance, had a limited tool kit in his arsenal to stop the bureaucracy from making a decision against a trading partner.

Congressional representatives on both sides of the aisle, however, repeatedly advocated for laws that forced foreign producers to follow the rules. In these cases and more generally, the congressional role in trade policy is complex, often permeated by symbolic actions. When some trade problem is politicized, one house of Congress will respond with legislation, often at odds with treaty obligations. The president will then mediate the conflict by offering some alternative to the legislated response. This relationship has been dubbed the “cry and sigh” syndrome by Robert Pastor (1980). According to Pastor, protectionists in congress regularly threaten to uproot open trade through some legislative action; the legislation or rabble rousing is quelled, to the relief of the representatives themselves, by presidential action, or often, inaction. In practice, neither party defends protectionism; most members of the legislature continue to believe that markets should dictate trade patterns, even when constituents pressure them for relief from imports. Consistent with their defense of free markets, legislators have limited patience for foreign practices that are at odds with the market-government relationship found in the US.

As result, the congressional shadow is more apparent in fair trade than in other aspects of US trade policy. Repeatedly, members of one chamber or the other have worried that the US is being poorly served in Geneva. One bill, H.R. 496 (Rangel) proposed to create an Office of the Congressional Trade Enforcer that would itself investigate restrictive foreign trade practices and then call upon the USTR to take them to ‘court’ in the WTO. Similarly, other legislation has proposed that there be recourse in the case of an adverse decision on dumping margins (2007), that the US Court of International Trade has primary jurisdiction in Section 301 cases, and a range of specific responses to harmful foreign practices. Most recently, the Senate has attempted to mandate a change in the Chinese exchange rate.

In all these cases, the relationship between Congress, the president and the WTO is more about symbols than real threats to the status quo. The US is increasingly interdependent with foreign producers and consumers. The system is stable because the norm of retaliation, inculcated in all treaties, means that any action on the part of Congress to protect one industry would lead to some harm for another. No congressman can predict, *ex ante*, what product will be hurt from their action, creating a disincentive to move far from current practice. Increasingly, strategic trading partners who understand electoral incentives in the US will target products and districts in disputes, something the US has long done with our trading partners. For example, in a 1995 US case against the EU, the first product on the list of

¹⁸ VERs on cars, textiles, and steel, among others, were agreements by the exporter to restrain their own exports into the US market. The effect akin to a tariff, i.e., it raised the domestic price, but the exporter, and not the US, reaped the ‘rent.’

threatened sanctions was “cheese and curd,” solely aimed to mobilize French farmers to pressure the EU to change course. Likewise, but in the other direction, representatives found it untenable to raise tariffs on Japanese Lexus producers in a Section 301 case because of resistance from Lexus dealers in their districts.

In short, the effect of globalized markets and an increasingly legalized and transparent international regime has been to undercut the nature of group politics in this issue area. The effect of international legalization has been policy stability; the unintended outcome, however, has been a reticence to expand international constraints by agreeing to ‘deeper’ international rules. We return to this point in section three.

The Ideational Landscape

Most public policy debates are fueled by some uncertainty about what is the optimal policy for the nation. Elites debate the virtues of policies and change often accompanies a shift in political control of government. The debate on trade policy exhibited this type of disagreement for the first 150 years of the nation’s history. Democratic governments opened the border while Republican governments raised the tariff. After the Great Depression, however, elites coalesced around one policy ideal, today espoused by just about every academic economist. That policy prescription is to keep your borders open, no matter what other nations do, if you want to increase welfare. Anti-dumping or ‘fair’ trade laws that protect domestic producers are equally problematic to a tariff—both, increase price, and hurt consumers. If other countries want to sell the US goods that are cheaper than production costs, economists see a buying opportunity.

The free trade position is unquestioned by academics, is accepted by many policy elites, and makes little sense to the general public. When academics see protectionism, they decry rent-seeking groups who distort the political process (Grossman and Helpman, 1995). In a recent letter to President Obama, for example, signed by the best-known trade economists in the nation, they urged the US to close the Doha Round and pass the pending Free Trade Agreements (FTAs). “The fear of the labour unions that trade with the poor countries produced poor in the rich countries is mistaken,” they suggest.¹⁹ Yet, these economists should not be surprised by rent seeking behavior. If a voter works in a sector that benefits from trade openness, his wages will rise; the opposite occurs if that individual is in a sector that is uncompetitive with foreign producers. The job loser may benefit from cheaper and more diverse goods, but whether or not he can afford those products depends upon whether or not the market creates new employment opportunities. In a perfect world that would occur; in the real world, that of numerous transaction costs and workers with unequal skills, that often does not. Given the American form of political representation, job gains in California will do little to quell the discontent

¹⁹ Letter dated August 31, 2011 on the letterhead of Jagdish Bhagwati of Columbia University.

of the Senator from Michigan. Trade is good in the aggregate but it is not equally good for everyone. Elected officials well familiar with the problems that followed the passage of the Smoot-Hawley Act may still find that advocating open trade is difficult.

Contemporary political elites were not the first to notice the distributional issues that accompany open borders. From the earliest debates in congress, three different lines of argument were offered for how to regulate trade. The first related to changing ideas about government regulation being developed in England. British ideas about open trade moved quickly across the Atlantic and were represented in legislative debate even before Britain opened its own borders in the 1840s. The Democratic Party and Southern agricultural producers were early advocates of the free trade position. This was met by the more protectionist or mercantile position long defended by the British Crown. Whigs would adopt this line of argument, advocating a more interventionist government and the Republican Party adopted that position after its creation. The Democratic Party retained its free trade position until the 1960s and thereafter began to feel pressure from manufacturing constituents who competed with cheaper labor abroad. The Republican Party advocated closed borders until the 1950s and only in 1958 did the party platform state that open trade was in the interest of the nation.

A second set of ideas developed as a response to British trade policy in the first half of the 19th century. The British worried about potential US competition and pursued predatory trade policies to undercut manufacturing in the US. American legislators were unsure of how to respond to British policies, especially after the War of 1812 and the resumption of trade. The debate about 'fair' trade dates back to this time, with the Whig Party arguing that the US needed to respond to British predatory policies in kind. The Democratic Party representatives argued against this position, fearing retaliation against Southern cotton exports. With the rise of the Republican Party hegemony, however, a set of new laws were passed that protected the US market against a variety of unfair trade practices, from the foreign use of subsidies, to anti-dumping laws, to protections of patents. By the time Congress delegated negotiating power to the president to lower tariffs, unfair trade laws were deeply institutionalized in legislation.

A third more uniquely American position came about as a result of early debates on the development of the relatively scarce American labor force, and whether or not the government needed to promote its development. Jefferson and Hamilton argued about the future of manufacturing in the US and in part, their positions reflected differing beliefs about the ideal society. Today, the parties continue to differ on the optimal relationship between government regulation and job growth. In regard to trade policy, they differ on how much to intervene in response to job losses due to foreign competition. The Democratic Party advocates Trade Adjustment Assistance (TAA) to both, compensate and retrain workers. The Republican Party is more reticent to sign on to such policies.

Trade politics in the US has always reflected these three lines of thought, often in strange ways. Predatory practices in other nations were the focus of 19th century debate and today, are the central issue in US-China trade. The free trade position, comparatively, became ascendant only after Smoot-Hawley when its proponents argued that protectionism caused the Great Depression. The 'slippery slope' to protectionism is still a potent response on the part of supporters of globalization to any hint of US policy makers wanting to close the US market. And the creation of the WTO itself in 1995 reflected that a majority still believed that open trade and deeper globalization is in the American interest. But, while elected officials mostly agreed that open markets make economic sense, they also need to do something about job loss from foreign competition. The response by the Democratic Party was to legislate a TAA program, initially in 1962; its continued authorization is fundamental to Democratic Party support for trade treaties. Republicans today worry about unfair trade but support open trade, just not redistribution of the gain via TAA. Democrats shift the argument on free trade agreements, whether multilateral or bilateral, away from whether or not the agreement is economically sound, to whether or not there are protections from job loss. Democrats agree with Republicans that fair trade is a problem. In fact, they advocate regulating a host of policies as part of the treaty process, from unionization to wage levels. As recent testimony shows, no one argues in defense of protectionism, even as they vote to retaliate against Chinese exchange rate policy.

The trade policy debate today is somewhat unique in that it revolves less about policy options than about the state of the world. If the US is faced by a nation that is breaking an anti-dumping rule, for example, there is no question about the response. The problem, however, is whether or not the dumping has occurred. Similarly, the US has defined fair labor standards as a necessary requisite for a trading partner. But, is Mexico keeping wages unfairly low, or does the wage difference reflect differences in productivity? The WTO makes it illegal for a nation to regulate a domestic policy so as to undermine a trade agreement but is the Chinese exchange rate peg a case of undermining its WTO obligations? More than in other issue areas, defining the problem to which the US needs to respond is a central stumbling bloc for decision makers. This is not to say that once defined, all problems have solutions. For example, Chinese infringement of intellectual property is recognized as problematic for US interests yet given US-Chinese interdependence the US finds it difficult to respond without endangering its own producers.

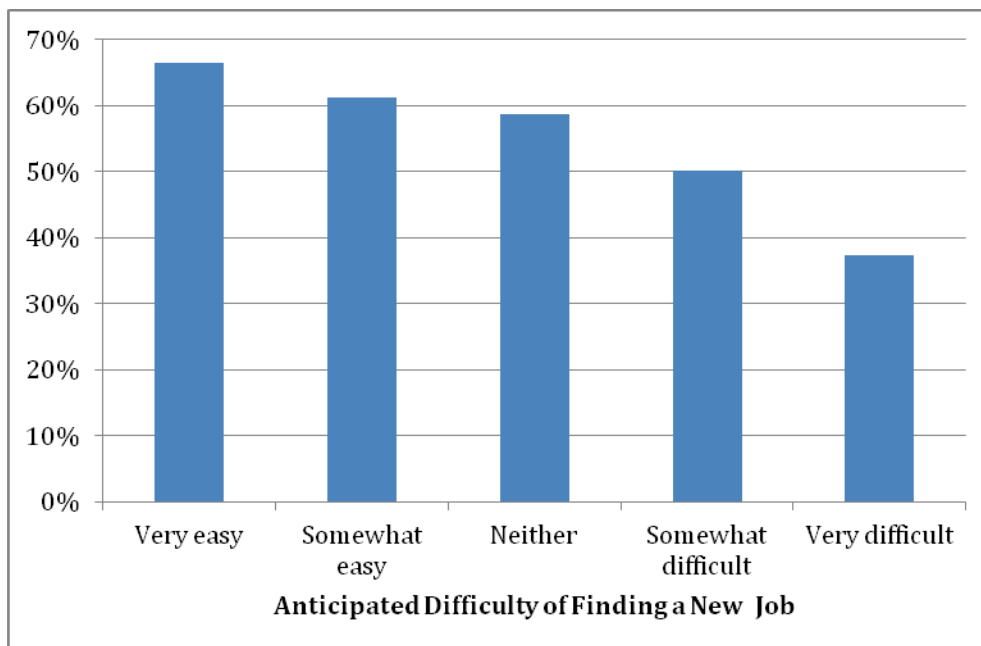
What do we know about popular attitudes?

While elites embraced free trade ideals after the Great Depression, the public has been more reticent in accepting the benefits of open borders. The canonical position on public attitudes on trade policy is that it is determined by a voter's factor endowment. This simple model is complicated by a host of other factors. Many households are two earners and the spouses may be in different occupations. Women are always less supportive of free trade than are men, no matter their

occupation (Burgoon and Hiscox, 2003). The more risk averse a person, the more they question open trade policy.

The most robust finding from polls is that the more highly educated the individual is, the more likely he or she is to support free trade. The education effect remains at all income levels (e.g. Scheve and Slaughter 2001, 2004; Mayda and Rodrik, 2005). Given the present unemployment rate, it may be relevant to know the relationship between job prospects and trade attitudes. Figure one provides the intuitive data: the more insecure the person, the less supportive they are of US trade policy. Job insecurity leads to even higher negative support for trade when both members of a household are worried about job prospects. (Goldstein et al. 2010). But even among the very insecure, 40% support open trade.

Figure 1. Support Trade by Labor Market Prospects



The recent recession has led to shifting support for trade openness but often in counter intuitive directions. In 2007, for example, before the financial meltdown, about 42.6% of Americans favored a reduced dependence on foreign markets; in 2009, only 37% of those same people favored market closure. The second result should not be interpreted as more support for open borders. What occurred was that more people answered that they just did not know what the US policy should be. Recession seems to lead to uncertainty about trade—not necessarily a move to the protectionist camp (Goldstein et. al. 2010).

Some fissures in support have developed since the recession. In the panel above, we looked more closely at respondents who had lost their jobs. Thirty-three percent of the newly unemployed had supported trade protection while employed; now, 40% supported an increase in trade barriers. Among those who remained employed throughout the recession, however, support for closure went the other direction, from 39% to 33%. When asked about welfare expansion, the reverse pattern emerged. Only 46% of this newly unemployed group had supported an expansion of welfare in 2007. In 2009, 65% of them said they supported welfare spending. Among those who had kept their jobs, however, support for welfare declined, from 48% to 44%.

Trade policy preferences for the educated and elites remain pro-free trade, although such support is not universal. Perhaps the good news is that most voters know little and care less about most aspects of trade policy. They do, however, care about jobs. The recent passage of the three free trade agreements was argued to be about job creation. While not untrue (some jobs will follow from trade), the net will more likely be job loss in the US. As job prospects decline, voters may well decide that open borders for goods and services are undermining their job prospects, not unlike criticism of open immigration policy. Elites can try to explain the virtues of free trade, but in the absence of a vibrant economy, cheap goods may be no substitute for employment. The argument in defense of 'fair trade' has far more appeal since it provides some explanation for cheap goods on the US market supplanting US production.

The US in an Interdependent World

Three observations about the history and politics of trade follow from the previous analysis. First, the administrative tools available for setting trade policy were fashioned for an earlier era. Not only did the Framers create a bias toward protectionism, but also, most legislation on trade since then has focused on protecting the US market from predatory foreign traders, not rent seeking interest groups. Second, the ability of the US to craft a policy that is in the interest of the country as a whole, not just in the interest of particular workers, firms, or regions, rests on the existence of a free trade coalition. It is this wide spread support in both parties that has balanced the existing institutional bias. And third, contemporary policy is constrained by a large number of agreements, both bilateral and multilateral, that undermine unilateral protectionism.

These domestic factors will determine just how Washington will respond to the changing interest of domestic groups. And, those interests will change depending upon the action of external actors. Will China be socialized into the trading regime? Will WTO law defend US producers? Trading patterns will continue to redistribute wealth in the US and this will change both the power and preferences of political actors. Changing interests and less flexible domestic institutions suggest a pattern of trade policy making that is more incremental than in the past.

In general, four variables should be considered when making predictions about the future of US trade policy:

- First, current international trade rules assume a type of trading partner. When the victors of WWII created the GATT, they shared a set of assumptions about the role of government and the relationship between politics and markets. For 50 years, these nations dominated world trade and created a web of trading relationships with each other. The GATT/WTO was dominated by an US-EU alliance and we shared a set of beliefs about the virtues of trade and the role of government in market transactions. Today, the WTO remains nominally controlled by this alliance but trade flows have moved East and South. A set of developing nations, often referred to as the BRICS (Brazil, Russia, India and China) are now at the epicenter of economic activity. From the perspective of US domestic law, these nations are not in compliance with the spirit of the trade regime. Industrial development occurred with far more government involvement than in the US. As American firms find themselves unable to compete and unions attribute lost jobs to production in these nations, the US will increasingly come to loggerheads with them over their practices. In particular, the rapid growth of China, both as an exporter and as the location of US foreign direct investment has created doubts about the fundamental virtue of open markets with particular types of nations. Chinese policies, ranging from exchange rate controls, to an aggressive policy of intellectual property transfer, to labor policy, all suggest that the rules of market exchange are biased against the US worker and the US economy.
- Second, and related, the free trade policy consensus that has existed since 1958 in the US is eroding. In its place is a more precarious political line-up, a Baptist-bootlegger coalition of unlikely bedfellows. On the far right of the Republican Party are those who eschew international law and institutions as constraining US autonomy. On the far left of the Democratic Party are those who see globalization as undermining US jobs, the environment and domestic production. They are equally as critical of the WTO regime but for very different reasons. The left sees the regime as encouraging cheap labor and undermining worker rights; the right sees the WTO injunctions as illegal constraints on US law. Together, the far right and the far left are a potential future veto group, and they will make it difficult to get any forward looking legislation through congress. Since both sides agree that the US should leverage access to the US market more forcefully as a means to get other nations, most recently China, to change their practices, the legislation that will gain majority support will be far more mercantile than at any time since the Great Depression. The US may not be able to re-create the rules of the regime to its liking, but we are large enough to play the role of spoiler. This would be problematic, given the importance of a stable and open world economy for American firms and domestic economic growth.

- Third, the political critique that the US has been treated poorly under current international rules has implications for the future of the GATT/WTO liberalization project. In the absence of US leadership, there will be limited or no new legislated trade Rounds. If the Doha Round is ever 'closed' it will be with minimal effect. In its place, the WTO will increasingly attempt to legislate via its judicial arm. Through the dispute settlement process, trade rules will be examined and often re-interpreted so as to increase trade flows. When these rulings challenge US law, the anti-trade coalition will make it difficult for the US to adhere. When they criticize other nations' practices but do not get adherence, critics will decry the futility of international law. An activist trade court in Geneva, whether ruling for or against the US, is problematic for the US. Not only will it raise legitimacy questions in Washington but also, it will focus attention on the lack of correspondence between the size of the member's economy and voting rights in the ever growing WTO.

The alternatives to the multilateral trading system are equally problematic. Over the last twenty years, nations have increasingly signed on to regional trade agreements, many of which counter aspects of WTO law. In the US, NAFTA, CAFTA and the more recent three FTAs regulate aspects of trade and reduce US barriers beyond what has occurred in the WTO. For many nations, these agreements are akin to insurance – a hedge against decisions they may dislike in the WTO. This disemboweling of the system into smaller, often regional, units may be the future of the international trading system. This is not in the interest of the US; the alternative, however, of support for the WTO has waning political support.

- Fourth, growing market interdependence means that external shocks will more quickly affect the US economy. The US government has limited means to deal with these market fluctuations. Thus, even small shocks will have substantial impact on employment. The erosion of the safety net and the absence of consensus on support for programs such as TAA means that trade policy itself will become the focus of the ire of the unemployed, even if unjustified. Further more, firms have become increasingly international and thus vulnerable to economic tsunamis —there are few, if any, products on the US market that are wholly American made. Workers and firms have recourse when hurt by market conditions. They can, and do, turn to legal remedies in order to get government support against market downturns. These remedies, however, are all in the direction of closing the US market.

Policy Implications and Recommendations

What is the best policy, given the changing nature of domestic politics and the international trading landscape? Let's assume that the goal of trade policy is

twofold: first, policy should provide the widest array of goods and services to the US public; second, policy should assure that US producers and their products are not discriminated against abroad. We know that the first best method of attaining this goal is to allow markets, and not governments, to set prices but two problems exist. First, there exists an institutional bias toward intervention – Congress has an incentive to use its legislative authority to increase border measures of many sorts, in response to constituent pressure to deal with unemployment at home, and discrimination against US firms abroad. And second, we are not interacting with nations who abide by laissez faire strictures. This may be most evident in US-China trade but other nations, as well, regularly support their domestic industries. Only in academic textbooks does the first best condition of market driven trade exist. Policy must reflect not only what we know about market mechanisms, but also what policy makers can sell to the voting public.

This suggests two responses. First, policy makers must recognize that trade always leads to some individual losing his or her job. New jobs will be created but they will rarely be those that the unemployed can aspire to. As suggested above, trade is good in the aggregate, but not good for everyone. Policy needs to address the interests of those hurt by trade, if not for normative reasons, then, because the losers are a potential political force. The 'losers' from trade need to be either compensated and/or retrained. Re-tooling, expanded unemployment insurance, and relocation services, are an inexpensive way to insure continued support for open markets. The easiest and best assurance against future protectionism is an expanded set of options for the unemployed that Congress can use to aid constituents. In their absence, Congress will respond with the tools at their discretion and that is to close the US market.

Second, to assure majority support for globalization, voters cannot think that other members of the trading community are treating the US unfairly. There is a long tradition in American law defending 'fair' trade, and American support for open markets evaporates in the face of the perception of other nations cheating. Trade must look free and fair -- the US should punish trade partners who break the trading regime rules. Yet, such retaliation, even in the face of a clear infringement of free trade norms, sits poorly with most elites. Many US policy makers believe that even a *single* defection by the US could undermine the trading regime. This is the ideological baggage we carry from Smoot-Hawley -- it is the fear that any pro-protection legislation will lead to an unstoppable flow of higher barriers to trade. This fear is important because it is the glue that has kept the 'free trade' coalition together. This fear, however, is outdated. The trading regime institutionalized retaliation as a method to re-enforce open trade rules. Retaliation is sanctioned and expected; it is also limited in use so to forestall that 'slippery slope'.

As a result of a fear of a protectionist tidal wave, the US rarely plays "tit-for-tat," more often selecting the cooperative move in the canonical prisoner's dilemma (PD) game; comparatively, what China has done is 'defect' on every move. The result, in that dyad, is that the US has cheap goods but China has market power, which is used

against US producers both in the Chinese and US market. Logic suggests that periodic US retaliation, or threat of retaliation, would be the correct policy response; tit-for-tat should encourage the Chinese to be more cooperative, even if they complain and take the case to the WTO. As a non-market economy, China will have a difficult time arguing that the US is not within its right to protect its market against government subsidies and selling prices that are substantially below production costs.

Retaliation, of course, must be viewed as a second best strategy. In a globalized world, retaliation is difficult; it often hurts a domestic constituency as much as some producer in the target nation. When countries renege on trade agreements in today's interdependent market, re-negotiation and arbitration is the more common response. Although students are often taught that trade negotiations are akin to a PD game, that metaphor is applicable only to a small number of US trade partners. The game theoretic metaphor that is more fitting to current utilities is a "battle of the sexes." Here, both sides want to cooperate but they differ in the exact nature of that cooperation. Being off the equilibrium path is painful and no nation wants to be there. In this strategic environment, negotiations are better than threats and retaliation is not as useful.

In conclusion, two policy changes that could enhance support for global markets follow from the discussion above. First, Congress needs to protect job loss; second, we should not discourage congressional action that defends 'fair' trade statutes that are consistent with treaty obligations. Fear of job loss undermines support for trade openness; similarly, predatory competition will provide fuel for politicians who incite xenophobia in the voting public. Trade policy is one of the few examples of consistently good policy emanating from Washington. It needs to be re-enforced, taking into account the changing nature of politics both at home and abroad.