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are being protected against the competition of foreign imports or kept competitive on world markets by special subsidies. This ties up financial resources which could have been allocated more efficiently in the development of new technologies. In many cases the overall social costs of protectionist measures have risen to such an extent that they outweigh the income gained by exporting protected or subsidised goods. This misallocation of scarce resources leads to growth losses and the loss of jobs. The chances of successfully eliminating structural faults in the economies of both industrialised and developing countries are thus reduced, and, to an equal degree, the chances of re-establishing the conditions of free trade.

The primary objective of international trade policies must therefore be to align each country's general economic policies to the requirements of a system of free international trade. This demands that national economic policies gradually refrain from protecting branches which are no longer internationally competitive and that more determined efforts are made to bring about structural adjustment in a framework of specialisation based on division of labour principles. At the same time, intensive efficiency-oriented competition must be guaranteed. The removal of trade restrictions and, in particular, the renunciation of "neo-protectionist" measures are essential prerequisites for success in this endeavour.

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## PROTECTIONISM

# Vested Interests, Domestic Transparency and International Trade Policy

by Gary Banks, Geneva\*

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It is ironic that the very success of the GATT as a forum for international trade liberalization throughout the post-war period has brought it criticism now that liberal trade is unravelling. People accustomed to looking to Geneva for progress in trade policy see the mounting abuses of the system as somehow originating there too. As illegal measures multiply, the existing trade rules are called into question, a position logically equivalent to blaming the Criminal Law for not preventing a rise in the crime rate.

The truth is that international trade policy, while ostensibly emerging from negotiations between countries on an international stage, is essentially domestic in origin. Trade disputes, such as those we have been witnessing lately between the United States, the European Community and Japan, are the external manifestation of an internal struggle within each country: a struggle between vested interests and the public interest. The rise in protectionism is simply a sign that special-interest pressure groups have been increasingly successful in their quest for public support;

in other words, that governments have found it increasingly difficult to resist.

Some governments have in effect admitted this, by explaining away the rise in protectionism as a temporary by-product of the recession – something to be regretted economically, but inevitable politically. It is implicit in this view that protectionism oscillates, almost as a matter of course, with the business cycle: when aggregate activity falls protectionism rises, and when growth resumes protectionism recedes.

There are a number of difficulties with this proposition. First, while protectionism in industrial countries has undoubtedly escalated with the recession, its roots can be found in the late 1960s, especially in such industries as shipbuilding, and textiles and clothing (not to mention agriculture). No simple correlation with macroeconomic activity seems possible. Second, it is not clear why an upswing in the economy should cancel out the protection imposed during the downswing. Even if the *increments* to protection diminish, the previous rise in the *stock* of protection will presumably remain, unless some positive action is taken.

In considering what action is possible or appropriate, we have to understand that protectionism is

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\* The author is an economist in the Economic Research and Analysis Unit of the GATT Secretariat. This article is solely the author's own responsibility and in no respect implicates the organization with which he is affiliated.

predominantly a secular, not cyclical, phenomenon. It reflects a *systematic bias* in the domestic policy environment in most countries, undermining the concessions granted in international negotiations and constricting the scope for additional ones. This bias arises within both the private and the government sectors.

### Pressure Group Bias

The demands on government to redistribute income from large to small groups within society will normally be uneven, those on the receiving end making a lot more noise than those who pay. This is a well-known phenomenon, elaborated in the seminal work of Anthony Downs and Mancur Olson.<sup>1</sup> It arises essentially from the difficulty of organizing a group for collective action (lobbying government) to obtain a benefit, or avoid a burden (subsidy and tax, respectively), where that action will eventually benefit *all* the potential members of the group, whether they join or not. This is the "free rider" problem. It is most intractable for large, regionally diffuse groups and least so for small groups, where communication is easier and the expected pay-off to individual members substantial. This is highly relevant to protection for industry because, irrespective of the particular measures used, it always involves a transfer of income from a very large, diffuse group of people – consumers and/or taxpayers – to a relatively very small and identifiable group. Simple arithmetic tells us that the per capita loss to the first group is "very small" compared to the per capita gain to the second. The result is that consumers-cum-taxpayers tend to be poorly organized compared to industry groups.

It might be supposed that consumers nevertheless have a convenient means of individually lobbying government through the ballot-box. As Olson notes: "With perfectly informed citizens, elected officials would not be subject to the blandishments of lobbyists, since the constituents would then know if their interests were betrayed and defeat the unfaithful representative at the next election."<sup>2</sup> The problem is precisely that voters are not "perfectly informed". What is more, they will

normally *choose* to remain ignorant about such matters because, as Downs has shown, the cost of searching for the necessary information will usually exceed the benefit to be expected from their individual informed votes. To produce an electoral impact, this information would have to be distributed among a majority of voters; but, again, no single consumer has an economic incentive to undertake this costly task, even if he or she has the necessary information.

This inherent imbalance in the demand for protection is compounded by the fact that uninformed public opinion frequently supports vested interests, either based on illusions of the "free lunch", or because the conflict is seen as being between the interests of a national group (local enterprises and their labour forces) and "foreigners". Such misconceptions are understandable, for the economist's notions of "comparative advantage" and "general equilibrium effects" are not intuitively obvious to the uninitiated. Moreover, the spokesmen for industry have an incentive to foster misconceptions about protection and in this they are aided by the human-interest perspective of the popular press. Imminent job losses and factory closures make much better "copy" than complicated arguments about the damage to job opportunities in other occupations and industries which protectionism engenders. As a result, members of the community tend to be much more aware of the adverse consequences for people resisting change of a refusal by government to grant them support, than of the ultimate cost to themselves of its agreeing to do so.

### Bureaucratic Bias

An equally important source of bias in the protection policy environment – though perhaps less familiar to economists than to political scientists – operates within government. In most countries, government bureaucracies are divided into numerous departments,

<sup>1</sup> Anthony D o w n s : An Economic Theory of Democracy, New York 1957; Mancur O l s o n : The Logic of Collective Action, Cambridge, Mass. 1965; and Mancur O l s o n : The Rise and Decline of Nations, New Haven 1982.

<sup>2</sup> Mancur O l s o n : The Rise and Decline of Nations, op. cit., p. 26.

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many established primarily to provide a communication link between government and various interest groups. In such departments, a symbiotic relationship naturally develops with their "client" groups, the existence and growth of each being to some extent interdependent. In a sense, a part of the bureaucracy becomes an extension of the private special-interest group. This does not mean that the public servants are behaving improperly; only that the "public" whose interests they are serving is a rather narrow segment of the whole. It often happens that, where that segment of the public is an industry seeking protection against imports, the main source of advice available to government in evaluating its claim is the very department with which it is associated (typically, the "Department of Industry"). The result is equivalent to a shopkeeper asking the Mafia's lawyer for advice about whether to pay protection money!

Even ignoring the problem of "clientelism", industry-oriented departments will generally be an inadequate source of information on such matters. This is because they are too specialized, their focus too narrow, to be capable of evaluating all the long-term, economy-wide consequences of industry assistance measures, and anyway it is not their job. The problem is that in most national bureaucracies no department does this job.

The combination of these two, mutually reinforcing phenomena, places politicians in a position where they are being urged to make decisions about industry assistance (a) on the basis of very partial and distorted information, and (b) in a political environment in which the bulk of the electorate (that is, those who must pay) is passive about the issues. This does not mean of course that vested interests will always get their own way. In situations where protection of Industry A would clearly prove costly to Industry B, there might be counterlobbying to prevent it. Also, some industry lobbies may not have much bargaining power and can be safely ignored. And there will always be those political decision-makers who are prepared to take a stand against powerful pressure groups on principle. But the fact remains that the dice *are* loaded in the protection seekers' favour.

There are three reasons why this inherent bias in the policy environment has been increasing over time, irrespective of cyclical developments in aggregate economic activity:

□ *Growth of Pressure Groups:* Mancur Olson's dynamic theory of pressure groups shows how the "free rider" problem is overcome at different rates by different groups, depending on their size, the expected benefits

per member and the possibility of utilizing forms of compulsion. He convincingly demonstrates that pressure groups will tend to accumulate over time, provided that political conditions are relatively stable. Just after World War II entrepreneurial pressure groups were in disarray in many countries and governments were not too constrained from this quarter in their liberalization endeavours. The years that followed have witnessed ever increasing constraints placed upon governments as more and more industry coalitions and specialist lobbying firms have been formed. The formation of industry lobbies has also been spurred by long-term shifts in competitiveness, which have generated secular "crises" in one established industry after another (and will continue to do so).

□ *Power of Precedent:* Each grant of protection establishes a precedent which simultaneously arouses new demands for protection and makes them harder to resist. It helps pressure groups organize by raising their expectations of success (the net return to lobbying) and often weakening their economic position. Having protected steel producers, for instance, on what grounds could the claims of the motor vehicle industry be denied?

□ *Growth of Government:* In parallel with the growth of pressure groups in the private sector, the unprecedented expansion of the government sector in the last four decades has been accompanied by the increased specialization or fragmentation of bureaucracies. This has enhanced the potential for clientelism and made it more difficult for governments to evaluate sectoral policies from a broad perspective. In the words of a former chief civil servant in the United Kingdom, "The system developed a life of its own, so that there is now almost certainly somewhere in the government a little unit of people whose job it is to acquaint themselves with what is happening in each industry, and as far as they can, watch over its interests".<sup>3</sup>

These considerations go a long way to explaining the decreasing returns to the traditional bargaining approach to international trade liberalization, so noticeable in the last decade. While this approach, with its emphasis on a quid pro quo for any tariff "concessions", was always flawed from the perspective of economic theory – which demonstrates that each country generally derives greatest benefit from its own liberalization, not that of its trading partners – its early success reflected the fact that there *were* many areas

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<sup>3</sup> Lord Armstrong, in: D. Letherbridge (ed.) *Government and Industry Relationships*, Oxford 1976.

where real concessions could be made. The accumulation and increased effectiveness of pressure groups has made this more and more difficult. Not only have new, substantive concessions been increasingly hard to find in the face of the secular pressures just described, the previous ones have become increasingly difficult to sustain. Hence, the rise of such innovations in protection policy as "voluntary" export restraints, trade "adjustment" assistance, and harassment of imports through anti-dumping action and other administrative devices.

### Implications for Policy

If democratic governments are to restore the benefits of liberal trade to their economies, they must "learn how to discipline and deorganise such minorities as special-interest pressure groups".<sup>4</sup> The key to this difficult undertaking would seem to lie in Olson's remark concerning "perfectly informed" citizens. There is a great need to improve the community's understanding about protection issues. A well-informed public would be much more likely to provide an ally to government in resisting pressures that are detrimental to the public interest. This refers not just to consumers and taxpayers, but also to export industries and their employees, who bear a great deal of the burden of protecting the import-competing sector.<sup>5</sup> It is also necessary, however, to improve the information available to political decision-makers themselves. Governments need to know more about the economy-wide effects of sectoral policy proposals – not just the likely short-term consequences for the industry demanding assistance – if they are to properly exercise their political judgement.

It has already been shown that the needed information will generally not be disseminated in the market. This information is not only a public good in the usual "market failure" sense, but also in the sense that much of it is generated within the public sector and is not made available to the market. Indeed, information about sectoral assistance seems to be one of the few public goods that governments have neglected to supply.

### A Transparency Institution

To redress this imbalance, it is clear from the discussion about bureaucratic fragmentation and clientelism that a separate institution would have to be established by government. We might call it a "sectoral assistance transparency institution" (SATI). The SATI

would need the following powers: (a) to advise governments on the national welfare effects of *all* proposed assistance/protection to all productive sectors *before* any decision can be taken; (b) to publicize this advice, preferably at the same time that it goes to government; and (c) to undertake a continuous, systematic survey and economic appraisal of the existing stock of assistance (border protection, subsidies, regulations, etc.) the details of which must also be *publicized* periodically, not just published in obscure gazettes. The SATI would not have any executive or judicial power, its role being confined to improving the quality and public availability of policy-relevant information. To perform this task effectively, it would need to be designed in such a way as to ensure its independence and impartiality.

"Politically impossible"? Vested interests would certainly resist the idea, as it poses a direct threat to their power. In this case, however, their lobbying would be so obviously self-seeking and contrary to the public interest that its effectiveness would be undermined. Governments might have misgivings about the possible usurpation of their political role, but to the extent that the SATI improved the understanding of government and the electorate about protection's long-term, economy-wide effects, it would *increase* the power of government to serve the national interest, not lessen it.

An awareness of the need for some such institution is growing. The OECD, for example, recently conducted a survey of existing transparency arrangements in member countries and has undertaken a further programme of study in its Consumer Policy Committee.<sup>6</sup> Also, an International Study Group on Domestic Transparency has been brought together by the Trade Policy Research Centre in London, under the Chairmanship of Olivier Long, former Director-General of the GATT. Among other issues, it has been examining precedents for a SATI-type institution (such as the Industries Assistance Commission in Australia) and the scope for concerted international action.

It is obvious that, however well conceived, a national Transparency Institution cannot be a trade policy panacea. All it can hope to do is to help counter the inherent bias against liberal trade in the domestic policy environment. But this is important enough. Unless something is done to tackle the problem at its source, we must not be surprised if national practice continues to deviate from GATT law – even during a recovery.

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<sup>4</sup> Henry Simons: *Economic Policy for a Free Society*, Chicago 1948, p. 151.

<sup>5</sup> See "Digression: A Tax on Imports is a Tax on Exports", in: GATT, *International Trade 1981/82*, Geneva 1982, p. 15-18.

<sup>6</sup> See OECD: *Transparency for Positive Adjustment*, Paris 1983.