same problem. If the domestic policy appears too costly or has undesirable side effects, the trade policy is almost surely even less desirable—even though the costs are less apparent.

In the European Union (EU), for example, banana producers were guaranteed a price up to a specified ceiling of banana production until 2007. Only around 16 percent of the total EU consumption was produced in the EU. The remaining consumption was exported from Latin American, African, Caribbean, and Pacific (ACP) countries. To support economic growth for some ACP countries, a large import quota was provided to access the EU market as a support for their economies.

In 1993, the EU had imposed tariffs on banana imports from non-ACP countries. However, the EU compensatory aid policy actually required large subsidy payments, which influenced the central government's budget deficit and required a tax increase. Furthermore, workers in the EU are among the highest-paid workers in the agriculture sector. Thus, the import quota provided to the ACP countries and gains received by the ACP exporters came at a high cost both to Latin American exporters and to EU consumers who had a distortion to consumer choice by paying a higher price. However, this cost came in the form of higher prices rather than direct government expenditures. Following several WTO disputes and subsequent reforms of its banana trade regime, the compensatory aid system for the EU farmers was withdrawn.

Critics of the domestic market failure justification for protection argue that this case is typical: Most deviations from free trade are adopted not because their benefits exceed their costs but because the public fails to understand their true costs. Comparing the costs of trade policy with alternative domestic policies is thus a useful way to focus attention on just how large these costs are.

The second defense of free trade is that because market failures are typically hard to identify precisely, it is difficult to be sure what the appropriate policy response should be. For example, suppose there is urban unemployment in a less-developed country; what is the appropriate policy? One hypothesis (examined more closely in Chapter 11) says that a tariff to protect urban industrial sectors will draw the unemployed into productive work and thus generate social benefits that would more than compensate for the tariff's costs. However, another hypothesis says that this policy will encourage so much migration to urban areas that unemployment will, in fact, increase. It is difficult to say which of these hypotheses is right. While economic theory says much about the working of markets that function properly, it provides much less guidance on those that don't; there are many ways in which markets can malfunction, and the choice of a second-best policy depends on the details of the market failure.

The difficulty of ascertaining the correct second-best trade policy to follow reinforces the political argument for free trade mentioned earlier. If trade policy experts are highly uncertain about how policy should deviate from free trade and disagree among themselves, it is all too easy for trade policy to ignore national welfare altogether and become dominated by special-interest politics. If the market failures are not too bad to start with, a commitment to free trade might in the end be a better policy than opening a Pandora's box of a more flexible approach.

This is, however, a judgment about politics rather than about economics. We need to realize that economic theory does *not* provide a dogmatic defense of free trade, even though it is often accused of doing so.

Income Distribution and Trade Policy

The discussion so far has focused on national welfare arguments for and against tariff policy. It is appropriate to start there, both because a distinction between national welfare and the welfare of particular groups helps to clarify the issues and because the advocates of trade policies usually claim that the policies will benefit the nation as a whole. When

looking at the actual politics of trade policy, however, it becomes necessary to deal with the reality that there is no such thing as national welfare; there are only the desires of individuals, which get more or less imperfectly reflected in the objectives of government.

How do the preferences of individuals get added up to produce the trade policy we actually see? There is no single, generally accepted answer, but there has been a growing body of economic analysis that explores models in which governments are assumed to be trying to maximize political success rather than an abstract measure of national welfare.

Electoral Competition

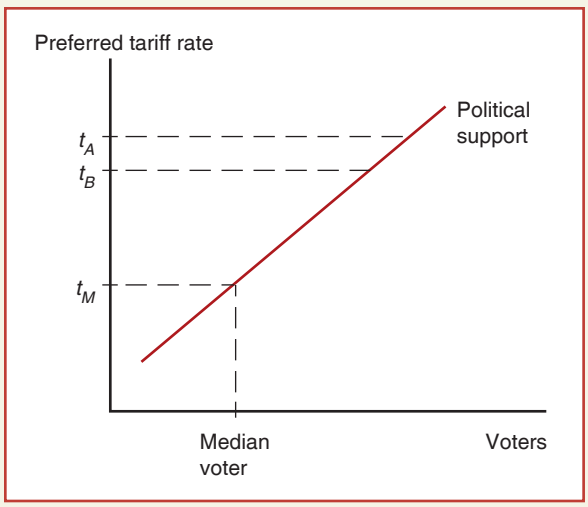
Political scientists have long used a simple model of competition among political parties to show how the preferences of voters might be reflected in actual policies.[2] The model runs as follows: Suppose two competing parties are willing to promise whatever will enable each to win the next election, and suppose policy can be described along a single dimension, say, the level of the tariff rate. And finally, suppose voters differ in the policies they prefer. For example, imagine a country exports skill-intensive goods and imports labor-intensive goods. Then voters with high skill levels will favor low tariff rates, but voters with low skills will be better off if the country imposes a high tariff (because of the Stolper-Samuelson effect discussed in Chapter 5). We can therefore think of lining up all the voters in the order of the tariff rate they prefer, with the voters who favor the lowest rate on the left and those who favor the highest rate on the right.

What policies will the two parties then promise to follow? The answer is that they will try to find the middle ground—specifically, both will tend to converge on the tariff rate preferred by the **median voter**, the voter who is exactly halfway up the lineup. To see why, consider Figure 10-4. In the figure, voters are lined up by their preferred tariff rate, which is shown by the hypothetical upward-sloping curve; t_M is the median voter's preferred rate. Now suppose one of the parties has proposed the tariff rate t_A, which is considerably above that preferred by the median voter. Then the other party could

FIGURE 10-4

Political Competition

Voters are lined up in order of the tariff rate they prefer. If one party proposes a high tariff of t_A, the other party can win over most of the voters by offering a somewhat lower tariff, t_B. This political competition drives both parties to propose tariffs close to t_M, the tariff preferred by the median voter.



[2]See Anthony Downs, *An Economic Theory of Democracy* (Washington, DC: Brookings Institution, 1957).

propose the slightly lower rate, t_B, and its program would be preferred by almost all voters who want a lower tariff, that is, by a majority. In other words, it would always be in the political interest of a party to undercut any tariff proposal that is higher than what the median voter wants.

Similar reasoning shows that self-interested politicians will always want to promise a higher tariff if their opponents propose one that is lower than the tariff the median voter prefers. So both parties end up proposing a tariff close to the one the median voter wants.

Political scientists have modified this simple model in a number of ways. For example, some analysts stress the importance of party activists in getting out the vote; since these activists are often ideologically motivated, the need for their support may prevent parties from being quite as cynical, or adopting platforms quite as indistinguishable, as this model suggests. Nonetheless, the median voter model of electoral competition has been very helpful as a way of thinking about how political decisions get made in the real world, where the effects of policy on income distribution may be more important than their effects on efficiency.

One area in which the median voter model does not seem to work very well, however, is trade policy! In fact, it makes an almost precisely wrong prediction. According to this model, a policy should be chosen on the basis of how many voters it pleases: A policy that inflicts large losses on a few people but benefits a large number of people should be a political winner; a policy that inflicts widespread losses but helps a small group should be a loser. In fact, however, protectionist policies are more likely to fit the latter than the former description. For example, the U.S. dairy industry is protected from foreign competition by an elaborate system of tariffs and quotas. These restrictions impose losses on just about every family in America while providing much smaller benefits to a dairy industry that employs only about 0.1 percent of the nation's workforce. How can such a thing happen politically?

Collective Action

In a now-famous book, economist Mancur Olson pointed out that political activity on behalf of a group is a public good; that is, the benefits of such activity accrue to all members of the group, not just the individual who performs the activity.[3] Suppose a consumer writes a letter to their congressperson demanding a lower tariff rate on their favorite imported good, and this letter helps change the congressperson's vote so that the lower tariff is approved. Then all consumers who buy the good benefit from lower prices, even if they did not bother to write letters.

This public good character of politics means policies that impose large losses in total—but small losses on any individual—may not face any effective opposition. Again, take the example of dairy protectionism. This policy imposes a cost on a typical American family of approximately $3 per year. Should a consumer lobby his or her congressperson to remove the policy? From the point of view of individual self-interest, surely not. Since one letter has only a marginal effect on the policy, the individual payoff from such a letter is probably not worth the paper it is written on, let alone the postage stamp. (Indeed, it is surely not worth even learning of the policy's existence unless you are interested in such things for their own sake.) And yet, if a million voters were to write demanding an end to dairy protection, it would surely be repealed, bringing benefits to consumers significantly exceeding the costs of sending the letters. In Olson's

[3]Mancur Olson, *The Logic of Collective Action* (Cambridge, MA: Harvard University Press, 1965).

phrase, there is a problem of **collective action**: While it is in the interests of the group as a whole to press for favorable policies, it is not in any individual's interest to do so.

The problem of collective action can best be overcome when a group is small (so that each individual reaps a significant share of the benefits of favorable policies) and/or well organized (so that members of the group can be mobilized to act in their collective interest). The reason that a policy like dairy protection can happen is that dairy producers form a relatively small, well-organized group that is well aware of the size of the implicit subsidy members receive, while dairy consumers are a huge population that does not even perceive itself as an interest group. The problem of collective action, then, can explain why policies that not only seem to produce more costs than benefits but that also seem to hurt far more voters than they help can nonetheless be adopted.

Modeling the Political Process

While the logic of collective action has long been invoked by economists to explain seemingly irrational trade policies, the theory is somewhat vague on the ways in which organized interest groups actually go about influencing policy. A growing body of analysis tries to fill this gap with simplified models of the political process.[5]

The starting point of this analysis is obvious: While politicians may win elections partly because they advocate popular policies, a successful campaign also requires money for advertising, polling, and so on. It may therefore be in the interest of a politician to adopt positions against the interest of the typical voter if the politician is offered a sufficiently large financial contribution to do so; the extra money may be worth more votes than those lost by taking the unpopular position.

Modern models of the political economy of trade policy therefore envision a sort of auction in which interest groups "buy" policies by offering contributions contingent on the policies followed by the government. Politicians will not ignore overall welfare, but they will be willing to trade off some reduction in the welfare of voters in return for a larger campaign fund. As a result, well-organized groups—that is, groups that are able to overcome the problem of collective action—will be able to get policies that favor their interests at the expense of the public as a whole.

Who Gets Protected?

As a practical matter, which industries actually get protected from import competition? Many developing countries traditionally have protected a wide range of manufacturing, in a policy known as import-substituting industrialization. We discuss this policy and the reasons why it has become considerably less popular in recent years in Chapter 11. The range of protectionism in advanced countries is much narrower; indeed, much protectionism is concentrated in just two sectors: agriculture and clothing.

Agriculture There are not many farmers in modern economies—in the United States, agriculture employs only about 2.5 million workers out of a labor force of more than 160 million. Farmers are, however, usually a well-organized and politically powerful group that has been able in many cases to achieve very high rates of effective protection. We discussed Europe's Common Agricultural Policy in Chapter 9; the export subsidies in that program mean that a number of agricultural products sell at two or three times world prices. In Japan, the government has traditionally banned imports of rice,

[5]See, in particular, Gene Grossman and Elhanan Helpman, "Protection for Sale," *American Economic Review* 89 (September 1994), pp. 833–850.

thus driving up internal prices of the country's staple food to more than five times as high as the world price. This ban was slightly relaxed in the face of bad harvests in the mid-1990s, but in late 1998—over the protests of other nations, including the United States—Japan imposed a 1,000 percent tariff on rice imports.

The United States is generally a food exporter, which means that tariffs or import quotas cannot raise prices. (Sugar and dairy products are exceptions.) In fact, farmers were hurt badly by the U.S.–China trade war we described at the beginning of this chapter. But farmers received $28 billion in special aid to compensate for their losses. And as we've seen, in 2020 Chinese promises to buy U.S. farm goods were the centerpiece of a deal intended to slow the trade war.

Clothing The clothing industry consists of two parts: textiles (spinning and weaving of cloth) and apparel (assembly of cloth into clothing). Both industries, but especially the apparel industry, historically have been protected heavily through both tariffs and import quotas. Until 2005, they were subject to the Multi-Fiber Arrangement (MFA), which set both export and import quotas for a large number of countries.

Apparel production has two key features. It is labor-intensive: A worker needs relatively little capital, in some cases no more than a sewing machine, and can do the job without extensive formal education. And the technology is relatively simple: There is no great difficulty in transferring the technology even to very poor countries. As a result, the apparel industry is one in which low-wage nations have a strong comparative advantage and high-wage countries have a strong comparative disadvantage. It is also traditionally a well-organized sector in advanced countries; for example, many American apparel workers have long been represented by the International Ladies' Garment Worker's Union.

Later in this chapter, we'll describe how trade negotiations work; one of the most important provisions of the Uruguay Round trade agreements, signed in 1994, was the phaseout of the MFA, which took place at the end of 2004. Although import quotas were reimposed on China in 2005, those quotas have since phased out. At this point, trade in clothing no longer faces many restrictions.

Table 10-2 shows just how important clothing used to be in U.S. protectionism and how much difference the end of the restrictions on clothing makes. In 2002, with the MFA still in effect, clothing restrictions were responsible for more than 80 percent of the overall welfare costs of U.S. protectionism. Because the MFA assigned import licenses to exporting countries, most of the welfare cost to the United States came not from distortion of production and consumption but from the transfer of quota rents to foreigners.

With the expiration of the MFA, the costs of clothing protection and hence the overall costs of U.S. protection fell sharply.

TABLE 10-2 Welfare Costs of U.S. Protection ($ billion)

	2002 Estimate	2015
Total	14.1	2.6
Textiles and apparel	11.8	0.5

Source: U.S. International Trade Commission.