reinforced the pro-trade position in a subtler way. Previously, congressmen had been susceptible to direct constituency pressure, and made-to-order tariffs had emerged under Smoot-Hawley in a process of log-rolling that reflected "reciprocal noninterference" among the legislators. This stopped when the setting of individual tariffs was shifted away from the Congress. Instead, protectionist pressures now had to be concentrated on protectionist *rules*. Now narrow questions concerning the favorite tariffs of individual legislators gave way to broader questions of protectionism versus free trade. Reciprocal noninterference was replaced by lobbying, which was somewhat less unevenly divided between the protectionists and the pro-traders. For any level of protectionist pressure, the supply of protection should then fall.[24]

In the end, then, the postwar liberalization of trade can be attributed to a richly textured interplay of interests, ideology, and institutions. But during the 1970s the scene changed conspicuously. There was an onset of protection, and a widespread outbreak of protection was feared. What went wrong?

24. This argument, developed by Nelson (1987), is explored further in Hall and Nelson 1987. On other institutional matters relevant to U.S. trade policy, see Baldwin 1985b.

The Rise of Protectionism

3

The downward trend in trade restrictions resulting from declining tariffs was rudely interrupted in the mid-1970s. An offsetting growth in trade barriers followed. The negotiated tariff reductions were accompanied, and their incremental effect in loosening the restraints on the world trading system was seriously compromised, by the growth of *nontariff barriers* (NTBs). Economists often refer to these barriers as *administered protection*, because they typically do not imply legislative enactment of each act of protection (although, of course, legislative consent—implicit and explicit—is necessary for the exercise of executive and quasi-judicial powers and discretion in the granting of protectionist demands made by specific petitioners and lobbies). These restrictions are customarily applied through institutions and processes set up to regulate imports, including the exercise of political power by the executive branch in making trade-restraining arrangements with other countries.

Two classes of nontariff barriers, with wholly different implications, must be distinguished: those that bypass GATT's rule of law and those that "capture" and pervert it. The former class consists of the "high-track"[1] (that is, visibly

and politically negotiated) restraints on exports by trading partners; the latter class consists of "low-track" restraints, such as countervailing duties and anti-dumping provisions.

The Growth of Nontariff Barriers

Voluntary Export Restrictions, etc.

The increase in high-track interventions restraining exports in one way or another has been rather dramatic since the 1970s. In 1974 the Long-Term Arrangement Regarding International Trade in Textiles became the comprehensive Multifibre Agreement, which was soon joined by steadily increasing interventions such as Orderly Marketing Agreements and Voluntary Export Restraints in industries as diverse as steel, automobiles, footwear, motorcycles, machine tools, and consumer electronics.[2]

The World Bank and the UN Conference on Trade and Development have mounted an extensive effort to calculate the incidence of nontariff barriers. The conceptual and measurement problems facing this effort are formidable. For one thing, the definition of "hard-core" NTBs that is used goes beyond voluntary export restrictions and other export-restraining arrangements to include import quotas, nonautomatic licensing, and variable levies[3]; for another, the measure

1. The distinction between the "high-track" and "low-track" processes of administered protection is drawn in Finger et al. 1982. The terminology itself is attributed to Richard Cooper.

2. The incidence of formal, negotiated restraints on manufactures during the period 1984–1986 is illustrated in figure 8.1 of the 1987 *World Development Report*.

3. Evidently, VERs are much more important in the industrialized countries, whereas import quotas and nonautomatic licensing are of

of the presence of such NTBs reflects only the percentage of imports covered by such measures, not the protective effects of the measures.[4] The orders of magnitude are, nonetheless, suggestive: In 1981, 13 percent of the imports of industrial countries were subject to such hard-core nontariff barriers; the 1986 estimate of 16 percent is broadly comparable.[5]

If one broadens the definition of NTBs to include state monopolies, import surveillance (including automatic licensing), countervailing duties, and anti-dumping provisions, the results are more compelling. Recently there has been a significant increase in this more comprehensive index of NTB coverage for all the major Organization for Economic Cooperation and Development country groups except Japan (which already had a higher initial level of NTB coverage than the European Economic Community and the United States).[6] One must be very cautious when contemplating such data, however. For instance, the inclusion of automatic licensing and of state trading in this augmented NTB index may mislead the unwary reader into an exaggerated sense of the incidence and growth of protection, since the protective effect of automatic licensing is surely negligible and since state trading may also be of no consequence.

Let us return, however, to export-restraining arrangements. By the late 1970s, voluntary export restrictions had become both significant and significantly more prevalent

corresponding importance in the developing countries. The World Bank-UNCTAD data therefore may be a good reflection of the VER situation in the industrialized countries.

4. Thus, if a VER is so effective as to rule out imports altogether, it will simply disappear from the index at hand, since the eliminated imports will not show as imports covered by VERs. Of course, the same problem afflicts the measuring of any trade restriction.

5. See *World Development Report* 1987, p. 142. The estimates for 1986 use 1981 trade weights, so comparability is facilitated.

6. See figure 5.

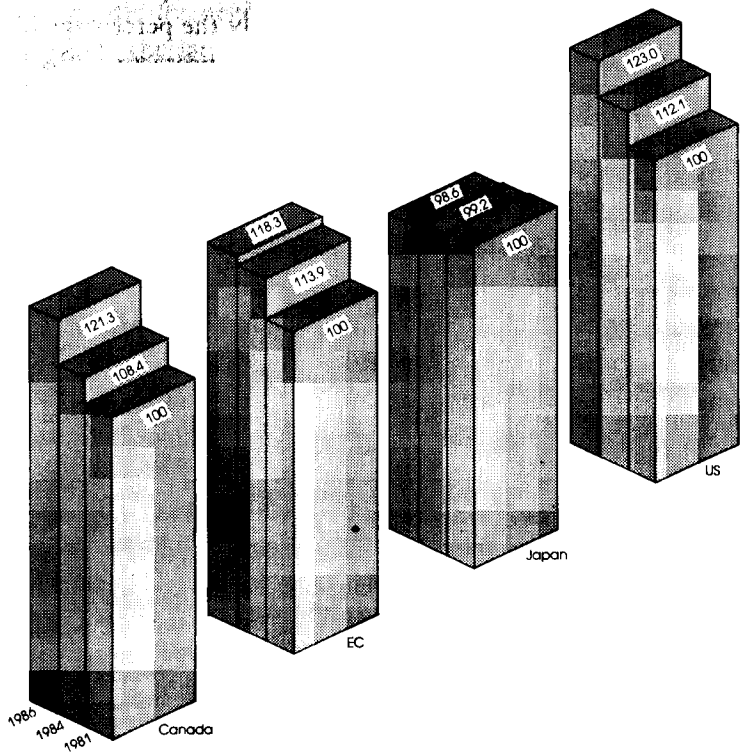

Figure 5 Import-coverage indexes of selected nontariff barriers in Canada, the European Economic Community (excluding Portugal and Spain), Japan and the United States for the years 1981–1986, where 100 is the index for 1981. (The import-coverage ratios—i.e., the sum of the value of a country's import groups affected by NTBs divided by the total value of its imports of these groups—were computed using 1981 import trade weights. Therefore, variations in the index between years can occur only if NTBs affect a different set of products or trading partners. The NTBs included are very broad in coverage, including even automatic licensing and price-control measures.) Source: UNCTAD 1987.

than GATT-approved Article XIX safeguards actions.[7] In 1982 the GATT Secretariat noted with alarm that other safeguards measures (mostly export-restraining arrangements) had been used in 63 cases since 1978, versus only 19 reported Article XIX actions.[8] The growth of this set of NTBs not only halted but partially reversed the process of trade liberalization. It also signified to many the possibility of a menacing shift in the nature of the international trade regime.

GATT represents the "rule of law." If all members play by well-defined rules—among which nondiscriminatory most-favored-nation agreements and a preference for tariffs over other trade barriers (in view of their greater transparency) are particularly important—the members must expect the chips to fall where they may. The resulting allocation of industries and trade among member countries is sacrosanct, having been legitimated by the approved process. This "fix-rule" system is in contrast to the "fix-quantity" regime that voluntary export restraints and other export-restraining arrangements (such as orderly marketing agreements) imply, for those restraints and arrangements allocate trade volumes by fiat, are often nontransparent in their protective magnitude, and necessarily lead away from most-favored-nation-based protection into discriminatory treatment of alternative suppliers.

Concern about a shift in the rules is legitimate if these developments indeed represent an enduring transition to a new fix-quantity regime. But they have their bright side: They can also be interpreted as ingenious, temporary, dam-

7. Article XIX provides for temporary protection of an industry from import competition.

8. Wolff (1983) cites this GATT study and comments that the actual ratio of VERs to Article XIX actions must have been even higher, since there was no legal need to notify the GATT of such non-GATT "extralegal" measures in the first place. For another discussion of VERs relative to Article XIX, see Hindley 1987.

age-minimizing ways in which pro-trade administrations have coped with protectionist pressures (a theme I will develop below).

Countervailing Duties and Anti-Dumping Provisions: Capturing the "Fair Trade" Provisions

An altogether different phenomenon is the translation of protectionist pressure into a "capture" of the mechanisms for maintaining fair trade—especially countervailing duties (CVDs) and anti-dumping (AD) provisions. These institutions have legitimate roles in a free trade regime, as I argued earlier, but not if they are captured and misused as protectionist instruments.

The incidence of CVD and AD actions accelerated significantly in the late 1970s. Between 1980 and 1985, "seven countries and the European Community . . . initiated 1,155 anti-dumping cases[;] there were also 425 anti-subsidy cases" (Finger and Nogues 1987, page 707). The data for CVD and AD actions by the United States, Australia, Canada, and the European Economic Community (table 2) show a preponderant reliance by the EEC on AD actions, whereas the United States was almost alone in resorting to CVDs.

The dramatic rise of such unfair-trade cases is itself *prima facie* evidence of their use for harassment of successful foreign suppliers. But the evidence in support of the capture theory is more compelling than that.

The traditional design and functioning of the national laws and institutions for initiating and settling AD and CVD complaints have encouraged the capture of these measures. For one thing, the absence of penalties for frivolous complaints means that a plaintiff often incurs only small costs, whereas a defendant (who has much to lose) often must hire the most expensive lawyers. Furthermore, although foreign firms are entitled to fair hearings, there is something to be

Table 2

Countervailing duties and anti-dumping actions initiated. (Adapted from Finger and Nogues 1987, p. 708.)

	United States	Australia	Canada	EEC
Countervailing duties				
1980	8[a]	0	3	0
1981	10[a]	0	0	1
1982	123[a]	2	1	3
1983	21[a]	7	3	2
1984	51[a]	6	2	1
1985	39[a]	3	3	0
	252	18	12	7
Anti-dumping actions				
1980	22[b]	62	25	25
1981	14[b]	50	19	47
1982	61[b]	78	72	55
1983	47[b]	87	36	36
1984	71[b]	56	31	49
1985	65[b]	60	36	42
	280	393	219	254

a. U.S. Trade Act, Section 701.
b. U.S. Trade Act, Section 731.

said in favor of procedures that do not make one's nationals both the plaintiffs and the judges in a climate that is protectionist and hence prejudicial to the interests of the defendants against whom unfair trading practices are alleged.[9] (That such a prejudicial atmosphere has existed in recent years is hardly in dispute.[10])

9. Finger et al. (1982, p. 454) make the altogether different criticism that these dispute-settlement mechanisms and institutions "by design . . . [weigh] domestic producers' interests more heavily than domestic users' " and have "the capacity to impose trade restrictions but not to remove them."

10. Finger and Nogues (1987, p. 721) record that "in 1980–81, twenty-six different pieces of legislation were proposed in the U.S. Congress to deal with such matters . . . , and by the end of 1985 several hundred pieces of trade legislation had been proposed" (to deal with unfair trading practices).

The capture of these procedures by protectionists is facilitated by the fact that the descriptions and characterizations of concepts such as "fair value" (used in determining and deterring dumping) are inherently vague and can therefore be interpreted restrictively and with bias against foreign suppliers. This has indeed been happening. Norall (1986), in his review of new trends in anti-dumping practice in the EEC, documents how the Commission of the European Community (whose anti-dumping regulations reproduce, in many respects, "the bland generalities of the GATT anti-dumping code") has been able to exercise considerable discretionary power, and notes that "even though these [anti-dumping] provisions are often equivocal, they are inflexibly interpreted to provide textual justification for some very harsh results" (page 98). Norall's alarming conclusion is this:

In a word, if certain facts are present, various aspects of the technical methodology now applied by the Commission in anti-dumping cases tend to make findings of dumping at significant levels automatic and inevitable and, secondly, to make it very difficult for exporters to modify or palliate the effect of anti-dumping duties by price increases after the imposition of duties.

This trend initiated in the arcane technicalities of the application of the anti-dumping regulation by the technicians—with varying degrees of tacit approval from the member countries of the European Community and those responsible for the political side of trade relations with Japan—seems to be becoming an instrument of trade policy. (pp. 98–99)

The economist Patrick Messerlin (1987) analyzed the 515 anti-dumping cases examined between 1970 and 1985 by the Commission of the European Community and reached an equally disturbing conclusion:

First, the EC AD procedure is now far from being marginal: it involves hundreds of cases, concerns all the important trade partners of the Community and shows increasingly restrictive outcomes. Second, there is a clear tendency for this GATT-honored procedure to generate outcomes embarrassing to GATT principles: harassment, discrimination between trade partners, nontariff barriers are intrinsic to this procedure. (page 21)

Even the asymmetries in the ways that foreign and domestic firms are treated by those charged with determining unfair trade practices have now been fairly well documented. Fred Smith of the Competitive Enterprise Institute has remarked of U.S. practice that "if the same anti-dumping laws applied to U.S. companies, every after-Christmas sale in the country would be banned."[11] Dickey (1979) also concluded that U.S. practice had become infected by unfair asymmetries that worked against foreign firms.

The determination "fair value" proceeds relentlessly, even in cases where elementary economics would suggest that it is meaningless and that the only outcome can be a political one. For example, Poland's exports of golf carts to the United States were challenged on anti-dumping grounds. Now, there is no way in which "true" or "fair" costs and prices can be meaningfully determined for centrally planned economies in the first place. And the Poles did not even play golf, so there were no domestic prices to work with: the Poles had put the cart before the course. But protectionists do not give up. A search was mounted for "comparable" countries, whose wages and other costs would be used to reconstruct Poland's true costs, with Spain finally chosen as the ideal candidate.[12]

11. Quoted by Bovard (1987).

12. See Holzman 1983. The procedure of constructing "fair value" for CPEs from prices of non-CPE producers was built into the 1974 amend-

Even minuscule subsidies have been countervailed. Aside from the fact that the margins of errors in the calculations must greatly exceed these subsidies, their distorting effects on competition must surely be outweighed by the protectionist advantage secured by the complainants who put their foreign rivals through the CVD wringer. Bovard (1987) notes that "in 1984, Italy was convicted of a 'less-than-fair-value' margin of 1.16 percent on its pads for the keys of woodwind instruments even though [the U.S. Department of] Commerce admitted that it did not compare sales of identical products in Italy and the U.S." Kenya's carnation exports were recently countervailed at an estimated "dumping margin" of 1.58 percent. Another CVD action established the grand finding that the Thai government was subsidizing rice exports by 0.75 percent.[13]

Thus, the protective capture of CVD and AD processes is clear. Findings of minuscule "dumping margins" and subsidies, and of biases in assessing the fairness of foreign firms' trading practices, are evidence of an inappropriate use of these mechanisms. But equally important is the fact that the absence of penalties for frivolous complaints makes for a large number of cases in which the petitioner is simply seeking to tie up his successful foreign rivals in expensive defensive actions in national processes which are not exactly models of impartiality and fairness. The filing of CVD and AD complaints has a protective impact thanks to the resulting increase in the uncertainty and cost of foreign trade.

In turn, it is obvious that countervailing-duty and anti-

ment to the Anti-Dumping Act of 1921. An equally bizarre case having to do with China's exports of porcelain-on-steel cookware to the U.S. is summarized in Bovard 1987.

13. See Sathirathai and Siamwalla 1987, p. 607. The CVD procedure did not allow any offsetting adjustment for Thailand's 5 percent tax on rice exports.

dumping actions can be utilized as tactical devices to soften up one's foreign rivals and propel them and their governments into negotiating voluntary restrictions on exports. The legitimate "low-track" mechanism is then deliberately misused to pave the way for the illegitimate protectionist use of the "high-track" mechanism of administered protection. This is the considered conclusion of many careful observers. Finger and Nogues (1987) conclude that in the United States the filing of an unfair-trade-practice petition has usually paved the way for a successful attempt to get the U.S. government to protect an industry: "Large cases, the facts show, almost always begin as administered protection cases and end up as negotiated 'voluntary' export restraints (VERs) (Finger, Hall, and Nelson 1982). The United States–Japan agreement on Japanese exports of automobiles was preceded by a safeguards case.[14] The network of VERs the United States had negotiated with several steel exporters has as its antecedent a series of anti-dumping and CVD petitions." (pp. 720–721) Similarly, the recent semiconductor pact between the United States and Japan followed a blitzkrieg of anti-dumping petitions against the major Japanese manufacturers.

Displacement versus New Protectionist Pressure

The evidence of increased nontariff barriers and administered protection just as tariffs had been reduced to new lows suggests the intriguing possibility that there may be a Law of Constant Protection: If you reduce one kind of protection, another variety simply pops up elsewhere. (You then have a Displacement Effect, not evidence of any increase in protectionist pressure.)

14. "Safeguards" cases involve requests for relief from the impact of market disruption (as under Article XIX).

But this argument is implausible. As I sketched earlier, there was indeed a dramatic conjunction of factors—drawing on ideology, interests, and institutions—that had clearly driven the engine of trade liberalization. Something surely had changed to make this engine sputter, even go into reverse. Protectionist pressures had certainly increased.

I will defer my analysis of the forces that generated this increase in protectionist pressure (among them the OPEC-led macroeconomic distress and the structural changes in the world economy) until chapter 4, where I shall consider these pro-protection forces in the context of the anti-protection forces that are being generated by other changes in the world economy.

The Efficacy of Protection

For the moment, I will simply ask: Given that protectionist pressures increased in the mid-1970s, and that they even translated into an increasing volume of nontariff barriers, how effective was all this in restraining trade? The dog did bark, but did it bite?

Trade expansion certainly slowed down considerably between 1973 and 1983. But, as figure 2 illustrates, trade continued to grow more rapidly than income through this period. Indeed, the increase in trade-to-GNP ratios that most countries had experienced up to 1973 continued thereafter through the early 1980s. Figure 6 illustrates this striking phenomenon for Canada, Japan, South Korea, the United Kingdom, and the United States, but it exists for several other countries as well. Even the developing countries' exports of manufactures grew almost twice as rapidly as their exports to one another, registering a growth rate of over 8 percent annually during the 1970s despite sluggish growth and high rates of unemployment in the industrialized countries.

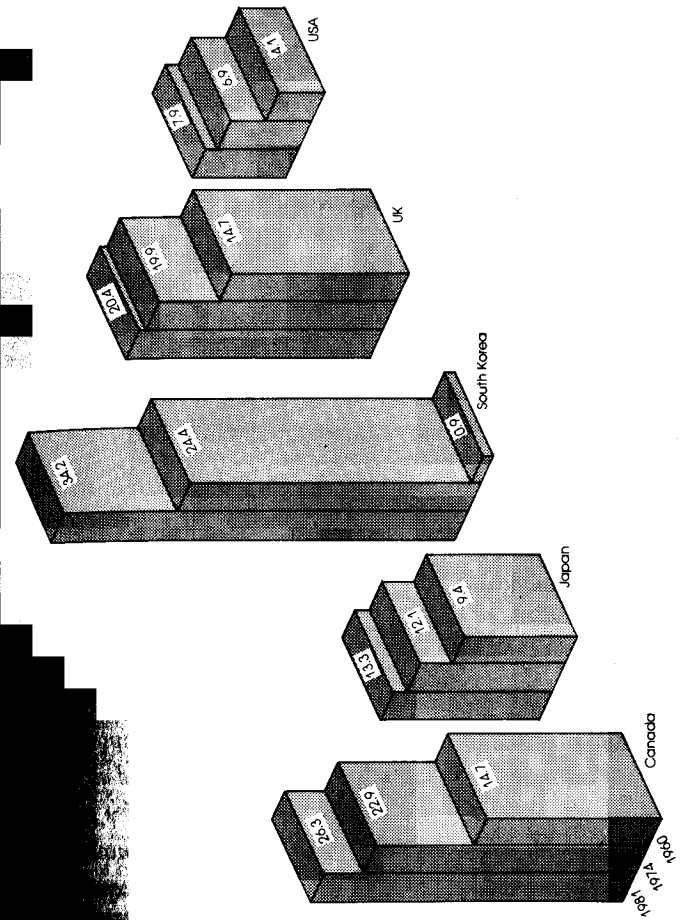

Figure 6 Ratio (percentage) of exports to gross national product in selected countries for the period 1960–1981, calculated from data in IMF International Financial Statistics (lines 70 and 99a).

Of course, world trade could have increased even more rapidly if the outbreak of nontariff barriers had been negligible.[15] In the present instance, however, it is plausible to maintain that the growth of nontariff barriers had, at worst, a moderately adverse effect on the growth of trade. Why?

This puzzle, in which the growth of protection appears significant but its consequences do not,[16] can be explained by drawing on, and adapting to our purpose, recent writings by Robert Baldwin (1982, 1985a). Baldwin reminds us that protection is often less than appearances would suggest, because there are many ways in which exporting countries can get around it and continue to increase their export earnings:

Consider the response of exporting firms to the imposition of tighter foreign restrictions on imports of a particular product. One immediate response will be to try to ship the product in a form which is not covered by the restriction. . . . One case involves coats with removable sleeves. By importing sleeves unattached, the rest of the coat comes in as a vest, thereby qualifying for more favorable tariff treatment. . . . The use of substitute components is another common way of getting around import restrictions. The quotas on imports of sugar into the United States only apply to pure sugar, defined as 100 percent sucrose. Foreign exporters are avoiding the quotas by shipping sugar products consisting mainly of sucrose, but also containing a sugar substitute, for example, dextrose. . . . At one time, exporters of running shoes to the United States avoided the high tariff on rubber footwear by using leather for most of the upper portion of the shoes, thereby qualifying for duty treatment as leather shoes. (page 110)

15. We economists always worry about getting our counterfactual scenarios right; without a yardstick, we are paralyzed. There is an apocryphal story about an economist who, when asked "How is your wife?," replied: "Compared to what?"

16. This puzzle was first noted by Hughes and Krueger (1984), in the context of developing countries' exports.

The ineffectiveness of trade barriers is even more apparent in the case of voluntary export restrictions and similar *export*-restraint arrangements than in the case of import tariffs. In choosing them in preference to tariffs sanctioned by Article XIX, the negotiating countries may well have opted for the least damaging way of responding to protectionist demands that could not be successfully rejected outright. I have recently argued (Bhagwati 1986, 1987) that some industries (e.g., footwear) seem to have two characteristics that lend support to this "VERs as porous protection" model as an explanation of why the trade-destroying effect of protection may have been contained:

- Undifferentiated products (such as the cheaper varieties of garments and footwear) are easy to "trans-ship"—that is, to cheat on the rules of origin by passing off products of a country restricted by VERs as products of countries not covered by VERs.

- Low start-up costs, and the attendant small recoupment horizons, facilitate the shifting of investments (and hence of products) to adjacent countries not covered by VERs, so that an exporting country can—at some cost—get around VERs by "investment-shunting" of its firms to sources unaffected by VERs.[17]

In such industries, voluntary export restraints can yield a "close to free trade" solution for the exporting countries that are afflicted by them. These countries can continue to profit from their comparative advantage by exploiting—legally (through investment-shunting) and illegally (through trans-shipment)—the fact that VERs do not apply to "third

17. This strategy allows the exporter to recover his investment costs, since it is usually some time before the VERs are extended to cover these alternative sources (or until the VERs are eliminated as the political pressure subsides, as happened in the case of U.S. footwear imports).

countries," whereas importing-country tariffs do.[18] The complaisance of the VER-afflicted exporters in regard to having VERs imposed (rather than being hit by import tariffs, as GATT Article XIX requires) is, therefore, easy enough to understand.[19]

But the question then arises: Why would the protecting importing countries prefer this "porous protection?" Does it not imply less protection than the industry would have under a corresponding import restraint? Indeed it does. But therein lies its attractiveness.

If a country's executive branch is characterized by the pro-trade bias I sketched above whereas its legislators must respond to protectionist pressure from various constituency groups, then it can be argued that a smart executive branch will prefer to use a porous form of protection that, while ensuring freer market access, will nonetheless appear to be a concession to political demands for protection from the legislators or from their constituencies. No doubt the protectionist constituencies and their legislative spokesmen will eventually complain about continuing imports; but then the executive branch will be able to cite its VER actions, promise to look into complaints and perhaps bring other countries into the VER net, and continue to obfuscate and buy time

18. Of course, the VERs in this instance represent only a partial and suboptimal approximation to the free-trade solution, which remains the desirable but infeasible alternative. Moreover, not all exporting countries are capable of the flexible and shrewd response that underlies the model of porous protection sketched above.

19. In the case of *effective* VERs, on the other hand, trade would indeed be restricted and we could not explain why trade would grow despite VERs. In these cases, however, the transfer of rents (on scarce imports) from the importing to the exporting country generally follows under VERs relative to import tariffs, and this too can provide a reason for their appeal to the exporting countries. For theoretical analyses of this rent-transfer rationale for VERs, and qualifications to it, see Brecher and Bhagwati 1987 and Dinopoulos and Kreinin 1987a.

without effectively protecting.[20] The nontransparency of VERs then is an advantage, not a hindrance, to the continuation of relatively free (although not free and undistorted) trade as long as the obfuscation does not become apparent before the industry has adjusted to the fact of effective foreign rivalry.

I do not put forth this view out of complacency about the growth of these discriminatory trade restraints. If they were to become an enduring trade regime, we would indeed have shifted to a fix-quantity system for overseeing international trade, in contradiction to all that good Economics implies. That was the apprehension of Jan Tumlir, who long guided the GATT Secretariat with distinction.[21] He feared, in fact, that the fix-quantity regime was already here. I am suggesting a more benign perspective on these practices: that they indicate the ingenuity and vigor with which governments have striven to maintain a pro-trade bias in the face of a difficult resurgence of protectionist pressures in the last decade.

This benign assessment still leaves open the question of how the institutions should be changed to prevent these practices from acquiring long-term legitimacy and undermining the fix-rule trading system. I shall turn to this in a later chapter, after examining the changes in the world economy that, through their effects on interests, bear on the question of protectionism.

20. This "two-headed" version of governments underlies the Feenstra-Bhagwati (1982) model of the efficient tariff, which postulates that one branch of the government (pursuing special interests) interacts with a protectionist lobby to enact a political-economy tariff. Then another branch of the government—pursuing the national interest—uses the revenue generated by this tariff to bribe the lobby into accepting a less harmful tariff that nonetheless leaves it as well off as under the political-economy tariff.

21. See Tumlir 1985.