THREE

The Politics of Protectionism

The repeal of the Corn Laws in 1846 symbolized the abandonment of mercantilism and the advent of the golden age of British free trade. Although by no means constituting complete free trade, British trade policy became the closest approximation to it that the world had yet seen.[1] The British example also contributed to a general decline of protectionism that occurred throughout Europe during the middle of the nineteenth century.[2] But from our historical vantage point, we can see that this change was neither complete nor permanent; instead, it was only one phase of the continuous cycle in which trade policy oscillates between relatively free and relatively protectionist.

Cycles of Global Mercantilism and Liberalism

By the last quarter of the nineteenth century, the pendulum was already moving the other way, and during the 1930s, Britain was carried with the rest of the globe into a frenzy of protectionism that reduced global trade by two-thirds with average tariff rates reaching 45 percent, not far from their peak prior to 1820. The cycle began again after World War II with a global movement back toward free trade led by the United States. Signs that mercantilist sentiment is again gaining strength have appeared since the late 1980s, but trade levels have continued to rise, fueled by explosive growth in the export-oriented economies of Asia that are the subject of chapter seven. Indeed, by the end of the twentieth century, international trade and investment has reached a level that leads many liberals to celebrate the death of mercantilism and conclude that globalization is irreversible. They would do well to recall that the historical record casts doubt on any judgement of permanent resolution of the dilemmas of trade.

In this chapter, I seek to explain this cyclical pattern by returning to the central analytic question of why nations select the foreign economic policies they do. The case of the decline of British liberalism in the late nineteenth and early twentieth century is an especially intriguing one because, for the most part, nineteenth-century free trade delivered on the promises of liberal theory. With barriers to trade rapidly declining, trade volume increased and total economic output grew with it. Despite the dire predictions of landowners during the Corn Laws debate, even English agriculture thrived until the 1880s. In part, this was a tribute to the magic of the market celebrated by liberal theory: English agriculture, facing foreign competition, became more efficient, especially through the application of agricultural science and mechanization.[3] But eventually the expected flood of imports did undermine English agriculture. By 1892, British importation of wheat and flour had grown to nearly ten times its volume in 1846, constituting nearly three-quarters of domestic consumption.[4] As grain prices fell, English landowners shifted land out of agricultural production and the volume of English arable land diminished by almost half.

Thus, exactly as predicted by liberal theory, free trade brought about an economic restructuring based on comparative advantage. Britain ceased to be self-sufficient in food as the comparative advantage of American farmers derived from superior factor endowments (richer farmland) dictated the shift of English production away from agriculture. Meanwhile, Britain experienced a rise in the production and export of the manufactured goods in which it had a comparative advantage by virtue of its abundant capital endowment and its technical superiority over foreign manufacturers.

But if the claims of liberal theory were validated by the growth of the British economy, the doubts of protectionists persisted and, indeed, eventually emerged triumphant again. The tensions between mercantilism and liberalism cannot be resolved by the temporary victory of one over the other because neither can satisfy the objections implicit in the dilemmas of trade. In fact, the cyclical character of these alterations are rooted in the excesses of each approach: As policy moves toward the pure form of either mercantilism or liberalism, trade dilemmas become more starkly perceived and inevitably draw a reaction that reverses the sweep of the pendulum.

At the core of these policy reversals are changes in economic conditions, political forces, and social ideas, all of which influence how the dilemmas of trade are perceived by different groups and different nations. In the following sections, the retreat from pure liberalism in Britain is explained in terms that provide the lessons needed to understand contemporary instances of the competition between free trade and protectionism. First, the triumph of laissez-faire ideas brought a theoretical and political reaction that sharpened the confrontation between the alternative values underlying mercantilism and liberalism. Second, the very economic development engendered in part by liberalism transformed the political power balance in Britain by reconstituting its class composition and governmental structure. The resulting political landscape contains the basic forces that compete for control over trade policy in the advanced industrial democracies of our own era. Third, the rapidly growing global economy altered the power balance among nations, thus changing attitudes toward trade in ways remarkably similar to the shifts we see at the end of the twentieth century.

THE REACTION TO LAISSEZ-FAIRE

Even while free trade emerged in the middle of the nineteenth century, key parts of the edifice that supported it were already crumbling. In particular, the leading theoretical challengers to the doctrine of economic liberalism were being born at almost the same instant that the repeal of the Corn Laws in 1846 signaled its highest triumph. The greatest of the neomercantilist works, *The National System of Political Economy,* was written in 1841 by Friedrich List (1789–1846). Karl Marx's (1818–1883) influential critique of liberal capitalism, which first appeared in *The Communist Manifesto* in 1848, was the forerunner of modern socialism.[5] Both reflected the reemergence of trade dilemmas, in the form of skepticism about the distributional consequences and the ethical basis of markets.[6]

The triumph of free trade in the nineteenth century followed from social and economic theories claiming that markets produced economically efficient and ethically acceptable outcomes. However, by the twentieth century, the limitation of markets and the ethical, social, and political dilemmas they produced were coming into even sharper focus. At the forefront was the continuing development of the factory system that emerged from the

Industrial Revolution.

Early in its evolution, there was little regulation of the industrial production process, especially with regard to the treatment of labor. It became apparent, however, that total reliance upon the market and total absence of governmental regulation had severe social ramifications. An excess supply of labor, signaled by high unemployment rates, drove wages near or beneath subsistence levels in conformity with the theoretical **iron law of wages**. Even factory laborers who worked twelve- to sixteen-hour days in miserable working conditions frequently lived in poverty. The market forces that held down wage rates were given free rein by labor laws highly favorable to capitalists, especially the notorious Combination Acts of 1799. These laws made it illegal for workers to act together in pursuit of economic interests: Trade unions were banned, strikes were outlawed, even holding meetings among workers was prohibited.

In this atmosphere, supply and demand for labor yielded abhorrent outcomes that undermined the legitimacy of the market. The exploitation of labor, including children, was rampant. Unregulated until 1819, the child-labor practices of that era were widely condemned, though they are a more grievous affront to modern sensibilities than to the standards of that age. The child-labor law of 1819, which was strongly opposed by capitalist interests, prohibited children eight and under from employment in cotton mills and limited those between nine and sixteen to twelve-hour days. Even after these prohibitions, children thirteen and under represented about 15 percent of the workforce in cotton and wool mills and nearly 30 percent in silk mills. In unregulated industries (that is, all but textiles), children as young as five or six years of age were frequently employed, sometimes as many as sixteen hours a day.[7] Women were not restricted to a twelve-hour day until 1844, and working hours for adult men were not regulated until 1908.[8]

These were the conditions that bred attempts to formulate an alternative ethic to that of the unbridled market. With the eclipse of an ethical theory rooted in medieval religious thought, workers sought an alternative source of protection from the vagaries of labor markets and the avarice of capitalists. They found it in the form of government regulation driven by increasing political power for the working class and informed by an economic and social theory—socialism —whose vision of economic life directly opposed that of economic liberalism.

Socialist ideas ranged from those of Robert Owen and Karl Marx to more moderate attempts to find a balance between the state and the market. The latter find expression in the British Labour Party and the various social democratic parties of Western Europe, which ushered in the mixed economy familiar to the twentieth century. Perhaps Joseph Chamberlain, a turn-of-the-century British cabinet member, put best the evolving understanding of the role of government and its place in regulating the market: "Government is the only organization of the whole people for the benefit of all its members; and the community may and ought to provide for all its members benefits which it is impossible for individuals to provide by their solitary and separate efforts."[9] It is no coincidence that Chamberlain was a leading figure in the movement to abandon free trade: Doubts about the legitimacy and efficacy of markets in the domestic sphere could not help but weaken the case for reliance upon markets in the conduct of international trade.

Similar concerns about the propensities of unregulated markets to yield undesirable outcomes, especially in labor markets, haunt less developed nations today. Horrible working conditions among unskilled workers in poor countries are often ascribed to the competitive pressures of international trade. However, the absence of government regulation of domestic markets, especially in non-democratic political systems, clearly plays a major role as well, because most developed nations are at least as open to international trade without suffering these same excesses. The theoretical lesson is that free trade is difficult to evaluate in a vacuum because its effects are not universal and invariant, but rather vary from one nation to another. In fact, the post-World War II Western European experience--where the welfare state grew in step with the expansion of international trade--suggests a fundamental contradiction in the prescription of liberal theory: To achieve a balanced resolution of the value and distributional dilemmas, *free* markets in international trade may well require *regulated* markets in the domestic economy.

The reaction against laissez-faire was not based solely on normative considerations, of course. The experience with unbridled capitalism, particularly during economic downturns, had also eroded faith in the efficiency of markets. Alternative economic theories, most notably the market-interventionist views of John Maynard Keynes, challenged liberalism as an article of faith. His argument on behalf of an enhanced role for government spending to restore equilibrium and full employment has been influential in many countries, including the United States, since the 1930s. He also favored tariffs, international cartels, and state trading, all anathema to liberal theory.

THE RISE OF THE WORKING CLASS AND POLITICAL DEMOCRACY

Of course, social and economic ideas attain practical importance only when tied to political forces that can bring them into play. In the case of the reaction against markets in general and free international trade in particular, the catalyst was a growing, partially organized working class within the context of an evolving democratic political system.

An important consequence of the Industrial Revolution was the creation of a new and self-conscious social class, that of industrial labor. Because the increased scale of production led to the demise of the artisan and apprenticeship system and because the decline of agriculture limited employment possibilities in the rural sector, workers became completely reliant upon the market for industrial labor. The political arrangements of the period were such that the labor market was rigged in favor of business: Owners were permitted to collude in order to hold wages down, but workers could not organize to push them up. Together with the poor working conditions and generally low wages, this led workers to a feeling of alienation from capitalists and solidarity with labor. The result was a growing trade union movement that eventually was to transform the political structure of society. The act of 1825, which legalized trade unions solely for the purpose of regulating hours and wages, was the beginning of a steady advance in the power of organized labor and a broadening of the political role of trade unions.

These developments occurred within the context of a political system that was slowly moving toward modern democracy through the expansion of the franchise. Controversies over the right to vote extend back at least to the Reform Bill of 1832, which broadened suffrage somewhat to encompass much of the growing capitalist middle class.[10] Nonetheless, working-class support was critical to passage of the reform bill, as workers became persuaded that parliamentary reform would weaken the legislative stranglehold of the wealthy minority of landed interests. As anticipated, this reform did eventually aid the repeal of the Corn Laws. Many had also hoped that the reform bill would be a steppingstone to their own enfranchisement. Although progress was slow, the working class did eventually achieve the franchise, with the first step being the doubling of the electorate from about 1 million to 2 million via the Reform Bill of 1867, sponsored by Benjamin Disraeli, head of the landed-gentry wing of the Conservative Party. In 1884, rural workers were added to the electorate, again doubling its size. In 1918, universal suffrage was finally granted to males over the age of twenty-one and females over the age of thirty. In

1928, that age gap was removed.

By the early twentieth century, these twin developments—the emergence of political democracy and the growth of labor unions—had come together to institutionalize political representation for the working class. The Labour Party was formed in 1900 by representatives of labor unions in concert with a group of intellectuals known as Fabian socialists. The latter included the noted writers George Bernard Shaw and H. G. Wells. By 1906, Labour had won fifty seats in Parliament and was well on its way to becoming one of two dominant political parties. Together with the declining political importance of landowners that resulted from the declining economic importance of agriculture, this development marked the beginning of a new era in British politics. The sectoral cleavage between industry and agriculture receded in importance, and the British political system came to be defined by the cleavage that is the mark of all modern political economies: a party of the right self-defined as pro-business and a party of the left self-defined as pro-labor.[11] It is tempting to define the resulting right to left continuum on politico-economic issues as lying between the extremes of complete trust in the market and complete trust in the state. Although this perspective contains some truth, it is a dangerous oversimplification, particularly concerning trade policy, because labor has sometimes been committed to free trade and business has sometimes preferred protectionism.[12] However, the growth of democracy and increasing power for the working classes certainly ensured that national policies would respond more vigorously to the perspectives of labor on the distributional dilemma than they had a century earlier. In any case, from this time forward, distributional issues centering on class— especially the primacy of unemployment as an economic problem— were as prominent in trade policy debates as those centering on economic sectors or geographic regions.

This is not to say that capitalists and workers were always in disagreement over trade policy. To the contrary, it is precisely their broad agreement in Britain until World War I that sustained free trade. Furthermore, the successful movement toward liberalizing trade in Europe after World War II was also the product of agreement between business and labor, this time as part of an implicit bargain in which both could expect to be rescued from the vagaries of trade by a Keynesian welfare state. Businesses were mollified by an activist state that could counteract the most disruptive consequences of trade by using demand management techniques like counter-cyclical spending that would prevent the economy from succumbing to externally generated crises. A more powerful and ambitious state was also a helpful partner in forging competitiveness and profitability for a nation's firms, motivated by the recognition that in an open economy the national interest was promoted by success in international trade. For labor, a welfare state offered a social safety net to insulate workers from the employment insecurity implicit in relying upon the ever-changing condition of international markets. Unemployment insurance and other generous welfare benefits eased the pain of adjustment when the restructuring of the economy in accord with comparative advantage entailed job loss. Liberated from this most dire concern about foreign competition, workers were more easily persuaded by liberal arguments about the long-term aggregate benefits from freer trade.

Of course, no state policy can eliminate the fundamental dilemmas of trade nor erase the political controversy over alternative responses to them. After all, to perform these tasks, the Keynesian welfare state requires high levels of revenue--on average nearly 50% of GNP in western Europe--which necessitate high levels of taxation that please no one. This resolution of the values dilemma sacrifices higher disposal income for greater security and reduced inequality, a trade-off that surely appeals more to some than others. This resolution of the distributional dilemma also shifts income from many segments of society to recipients of state aid, never a non-controversial action. Indeed, in the U.S., where different value priorities and a different distribution of political power shapes policy, the state plays a much smaller role in ameliorating the impact of international trade.

Still, even this happy, if limited, coincidence of interests depends centrally upon the existence of a state that can be trusted to play its role in protecting the interests of both capital and labor. This, in turn, depends upon a rough balance in the political power of these two groups within a political system that grants each a voice in shaping government policy. These conditions did not exist prior to the emergence of political democracy and working class representation in western Europe near the middle of the twentieth century. They do not exist today in the contemporary Third World. Thus, the relative political power of capital and labor continue to determine the shape of trade policy whenever conditions in international markets cast them into opposition to one another. Then their mutual opposition stems from the different stake that capital and labor have in trade. These distributional effects of trade can be seen with clarity only in the context of modern international trade theory, a topic to which I now turn.

MODERN ELABORATIONS OF LIBERAL TRADE THEORY

Since Smith and Ricardo, liberal theory has consistently advocated free trade, but its foundation has been elaborated and strengthened by subsequent theorists, especially Eli Heckscher and Bertil Ohlin, two Swedish economists of the 1930s. The Heckscher-Ohlin theory, abbreviated H-O or sometimes H-O-S to acknowledge the role of the American Nobel Prize–winning economist Paul Samuelson in advancing it, is important to us for two reasons. First, it reinforces free trade doctrine by specifying the precise economic conditions that constitute the sources of comparative advantage. In so doing, H-O clearly accepts the liberal tenet that governmental intervention is not required to steer the market to the gains from trade. Second, and more immediately, H-O leads directly to the Stolper-Samuelson theorem (explained further on), which exposes the class basis of the distributional effects of free trade. These distributional effects help to explain why contemporary controversies over trade policy, such as NAFTA, tend to follow a characteristic pattern in which some classes and sectors prefer free trade while others prefer protectionism.

Ohlin's classic work *Interregional and International Trade* remained squarely in the liberal tradition, but it advanced Ricardo's analysis by specifying in greater detail the sources of national comparative advantage. In the context of a simple economy, the early formulations of Smith and Ricardo were understandably rudimentary: They emphasized natural advantages such as climate or soil quality and acquired advantages such as specialized skills in weaving or metalworking. Ohlin went beyond these simple ideas to argue that a nation's comparative advantage lies in the relative abundance of some **factors of production** and the relative scarcity of others.

To reach this conclusion, he began by improving upon the simple labor theory of value that Ricardo used to demonstrate the gains from trade. Whereas Ricardo described the differences in the productive efficiency of a nation's industry solely in terms of the amount of labor required to produce any given level of output, Ohlin noted that production actually requires at least three factors of production: land, labor, and capital. All products require some quantity of each factor, but the proportion of each varies widely depending on the nature of the product and the processes used to produce it. For example, agricultural goods require large amounts of land (thus, they are dubbed land-intensive); heavy manufactures such as autos are considered capital-intensive because they require such large quantities of expensive plant and equipment; and light manufactures involving simple assembly or processing are labor-intensive because they rely on large numbers of unskilled workers. Ohlin claimed that differences in the factor intensity of various products would determine where they could be produced most efficiently.

Just as products differed in their factor intensities, Ohlin also observed that different nations possessed vastly different factor endowments. In the modern era, for example, capital is relatively abundant in the developed countries (such as the United States, Japan, and Western Europe), land is abundant in countries such as Canada and Australia, and unskilled labor is abundant in countries such as Mexico and the poorer nations of East Asia. Ohlin further reasoned that production of goods that used intensively any particular factor would naturally be more efficient in nations that possessed a relative abundance of that factor. Thus, land-abundant nations, for example, will have a comparative advantage in land-intensive products and capital-abundant nations will have a comparative advantage in capital-intensive products.

This theory of factor proportions and factor intensity perfectly explained Ricardo's classic example of British specialization in manufactured goods and Portuguese specialization in wine. Britain, with abundant supplies of capital, had a comparative advantage in the production of capital-intensive products, and Portugal, with its abundance of good land for the growing of grapes, had a comparative advantage in wine. Moreover, Ohlin's theory had broader application because it could be used to identify which nations would have a comparative advantage in which products: *Each nation has a comparative advantage in the production of those goods that use intensively the factor they possess in relative abundance.* It also was in accord with simple observations of the trade patterns among nations: Developed countries tend to export capital-intensive products while they import food from land-abundant countries and simple manufactures from labor-abundant countries.[13]

At the heart of this theory is the interaction between markets for final goods and the markets for the factors required for their production (land, labor, and capital). For example, in nations where labor is relatively abundant and land relatively scarce, the surplus supply of labor will cause wage rates to be relatively low, and the short supply of land will cause land rents to be relatively high. That is precisely why labor-intensive products are cheapest to produce in nations with an abundance of labor.

For our purposes, the consequences of trade are as important as its causes, and in this respect the contribution of H-O to understanding the interaction between goods and factor markets also is significant. That is because the distributional effects of international trade depend directly on how trade affects the supply and demand for the various factors of production.

THE DISTRIBUTIONAL DILEMMA: THE IMPACT OF TRADE ON CLASS

To see how factor markets shape the distributional effects of trade, let us return to Britain at the time of the Corn Laws and stipulate that it is relatively abundant in capital and relatively scarce in land. That would imply that capital should be relatively cheap and easy to acquire in Britain and that land would be relatively expensive. If that is so, Ohlin would expect that Britain would be a relatively efficient producer of capital-intensive products such as manufactures but a relatively inefficient producer of land-intensive products such as grain. That seems to accord with the historical record of what happened when Britain adopted free trade: It became an importer of (land-intensive) grain and an exporter of (capital-intensive) manufactured products. Britain's food imports came largely from the United States, Canada, and Australia, all of which were abundantly endowed with land. Their manufactured exports went to nations with a relatively poor endowment of capital, including the land-abundant grain exporters.

But what were the effects of free trade on factor markets? The answer defines the distributional effects of free trade. We know that free trade led to the expansion of British manufacturing. That expansion required a considerable increase in investment in plant and equipment, which in turn increased the demand for capital. The owners of capital found that greater demand enabled them to charge a higher interest rate to manufacturers who wished to borrow capital to expand their facilities. That is, the increase in the production of capital-intensive products increased the return on capital. This result can be stated more generally as the first half of the Stolper-Samuelson theorem: *Free trade benefits the owners of the abundant factor of production.*

At the same time, the repeal of the Corn Laws caused domestic production of grains to decline in the face of foreign competition and the lower grain prices it engendered. With grain production less profitable in Britain, British landowners had to lower the rents charged to farmers to use their land; otherwise those farmers could not compete with foreign imports. British landowners, owners of the scarce factor of production, lost from free trade. Thus, the second half of the Stolper-Samuelson theorem: *Free trade harms the owners of the scarce factor of production.*

The political corollary to Stolper-Samuelson is now simply seen: Owners of the abundant factor of production will prefer free trade; owners of the scarce factor of production will oppose it. Because of this, debates over free trade frequently involve class divisions and in a political system with class-based parties—that is, all modern advanced industrial democracies—trade policy frequently becomes a highly partisan issue.

The Distributional Politics of Trade Policy

We can now state more clearly the distributional dilemma of trade and the resulting political patterns that emerge in the debate over trade policy. These distributional effects—that some groups gain from free trade while others lose—can be described along three lines: economic sectors, socioeconomic classes, and producers versus consumers.[14]

Those sectors of the economy that rely upon exports will ordinarily favor free trade, especially if the firms involved are relatively efficient by international standards. Those sectors of the economy that compete against foreign imports will ordinarily favor protectionism, especially if the domestic firms are relatively inefficient. Sectors of the economy that utilize imports or import substitutes will, like any ordinary consumer, favor free trade because it is likely to lower their costs.

How individuals will react to these sectoral effects can be difficult to predict. Liberals urge most workers to ignore these considerations because they contend that any factor of production—including labor—that can no longer find productive employment in a sector damaged by free trade can simply shift to a sector that benefits from it. Protectionist sentiments arise from concerns about the costs and uncertainties involved in these sectoral transitions. For some, the transition costs are exorbitant because their highly specialized skills are adapted to a particular sector. Few middle-aged steelworkers are also skilled computer programmers, for example. Others find that personal circumstances such as the employment of a spouse or reliance upon family reduces geographic mobility. Nearly all will face temporary unemployment. Many may be averse to the risk that is inherent in predicting the uncertain future course of comparative advantage. For example, at one time England was a low-cost producer of grains, though by the time of the last

Corn Law its comparative advantage had shifted elsewhere. An alert worker, observing this shift, might well question where and when the next change might take place. Indeed, by the middle of the nineteenth century, the comparative advantage in textile production, the earliest and largest of the English manufacturing industries, was also beginning to shift away from England. Thus, protectionism can be comforting to workers who, though currently employed in a competitive industry, fear that they may be next to be displaced. This risk element helps explain why protectionism can be sustained politically even when it appears to benefit so few and harm so many. This argument carries even more weight in the modern era of more rapidly changing comparative advantage.

However, Stolper-Samuelson suggests that both these liberal and protectionist views will remain incomplete so long as they focus on the sectoral composition of the economy. Instead, a class perspective may be more appropriate because trade policy affects the owners of different factors of production very differently: Free trade benefits owners of the abundant resource and harms owners of the scarce resource. For example, since the United States is capital-abundant and labor-scarce relative to the rest of the world, Stolper-Samuelson predicts that wage rates for unskilled labor will decline under free trade just as the profit rates for capital will increase. This explains why American labor unions opposed NAFTA and protested the expansion of the WTO, whereas multinational corporations supported both.

Predicting the responses of individuals is further complicated because workers are also consumers—and their interests in these roles are often contradictory. Liberal trade theory emphasizes that consumers benefit from free trade because they can purchase goods more cheaply from those countries that have a comparative advantage than from inefficient domestic producers. From this vantage point, one would expect that consumers would be a major actor in the distributional politics of trade policy; indeed, they should be the strongest advocates of free trade. In fact, they usually are not.

There are several reasons consumers are seldom effective advocates of free trade. First, the costs of protectionism are ordinarily difficult for consumers to see because the trade barriers that affect the prices of foreign goods are not easily visible. Readers are invited to test this proposition for themselves: Can you identify the tariff rate presently imposed on *any* product by the United States?

Second, even if tariff costs were precisely known, they are seldom large enough to motivate any single consumer. For example, trade barriers in the textile and clothing industries are among the highest in any sector of the U.S. economy, yet they probably increase the price of clothing in the United States by under $100 per person per year.[15] Is this impact on your personal budget enough to persuade you to hire a Washington lobbyist to overturn the Multi-Fiber Agreement, which sustains these trade barriers?

Third, because those hurt by protection are geographically diffused and only marginally affected by trade legislation, they are unlikely to organize very effectively to press for free trade. By contrast, because those who benefit from protection tend to be geographically concentrated and intensely affected by trade legislation, they are much more likely to organize effectively and use their political influence to achieve protection. For example, the Multi-Fiber Agreement provides $22 billion in benefits to U.S. domestic firms that employ more than 2 million American workers. Those firms and their employees have far greater motivation and opportunity to lobby in favor of protectionist trade policies than consumers have to oppose them.

All of these factors are commonly present in debates over trade policy, and they help explain why consumers were not in the forefront of the drive for repeal of the Corn Laws. However, for several reasons, consumers were actually a stronger force in opposition to the Corn Laws than is common in trade policy controversies, a fact that helps explain both why free trade achieved a rare triumph in 1846 in Britain and why it later faded.

Because the free trade issue was fought out over food, the welfare effects of the Corn Laws were much more visible than is usual for protectionist legislation. Since food occupied the largest share of the budget in most households and since imports constituted a significant share of food consumption, citizens were unusually attentive to the factors that influenced the price of imports. Thus one key to the emergence of free trade in England at this time is the unusually visible effect of the Corn Laws on an unusually large share of the population. Because the stakes were so large, so immediate, and relevant to so many, political action was easy to organize.

By the twentieth century, trade policy debates in Britain ceased to revolve around food prices, so consumers ceased to be a major factor in them. In most modern developed democracies, class-based political parties have been the major protagonists in the battle between free trade and protectionism. In most of those battles, the outcome is driven by the condition of markets, especially the relative efficiency of domestic and foreign producers.

The Effects of Market Dominance and Decline

When an industry is confident that it is able to compete effectively against foreign manufacturers, it typically advocates free trade. An industry in doubt about its competitiveness seeks protection or subsidy. Workers ordinarily follow the lead of the industry in which they are employed; other citizens usually follow the industry dominant in their region. Thus it is for nations in aggregate: Liberal policies will suffice when a favorable balance of trade can be maintained without actions that encourage exports and discourage imports. Protection is the preferred policy when balance-of-trade difficulties signal declining competitiveness. That pattern was perfectly manifested in the period we have been considering.

Until the middle of the eighteenth century, the productive efficiency of British industry was not superior to that of its continental competitors. Indeed, in some important areas it lagged behind such early leaders as the Dutch. As we have seen, the government responded as early as the sixteenth century by encouraging the growth of key industries with a variety of subsidies, legal monopolies, and trade restrictions. Moreover, English manufacturers who lacked *economic* advantages over foreign competitors generally supported the measures that gave them *political* advantages: the colonial system, the Navigation Acts, and the great trading companies that monopolized trade with the colonies; the import barriers that enabled them to develop infant industries; and the restrictions on exports of raw materials, technology, and skills designed to retard the development of competitors abroad.

However, the technological advances of the Industrial Revolution came a generation earlier to England (circa 1760) than to its continental competitors, giving British producers a natural competitive edge against others by the early nineteenth century. When English manufacturers became confident of their ability to compete successfully with foreigners on economic terms alone, they gave up their own tariff protection in exchange for the repeal of the Corn Laws.

Thus, it is no surprise that free trade was adopted more completely and for a longer period in Britain, the dominant economic power, than in any other nation: Competitive industries do not need protection, so the governments that represent them oppose it. Still, even Britain encountered protectionist movements during economic downturns, first the

Fair Trade movement of the 1870s and then the Tariff Reform crusade of 1903, but unlike the less competitive nations of Europe, it retained its free trade orientation. The Great Depression of 1873–1896 produced increasing protectionism throughout Europe as nations sought to defend employment and profits, especially against the competition of the British. Thus in the 1920s, Britain still maintained among the lowest tariff barriers in the world. By the end of the 1930s, however, when the end of Britain's economic dominance left it unable to resist the global move toward protectionism, Britain had become as protectionist as any.

In the twentieth century this pattern remains clearly visible: The economically dominant nation advocates free trade, but challengers opt for mercantilism. Immediately after World War II, the United States, by then the most productive and cost-efficient economy in the world, took up from the British the mantle of the leading champion of free trade. Both Japan and most of Europe, recovering from the war, adopted a sharply mercantilist stance.

By the 1990s, the positions had changed again. The policy of the United States, whose share of world exports declined from 45 percent in 1950 to under 15 percent in 1997, has become increasingly protectionist (though its rhetoric remains mostly liberal). Moreover, the United States assumes very different stances with respect to different sectors of the economy. It is protectionist in declining heavy industries such as steel and automobiles in which it no longer enjoys a comparative advantage but adopts a very liberal position in those areas in which America still dominates, such as technology, services, and intellectual property.

Theorists have long contended that a policy of free trade may be beneficial for dominant nations but harmful for others. For example, List countered free trade doctrine on the grounds known to posterity as the infant-industry argument. It states that an industry in its early stages requires protection against its better-established foreign competitors. Only after it has benefitted from a protected domestic market can it achieve the maturity, efficiency, and **economies of scale** necessary to withstand foreign competition. Premature free trade will doom an economy to specializing only in those products the dominant power may choose to ignore, presumably because they offer little profit or limited growth opportunity.

List urged France to avoid free trade and the specialization in wine that would result from it. Because he doubted that wine production could fuel broad and diversified economic development, he instead advocated the creation of new French industries even though they would require tariff protection against established British firms until they matured. He noted that centuries earlier Elizabethan England had similarly emphasized developing infant industries in order to augment its agriculture and had similarly protected them. From our vantage point in the late twentieth century, we can add to the list of nations opting for this approach. A nearly identical choice faced the Japanese in the American-dominated post–World War II period. They too rejected free trade—and the specialization in textiles, their comparative advantage at the time, that it would have implied. Instead, Japan elected the mercantilist path of protecting the fledgling firms in its electronics and automobile industries.

Indeed, this gap between the rhetoric of the dominant nation and the self-interest of its challengers has produced more than a little bitterness. For example, in this passage, List wrote powerfully in defense of the proposition that free trade is the policy of the dominant power and protection is the policy of the challenger:[16]

> It is a vulgar rule of prudence for him who has reached the pinnacle of power to cast down the ladder by which he mounted t
> follow. In this lies the secret of Adam Smith's theory,... as well as all of his successors in the government of Great Britain. A n

protective duties and maritime restrictions has built up a manufacturing industry and a merchant marine to such a point of str not to fear the competition of any other, can pursue no safer policy than to thrust aside the means of elevation, to preach to o advantages of free trade, and to utter loud expressions of repentance for having walked hitherto in the way of error, and for h to the knowledge of the truth.

Although considerations of relative efficiency suggest that nations will choose quite different trade policies, specific historical events will often cause nations to respond more similarly. Indeed, both the dramatic collapse of trade in the 1930s and the rise of liberal trade in the 1940s were global phenomena.

Trade and the Great Depression

The collapse of the global economy during the 1930s affirmed an important lesson: Liberal theorists advocate free trade even if a nation must adopt it unilaterally, but its greatest benefits can occur only if liberalism is practiced by all nations. The experience of the Great Depression reveals both an economic and a political reason for this.

The economic reason stems from the simple fact that one nation's exports must constitute another nation's imports. Since no nation can export unless another imports, free trade cannot be fully effective unless all nations approximate this ideal at the same time.

Parnell's role in the Corn Law debates also suggests a political reason that unilateral free trade policies are very difficult to enact: They impose painful adjustments that will be strongly resisted without assurance that other nations are experiencing similar disruptions. This demand for reciprocity is partly a natural psychological reaction against free riders who enjoy the open markets of others but refuse to open their own. After all, no nation wants to be taken advantage of any more than individuals do. Moreover, the cost of adjusting to free trade will exceed the benefits unless a substantial expansion of trade results, which cannot occur unless other nations reciprocate.

As a result, both free trade and protectionism usually occur as global processes. One dominant nation that champions free trade can sometimes induce others to follow suit, as happened under the leadership of Britain in the middle of the nineteenth century and again under the leadership of the United States after World War II. But when one nation moves sharply toward protectionism, others also tend to follow—sometimes with disastrous consequences. That is exactly what happened during a sequence of events that led to the collapse of world trade during the Great Depression of the 1930s. And that is why, in the mid-1990s, some feared a trade war between the United States and Japan.

Though protectionist sentiment had familiar domestic roots, international politics fanned its flames after World War I. British protectionism focused on accusations that Germany was undermining its rivals by **dumping** iron and steel. Britain claimed that German steel companies were using unfair trading practices to drive British steel firms out of business. Coming soon after the war and in an industry critical to war planning, these claims received greater credence than now appears to be justified by the facts.[17] British tariffs were also motivated by the need to grant imperial preferences to members of the British Empire, which presupposes tariffs from which the empire would be exempted. In all countries, tariffs were said to be useful in strengthening the nation's bargaining position in dealing with other nations who practiced—or threatened—protectionism.[18]

These national security and reciprocity aspects of the state goals dilemma produced a spiral of protectionism with competitiveness issues at its base. Initially, severe unemployment triggered political pressures in several countries to save jobs, but the extreme protectionism that resulted had two dire consequences. First, it exacerbated the economic downturn itself by sharply reducing the gains from trade. Second, it goaded nations to increase their own protectionist policies in retaliation. European protectionism against the onslaught of competitive American firms had been building for years; the Smoot-Hawley Tariff, enacted by the United States in 1930, overwhelmed the last supporters of liberalism even in Britain.

After Smoot-Hawley, more than sixty nations retaliated directly against the United States.[19] The resulting global trade war produced a spiral of retaliation that cut trade further, and the political relations between nations continued to deteriorate. In 1930, 85 percent of goods had entered Britain free of duty, but by April 1932 only about 30 percent did so. Meanwhile, the average tariff level had reached 45 percent in the United States, 41 percent in Germany, 38 percent in France, and up to 70 percent elsewhere in Europe.[20] By 1935, 70 percent of global trade also was subject to nontariff barriers, mostly quotas.[21] In just three years global trade plummeted by 70 percent. The Great Depression and the global trade war fed on one another to produce the most devastating economic chaos of modern times.

Unemployment reached 22 percent in Britain and more than 30 percent elsewhere in Europe, America, and Asia. However, the consequences were not just economic. Unemployment exceeding 40 percent in Germany fueled the growth of Nazism, which in turn led to the outbreak of World War II.[22] Diminishing trade prospects strengthened militarism in Japan, which was already building toward a second locus of the coming global war. As economies nosedived, more than half of the republics of South America experienced revolts in 1930 or 1931. When unemployment in the United States grew from around 5 percent to more than 36 percent between 1928 and 1932, the popular vote for the Communist and Socialist Parties tripled. With unemployment constantly over 25 percent for nearly a decade—before the advent of unemployment insurance and other welfare programs to ease the burden—both the marriage rate and the birth rate declined by 25 percent in the United States.[23]

It must be emphasized that the Great Depression was not caused by protectionism: Many forces conspired to make the global economy of the 1920s vulnerable to a serious contraction.[24] Neither did global protectionism begin in the late 1920s: In fact, it had been on the rise for half a century. But protectionism did reach a frenzied peak at the onset of the 1930s, and the Great Depression was certainly deepened by the protection-inspired trade wars that followed.[25] Moreover, these events—the Great Depression, World War II, and the collapse of global trade— became so indelibly linked in the minds of policymakers in the 1940s that they created the Bretton Woods system, discussed in Chapter 4, in order to prevent a recurrence.[26] Their recent experience with depression and war made economic prosperity and international peace more compelling than alternative values such as national autonomy, employment security, and distributional considerations, which in other times had inclined nations toward mercantilism. Furthermore, ascendant liberal theory suggested that these values would be best achieved by practicing liberalism. As a result, they were frightened into constructing an international trade system built more upon multilateral liberalism than unilateral mercantilism.

CONCLUSION: THE SOURCES OF POLICY CYCLES

Classical mercantile trade policy evolved in response to existing conditions in the economy and foreign affairs, in tune with prevailing currents of social and economic theory, and in recognition of the realities of the distribution of power. By the middle of the nineteenth century, these foundations had crumbled—and liberalism was erected on the ruins. The process was repeated a century later when the chaotic protectionism of the 1930s yielded to the American-led liberal system of the 1940s and beyond.

It is striking that the two great liberal movements in modern times were both a response to the worst excesses of protectionism. It was the extreme and irresponsible Corn Law of 1815 that spawned a liberal reaction against the agricultural protection that had been sustained for centuries. Similarly, Bretton Woods was the product of **beggar-thy-neighbor** protectionism enacted in the 1930s as a mad drive to retain employment in desperate circumstances. It is doubtful whether a less radical protectionism could have so thoroughly discredited mercantilism, which in its sober, classical form had been well rooted in established values and consistent practice. Nor would a less severe implosion of the global system have generated the same enthusiasm for the supranational solution created at Bretton Woods.

Why Liberalism Was Overturned by the 1930s

1. State of theory

Government intervention was justified by socialist theory (because markets produce unethical outc Keynesian theory (to relieve unemployment).

2. State of markets

Even English producers feared foreign competition; market intervention by other governments bro retaliation.

3. Political power balances

Domestically, organized labor achieved power through democracy; globally, there was no dominant lead.

Of course, liberal policies are no more immune to changes in prevailing theories and values, conditions in markets, and domestic and international power balances than was classical mercantilism. Indeed, just as mercantilism’s inherent liabilities are most apparent when the state thoroughly dominates the market, liberalism is especially vulnerable when the market threatens to overwhelm the political functions of the state. Thus, liberalism was swept away in the 1930s when trade levels had reached historic highs, only to reemerge in altered form after World War II. After half a century of growth, trade has now surpassed those levels. Will the pendulum continue its swing?

Chapter Three endnotes

1. The average import duty tumbled from more than 50 percent in 1820 to 30 percent in 1846 and finally to under 10 percent by the 1870s.
2. See Charles Kindleberger, "The Rise of Free Trade in Western Europe," *Journal of Economic History* 35, 1 (1975).
3. Increasing demand for food was a greater factor, however, as the population grew from 9 million to 33 million during the nineteenth century.
4. Two-thirds of those imports came from the United States because of the advent of steam-powered shipping. In 1846, English farmers were largely insulated from American competition by transatlantic transport costs that added more than a third to the price of American grain in Britain, but by the 1890s, transport costs had fallen by 75 percent.
5. *Das Kapital*, published in 1867, was his classic statement on capitalism.
6. Given the conditions of the time, Marx himself was a free trader, but most subsequent Marxists have disagreed with him on this point.
7. E. Lipson, *The Growth of English Society: A Short Economic History* (New York: Henry Holt, 1950).
8. The regulation of industrial labor—especially the Ten Hours Act of 1847—was passed by a parliament still dominated by landed interests, partially out of revenge against industrial interests for their leading role in the demise of the Corn Laws.
9. Lipson, *The Growth of English Society*, p. 285.
10. Middle-class suffrage is not to be confused with working-class suffrage. Even after the Reform Act of 1832 increased the number of eligible voters by half, only about a seventh of the adult male population met the stringent requirements.
11.In the modern era, parties of the right include British Conservatives, American Republicans, and European Christian Democrats; parties of the left include British Labour, American Democrats, and European Socialists and Social Democrats.
12. For example, Labour was the party of free trade in Britain throughout the 1920s; it was the Conservatives who enacted the protectionist policies associated with the collapse of the trading system. Similarly, in the United States, Democrats were free traders and Republicans were protectionist during this key period.
13. The famous Leontief paradox shows that the United States after World War II did not fit the predicted pattern because American imports were more capital intensive than American exports. This paradox is hotly debated; most economists deny that the Leontief paradox constitutes a disconfirmation of Heckscher-Ohlin theory, arguing instead for a reformulation that encompasses other factors of production.
14. Geographic cleavages also occur, but these are largely the product of sectoral considerations.
15. See Gary C. Hufbauer, Diane T. Berliner, and Kimberly A. Elliot, *Trade Protection in the United States: Thirty-one Case Studies* (Washington, D.C.: Institute for International Economics, 1986).
16. Friedrich List, *The National System of Political Economy* (Philadelphia: J. B. Lippincott, 1956), p. 440.
17. Forrest Capie, *Depression and Protectionism: Britain Between the Wars* (London: George Allen and Unwin, 1983), chapter 4.
18. Armed with very steep tariffs enacted in 1931 and 1932, Britain did negotiate bilateral agreements with sixteen nations between 1932 and 1935 to improve British access to those markets. In the United States, the high Smoot-Hawley tariff of 1930 provided the leverage for eighteen bilateral treaties between 1934 and 1938.

19. John A. C. Conybeare, *Trade Wars: The Theory and Practice of International Commercial Rivalry* (New York: Columbia University Press, 1987), p. 241.
20. Michael Kitson and Solomos Solomou, *Protectionism and Economic Revival: the British Inter-war Economy* (Cambridge: Cambridge University Press, 1990), p. 4.
21. See Conybeare, *Trade Wars*, p. 242.
22. This was not unforeseen. The unsuccessful Labour campaign to retain free trade had cautioned, in vain, regarding the global consequences of rising British protectionism, asking, "Will the British people take the responsibility for the setting up of a fascist despotism in a Germany, driven to despair?" See Gerhard Kumleden, *The Workers' Case for Free Trade* (London: International, 1932)
23. Barry Eichengreen and T. J. Hatton, eds., *Interwar Unemployment in International Perspective* (Dordrecht, Netherlands: Kluwer Academic, 1988), chapter 1.
24. For a survey, see Charles Kindleberger, *The World in Depression 1929–1939* (Berkeley: University of California Press, 1973).
25. Recent scholarship suggests that protectionism played a smaller role in the economic collapse than was generally assumed at the time. For example, it has been estimated that Smoot-Hawley and the resulting retaliation from other countries cost the United States only 0.44 percent of GNP. See Lawrence Brunner, "The Effect of Trade Restrictions on the U.S. Economy in the Great Depression," paper presented to the American Economic Association, New York, December 1985 (cited in Conybeare, *Trade Wars*). Moreover, Kitson and Solomou, *Protectionism and Economic Revival*, contend that the British tariff of 1932 was actually beneficial to the British economy.
26. Recall that the explosion of protectionist and anti-Japanese sentiment of the early 1990s and President Bush's defeat in his 1992 bid for reelection were triggered by an American unemployment rate that never reached 8 percent.