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A U.S. DEPARTMENT OF TRADE---OR PROTECTION

INTRODUCTION

In response to pressure from politicians and businessmen, and despite widespread internal dissent, the Reagan Administration has proposed creation of a new cabinet-level Department of International Trade and Industry (DITI), the avowed purposes of which include "expansion of U.S. exports" and "reduction of overseas barriers (to U.S. firms)."[1] Like many administrations before it, the Reagan White House faces political problems on the trade front as international markets become more competitive, as domestic firms face greater competition from overseas firms, and as some domestic industries weaken because of changes in the economic environment. Recessions add considerably to these problems, and firms and workers hit hard by declining fortunes beseech Washington for various forms of aid. Trade protection is one of them.

Because the effects of trade policies vary from group to group, the voices heard by government on trade issues are mixed and often difficult to reconcile. They are nevertheless loud. The friction and confusion are reflected in the process of government itself, as these groups appeal to their respective patrons in Congress and in the bureaucracy. And while some government officials would love to rid themselves of such controversy, other officials, less harassed, covet new authority.

It is therefore not accidental that the particular circumstances of the times have produced a proposal by the Reagan Administration for an international trade department--or that the advocates of protectionism and other versions of industrial policy are so warm to the idea. But would it make society as a whole

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1 Statement by the President, June 1, 1983.

better off? Most unlikely: a DITI would tend to concentrate and focus the pressures for economic protection and governmental subsidies, have no aggregate effect on employment, and enlarge the government at a substantial net cost to the American economy.

THE ROLE OF ECONOMIC POLICY

The appropriate goal of economic policy is the maximum expansion of national wealth and productivity--that is, economic efficiency. This goal includes the promotion of such intangibles as environmental quality. While seemingly sterile, economic efficiency, as a goal, amounts to the quest for maximum satisfaction of human wants, given that not all such wants can be satisfied simultaneously. In short, economic policy should strive to make society better off as a whole; however, this may or may not be consistent with actions taken to improve the position (wealth) of particular groups.[2] The issue of the proposed DITI turns, then, on the analytic answer to the question: would a trade department improve the efficiency of overall economic activity?

IS THERE A SPECIAL TRADE PROBLEM?

Specialization is productive. For a myriad of reasons, different individuals, groups, and nations enjoy a comparative advantage (that is, lower costs) in the production of certain goods. Just as efficiency in resource use serves the overall interests of a given nation, so economic efficiency maximizes the productivity of the world economy.

This efficiency goal requires that goods be produced at lowest real cost, that is, by those able to produce them most cheaply. By minimizing production costs for a given good, more resources are left available for production of other goods, yielding greater overall productivity. In this regard, it should be noted that low wage rates in a given nation do not necessarily imply low costs per unit output; low wages may merely reflect low labor productivity. Shifting demands, technological advances, changes in relative prices, new resource discoveries, political events, and innumerable other factors change comparative advantages among nations for the production of goods. This is a never-ending process, and it is efficient for the world economy for economic behavior to change as circumstances change.

Inevitably, this dynamic process produces winners and losers. The winners are those upon whom changing circu stances have bestowed new opportunities for productive (that is, profitable)

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2 Furthermore, the goal of distributional equity, however defined, is consistent with the efficiency objective: a growing social pie yields more for redistribution purposes and clearly is the only environment consistent with upward mobility.

activity. The losers are those whose past investments in a particular activity have been rendered obsolete, or at least less valuable.[3] The losers are easily identifiable industries, laborers, and participants in related activities (such as suppliers). They are, in a word, concentrated, and a united appeal to government for a reversal of the effects of market shifts is relatively easy and politically persuasive.

These demands by losers for governmental aid combine with competition among politicians for votes in the democratic process to form the first source of the trade problem. Concentrated interest groups have a natural advantage in terms of lobbying for policies favoring their interests. They are easily identifiable, their interests are relatively clear. And members of such groups, particularly the large ones, have the incentive to engage in the lobbying effort rather than to wait for others to make lobbying investments. Industry trade associations provide a vehicle for such appeals.

Greater economic efficiency, on the other hand, accrues to the benefit of the whole decentralized economy, and the stake that any single individual has in a given efficient policy is trivial. Each individual, therefore, has an incentive to wait for others to lobby for efficient policies, just as on a windy day each homeowner has an incentive to hope for a "free ride" on the efforts of his neighbors to gather up the blowing newspapers. The democratic process, therefore, has a natural tendency to respond to the appeals of concentrated interest groups rather than to policy proposals yielding greater wealth for society as a whole.

Subsidies of various kinds by foreign governments may enable foreign producers to compete in world markets more effectively than they might without such assistance, thus placing U.S. firms at a competitive disadvantage.[4] This is a second source of the trade problem. U.S. firms often justify their efforts to obtain subsidies, in part, on grounds of unfair competition by foreign countries, regardless of the actual nature of the alleged foreign subsidies.

Finally, protectionist policies pursued by given foreign governments may reduce the ability of U.S. firms to compete in those foreign markets. Efforts to induce relaxation of such

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3 Note that this market reallocation process maximizes aggregate wealth, thus making everyone--with the exception of politicians, bureaucrats, and a few others--better off. Even those who lose because of a particular market shift are better off because of the operation of the process in all other markets.

4 Foreign governments are hardly the only sinners in this particular congregation. Export-Import Bank support, natural gas price controls, and other manifestations of governmental "benevolence" are forms of business subsidy in the U.S.

foreign restrictions through imposition of protectionist policies at home are a third source of the trade problem.

THE INEVITABLE BEHAVIOR OF A TRADE DEPARTMENT

The DITI issue hinges on the following questions. Is the trade problem in its various manifestations a problem for particular industries and interest groups or for society as a whole? Are specific government policies directed at the trade problem likely to yield net aggregate benefits? And if so, is a trade department the appropriate institutional framework in which to formulate and implement such policies?

Institutional Biases and Behavior

While it professes great foresight, Congress usually acts only after the manifestation of a crisis--itself typically the result of other government policies. The behavior of the bureaucracy is similar because it, too, finds it far easier to adapt to the past than to the unknown future. It is therefore natural and inevitable that, as the economic environment changes, government policy tends to subsidize losers, who are visible, instead of winners, who only emerge after a time lag.[5] The potential winners often are not known, even to themselves; the losers, in contrast, usually are established, concentrated industries or interest groups, enjoying entrenched political advantages.

The DITI, therefore, would be driven inexorably toward policies protecting existing firms and industries from foreign competition. The costs imposed upon the economy by protectionist policies are considerable. Weidenbaum and Munger[6] conclude that a conservative estimate of this cost for 1980 was $58.5 billion (in 1980 dollars), or $255 per person. The cost has grown significantly since 1980 because of numerous protectionist policies implemented since then.

Furthermore, the institutional biases and pressures of a DITI would cause this aggregate cost to grow considerably. A trade department would harbor an institutional bias favoring subsidization of losers, thereby reducing economic efficiency and productivity for the economy as a whole. This natural bias would be given added impetus by the fact that existing industries and groups have allies in Congress, to whom the department would have to turn for its annual budget. Trade policy outcomes in a world

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5 This is only one of the numerous fatal flaws in the new (but really quite old) arguments for "industrial policy," known in simpler times as central planning. Government cannot identify and subsidize fledgling winners because that would require foresight, an attribute for which government has few incentives and even less reputation.

6 Murray L. Weidenbaum and Michael C. Munger, "Protection At Any Price?" Regulation, July/August 1983.

in which bureaucracies demand protection would not be difficult to predict. Inevitably, a DITI would soon evolve into a central receiving station for the demands of innumerable interest groups favoring protection and other policies bestowing benefits upon themselves and costs upon the economy as a whole.

Experience in other federal departments supports this prediction. The Agriculture and Labor Departments are traditional allies of the farming interests and Big Labor, respectively. The Transportation Department is a vocal supporter of the maritime and other transportation interests. The Energy Department generally supports the demands of small refiners and others whose activities have been made more difficult by volatile world energy markets. And the Education Department was created largely as a result of a political deal between President Carter and the organized education lobby. Any wager that a DITI would ignore special interests and place its greatest emphasis upon aggregate efficiency and social effects would be a long shot indeed.

Promoting Exports and Opening Foreign Markets

The only way that government can promote anything is to subsidize it. With the exception of certain national security activities, discussed below, it is difficult to see how such subsidies, whether implicit or explicit, can bestow net benefits upon society as a whole.

Such subsidies are already significant and, without doubt, would be supported and expanded by a trade department. Legislation introduced by Senator William V. Roth, Jr. (R-Del.) would confer upon the new Secretary of Trade the chairmanships of the Export-Import Bank and the Overseas Private Investment Corporation. The legislation also provides that the proposed DITI and the Agriculture Department would consult closely and that an agricultural liaison would be ensconced in the DITI. These arrangements are far more than mere social niceties; advocacy of subsidies will be the name of the game under the guise of promotion of exports. These agencies are by no means the only special interests in the U.S., of course, so the membership in this fraternity will probably grow substantially as the legislation moves through Congress.

Trade and other microeconomic policies cannot create or save jobs; they can only shift jobs among industries and sectors. One important reason for this is that the exchange rate effects of such trade policies render them self-defeating in the aggregate. If the U.S. protects some domestic industries by imposing import restrictions, fewer dollars are sent overseas, thus strengthening the dollar. This makes other export industries less competitive in world markets. The net effect, therefore, is to save jobs in the industries being protected, but to lose jobs in other export sectors. The impact upon the overall economy is adverse because resources are not used in the most productive manner and because goods are not provided to consumers as cheaply as possible. Efforts by government to promote exports artificially have the same exchange rate effect and thus the same adverse impacts on other export sectors.

It should be noted that the same holds true for foreign governments: their efforts to protect or promote industries are also self-defeating. Such policies tend to strengthen those currencies relative to the dollar, reducing their competitiveness in world markets and increasing that of the U.S.

In short, even if subsidies for domestic industries are designed to offset foreign subsidies, society as a whole does not benefit; only the industry in question is better off. And even if such policies were sound for society as a whole, it is not clear why a cabinet-level department of trade would be necessary for purposes of implementing them. Platitudes about consolidation and speaking with one voice are not an adequate rationale because the value of such consolidation hinges upon the likely behavior of the new agency or department. Consolidation itself is not a goal; it is simply a means to other ends and is desirable only if these latter ends are socially beneficial.

Budget and Policy Implications

A bureaucracy is a concentration of interest groups, and there are always divergent interests within it. This observation applies to both budgetary and policy matters. Different agencies with responsibility in the same general area tend to constrain each other's budget requests because Congress can always shift responsibilities among them. In effect, the agencies must engage in limited, but real, budget competition. Consolidation of trade matters in a single DITI inevitably would reduce this competition significantly, thus increasing the ability of the overall trade bureaucracy to extract budget dollars from Congress--that is, from the taxpayers.

This outcome is consistent with experience under previous governmental consolidations; spending in a given area has invariably risen faster after the creation of a new department. The scope of government activity in a given policy area also tends to increase substantially after a new department is created. The various agencies currently responsible for trade matters are constrained by the larger interests of the departments or offices in which they reside. There is, in effect, political competition in trade matters. If a DITI were to be created, consolidating trade functions under one roof, these constraints would be reduced sharp y, facilitating the natural protectionist pressures felt and reflected by these agencies.

In short, the creation of a trade department would increase government spending in the trade area and transform the bureaucracy into a monolithic voice favoring protectionist policies. Senator Roth implicitly has admitted this: "[Our senior trade officials] are still saddled with...a system of institutionalized bureaucratic in-fighting."[7]

Only free trade can benefit society as a whole; protectionism and subsidies will make some better off, but others will be worse off, and society as a whole will lose. Protectionism is just one example of a whole class of policies designed to confiscate and transfer wealth without use of the explicit tax system. Adding to governmental power in this way makes the outcome of political battles more important. By raising the stakes, winners and losers alike are induced to invest more in political competition, because the benefits of winning and costs of losing are correspondingly higher. This reduces the production of real goods and services and yields greater politicization of social interaction.

The politicization of private decisions must not be underestimated in terms of its scope and effect. Government is sure to demand something in return for the benevolence it provides in the form of protectionism, and these demands will have a considerable effect upon incentives for cooperation through market processes. Can society allow the private sector to enjoy up-side opportunities, while down-side risks are imposed upon the economy at large?

Finally, the increase in governmental power inherent in a DITI can be expected to be used in the interests of coordinated political majorities. But the Constitution is a contract designed to prevent this sort of confiscatory activity by political majorities. By facilitating this behavior, therefore, a DITI would contribute to the gradual weakening of the checks and balances of U.S. constitutional democracy.

National Security

Arguments for the protection of certain industries often are based on a national security rationale: a healthy domestic industry is required in the event of war or national emergency. This position is usually followed by an assertion that protection from foreign competition is therefore necessary for maintenance of such domestic capabilities.

Since general price controls have been imposed in the past during wars or national emergencies, it is reasonable to expect them to be imposed again in the event of war. This means that private sector incentives to invest in defense-related industries for use during wartime are likely to be distorted and inadequate. A subsidy for investment in strategic industries, therefore, might be an efficient me hod of securing the nation's defense, and trade restrictions might in some cases be the efficient form of the subsidy. But would a DITI be likely to improve efficiency in the

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7 Congressional Record, No. 4-Part III, January 26, 1983.

choice, formulation, and allocation of such subsidies? The answer is not clear, but by reducing competition among bureaucracies, a trade department would be likely to skew the decision process in ways consistent with its institutional biases and thereby increase the total social cost of the national defense effort. And by supporting actions that reduce aggregate wealth and increase government spending, a DITI would tend to reduce congressional willingness, and the nation's ability, to allocate sufficient resources to defense.

CONCLUSION

The trade problem is not a national economic problem--it is an issue for certain industries and sectors and for politicians seeking votes. Government policy directed at the problem can net only adverse effects for the economy as a whole, and the creation of a new cabinet department for trade would only facilitate such perverse governmental activity.

The pressures upon and incentives faced by a trade department would lead it to advance protectionist and other policies favored by concentrated interest groups, while imposing net costs upon the overall economy. Such policies would not save jobs or provide other social benefits in any meaningful sense, but they would increase government spending and resource allocation. By expanding the power and intrusiveness of government, a DITI would contribute to an erosion of the private sector and of constitutional constraints on confiscatory behavior. It would provide strong incentives for further politicization of economic activity.

Given that expansion of government authority and activity does not make society better off, it makes no sense to create another department. Among the numerous dismal achievements of the Carter Administration was the creation of two new cabinet departments. The 1980 election would seem to indicate that Americans do not want to follow in those steps with yet another bureaucracy.

Prepared for The Heritage Foundation
by Benjamin Zycher, Ph.D.*

* Until July 1983 a Senior Staff Economist for President Reagan's Council of Economic Advisors and now a Senior Economist at the Jet Propulsion Laboratory, California Institute of Technology. The views expressed are his own.