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5 The Political Economy of Trade Policy: A Balancing Act

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Reducing trade barriers is almost always controversial. The positive impact on aggregate social welfare runs up against the interests of those whose profits and jobs depend on trade protection. Most people in the region recognize the advantages of integration into world markets, but many also know that the gains from trade are unevenly distributed and can create both winners and losers.

In principle, some of the gains could be used to compensate the losers, so that everybody benefits. In practice, however, compensation can be politically difficult. Once trade is liberalized, winners may resist sharing the benefits, and *ex ante* promises to compensate potential losers may not be credible.

Thus, those who expect to be harmed by trade are likely to oppose liberalization. Moreover, opponents of liberalization are often powerful and may have the resources and political clout to block reform. Understanding trade policy, therefore, requires an analysis of the constellation of actors—both public and private—who participate in the making of trade policy, their interests, and the nature of the making of policy institutions involved.

Most of the time, trade policy involves policymakers and special interest groups—private sector actors for whom the stakes are high. These include firms (and their workers) that compete with imports, firms that import, firms that make substantial use of imported inputs, and firms that export and fear retaliatory protection by trading partners. Consumers, who benefit from trade liberalization through access to a wider range of products and lower prices, are not typically active participants in this game. They are a diffuse, disorganized group, for whom the stakes are lower. To be sure, policymakers may have broad consumer, and voter, interests in mind as they formulate trade policy, but final consumers rarely impact trade policy directly.

Occasionally, something happens that turns trade policy into a central issue in the broader political game. This may be triggered by a specific negotiation (such as CAFTA-DR in Costa Rica), or a recession that turns public attention against a country's imports. Understanding these episodes requires a better understanding of attitudes toward trade among the general public, and of its determinants and consequences, both in terms of policy and electoral outcomes.

The trade policymaking process, with its key actors and institutions, shapes trade policy. But changes in trade policy, in turn, can have substantial feedback effects on that process. Such was the case with Latin America's Great Liberalization of the late 1980s and early 1990s, which opened domestic markets to foreign competition while seeking better access to foreign markets for local producers (see Chapter 1). New exporting firms and economic activities emerged, while previously protected firms either adapted or exited, thus transforming the constellation of actors involved in trade policymaking and their interests. But since the depth of trade liberalization varied across countries, the extent to which the new policies changed the underlying political economy varied as well.

Countries' trade policy experience since the 1990s shows substantial variation. Some countries sustained or extended liberalizing policies. Others followed periods of liberalization with policy reversals, increasing tariffs and nontariff barriers. Many governments extended special protection to favored economic sectors and used anti-dumping instruments extensively.

How can the different patterns of trade policy in the region be explained? Why has liberalization marched on in some countries, while others have reversed course or applied protectionist measures? Why have some sectors been favored over others? Looking forward, what constraints do governments face to further liberalize? This chapter uses insights from economics and political economy, along with the results of an ongoing multi-country project on the political economy of trade policy in Latin America (plus additional work on the United States and Australia), to explore these issues.[1] A detailed discussion of attitudes towards trade in Latin America, based on the Latinobarómetro survey, follows in Chapter 6.

Making Trade Liberalization Last

Once trade is liberalized, there is no guarantee that it will remain liberalized. In fact, countries in the region have followed different policy

1 For a recent review of the literature on the political economy of trade policy, see McLaren (2016). An early review can be found in Rodrik (1995). For earlier work on trade policymaking processes in Latin America in the 1990s and early 2000s, see IDB (2002) and Sáez (2005).

trajectories since the liberalization of the 1980s and 1990s. Some, such as Chile, Colombia, Costa Rica, and Mexico, have continued to reduce trade barriers, signed preferential trade agreements with an increasing number of regional and extraregional partners, and persisted in maintaining and deepening open trade. Others, such as Argentina, Brazil, and Venezuela, have resurrected some trade barriers or come up with new ones. What explains whether trade liberalization persists?

One key source of persistence is mobilized winners. Those regions, industries, firms, and workers that gain from access to world markets constitute a potential force to sustain and extend openness. They can push for trade agreements with other countries, and support them in the national public debate. They can oppose protectionist measures when they are proposed. And they can, as in the recent case of Mexican firms faced with the prospect of American protectionism, work with like-minded interests in partner countries to preserve existing commercial ties (Córdoba et al., 2019).

Protection, indeed, changes the very nature of interests in an economy. Trade policies have a powerful impact on the structure of production and, therefore, on the interests in play. In addition to mobilizing winners, liberalization has another important effect relevant for the subsequent politics of trade policy. Over time, firms and industries that had been protected either adjust to import competition or go out of business (and thus no longer lobby for protection). Some, in fact, may discover that the effects are less negative than expected (Fernández and Rodrik, 1991), and that liberalization creates new, unsuspected opportunities. The Chilean experience clearly illustrates these sources of persistence.

A related point is that once a country liberalizes its trade relations, it can be costly to turn back, particularly when doing so implies reneging on prior international commitments—even the commitments of previous governments. This may help explain why Costa Rica's Partido de Acción Ciudadana opposed the Central American Free Trade Agreement in the country's 2007 referendum but did nothing to reverse course when it reached power in 2014.

The (Not So) Boring Case of Chile

A prominent Chilean economist remarked that the political economy of trade policy is not very interesting in his country: "this issue in Chile is boring… everyone is in favor of free trade." But the story of how this shared vision emerged in Chile, as told in Rebolledo (2019), is anything but boring.

The opening of the Chilean economy began in 1973. The military government embarked on a deep process of unilateral trade liberalization, reducing tariff levels from an average of about 100 percent, with high tariff dispersion, to uniform tariffs of 10 percent in 1979. The return to democracy in 1990 represented a critical juncture for Chilean trade policy, which could have resulted in policy reversals. Instead, Chile continued along the path of liberalization, this time on the basis of a wide web of bilateral free trade agreements (FTAs). As a result, today Chile has 26 trade agreements with 64 countries in Latin America, North America, the European Union, and Asia, representing close to 90 percent of world GDP.

A crucial question is why the democratic government that took office in 1990 did not reverse the trade policy of the military dictatorship. One important consideration is that by 1990, the constellation of private actors with a stake in trade policy had changed dramatically from the import substitution periods. After nearly 20 years of liberalization, many of the influential import-competing sectors—including most car manufacturers and most of the country's textile and footwear industry—were gone.

The export sector had replaced the highly protected industries in influence.[2] By 1991, fresh fruit exports had soared to $1 billion, taking advantage of off-season markets in developed countries. Together with other booming export sectors, such as fish and wine, these sectors became active participants in the trade policymaking process.

The process of opening did more than change the identity of the players; it also shifted the preferences of some of the remaining players. The result has been a surprisingly broad consensus favoring trade agreements that includes labor unions, along with the remaining textile and footwear manufacturers.

In almost any other Latin American country, the notion of unions and the textile sector supporting liberalization would be unthinkable. The explanation in Chile is rather simple. Average most-favored-nation (MFN) tariffs in Chile are now at 6 percent. Due to the extensive network of trade agreements, most important countries already have free access to the Chilean market. Thus, applied tariffs actually average 0.8 percent. If Chile negotiates an FTA with another country, it provides access to an already-open market, while Chilean firms gain access to a more protected one. Chile would give up little, and receive much in return. That is why unions support FTAs. They believe, correctly, that they generate jobs.

How about textile companies? Consider the case of Caffarena, an apparel company responsible for the majority of Chilean textile exports. Starting in 2007, it relocated an important part of its production to Asia,

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2 The fact that the import substitution process was not as deep as it was in countries such as Argentina and Brazil, owing in part to scale, may have facilitated the process as well.

after opening an Office of Purchases and Development in Shanghai. Design and material selection are still done in Chile, but the company takes full advantage of the FTA with China signed in 2005. Some apparel lines are still produced in Chile, and, as of 2010, were exported to nine countries: Argentina, Bolivia, the Dominican Republic, Mexico, New Zealand, Paraguay, Peru, United States, and Uruguay. All but the Dominican Republic have FTAs with Chile. Given the way in which they have adapted to liberalization, it is not surprising that the remaining textile companies support FTAs.

The Chilean experience illustrates how trade policies adopted in one period go on to affect the policymaking process in the next.[3] An open trade regime can lead to broad support for further liberalization, so much so that it can render trade politics almost … well, boring.[4]

Trade Policy as Citizen´s Choice: The CAFTA-DR Referendum in Costa Rica

The general public does not normally focus on trade policy as a prominent political issue. However, there are times when the public, including voters, does pay attention to trade policy. Episodes when major international trade agreements are being considered are one of those times. Such is the case of Costa Rica's CAFTA-DR referendum, which illustrates the dynamics of mass participation in the political economy of trade policy (Monge-González and Rivera, 2018).[5] This episode also illustrates how today's policy decisions affect tomorrow's policymaking process and outcomes. In particular, the dynamics set in motion by the highly contested CAFTA-DR vote would be very costly to reverse, even though preferences regarding trade policy remain deeply divided.

Unlike the case of Chile, after years of gradual but steady trade reform, a broad pro-trade consensus had not emerged in Costa Rica when the country confronted the CAFTA-DR decision. While most of the private sector supported trade, public opinion and policymaking elites were at odds with regards to trade policy.

Costa Rica signed the CAFTA-DR treaty in January 2004, but President Pacheco, sensing opposition, did not send it to Congress until

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3 This is in line with the conclusion in Ostry (2002) that "policy influences process and process influences policy."

4 Recent discussions seem to be heating up, however, in relation to Chile's participation in the Trans-Pacific Partnership.

5 For a more thorough analysis of the political economy behind the CAFTA-DR decision in Costa Rica, see also Hicks, Milner, and Tingley (2014).

October 2005. With the 2006 elections looming, Congress postponed the debate. Thus, when President Arias was elected, CAFTA-DR had not yet been ratified. Facing a March 2008 ratification deadline and the prospect of a deadlock in Congress—where procedural rules allow small minorities to stall any debate—President Arias called for a referendum.

The alignment of political parties and civil society organizations for and against ratification had begun years earlier, when, in March 2000, a proposal to open up the electric power market polarized Congress and sparked street demonstrations. Most of the private sector and the two major political parties supported the reform; public sector unions, student organizations, antiglobalization groups, and left-wing political parties were against it. The same forces faced off in the 2006 election. Those in favor of the export-oriented, liberalizing reforms lined up behind Oscar Arias, while those opposed to such reforms supported Ottón Solís. Arias won the election by the slimmest of margins.

Public opinion polls tracked public sentiment on CAFTA-DR until the October 2007 referendum. As public knowledge of the treaty increased, so did opposition. The gap between positive and negative opinion went from +24 percent in May 2007 to a virtual tie in September. Dwindling support did not reflect voters' interests: throughout the period, the share of respondents who thought the treaty would either benefit them or have no impact was stable around 60 percent. But other drivers of public opinion changed. Between May and September, an increasing share of respondents thought the treaty would reduce public services in health and education (from 32 to 40 percent), would not benefit the poor (from 57 to 68 percent) and would hurt small farmers (from 55 to 59 percent). Moreover, by October, 66 percent of respondents thought the treaty would give the United States excessive influence over Costa Rican internal affairs (Rodríguez, 2013).

Despite the drop in support, the "Yes" movement won by a very narrow margin, obtaining 51.2 percent of the vote. There is some evidence of economic self-interest motivations, as "Yes" did best in export-oriented districts (Hicks, Milner, and Tingley, 2014). However, interviews with leaders of both campaigns highlight the importance of noneconomic, worldview factors (Monge-González and Rivera, 2018). The virtual draw between the two worldviews and their political expression persists. Nevertheless, in the long run, the triumph of the "Yes" movement is undeniable and has brought with it almost irreversible changes in Costa Rica's trade policy.

By 2014, the Partido de Acción Ciudadana, which had opposed CAFTA-DR in the referendum, came to power. The new president, Luis Guillermo Solís, had the authority to unilaterally withdraw from the treaty. However, by the time he took office, a package of 13 legal reforms associated with the CAFTA-DR had already been approved by Congress. The telecommunications and insurance markets were already open; intellectual property rights had been strengthened. The institutional changes that motivated the "No" movement to oppose CAFTA-DR had already taken place, and repudiation of the treaty would not undo them.

The slim but strategic victory of the "Yes" movement may not have settled the battle of ideas, but the long-term configuration of economic interests has been altered in fundamental ways. With few exceptions, protection for agriculture and agroindustrial sectors is on a clock. However gradually, protection is slated for disappearance. Once gone, those who depend on it for survival will no longer be part of the economic landscape, while those who can adapt to the new environment will do so.

This is not to say that CAFTA-DR is irreversible. But the costs of reversal are huge, and barring a dramatic change in the political landscape, the battle for free trade in Costa Rica seems to be over.

Special Interest Trade Politics

While in special circumstances, such as the CAFTA-DR referendum in Costa Rica, trade policy takes center stage in the broader political debate, most of the time trade policy is the province of interest groups for whom the stakes are high: import-competing firms and their representative associations, seeking protection; importers and users of protected inputs, who stand to lose from protection that raises the prices of what they sell or use; and exporters, who favor open markets to lower their production costs, obtain reciprocal access to other markets, and minimize the risk of retaliatory protection by trading partners. A recent episode in Brazil illustrates some of the actors and processes involved.

Players in the Trade Policymaking Game

On July 20, 2016, Brazil initiated an anti-dumping investigation of imports of flat steel from China and Russia at the request of two domestic steel producers. The Department of Trade Defense of the Ministry of Development, Industry, and Foreign Trade (MDIC) concluded that imports from both countries were dumped and recommended the application of duties.

The MDIC report generated much controversy. In one corner were the steel producers, represented by their association, Aço Brasil, with the support of MDIC. In the other corner stood a broad coalition of public and private players, including the ministries of finance and agriculture and some 20 business associations of sectors that use steel intensively, under the leadership of ABIMAQ, Brazil's association of machinery manufacturers.

On the eve of the decisive meeting at CAMEX, the interministerial council charged with implementing Brazilian trade policy, the Ministry of Finance published a note stressing the adverse effects of duties on downstream sectors and the consumer price index, and challenging the claim that steel imports had caused "serious harm" to Brazilian producers. The Ministry of Agriculture also argued against the duties, citing the risk of Chinese retaliation against Brazilian exports. Consumers—who would have been affected through the price of appliances and cars, for example—were nowhere to be found.

This episode, detailed in Veiga et al. (2019), illustrates the contending private sector interests in play. It also shows that the public sector is not monolithic. Ministries of industry tend to support industries facing import competition; ministries of finance, in contrast, are more likely to consider the impact on the economy as a whole.[6] All these public and private actors, in turn, interact within the context of a given set of formal and informal institutions that define the way the game is played.

The role of private sector actors can also vary according to circumstance. Import competitors are almost always central actors, but the engagement of other private actors depends on several factors.

Consider the case of exporters. They may be active if they fear retaliation, but not if the threat of retaliation is not serious enough. China accounts for nearly 20 percent of Brazilian exports, including 75 percent of Brazilian soybean exports. Primary exporters cannot risk retaliation from China, and neither can the minister of Agriculture. Russia, in contrast, receives 1.2 percent of Brazilian exports. If the antidumping case were against Russia, would exporters and the minister of Agriculture be playing a similar role? Most likely not. Exporters may also engage in the process in the context of bilateral trade negotiations, when providing market access to a partner country entails receiving market access in return. They may be less likely to participate in discussions regarding unilateral liberalization.[7]

Finally, exporters may be active because they care about access to inexpensive and high-quality inputs, which they need to be competitive in export markets. However, exporters can be neutralized by policies such as special drawback regimes, exempting them from paying tariffs on imported inputs. This mechanism, prominent in Brazilian trade policy,

6 Ministries of agriculture tend to defend the interests of their stakeholders, which may be offensive or defensive depending on the issues under discussion.

7 An historic example will be illustrated below in the discussion of the U.S. Reciprocal Trade Agreement Act of 1934.

solves the exporter's problem, but in doing so also reduces their incentive to participate in trade policymaking.

The Brazilian steel case suggests that sectors that use protected inputs intensively may also play an important role in demanding liberalization. While this coincides with the theoretical expectation, the episodes studied in the preparation of this report suggest that this is not always the case. There are instances where, contrary to expectations, suppliers of a protected input and their clients push in the same direction, or at least do not get in each other's way.

Firms producing protected intermediate inputs can purposely attempt to "deactivate" potential challenges by their customers, particularly when they are the dominant market player. In one of our case studies, a dominant firm in the steel sector used a number of strategies to align their customers' interests with their own. For example, the company invests heavily in activities for the whole value chain. It created a program to support their small and medium clients and suppliers, which lists among its objectives to improve their management practices, strengthen their export capabilities, and promote "efficient import substitution." An example of their help in improving management practices is that, according to a firm executive interviewed, all courses available for their executives are also accessible to their clients.

In terms of "efficient import substitution," the company makes its ample legal resources and expertise available to its clients for their own antidumping cases. Rather than be challenged by their clients, who would benefit from lower prices if steel protection were reduced, they lobby to protect downstream industries, so that everyone's interest align.

In addition to these positive incentives, there are cases where fear of retaliation may discourage challenges to protection. This is particularly relevant when a supplier is a dominant player, and downstream firms cannot risk having their supplies cut off. Even if the downstream firm is successful and obtains access to cheap products from abroad, the risk of policy reversals means that downstream firms must think twice before challenging the dominant supplier. Trade policies may not be enough to deal with this problem. They may need to be complemented with competition policies that challenge the dominant power of the domestic market leader.

The Challenges of Leaving Protectionism Behind

Argentina illustrates the challenges that a reformist government faces when trying to reverse years of protectionist policies in the midst of macroeconomic and political difficulties. The case illustrates why, in pursuing trade liberalization, governments may treat different sectors differently. It also shows the role of compensatory policies in facilitating trade reform.

The Macri administration pursued a "smart integration" strategy, but needed to proceed gradually given negative public opinion of the 1990s reforms, high unemployment, and an impending midterm election. From the outset, the decision was made to advance faster in liberalizing intermediate inputs and other products affecting downstream competitiveness, while proceeding more slowly in sensitive sectors in which many jobs—particularly in politically sensitive electoral districts—would be at stake.[8]

The study by Marin, O'Farrell, and Obaya (2019) compares trade policy in three sectors. Here, we will focus on two of them, computers (and other electronics) and textiles.

Computers and Other Electronics

Under the previous administration, computers were assembled domestically using imported components. Personal computers, notebooks, and tablets paid 35 percent tariffs, while their components paid 12 percent. More importantly, a discretionary system of import licenses (called DJAIs) made it easy to import components, but almost impossible to import the final products.

Protection of computers clearly affected competitiveness downstream and was unpopular with consumers. Local value added was minimal, and little employment was generated. The industry had two main locations: the outskirts of Buenos Aires, populated by specialized small and medium-sized enterprises, and the island of Tierra del Fuego, where large, diversified firms produced cellphones, TVs, and computers under a special industrial promotion regime. These groups of firms are represented by different business associations. AFARTE, representing producers in Tierra del Fuego, has ample access and resources. It is stronger than CAMOCA and CADIEL, which represent firms on the mainland. Given that benefits for the island discriminate against mainland firms, the relationship between these associations is characterized by conflict rather than cooperation.

Given all these factors, it is not surprising that the computer sector was the first to be liberalized. In February 2017, the government eliminated

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8 Obviously, this is not the only possible gradual liberalization path. From a normative perspective, an across-the-board gradual reduction in tariffs and nontariff barriers may have been more efficient, eliminating distortions and discouraging rent-seeking. But it would have been incompatible with Mercosur's common external tariff and, from a political economy perspective, probably detrimental to electoral success.

tariffs on final goods and components. Later that year, nonautomatic licenses (NALs) were eliminated as well. Requests for a more gradual approach by CAMOCA, CADIEL, and UOM, the worker's union, were denied. AFARTE, meanwhile, was happy to sacrifice computer production in exchange for continued benefits for cellphones and TVs, which make up a larger part of their firms' product mix.

The government dealt with the losers with mechanisms of compensation, transformation, and coordination (Marin et al., 2019). Compensation happened through Conectar Igualdad, a national program to distribute domestically produced notebooks in schools.[9] Transformation happened by including several computer manufacturers in the Programa Nacional de Transformacion Productiva (discussed in Chapter 9), which provides expanded unemployment insurance for displaced workers, subsidies for reemployment, and credit to help firms pivot toward activities with more competitive potential.

Finally, the government implemented a three-way coordination process designed to increase competitiveness and reduce prices, involving TV and cellphone production in Tierra del Fuego. Tariffs were preserved temporarily and internal taxes eliminated.[10] Labor unions agreed to wage freezes for two years, and firms committed not to fire workers during that time.

Textiles

Textiles were also heavily protected. Tariffs were 26 percent on fabrics, and 35 percent on apparel. According to e-commerce platform Linio, Argentina was the most expensive place to buy apparel in Latin America. Nevertheless, the government adopted a more gradual approach than in the computer case. Several factors explain the difference.

The first factor was employment. In contrast to computers, which directly employed fewer than 5,000 workers, the textile and apparel sector employed more than 250,000. The second factor was politics: most jobs are located in the politically sensitive Conurbano Bonaerense, the electorally crucial district surrounding the city of Buenos Aires.

The third important factor was lobbying: in contrast to computers, the sector has strong business representation acting cohesively on behalf of the entire value chain. Particularly interesting is the case of Pro-Tejer, an

9 Although the program was deployed prior to the liberalization of computers, the domestic purchases requirement was a clear compensation for this liberalization.

10 Over a five-year period, it will gradually eliminate these taxes on the mainland, effectively ending the special regime.

NGO created in 2003 by the owners of a large yarn and fabric company who understood that to survive they had to protect downstream apparel and design firms. They worked to shift the sector's public perception, arguing that the sector was efficient but that systemic "Argentine costs" (taxes, labor regulations, logistics, etc.) hindered its competitiveness. Thus, they proposed that the sector be opened only once these systemic costs were reduced through tax and labor reform.

Given these very different circumstances, it is not surprising that trade policy outcomes were different as well. In this case, tariffs were not changed, and when DJAIs were replaced with NALs, more than half of the products covered were in the textile and apparel sector. Still, unlike the DJAIs, which were completely discretionary and did not have time limits (and were successfully challenged at the WTO), the NALs had to be granted within 60 days. As a result, imports of apparel increased sharply and production along the value chain contracted significantly.

Even though the government preserved protection through tariffs and NALs, it still introduced a number of compensatory measures in response to the import surge and lobbying by the sector. First, it established a fund to finance consumption of domestic apparel in six interest-free monthly installments. Second, it created an express facility for sensitive industries for the Program of Productive Recovery (REPRO), which provides employment subsidies to firms in crisis in exchange for a commitment not to fire personnel. Third, in November 2018, it reduced employers' social security contributions for the textile and footwear industry. Finally, the government and the sector established a roundtable (Mesa Sectorial) focused on resolving labor issues, product quality and internationalization.[11]

These contrasting cases illustrate the challenges faced by a government that wants to leave protectionism behind and engage in "smart integration." It is not easy, especially in the midst of a recession (as in Argentina now) or with an appreciated exchange rate (as it had until mid-2018), particularly when the government wants to win reelection. The comparison of these sectors and their differences clearly suggests that issues like the number of jobs at risk, the political importance of the districts where those jobs are located, the strength and cohesion of sector representation, and the degree to which protection affects the competitiveness of relevant

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11 Not all textile products received the same treatment, however. Consistent with the analysis of this section, synthetic yarns, a highly concentrated, capital-intensive activity that produces intermediate inputs affecting competitiveness downstream, was liberalized more aggressively.

downstream industries are important elements that contribute to explain differences in trade policy outcomes.

Agricultural Protectionism: A Hard Nut to Crack

Trade liberalization in agriculture has been slower than in most other sectors. Tariffs have declined more gradually, and exemptions in FTAs are more frequent, as is the use of nontariff barriers to compensate for tariff reductions. The cases of rice and sugar in Colombia (Arbeláez et al., 2018) and Costa Rica (Monge-González and Rivero, 2018), two countries that are largely open in other sectors of the economy, provide insights into the specific features of the political economy of agricultural trade policy.

Sugar and Rice...and Everything Nice

Sugar and rice are agroindustrial products: before reaching consumers, they must be processed at industrial mills. While sugar and rice farms come in different sizes, the milling stage is highly concentrated in both crops. To give an extreme example, Colombia has more than 32 thousand rice producers, but only two important rice mills. Small farmers are dependent on millers to sell their crops.

In Costa Rica, rice is the only product with regulated prices at every stage of the value chain. Tariffs are 35 percent but, when domestic production falls short of local consumption, rice millers are assigned tariff-free import quotas in proportion to the share of domestic crop they buy (including their own production when vertically integrated). Average applied tariffs for refined sugar stand at 45 percent. In Colombia, MFN tariffs on rice are 80 percent, and the sector was protected by a price band system until 2003. Sugar, also formerly covered by the price band system, is subject to 55 percent tariffs, although they were even higher in the past.

The coexistence of very large, politically and economically powerful millers and a large number of small, relatively poor farmers or agricultural workers in rice and sugar production in Colombia and Costa Rica goes a long way in explaining the strong protection and long tariff phaseout periods these sectors have secured. The millers provide the lobbying capabilities; the farmers help garner sympathy and support. No one ever said, “Let’s rise to defend the millionaire mill owners.” Agricultural support programs and agricultural protectionism are always justified as a means to protect small farmers, the quintessential embodiment of the hard-working poor.

Despite this, trade agreements have proven to be a powerful tool for reform. In Costa Rica, tariffs on rice imports from the United States will be phased out over 20 years.[12] In Colombia, the United States was granted increasing tariff-free quotas, and tariffs will be phased out in 25 years for sugar and 15 years for rice. Thus, trade agreements—particularly those with the United States—have achieved what once seemed unthinkable: gradual but significant liberalization of these countries' agricultural trade.

Impact of the Institutional Structure

Governments are not monolithic: legislatures, the executive, and different ministries may have different trade policy preferences and different capabilities. Thus, the institutional architecture for trade policymaking—who is responsible for what, how different actors engage in the process, etc.—can have a profound effect on policy outcomes. The organization of the trade policymaking process may vary across time and across countries, which helps explain differences in trade policy outcomes.

Making Trade Policy in the United States: The Legislative and Executive Roles

The U.S. Constitution explicitly assigns Congress the power to set tariffs. Congress is made up of 435 representatives, each representing geographically delimited districts, and 100 senators, two from each state.[13] Districts vary enormously in their industrial composition: some are heavily agricultural, others largely urban and industrial. Industries tend to cluster, so many congressional districts (and states) have heavy concentrations of specific industries. For example, Kansas produces grain and cattle while Detroit—and the state of Michigan—is the country's automotive leader. Members of Congress fight for industries located in their districts, and if a locally powerful industry is protectionist, the representative is likely to support protection. Protection imposes costs on downstream industries and consumers, but these externalities are not fully internalized by the members of Congress, who are accountable only to their voters. Legislators have incentives to engage in a process known as logrolling, in which members of Congress trade support for the protection of each other's industries. This can lead congressional trade policy to a high-tariff equilibrium.

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12 The phaseout period for sugar is 15 years, but it is contingent on the United States becoming a net exporter, which is not expected to occur anytime soon.

13 This section draws heavily from Frieden (forthcoming).

The president is elected by an Electoral College comprised of all districts.[14] This means that, unlike members of Congress, the president internalizes the broad national impact of policies.

For over 150 years, Congress used its constitutional power to dominate trade policymaking, generating a strong protectionist bias. This reached its height during the Great Depression with the passage of the Smoot-Hawley Tariff of 1930, which raised tariffs to one of their highest levels in American history and elicited retaliation from trading partners.

As the Depression dragged on, the Democratic Party, with a strong base in the pro-trade, export-oriented farm South, won control of both the legislature and the presidency. As a result, during Franklin Roosevelt's presidency (1933–45), Congress passed the Reciprocal Trade Agreements Act (RTAA) of 1934, giving the president the authority to negotiate up to a 50 percent reduction in tariffs in exchange for similar concessions from trading partners. Moreover, the reciprocal nature of the deals gave exporters an active interest in supporting liberalization, since reducing tariffs would mean increased access to foreign markets for their products. By 1940, agreements had been signed with 21 countries, covering 60 percent of U.S. imports.[15]

The RTAA and successive related mechanisms—fast-tracking and, more recently, Trade Promotion Authority—allow the president to present a trade agreement to Congress that cannot be amended or filibustered. This gives the executive control and forces Congress to decide whether it prefers the executive's proposal to the status quo. The fast-track procedure shifts bargaining power from Congress to the president. This may be the actual purpose of the legislation: Congress ties its own hands to keep itself from logrolling its way to higher aggregate trade barriers than it would like.[16]

Congress has not given over all control to the executive branch. It can refuse to renew fast-track authority, and it plays a major role in treaty negotiations. Yet in many relevant instances the president controls the agenda and strongly influences outcomes. This typically reduces the impact of the local particularistic interests best represented in Congress, and increases the impact of national-level considerations. Until recently, the ability of the president to make take-it-or-leave-it offers to Congress on trade policy issues pushed policy in the direction of trade liberalization. Box 5.1

14 The distribution of electoral votes across states (based on the number of representatives and senators) is roughly proportional to population.

15 See Irwin (1998) for details.

16 The rationale for Congress to delegate fast-track authority has been explored in detail by Bailey, Goldstein, and Weingast (1997) and Schnietz (2000).

BOX 5.1 THE TWISTS AND TURNS OF U.S. TRADE POLITICS

At the time of this writing, the United States is engaged in a trade war with China, after recently renegotiating NAFTA. What explains the recent evolution of trade politics in the United States? Recall that the post-1930s logic of U.S. trade policy was to give presidents control of the trade-policy agenda, as presidents favor trade liberalization more than members of Congress. That institutional logic depended on the idea that presidents, unlike individual members of Congress, represent the national interest when it comes to trade policy.

This logic is challenged in an environment in which most U.S. states are solidly and predictably Democratic or Republican. Presidential candidates must compete over the swing states, whose votes determine the outcome of presidential elections. U.S. presidential elections are not decided by the popular vote, but in an Electoral College, in which *all* of the votes of nearly every state are allocated to the party that obtains the most votes in that state. This means that presidential candidates need to win the median voter in swing states, rather than the median voter in the country. If the pivotal voters of the pivotal states are protectionist, the president will need to attend to their desires.

In fact, the Industrial Belt contains some of the most hotly contested states in U.S. politics. Elections in such states as Pennsylvania, Ohio, Michigan, Illinois, and Wisconsin are fiercely disputed by Democrats and Republicans, which makes them central to the politics of trade policy.

The dramatic increase in manufactured imports from low-wage developing countries since the 1970s contributed to the decline of traditional U.S. manufacturing, whose share in employment fell from 26 percent in 1970 to 10 percent in 2010. This decline, along with stagnant real wages and median household income, fueled skepticism about international economic integration, especially in the country's industrial heartland. The pivotal electoral nature of these states profoundly affected the politics of trade policy.

Two important factors contributed to growing dissatisfaction with globalization. First, U.S. social and labor market policies did little to compensate those harmed by the decline of manufacturing or help them transition into new activities (see Chapter 8). Second, many Americans felt that the country's political leaders were not taking seriously the concerns of those who were not doing well. These *failures of compensation* and *failures of representation* contributed to an upsurge of hostility to existing political elites and political institutions (Frieden, forthcoming). Donald Trump took advantage of this sentiment, and of the country's electoral geography, in 2016. His messages played well in regions that had lost many manufacturing jobs to trade and to technology.

U.S. trade policy today has departed from the standard postwar model, in which the executive, generally with a pro-trade stance, negotiates free trade agreements that Congress approves, while sectoral protection is provided by antidumping regulations and other special trade barriers. Today, the president's stance regarding trade agreements has shifted and he becomes directly involved

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BOX 5.1 THE TWISTS AND TURNS OF U.S. TRADE POLITICS *(continued)*

in matters of sectoral protection. Moreover, trade has risen from the relative banality of special-interest politics to the high drama of national electoral competition.

Public opinion on trade is deeply divided and has become increasingly partisan. As the Republican Party turned toward protection, its voters tended to follow suit, while Democrats moved in the opposite direction. In 2009, 59 percent of Republicans and 53 percent of Democrats supported free trade agreements. By 2017, 67 percent of Democrats supported them but only 36 percent of Republicans. For the first time in decades, Republican voters are significantly more protectionist than Democratic voters.[a]

This discussion illustrates the fact that while, in general, delegating decision-making power to the executive brings an economy-wide perspective to trade policy, excessive executive discretion may lead to policy volatility as parties with different preferences alternate in power. In this context, preserving or even strengthening the oversight function of the legislature on trade policy may lead to more stable and predictable policy outcomes.

The politics of American trade policy are likely to be increasingly volatile. The Industrial Belt will continue to be a battleground where this conflict is fought out. Future presidential candidates may find a winning platform that eschews protection; but a protectionist stance has been an important part of national political success over the past few years and will likely continue to be so.

[a] See, for example, Jones (2017).

discusses contemporary trade politics in the United States, which seem to be at odds with this logic.[17]

Institutional Architecture for Trade Policy in Chile and Brazil

As in the United States since the 1930s, trade policy initiative in most Latin American countries is mainly in the hands of the executive. Legislatures approve trade legislation and vote on trade agreements, but they can only vote them up or down (Sáez, 2005). While executives have to consider legislative preferences, they have agenda-setting power and dominate

[17] For lack of space, this chapter will not discuss another important component of trade policy that has a different institutional structure: the management of antidumping and countervailing duties, delegated to the International Trade Commission. These policies act as an escape valve, providing relief through protection to industries facing difficulties due to import competition. For a discussion of the political economy considerations regarding this everyday component of U.S. trade policy, see Frieden (2018) and Irwin (2005).

trade policymaking. Within the executive, the role of different ministries varies from country to country, which can have consequences for trade policy. Ministers of industry or trade tend to be closer to industry and more protectionist than finance ministries, which usually consider the economy-wide implications of protection.

Chile: Strong Trade Institutions

In Chile, trade policy is managed by the Directorate General for International Economic Relations (DIRECON), within the Ministry of Foreign Affairs. DIRECON's director is jointly appointed by the ministers of foreign affairs and finance, which gives the Ministry of Finance influence over trade policy.

In addition, Chile's Interministerial Committee on International Economic Relations (CIREI) advises the president on international economic negotiations. CIREI is composed of the ministers of foreign affairs, finance, the economy, and agriculture, the secretary general of the Office of the President, and DIRECON's general director, who acts as the committee's executive secretary.

CIREI, which has a ministerial level decision-making body and a technical committee chaired by DIRECON, with representatives from the ministries of foreign affairs and finance, is instrumental in coordinating negotiations among government agencies over the broad issues raised by trade agreements. When agencies cannot reach consensus on an issue, it is brought to CIREI's technical committee. If the committee cannot resolve the conflict, it is brought to CIREI's ministerial committee. In the rare cases when this does not settle the issue, the president has the final word.

During Chile's negotiations with Mercosur, in October 1995, such a contentious issue arose, and its course illustrates the policymaking process. The minister of agriculture wanted a long list of products to be exempted from the agreement, and this was unacceptable to the partner countries. Presented with the inability of CIREI to resolve the conflict, President Frei made it clear that Mercosur was a priority and ordered the list of exemptions revised to complete the negotiation.

Negotiations with Mercosur also offer a good example of the role of Congress, as well as the importance of compensation in order to advance trade liberalization. In Chile, as elsewhere in the region, Congress is limited to approving or rejecting international agreements, without amendment. Governments do have to take into consideration the political viability of the treaties they propose, so the preferences of members of Congress matter. The Mercosur negotiations potentially affected some sensitive agricultural products in regions that were overrepresented in Congress.

Parliamentarians representing these regions conditioned their support on measures to offset the negative impact of opening agricultural markets, especially to Argentine producers. To approve the deal, the government put together a compensation package, committing money and services to agriculture.

Much of the compensation program aimed to transform Chilean agriculture into an export industry. It included: (i) a fund to promote agricultural exports; (ii) appointing representatives responsible for furthering Chilean agricultural exports in target markets; (iii) credit guarantees for small farmers; (iv) irrigation infrastructure; (v) programs for innovation, and for soil and forestry management; and (vi) a price band system to shield domestic prices from the volatility of international prices. These commitments exceeded $200 million per year (Rebolledo, 2019), and helped Chilean agriculture increase exports from $4 billion in 1996 to more than $15 billion today.

Private actors also take part in Chilean trade negotiations, mainly through the *Cuarto Adjunto* ("side room"). This allows information exchange, public-private consultation, and consensus building to formulate national bargaining positions. During the TPP negotiations, representatives from civil society, including NGOs, unions, and academia, were added to the side room, thereby expanding the set of actors involved in the trade policymaking process.

Brazil: Strong Industries

While Chile is among the most-open economies in the region, Brazil ranks last in terms of imports/GDP.[18] Tariffs fell substantially at the beginning of the 1990s but have remained around 13 percent on average in the context of Mercosur's common external tariff. Some manufactured goods, such as automobiles, textiles, toys, furniture, and shoes, have tariff rates of up to 35 percent. Moreover, Brazil has signed few trade agreements. Despite a huge increase in agricultural exports and a substantial drop in the share of manufacturing in GDP over the years, protectionist interests at least until recently, had continued to dominate Brazilian trade policy.[19] What are the institutional underpinnings of this result?

Like Chile, Brazil has a high-level interministerial council, CAMEX, which is responsible for all trade policy matters and chaired until very recently by

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[18] See https://data.worldbank.org/indicator/ne.imp.gnfs.zs. See also Chapter 2 of this report.

[19] The participation of the industrial sector in GDP peaked at 32 percent in the mid-1970s but fell below 12 percent by 2017.

the MDIC.[20] Before 2001, the relatively more liberal Ministry of Finance was responsible for tariff policy, and other protectionist measures were decided jointly by this ministry and the MDIC. Institutional changes in 2001 reduced the power of the Ministry of Finance and strengthened the MDIC, whose main constituency is the import-competing industrial sector (Veiga et al., 2019).[21]

CAMEX determined policies on antidumping, subsidies, and countervailing duties, but the MDIC's Department of Trade Defense conducted investigations and proposed trade remedies. The dominant influence of the MDIC may help explain why between 2010 and 2017 Brazil ranked second in the world in antidumping cases, having initiated 230 investigations.[22]

The main private-sector participant in trade policymaking is the Brazilian Business Coalition (CEB), which brings together industry, agriculture, and services, and participates in trade negotiations through a semi-formal channel analogous to Chile's "side room." While the CEB seeks consensus among sectors, it is dominated by the powerful Confederação Nacional da Indústria, which represents Brazilian industry, especially import-competing sectors. Thus, both on the public and private sides, interests of import competitors were well represented in Brazilian trade policymaking.

Brazil's institutional setup resembles Chile's in some respects. Trade policy in both is managed by an interministerial council, with substantial private sector participation through the side room. However, there are significant differences. Chile's interministerial council is led by DIRECON, whose director is appointed jointly by the finance and foreign affairs ministers, who both support liberalization. In Brazil, CAMEX was until very recently dominated by the MDIC, which is close to industry and regards protection as a crucial component of Brazil's development strategy. On the private side, protectionist interests in Chile were weakened by years of liberalization, while exporters gained substantial power in the policymaking process, whereas in Brazil, despite industry's relative decline and the rise of export agriculture, industry continues to dominate the trade policymaking process.

It is puzzling why Brazil's exporting agricultural sector has not been more active in supporting trade liberalization. Perhaps, with surging demand from Asia and particularly from China, agricultural interests simply do not think existing trade barriers are significant enough for them to confront powerful industrial interests. As long as exports to China are not

[20] As discussed below, the government of Jair Bolsonaro eliminated the MDIC in 2018, and subsumed it as a secretariat within the Ministry of Economy.

[21] For a discussion of the Brazilian trade policymaking process in the 1990s and the decline in the role of the previously dominant Foreign Ministry, see Veiga (2002).

[22] *PC em Foco: Observatório de Política Comercial*, various issues.

threatened, the sector has kept its distance from the trade policy arena, allowing defensive industrial interests to take hold.

Which leads back to the case of steel antidumping discussed earlier. The case provoked fears of Chinese retaliation, which spurred agricultural export-oriented actors into action. They were represented by the Ministry of Agriculture, which publicly argued against imposing antidumping duties ahead of the decisive CAMEX meeting. The Ministry of Finance, for its part, issued a technical note stressing the adverse effects of adopting protectionist measures. On January 18, 2018, the CAMEX plenary of ministers decided to apply the antidumping measure as recommended by the Department of Trade Defense within the MDIC. However, it suspended the application of duties for one year, and recently extended the suspension for another year.

Brazil's trade policymaking process seems to be changing. The Bolsonaro administration has overhauled the cabinet structure, eliminating the MDIC, and putting it under the new Ministry of Economy. The new institutional architecture for trade policy is still a work in progress. For one thing, the new composition of CAMEX has yet to be defined. Despite this, there are already important changes in Brazilian trade policy. On June 28, 2019, after 20 years of negotiations, Mercosur reached an agreement with the European Union that must still be ratified by the legislatures of each member country. Within Mercosur, changes to the common external tariff are being negotiated, with Brazil taking a more liberal stance. While it is difficult to know for sure the extent to which policy changes are attributable to changes in the institutional structure—for example, they could be associated with the change of ideology in the government—these changes are at least consistent with the idea that trade policies are not independent of the relative power of different ministries in the trade policymaking process.

The discussion of the U.S., Chilean, and Brazilian cases suggests that institutional architecture matters. To complement this analysis, Box 5.2 presents the case of a unique institution, Australia's Productivity Commission, (and its predecessor, the Tariff Board), which played an important role in the process of liberalizing trade in what had long been a highly protected economy.

Understanding the Rules of the Trade Policymaking Game

Thus far, the report provides support for the notion that countries gain from trade. This is more than just a theoretical expectation. It is supported by the empirical analysis of Chapters 2 through 4. As expected, the analysis also shows that trade liberalization produces winners and losers.

BOX 5.2 AUSTRALIA'S PRODUCTIVITY COMMISSION

Until the early 1970s, Australia was among the world's most-protected economies. A competitive primary sector based on abundant natural resources coexisted with a large, inefficient manufacturing sector, protected by substantial trade barriers. Strong unions and highly regulated labor markets ensured that the benefits of protection were shared with workers. Protection had broad support from all parties in Parliament, and from the public.

Beginning in the 1970s, Australia embarked on a profound trade liberalization process, which gathered steam in the 1980s under the labor governments of Bob Hawke and Paul Keating. With some exceptions, such as automobiles and textiles, which had special regimes and were liberalized later, trade barriers were gradually but relentlessly dismantled. As a result, Australia became a substantially open economy. But how did this transformation occur? This box analyzes the role of a unique institution that played a key role in this process: The Productivity Commission and its predecessors.

From the Tariff Board to the Productivity Commission

The history of the Productivity Commission goes back to the 1920s, with the establishment of the Tariff Board, an independent advisory body charged with recommending the level of protection to be accorded to industry. Early on, the Tariff Board was an instrument of protectionist policy. While its mandate was to encourage the development of "economic and efficient" industries, no clear criteria existed to determine whether an industry was economic or efficient. The common practice was to focus on the level of protection required for domestic production to remain competitive, without considering the impact on downstream industries or consumers. To quote a former official, the Tariff Board was "a calculating machine for made-to-order protection."[a]

But beginning in the late 1960s, under Alf Rattigan's leadership, the Board changed. Following recommendations from the influential Vernon Report (Committee of Economic Enquiry and Vernon, 1965), Rattigan championed a new approach. It involved an economy-wide systematic tariff review, rather than piecemeal product-by-product analyses of industries' protection demands, and the use of objective criteria, namely measures of effective rates of protection, to determine what was economic and efficient.

The new approach was opposed by the powerful minister of trade, who favored the status quo, with the support of industry. That the Tariff Board had statutory independence and its chairman could not be fired was crucial in enabling Rattigan to turn it around. In 1973, with the backing of incoming Prime Minister Whitlam, Rattigan transformed the Tariff Board into the Industries Assistance Commission (Rattigan, 1986).

The Commission could extend recommendations on all forms of industry assistance (not just tariffs), and had an explicit mandate to focus on the economy-wide impact of industry assistance. The new focus required new tools:

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BOX 5.2 AUSTRALIA'S PRODUCTIVITY COMMISSION *(continued)*

broader measures of effective rates of assistance, including subsidies and tax breaks; general equilibrium models, to understand the economy-wide impact of protection; and a broader inquiry process, including consultation with a wider set of stakeholders.

Coming in the midst of a recession, Australia's first liberalization effort—a sudden, across-the-board 25-percent tariff cut in 1973—provoked considerable backlash in the form of quotas, subsidies, and temporary assistance measures. The policy lesson was learned: subsequent efforts in the 1980s were gradual and preannounced, giving firms and workers time to adjust. The Commission played a central role, providing evidence-based recommendations, involving all stakeholders, and informing the public debate.

In 1989, the Industries Assistance Commission became the Industry Commission, and in 1998, the Productivity Commission. The focus became broader, overarching issues like energy, transportation, infrastructure, and, eventually, social and environmental issues. However, three key aspects of the Commission's work remained unchanged:

Independence

The Commission was established by an Act of Parliament. Its members, nominated by the Treasury and appointed for five-year periods, cannot be removed by the government. The government can tell the Commission what to work on, but not what to say (Banks, 2012). When conducting an inquiry, it may investigate any issue it deems relevant. It may also conduct and publish research on any subject of its choice, thus bringing into the public debate policy-relevant issues. The Commission has exercised this freedom judiciously. Getting into issues the government would prefer not to discuss would probably not be the best way to ensure the Commission's survival.[b]

At the same time, the Commission issues its recommendations but leaves decisions to the government without heavy-handed attempts to have its recommendations implemented. This is part of the subtle game by which it retains its independence.

Transparency and participatory process

Every aspect of the Commission's work is open to public scrutiny, and the process of consultations surrounding an inquiry ensures that all stakeholders can voice their concerns. References received from the government are made public, and the Commission invites written submissions from all interested parties. Submissions are published and can be challenged by other stakeholders. A draft report is followed by a public hearing at which interested parties can provide feedback. The final report itself needs to be presented to Parliament within 25 "sitting days." The government need not adopt the Committee's recommendations, although it typically does. Other-

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BOX 5.2 AUSTRALIA'S PRODUCTIVITY COMMISSION *(continued)*

wise, it usually explains why it departs from them, although it is not formally required to do so.

This transparent and participatory process, together with the Commission's high-quality technical analysis, has been instrumental in getting rid of bad policy ideas. Interest groups are less likely to propose self-serving policies if they know their proposals will be subject to careful scrutiny and misleading claims will be challenged.

Economy-wide mandate

The Commission's mandate explicitly stipulates that inquiries must adopt an economy-wide focus. This mandate, strongly opposed by industry in the 1960s and 1970s, has since become a universally accepted feature of the Commission's work.

The Commission's Role in the Process of Liberalization

The Tariff Board and successive Commissions were advisory boards without executive responsibilities. So how did they affect trade liberalization? Although governments were not compelled to follow their recommendations, they usually did. Moreover, as the Commission gained credibility, it strongly influenced the public debate.

Perhaps the most important channel of influence was as a provider of information. In addition to the inquiries, the successive commissions published an annual *Trade and Assistance Review,* including measures of effective rates of assistance, broken down by industry. These measures were translated into simple figures that the public could easily understand. For example, the 1997 automotive industry inquiry reported that, due to industry assistance, consumers were paying an extra AU$3,400 per year for their cars (see Industry Commission, 1997: 224–25). Another usual practice was to convert assistance measures into dollars per protected job. This information, picked up by the pro-trade press, helped change the narrative from "we need protection to save these jobs" to "why are we spending all this money?"

The Commission also helped bring into the debate interest groups from exporting sectors that would benefit from liberalization. Most prominent among them was the National Farmer's Federation (NFE), which relied on the Commission's analysis to argue its case. In the words of a former NFE economist, "the [Industry Assistance Commission] provided the bullets, and we fired them."[c] It also provided ammunition to Bert Kelly, a parliamentarian representing agrarian interests, who wrote a very influential column in *The Australian Financial Review* explaining in simple terms the costs of protection for exporters and consumers (Kelly, 1982).

The Commission helped build a coalition for trade reform, but it could not have done it alone. Together with exporters, politicians, academia, and the press,

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BOX 5.2 AUSTRALIA'S PRODUCTIVITY COMMISSION *(continued)*

it laid down the groundwork that, eventually, made possible the gradual but irrevocable liberalization process of the 1980s.

Productivity Commissions in Latin America?

More countries in Latin America and the Caribbean would do well to adopt institutions inspired by Australia's Productivity Commission, as Chile has done. But it will not be easy. As in Australia, they will face resistance within government and from industry. Building such institutions will take time and require careful strategies.

Today's Productivity Commission is the result of 100 years of history. Pretending to strictly replicate it in the different setting of Latin American countries would be unwise. But a lot can be learned from the Australian experience. The key question is how to start with a less ambitious, more feasible plan involving a modest but viable product that can then gain credibility and gather support as it produces results.

While statutory independence would make a new entity more likely to survive once it were up and running, it would also make it harder to launch, at least in some countries. One possibility would be to start with a temporary task force or administrative body with a strong leader and a small but competent staff, responsible for producing recommendations on a few key sectors or issues. Another option would be to broaden the mandate of an existing institution with a reputation for independence and analytical rigor.

Choosing the right leader is essential. Success would require someone with solid analytical skills, a stellar reputation of integrity and independence, and the skills necessary to manage the team and the process, navigating through often hazardous waters. Choosing the right home is important as well. The Australian experience suggests that a treasury ministry is a better choice for a group tasked with analyzing the economy-wide impact of policies than a ministry of production or industry, which is likely to be more closely aligned with the protected sectors.

[a] Interview with Terrence O'Brien, November 2018.

[b] While nowadays the Commission's role is unquestioned, in the past there have been calls for its abolishment.

[c] Interview with David Trebeck, November 2018.

Both winners and losers, moreover, participate in the trade policymaking process, trying to steer outcomes in their favor. And, absent sufficient compensation, those who stand to lose will try to block reform.

Firms that compete with imports, in particular, will press for protection. Those that want access to cheaper imported inputs and exporters, who fear retaliation, favor a more open trade regime. This process takes place within an institutional setup for the management of trade policy that may be more or less favorable to trade liberalization and under governments with differing ideologies, more or less supportive of open trade regimes.

As a result of all of these factors, after the liberalization of the late 1980s and early 1990s, countries in the region have had diverse trade policy experiences. Chile doubled down on its early unilateral liberalization through a wide range of trade agreements with most trading partners. Other countries progressed more slowly. Still others, such as Argentina, Brazil, or Venezuela, experienced different degrees of policy reversals. Through the detailed discussion of country cases, this chapter has attempted to show real trade policy in action. Several lessons can be drawn from the analysis:

Trade policy shapes the policymaking process, affecting the constellation of actors and their interests. By creating new economic realities, liberalization, particularly when deep enough and prolonged enough, can generate the conditions for its persistence. Uncompetitive producers adapt or go out of business, while new export producers arise, as the example of Chile shows clearly. The argument, however, cuts both ways. Protection does not just preserve those firms that benefit from it. Each wave also generates a new cadre of import competitors who will oppose future liberalization. Argentina, where the government is trying to move to a more open regime after a decade of increased protectionism, is a case in point.

Compensation can help move liberalization forward. But not all compensation is created equal. In the Chilean compensation package for agriculture during the Mercosur negotiations, losers were overrepresented in Congress and, absent sufficient compensation, would have become veto players. Compensation was generous—and fiscally costly—but much of it focused on providing the conditions for transforming Chilean agriculture, favoring exports through the provision of public goods. Thus, at the same time that it allowed liberalization to move forward, it created new actors that would support open markets thereafter. Usually, however, compensation takes the form of inefficient subsidies, price supports, or public purchases rather than public goods, and thus sometimes delays the reallocation of factors of production toward more competitive firms and sectors.

Interestingly, some countries engaged in what we call "compensation on its head." Rather than liberalize and compensate the losers, they kept markets protected and compensated special interest players who would have benefitted from liberalization. Ecuador is a good example. Instead of negotiating an FTA with the United States to extend market access provided by the Andean Trade Preference Act (a unilateral concession about to expire), an anti-trade government decided to compensate exporters that were about to lose access. So instead of redistributing a larger pie so that everyone would be better off, they reduced the size of the pie and compensated those that were powerful enough to block the move.

Gradual seems to be the way to go. Sudden liberalization does not provide private actors time to adapt and may generate significant backlash. The Australian across-the board tariff reduction in 1973, which led to important reversals, is a case in point. The 1980s liberalization, in contrast, was gradual and preannounced, and it stuck. Moreover, with the exception of a few sensitive sectors that obtained longer phaseout schedules, it did not discriminate across sectors. Even the Chilean liberalization of 1973 under the military was gradual, with most tariffs declining from about 90 percent to a uniform 10 percent over five years. Argentina's recent gradualism was different: varying speeds for different goods, depending on employment and impact on downstream products. A gradual, across-the board approach would have probably been more efficient and less prone to rent-seeking. It is not clear, however, whether it would have been consistent with electoral success.

Trade agreements can be a powerful tool for trade reform. Several examples from our studies support this conclusion. FTAs with the United States have been instrumental in opening up rice and sugar markets in Colombia and Costa Rica. While it will be a gradual process with long phaseout periods, the liberalization of these sectors with very powerful lobbies would have been unthinkable without the FTAs. International commitments associated with FTAs can also make it more costly for countries to renege on open regimes even if society is deeply divided, as the case of Costa Rica and CAFTA-DR clearly shows.

Public actors with an economy-wide perspective should be heavily involved in trade policy. The institutional architecture for managing trade policy matters. It is best to involve in the decision-making process actors whose incentives are more closely aligned with those of the economy as a whole. Executives tend to have broader purview than legislators, which care about protecting industries in their districts; however, congressional oversight is essential to avoid sudden changes in policy when executives with different preferences alternate in power. Within the executive, finance ministries tend to have broader incentives than ministries of trade and industry, although the incentives and makeup of the latter vary from country to country. The specific institutional solution may vary across countries, but trade policy is too important to leave solely in the hands of actors aligned with special interests.

Credible institutions providing independent, high-quality analysis can play an important role in moving liberalization forward. The case of Australia has important implications for Latin America. It shows that an institution like the Productivity Commission, by engaging in high-quality analysis of the costs and benefits of protection, providing advice to government, and disseminating the results, can be a powerful catalyst for reform. While Latin American countries may not be able to exactly replicate this institution, they may be able to adapt it to their local conditions, preserving its most important features: some level of independence; transparent, participatory processes; and an economy-wide focus. The early success of Chile's productivity commission suggests that it can be done.

While the political economy of trade policy is usually dominated by special interests, there are times when voters/consumers become deeply involved. Episodes of import surges, negotiation of important trade agreements, or more broadly antiglobalization events tend to elicit this broader participation. At times like these, understanding the incentives of special interests and the way they play the policymaking game is not enough. It is important to understand the attitudes towards trade of the population as a whole. This is the topic of Chapter 6.

TAKING STOCK

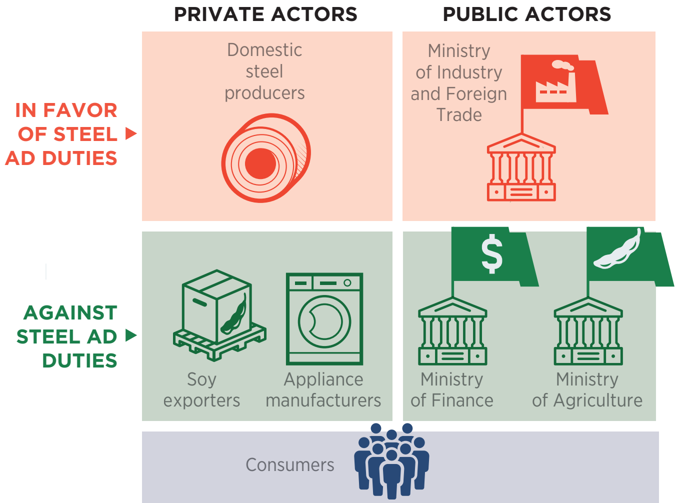
A BALANCING ACT: THE POLITICAL ECONOMY OF TRADE POLICY

Trade policy is the outcome of a policymaking process in which different public and private actors participate actively, within a given set of institutions. The 2016 Brazilian steel anti-dumping (AD) case illustrates the actors at play.

1. In 2016, Brazil initiated an AD investigation of flat steel imports from China and Russia.

2. **Private actors**
   a. Domestic steel producers lobbied for AD duties.
   b. Appliance manufacturers and other intensive steel users lobbied against AD duties.
   c. Soy exporters favored open markets to minimize risk of retaliation.

3. **Public sector actors**
   a. Ministry of Industry and Foreign Trade recommended AD duties.
   b. Ministry of Finance worried about impact on downstream sectors, consumers, and inflation.
   c. Ministry of Agriculture worried about retaliation from China, Brazil's main destination for soy exports.



4. **Consumers** gain from liberalization but are no key players in this game.

THE BOTTOM LINE

Trade policy involves interest groups for whom the stakes are high, and even public sector actors may have different incentives. Public actors with an economy-wide perspective should carry more weight.