



The Political Economy of Trade Policymaking in Latin America: An Introduction

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Reducing trade barriers is almost always controversial, as 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 Latin America recognize the advantages of integration into world markets, but they also see 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, compensation is sometimes 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, liberalization opponents 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 public and private actors that participate in the trade policymaking process, the interests of those actors, and the nature of the trade policy institutions involved.

Most of the time, trade policy involves policymakers and special interest groups—typically private sector actors for whom the stakes are high. These actors 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 are not typically active participants in this process, even though they benefit from trade liberalization through access to a wider range of products and lower prices. This is because consumers in general are a diffuse, disorganized group

for whom the stakes are lower. To be sure, policymakers may have broad consumer as well as 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 trade negotiation (such as the Central America-Dominican Republic Free Trade Agreement, or CAFTA-DR, in Costa Rica) or a recession that turns public opinion against a country's imports. Understanding these episodes requires a better understanding of the general public's attitudes toward trade in terms of its determinants and consequences, both for policy and electoral outcomes.

The trade policymaking process, with its key actors and institutions, helps shape trade policy. But changes in trade policy, in turn, can have substantial feedback effects on trade policymaking. Such was the case with Latin America's "Great Liberalization" of the late 1980s and early 1990s that opened domestic markets to foreign competition while seeking better access to foreign markets for local producers. New exporting firms and economic activities emerged, while previously protected ones 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 has varied as well. Some 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 Latin America 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? To explore these issues, this chapter uses insights from economics and political economy, along with the country studies that follow in the rest of this volume.¹

1.1. 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 trajectories since

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 INTAL and IDB (2002) and Sáez (2005).

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 nonregional 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 U.S. protectionism, work with like-minded interests in partner countries to preserve existing commercial ties (see Chapter 8 in this volume).

Indeed, protection 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 and unexpected 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* (PAC) opposed CAFTA-DR in the country's 2007 referendum but did nothing to reverse course when it reached power in 2014 (see Section 1.1.2 below).

1.1.1. The (Not So) Boring Case of Chile

A prominent Chilean economist once 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." However, the story of how this shared vision emerged in Chile, as told in Chapter 4 of this volume, 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 that 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 (EU), and Asia. Taken together, these trading partners account for 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 import-substitution industries in influence.² By 1991, fresh fruit exports had soared to US\$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 both 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. When 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 therefore gives up little and receives much in return. That is why unions support free trade agreements. They believe, correctly, that FTAs generate jobs.

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

² The process may also have been facilitated by the fact that Chile's import-substitution industrialization process was not as deep as it was in countries such as Argentina and Brazil, due in part to scale considerations.

China signed in 2005. Some apparel lines are still produced in Chile, and, as of 2010, those lines were exported to nine countries: Argentina, Bolivia, the Dominican Republic, Mexico, New Zealand, Paraguay, Peru, the United States, and Uruguay. Except for the Dominican Republic, all of them have FTAs with Chile. Given the way in which textile companies have adapted to liberalization, it is not surprising that the textile companies that remain support FTAs.

The Chilean experience illustrates how trade policies adopted in one period go on to affect the policymaking process in the next period.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

1.1.2. Trade Policy as the Citizens' 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 it. Episodes when major international trade agreements are being considered are among those times. Such was the case of Costa Rica's CAFTA-DR referendum, an example that illustrates the dynamics of mass participation in the political economy of trade policy (see Chapter 6 in this volume).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 at this point be very costly to revert, even when preferences regarding trade policy remain deeply divided.

Unlike the case of Chile, after years of gradual but steady trade reform in Costa Rica no broad pro-trade consensus had emerged 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 regard to trade policy.

Costa Rica signed the CAFTA-DR treaty in January 2004, but the country's president, Abel Pacheco, sensing opposition, did not send it to Congress until October 2005. With the 2006 elections looming, Congress postponed the debate. Thus, when President Oscar Arias was elected, CAFTA-DR had not yet been ratified. Facing a March 2008 ratification deadline and the prospect

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).

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, while public sector unions, student organizations, anti-globalization groups, and left-wing political parties were against it. The same forces faced off in the 2006 presidential election. Those in favor of the export-oriented, liberalizing reforms lined up behind 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 up 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 at 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 of respondents), 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 Rica's internal affairs (Rodríguez 2013).

Despite the drop in support, the "Yes" won by a very narrow margin, with 51.2 percent of the vote. There is some evidence of economic self-interest motivations, as "Yes" got more votes in export-oriented districts (Hicks, Milner, and Tingley 2014). However, interviews with leaders of both campaigns highlight the importance of noneconomic, worldview factors (see Chapter 6 in this volume). The virtual draw between the two worldviews and their political expression persists to this day. Nevertheless, in the long run, the triumph of the "Yes" movement has brought with it almost irreversible changes in Costa Rica's trade policy.

In 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 CAFTA-DR had already been approved by Congress. The telecommunications and insurance markets were already open, and 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 in Costa Rica. With few exceptions, protection for agriculture and agroindustrial sectors is on a clock. However gradually, protection is slated for disappearance. Once that protection is 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 remain.

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.

1.2. Special Interest Trade Politics

While in special circumstances such as the CAFTA-DR referendum in Costa Rica trade policy becomes central in the broader political debate, most of the time trade policy is the province of interest groups for which 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.

1.2.1. 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 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 the 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 from sectors that use steel intensively, under the leadership of Brazil’s Machinery Builder’s Association (*Associação Brasileira da Indústria de Máquinas e Equipamentos* – ABIMAQ).

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 Chapter 3 of this volume, 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 depending on the circumstances. Import competitors are almost always central actors, but the engagement of other private sector actors depends on several factors.

Consider the case of exporters. They may be active if they fear retaliation, but inactive 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 by China, and neither can the Minister of Agriculture. Russia, in contrast, receives 1.2 percent of Brazilian exports. If the anti-dumping case were only 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. Exporters 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 that exempt them from paying tariffs on imported inputs. This mechanism, prominent in Brazilian trade policy, solves the exporters’ problem, but in doing so also reduces their incentive to participate in trade policymaking.

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 A historical example will be illustrated below in the discussion of the U.S. Reciprocal Trade Agreement Act of 1934.

The Brazilian steel anti-dumping 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 this volume suggest that this is not always the case. There are instances when, 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, as in the case of the flat steel industry in Argentina discussed in Chapter 2 of this volume. The dominant firm in the sector uses a number of strategies to align its customers' interests with its own. For example, the company invests heavily in activities for the entire value chain. In 2002, it created a program to support its small and mid-size clients and suppliers that aims to improve their management practices, strengthen their export capabilities, and promote “efficient import substitution.” An example of the company's help in improving management practices is that, according to a firm executive interviewed, all courses available for its executives are also accessible to its clients.

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

In addition to these positive incentives, there are cases where fear of retaliation sometimes discourages challenges to protection. This is particularly relevant when the 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 by competition policies that challenge the dominant power of the domestic market leader.

1.2.2. 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 administration of President Mauricio Macri from 2015 to 2019 pursued what it characterized as 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 where many jobs—particularly in politically sensitive electoral districts—would be at stake.⁸

Chapter 2 of this volume compares trade policy in three sectors in Argentina: computers, flat steel, and textiles. Having discussed flat steel above, here the focus is on computers (and other electronics) and textiles.

Computers and Other Electronics

Under the administration prior to that of President Macri, computers were assembled domestically using imported components. Personal computers, notebooks, and tablets were subject to 35 percent tariffs, while imports of their components were levied at 12 percent. More importantly, a discretionary system of import licenses known as the *Declaración Jurada Anticipada de Importación* (DJAI) 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 mid-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. The *Asociación de Fábricas Argentinas Terminales de Electrónica* (AFARTE), which represents producers in Tierra del Fuego, has ample access and resources. It is stronger than the two associations that represent mainland firms, the *Cámara Argentina de Máquinas de Oficinas Comerciales y Afines* (CAMOCA) and the *Cámara Argentina de Industrias Electrónicas, Electromecánicas y Luminotécnicas* (CADIEEL). Given that benefits for the island discriminate against mainland firms, the relationship among these associations is characterized by conflict rather than cooperation.

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 might 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.

Given all these factors, it is not surprising that the computer sector was the first to be liberalized. In February 2017, the government eliminated tariffs on final goods and components and, later that year, eliminated non-automatic licenses as well. Requests for a more gradual approach by CAMOCA, CADIEL, and the worker's union (*Unión Obrera Metalúrgica* - UOM) 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 the product mix of its member firms.

The government dealt with the losers with mechanisms of compensation, transformation, and concertation (see Chapter 2 of this volume). 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 National Productive Transformation Program (*Programa Nacional de Transformación Productiva* - PNTP), which provides expanded unemployment insurance for displaced workers, subsidies for reemployment, and credit to help firms pivot toward activities with more competitive potential.¹⁰

Finally, the government implemented a three-way concertation process designed to increase competitiveness and reduce prices of TV and cellphone production in Tierra del Fuego. Tariffs were preserved temporarily and internal taxes eliminated.¹¹ Labor unions agreed to wage freezes for two years, and firms committed not to fire workers during that time.

Textiles

Prior to the Macri administration, textiles were also heavily protected in Argentina: tariffs were 26 percent on fabrics and 35 percent on apparel. According to the e-commerce platform Linio, Argentina was the most expensive place to buy apparel in Latin America. Nevertheless, the government adopted a more gradual approach to reducing protection of textiles. Several factors explain the difference.

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

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

¹⁰ For a discussion of the PNTP, see Mesquita Moreira and Stein (2019, Chapter 9).

¹¹ Over a five-year period, the government will gradually eliminate these taxes on the mainland, effectively ending the special regime.

The third important factor was lobbying. In contrast to computers, the textile sector has strong business representation that acts cohesively on behalf of the entire value chain. Particularly interesting is the case of Pro-Tejer, a nongovernmental organization (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 non-automatic licenses, 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 World Trade Organization), the non-automatic licenses 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 non-automatic licenses, 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 Productive Recovery Program (*Programa de Recuperación Productiva* – 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 sectoral round-table (*Mesa Sectorial*) focused on resolving labor issues, product quality, and internationalization.¹²

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 the country had until mid-2018), particularly when the government wants to win reelection.

¹² Not all textile products received the same treatment, however. Consistent with the analysis of this section, synthetic yarns, a highly concentrated, capital-intensive industry that produces intermediate inputs affecting competitiveness downstream, was liberalized more aggressively.

The comparison among these sectors and their differences clearly suggests that, under these circumstances, 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 downstream industries are important elements that contribute to explaining differences in trade policy outcomes.

1.3. From Free Trade to Protectionism and Back

Some countries, such as Brazil, Chile, and Costa Rica, have trade policies that are quite consistent over time (albeit with a protectionist bent in the first case, and a liberalizing bent in the last two). Others, such as Argentina and Ecuador, are remarkable for frequent policy shifts.¹³ But while Argentina's policy shifts as of late have been associated with changes in the party in power, Ecuador's recent policy changes have taken place under the same party, *Alianza País*. The case of Ecuador provides insights into the role of ideas, or ideological preferences, but also shows how the link between these ideas and actual policies is mediated by constraints imposed by the underlying economic conditions.

In spite of widespread political instability, trade policy in Ecuador was consistently liberalizing from 2000 to 2006. Despite last-minute disagreements and a dispute concerning a U.S. oil company, it seemed that Ecuador would eventually sign and ratify an FTA with the United States.

Things changed with the election of President Rafael Correa, who engineered a dramatic shift from liberalization to protectionism. The idea of restarting the FTA with the United States was discarded, and although negotiations for an FTA among Colombia, Ecuador, Peru, and the EU began in 2009, Ecuador withdrew from them soon thereafter.

This shift seemed to arise out of a combination of Correa's preferences, a highly centralized institutional setting that concentrated decision-making authority in the president, and favorable economic conditions that allowed the government to compensate economic sectors that lost from protectionist policies.

Ecuador's concentration of trade policy decision-making authority in the president was stark and was even enshrined in the 2008 constitution.

¹³ This is not just a recent phenomenon. Stein et al. (2006) classified Latin American countries over the previous quarter century according to their overall policy stability and five other features of public policies. Argentina, Ecuador, and Venezuela were the only countries classified as having a low level of policy stability. The rest of the countries included in this volume (Brazil, Chile, Colombia, Costa Rica, and Mexico) were deemed to have high levels of public policy stability.

Article 305 establishes that the executive has exclusive responsibility to create tariffs and determine their level. In line with President Correa's trade policy preferences, Article 206 states that the government should support imports that are necessary for development objectives but discourage those that negatively affect domestic production. And while the National Assembly's approval is required for international treaties such as FTAs, President Correa's party had an overwhelming majority of seats in the legislature, which during his second term became almost an extension of the executive.

President Correa also took steps to limit the influence of the private sector over trade policy. In 2010, the *Consejo de Comercio Exterior e Inversiones* (COMEXI), which included representatives of both the public and private sectors and had played a major role in trade policymaking, was replaced by COMEX, which had no private representation. In this context, President Correa exercised his trade policy authority in a very personalistic way, including assessing particular tariff headings and discussing specific tariff levels.

But while ideology played a primary role in trade policy in Correa's administration, the fact that negotiations with the EU were restarted during his government, while negotiations with the United States were not, shows that other considerations were also in play.

In both cases, failure to conclude an FTA carried with it the danger of losing trade preferences. However, the potential cost was relatively small in the case of the United States, where the Andean Trade Promotion and Drug Eradication Act (ATPDEA) was set to expire in 2006. With oil prices high in the international market, Ecuador's government could afford to compensate exporters, and in fact compensated them, for the loss of preferential market access. That policy in effect turns the typical argument about liberalizing to achieve efficiency and compensating the losers on its head.

In the case of the EU, the situation was different. The cost to Ecuador of losing the Generalized Scheme of Preferences Plus was estimated to be much higher than the cost of losing trade benefits under ATPDEA, because tariffs in Europe were significantly higher than those in the United States. Additionally, Colombia, Peru, and Central America had already signed FTAs with the EU, putting Ecuadorian exporters to the EU at a competitive disadvantage. Finally, the period of high oil prices that had allowed the government to compensate exporters' losses from protectionism was coming to an end by 2013, when negotiations with the EU restarted, and had definitely ended by November 2016, when the treaty was signed. The treaty entered into force in early 2017. Compensation would have been costly in the midst of resource constraints, and ideology gave way to pragmatism.

In the aftermath of President Correa's government, his former vice president, Lenin Moreno, tried to restore relations with the United States and with international financial institutions such as the International Monetary Fund and the World Bank and involve the private sector actors in his cabinet and trade policy. This completed a full circle back to the pro-trade stance of the early 2000s.

1.4. Cross-Border Interests and Alliances

A recurring theme in this book is how trade policy itself changes the political economy of trade policy. The renegotiation of the North American Free Trade Agreement (NAFTA) that culminated with the signature of the new U.S.-Mexico-Canada Agreement (USMCA) provides a perfect example.

When the original treaty was negotiated, trade liberalizers were in office in Mexico, the United States, and Canada. For Mexico, signing this treaty was in many ways the culmination of the pro-market reforms of the administration of President Carlos Salinas de Gortari that were widely regarded at the time as an example of modern, market-oriented economic reforms.

The treaty, however, was strongly opposed by some industrial groups and by unions on both sides of the U.S.-Mexico border. Even though by the time U.S. President Donald Trump was sworn into office the treaty had been in force for more than 20 years, opposition to it had not disappeared. The Trump administration vowed to renegotiate it or repudiate it if Mexico did not accept its demands.

However, when the new negotiations started in 2017, the economic and therefore the political economy landscape on both sides of the border had been dramatically changed by the treaty itself: North America, and particularly the United States and Mexico, had become home to tightly integrated production processes spanning the partner countries.

How did NAFTA-induced integration affect the politics of the NAFTA renegotiation? In order to understand this, Chapter 8 of this volume argues that it is important to go beyond the conventional political economy analysis of trade agreements based on the Grossman and Helpman (1994) model, in which self-interested politicians weigh the concentrated interests of domestic producer alliances versus the dispersed interests of domestic consumers (who are also voters). Chapter 8 shows that the real circumstances that played out in the NAFTA renegotiation had at least as much to do with cross-border producer alliances as with domestic ones, and that, in shaping these cross-border alliances, international mobility of intermediate and final goods via global value chains played a crucial role as well.

Therefore, understanding NAFTA's renegotiation requires augmenting the conventional perspective on how trade agreements are negotiated: given the economic integration that had taken place, players on both sides of the border found that it was in their interest to lobby not only their own government but also the governments of the other parties to the agreement. Moreover, they found a commonality of interest with their counterparts on the other side of the border, particularly in the case of highly integrated industries such as the automotive industry, where auto parts are produced in the United States, exported to Mexico, assembled, and then exported back to the United States in the form of complete vehicles.

Consequently, not only did interested parties such as the Canadian, Mexican, and U.S. Chambers of Commerce mobilize resources to preserve NAFTA, they did so jointly—and their motive for joint action is seen in their common interest to preserve their supply chain security.

The emergence of cross-border alliances depends on the comparison of their benefits—which are related to the extent to which there is commonality of interests and the advantages of sharing resources and information—and their costs—which are related to the difficulty of coordinating with actors operating in a different institutional environment.

Not surprisingly, no effective cross-border alliance was formed for the purpose of ending NAFTA or modifying it in a substantially more protectionist fashion. Being import-competers, producers in Mexico and the United States seeking protection and the rejection of NAFTA were unlikely to be tightly linked to their foreign counterparts by production processes. Absent such preexisting links, their coordination costs would have been high. In contrast, producers that had developed a vested interest in preserving NAFTA trade found it in their interest to share resources and information, particularly when they were in tightly integrated production processes that substantially lowered coordination costs.

As discussed earlier in Section 1.2, losers from free trade policies either adapt or exit the market after those policies have been in place for a long time. In the case of NAFTA, part of this adaptation took the form of increased international value chain integration. Thus, for all of the heated public declarations, NAFTA was transformed into USMCA without causing major disruptions in trade flows or trade regulations among its three partners.

1.5. 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 (Chapter 5) and Costa Rica (Chapter 6), two countries that are largely open in other sectors of their economies, provide insights into the specific features of the political economy of agricultural trade policy.

1.5.1. Sugar and Rice... and Everything Nice

Sugar and rice are agroindustrial products in that, 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 32,000 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 a 55 percent tariff, and that rate was even higher in the past.

The coexistence of very large and 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 toward explaining the strong protection and long tariff phase-out periods these sectors have secured. The millers provide the lobbying capabilities, and the farmers help garner sympathy and support (since no one has ever said "let's rise to defend the millionaire mill owners"). Agricultural support programs and protectionism are always justified as a means to protect small farmers, the quintessential embodiment of the hard-working poor.

Despite this, trade agreements have proved 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.¹⁴ 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.

¹⁴ The phase-out period for sugar is 15 years but is contingent on the United States becoming a net exporter, which is not expected to occur anytime soon.

1.6. Impact of the Institutional Structure

Governments are not monolithic: the legislature, the executive, and different ministries may have different trade policy preferences and different capabilities. Thus, the institutional architecture for trade policymaking—that is, 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.

1.6.1. Legislative and Executive Trade Policymaking in the United States

The U.S. Constitution explicitly assigns Congress the power to set tariffs. Congress is made up of 435 representatives and 100 senators, each representing geographically defined districts (and states).¹⁵ 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 congressperson is likely to support protection. Protection imposes costs on downstream industries and consumers, but these externalities are not fully internalized by the protection-advocating congressperson, who is accountable only to his or her district's voters. Legislators have incentives to engage in "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.

The U.S. president is elected by an Electoral College comprising all districts,¹⁶ which 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 among their highest levels in American history and elicited retaliation from trading partners.

¹⁵ This section draws heavily from Frieden (2018).

¹⁶ The distribution of electoral votes across states (based on the number of representatives and senators) is roughly proportional to population.

As the Depression dragged on, the Democratic Party, with a strong base in the pro-trade, export-oriented, and farm-based South, won control of both the Congress and the presidency. As a result, during Franklin Roosevelt's presidency (1933–1945), 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, these agreements had been signed with 21 countries, covering 60 percent of U.S. imports.¹⁷

The RTAA and successive related mechanisms—including fast-track authority 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 agenda 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.¹⁸

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 most 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 1.1 discusses contemporary trade politics in the United States, which seem to be at odds with this logic.¹⁹

¹⁷ See Irwin (1998) for details.

¹⁸ The rationale for Congress to delegate fast-track authority has been explored in detail by Bailey, Goldstein, and Weingast (1997) and Schnietz (2000).

¹⁹ For lack of space, this chapter will not discuss another important component of trade policy that has a different institutional structure: the management of anti-dumping 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).

Box 1.1**The Twists and Turns of U.S. Trade Politics**

At the time of this writing, the United States was engaged in a trade war with China, after having recently renegotiated the North American Free Trade Agreement (NAFTA) with Canada and Mexico. 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, are responsible for the national externalities associated with 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 where 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 active labor market policies did little to compensate those harmed by the decline of manufacturing or help them transition into new activities. 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 representation contributed to an upsurge of hostility toward existing political elites and institutions (Frieden 2018). In 2016, Donald Trump took advantage of this sentiment, and of the country’s electoral geography, to win the presidency. His anti-trade rhetoric played well in regions that had lost many manufacturing jobs to trade and technology.

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Box 1.1 *(continued)***The Twists and Turns of U.S. Trade Politics**

Recent U.S. trade policy has departed from the standard postwar model under which the executive, generally with a pro-trade stance, negotiates free trade agreements that Congress approves, while sectoral protection is provided by anti-dumping and other special trade barriers. Today, the president's stance regarding trade agreements has shifted, and he gets directly involved 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 those agreements but only 36 percent of Republicans. For the first time in decades, Republican voters are significantly more protectionist than Democratic voters (Jones 2017).

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 is likely to be increasingly volatile. The Industrial Belt will continue to be a battleground where this conflict plays 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.

1.6.2. 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 branch. Legislatures approve trade legislation and vote on trade agreements but can only vote them up or down (Sáez 2005). While the executive has to consider the preference of Congress, it has agenda-setting power and dominates trade policymaking. Within the executive, the role of different ministries varies from country to country. This can have consequences for trade policy. Ministries 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 (*Dirección General de Relaciones Económicas Internacionales* – 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 Presidency, and DIRECON's General Director, who acts as its Executive Secretary.

CIREI has a ministerial-level decision-making body and a technical committee chaired by DIRECON with representatives from the Ministries of Foreign Affairs and Finance. The committee 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.

Just such a contentious issue arose during Chile's negotiations with the Southern Cone Common Market (Mercosur) in October 1995, and the process of resolving it (discussed in more detail in Chapter 4 of this volume) 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 Eduardo Frei made it clear that Mercosur was a priority and ordered the list of exemptions revised to complete the negotiation.

The 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. The government does have to take into consideration the political viability of the treaties it proposes, however, 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 gain approval of 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 (1) a fund to promote agricultural exports; (2) the appointment of representatives responsible for promoting Chilean agricultural exports in target markets; (3) credit guarantees for small farmers; (4) irrigation infrastructure; (5) programs for innovation and for soil and forestry management; and (6) a price band system to shield domestic prices from the volatility of international prices. These commitments exceeded US\$200 million per year and ultimately helped increase Chilean agriculture exports from US\$4 billion in 1996 to more than US\$15 billion today.

In Chile, private actors also take part in trade negotiations, mainly through what is called the *Cuarto Adjunto*, or “Side Room.” This allows for information exchange, public-private consultation, and consensus-building to formulate national bargaining positions. During the Trans-Pacific Partnership 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 as a share of GDP.²⁰ 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.²¹

What are the institutional underpinnings of this result?

Like Chile, Brazil has a high-level interministerial body, the Foreign Trade Chamber (*Câmara de Comércio Exterior* – CAMEX), that is responsible for all trade policy matters and was chaired until 2019 by the Minister of Development, Industry, and Foreign Trade (MDIC). 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

²⁰ See the World Bank’s goods and services tables, available at <https://data.worldbank.org/indicator/ne.imp.gnfs.zs>.

²¹ 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, whose main constituency was the import-competing industrial sector (see Chapter 3 of this volume).²²

CAMEX determined anti-dumping, 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 anti-dumping cases, having initiated 230 investigations.²³

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 Side Room. While the CEB seeks consensus among sectors, it is dominated by the powerful National Confederation of Industry (*Confederação Nacional da Indústria* – CNI), which represents Brazilian industry, especially import-competing sectors. Thus, both on the public and private sides, interests of import competitors have been well represented in Brazilian trade policymaking.

Brazil's institutional setup resembles Chile's in some respects. Trade policy in both countries 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 Ministers of Finance and Foreign Affairs, both of whom support liberalization. In Brazil, until recently CAMEX was dominated by the MDIC, which was close to industry and regarded protection as a crucial component of Brazil's development strategy. On the private side, while in Chile protectionist interests were weakened by years of liberalization as exporters gained substantial power in the policymaking process, 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 threatened, the sector has kept its distance from the trade policy arena, allowing defensive industrial interests to hold sway.

This leads back to the steel anti-dumping case discussed earlier in Section 1.2.1. 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 steel anti-dumping duties ahead of the decisive CAMEX meeting. The Ministry of

²² For a discussion of the Brazilian trade policymaking process in the 1990s and the decline in the role of the previously dominant Ministry of Foreign Affairs, see da Motta Veiga (2002).

²³ *PC em Foco—Observatório de Política Comercial*, various issues.

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 anti-dumping measure as recommended by the Department of Trade Defense. 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 subsuming it as a secretariat under the new Ministry of Economy. While the new institutional architecture for trade policy is still a work in progress and the new composition of CAMEX has yet to be defined, there have already been important changes in Brazilian trade policy. On June 28, 2019, after 20 years of negotiations, Mercosur reached an agreement with the EU, though the agreement must still be ratified by the legislature 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 Brazil's institutional structure—for example, they could be associated with the change of ideology in 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 presented in this section suggests that institutional architecture matters. To complement this analysis, Box 1.2 presents the case of a unique institution, Australia's Productivity Commission (and its predecessors, the Tariff Board and Industries Assistance Commission), which played an important role in the process of trade liberalization of what was once a highly protected economy.

Box 1.2

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 community at large.

Beginning in the 1970s, Australia embarked on a profound trade liberalization process, which then gathered steam in the 1980s under the labor governments of Bob Hawke and Paul Keating. With some exceptions like autos and textiles, which had special regimes and were liberalized later, trade barriers were gradually but relentlessly dismantled. As a result, Australia has become a substantially open economy. But how did this transformation occur? This box

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Box 1.2 *(continued)***Australia's Productivity Commission**

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 establishment in the 1920s of the Tariff Board, an independent advisory body charged with recommending the level of protection 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 and 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” (interview with Terrence O'Brien, November 2018).

But beginning in the late 1960s, under Alf Rattigan's leadership, the Tariff Board changed. Following recommendations from the influential Vernon Report (Australia Committee of Economic Enquiry 1965), Rattigan championed a new approach that involved an economy-wide, systematic tariff review, rather than piecemeal product-by-product analyses of industries' protection demands. It also recommended that objective criteria be used, 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. The fact that the Tariff Board had statutory independence and its chairman could not be fired was crucial for Rattigan to turn it around. In 1973, with the backing of incoming Prime Minister Gough Whitlam, Rattigan transformed the Tariff Board into the Industries Assistance Commission (IAC) (Rattigan 1986).

The IAC 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: 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.

Australia's first liberalization effort—the sudden across-the-board 25 percent tariff cut in 1973—provoked, in the midst of a recession, 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 IAC played a central

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Box 1.2 *(continued)***Australia's Productivity Commission**

role, providing evidence-based recommendations, involving all stakeholders, and informing the public debate.

In 1989, the IAC became the Industry Commission, and, in 1998, the Productivity Commission. The focus became broader, incorporating issues such as energy, transportation, infrastructure, and eventually social and environmental issues. However, three key aspects of the commission's approach remained unchanged: its independence, transparent and participatory process, and economy-wide mandate.

Independence

The Productivity 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 do (for example, which inquiries to work on), but not what to say (Banks 2012). When conducting an inquiry, the Productivity Commission may investigate any issue it deems relevant. It can 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.

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 but respects the prerogative of the government to decide what to do.

Transparent and Participatory Process

Every aspect of the Productivity 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 in which interested parties can provide feedback. The final report itself needs to be presented to Parliament within 25 "sitting days." The government does not need to adopt the commission's recommendations, although it typically does. Otherwise it usually explains why it departs from the recommendations, though 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

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Box 1.2 (continued)**Australia's Productivity Commission**

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 Productivity Commission's work.

The Commission's Role in the Process of Liberalization

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

Perhaps the most important channel of influence for these entities was as providers of information. In addition to the inquiries, the successive commissions published an annual *Trade and Assistance Review*, including measures of effective rates of assistance 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 US\$3,400 per year for their cars (Industry Commission 1997, 214). Another routine 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 Productivity 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 (NFF), which relied on the commission's analysis to argue its case. In the words of a former NFF economist, "The IAC provided the bullets, and we fired them" (interview with David Trebeck, November 2018). 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 1981).

The Productivity Commission helped build a coalition for trade reform, but it could not have done it alone. Together with exporters, politicians, academia, and the press, it laid the groundwork that eventually made possible the gradual but irrevocable liberalization process of the 1980s.

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Box 1.2 (continued)**Australia's Productivity Commission****Productivity Commissions in Latin America?**

Countries in Latin America would do well to adopt institutions inspired by Australia's Productivity Commission. In fact, Chile has already done so. That is not to say such a process is easy—as in Australia, those promoting such a commission would face resistance within government and from industry. Building such institutions would take time and require careful strategies.

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

While statutory independence would make it more likely for such a commission to stick once it is up and running, at least in some countries it would also make it harder to launch. 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 that has 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 managerial and soft 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 that is more closely aligned with the protected sectors themselves.

1.7. Understanding the Rules of the Trade Policymaking Game

In general, the economics profession supports the notion that countries gain from trade. This is more than just a theoretical expectation—it is strongly supported by evidence, as shown by recent IDB reports such as *Trading Promises for Results* (Mesquita Moreira and Stein 2019). But, as expected, the analysis also shows that trade liberalization produces winners and losers. Moreover, both winners and losers participate in the trade policymaking process, trying to steer outcomes in their favor. And lack of sufficient compensation means that 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 that export, and 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, under governments with differing ideologies that are more or less supportive of open trade regimes.

As a result of all of these factors, since the liberalization of the late 1980s and early 1990s, countries in Latin America 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, while yet others such as Argentina, Brazil, Ecuador, and 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:

1. ***Trade policy itself impacts the trade policymaking process, affecting the constellation of actors and their interests.*** By creating new economic realities, liberalization, particularly when sufficiently deep and prolonged, can generate the conditions for the liberalization process to take hold and persist. Non-competitive producers adapt or go out of business, while new export producers emerge, as the example of Chile clearly shows. The argument cuts both ways, however. Protection does not just preserve those firms that benefit from it. Policy reversals generate a new cadre of import competitors that will oppose future liberalization and make it more costly to achieve. A case in point is Argentina, where the Macri administration was trying to move to a more open regime after a decade of increased protectionism.
2. ***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 in a way that favored exports through the provision of public goods. Thus, at the same time that the compensation allowed liberalization to move forward, it also created new actors that would support open markets thereafter. Usually, however, compensation takes the form of inefficient subsidies, price support, or public purchases rather than public goods, and sometimes it delays the reallocation of factors of production toward more competitive firms and sectors. Interestingly, some countries have engaged in what might be called “turning compensation

on its head.” Rather than liberalize and compensate the losers, they kept markets protected and compensated special interest players that would have benefited 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 about to lose such access. So instead of redistributing a larger piece of the pie so that everyone would be better off, the government reduced the size of the pie and compensated those that were powerful enough to block the move or make enough noise.

3. ***Gradual seems to be the way to go.*** Sudden liberalization does not provide private actors time to adapt and may generate significant backlash. A case in point is the across-the-board tariff reduction in Australia in 1973 that led to important reversals. In contrast, the country’s liberalization in the 1980s was gradual and preannounced, and it stuck. Moreover, with the exception of a few sensitive sectors that got longer phase-out schedules, Australia 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 10 percent uniform tariffs in a period of five years. Argentina’s recent gradualism was different: it had different speeds for different goods, depending on employment and the impact on downstream products. An across-the-board gradual approach would have probably been more efficient, and less prone to elicit rent-seeking. It is not clear, however, whether it would have been consistent with electoral objectives.
4. ***Trade agreements can be a powerful tool for trade reform.*** Several examples from this chapter support this conclusion. FTAs with the United States have been instrumental in opening up rice and sugar markets in Colombia and Costa Rica. While this will be a gradual process with long phase-out periods, the liberalization of these sectors with very powerful lobbies would have been unthinkable without these 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 the CAFTA-DR clearly shows.
5. ***The institutional architecture for managing trade policy matters, so public actors with an economy-wide perspective should be heavily involved.*** It is best to involve actors in the decision-making process whose incentives are more closely aligned with those of the economy as a whole. Executives tend to have broader purview than legislators, who care more about protecting industries in their districts. On the other hand, 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 make-up of the latter vary from country to country. The specific institutional solution may vary across countries, but trade policy is too important to leave in the hands of actors that are too closely aligned with special interests.

6. ***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 American countries. It shows that an institution like the Productivity Commission can be a powerful catalyst for reform by engaging in high-quality analysis of the costs and benefits of protection, providing advice to government, and disseminating the results. While Latin American countries may not be able to exactly replicate this institution, they may be able to adapt it to their local conditions and preserve its most important features, including some level of independence, transparency, participatory processes, and an economy-wide focus. The early success of the Productivity Commission in Chile suggests that it can be done.
7. ***While the political economy of trade policy is usually dominated by special interests, there are times when voters/consumers become deeply involved.*** This broader participation tends to result from episodes of import surges, negotiation of important trade agreements, or, more broadly, anti-globalization events. At times like these, understanding the incentives of special interests and the way they play the trade policymaking game is not enough. It is important to understand attitudes toward trade among the population as a whole, an issue discussed in some detail in Chapter 6 of this volume on Costa Rica, and, from a more general perspective, in Chapter 6 of Mesquita Moreira and Stein (2019).