EDITORIAL POLICY STATEMENT

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Trade Policy and Protectionism
A Conversation with Jagdish Bhagwati*

EEJ: Let me begin by congratulating you on behalf of the members of the Eastern Economic Association on being awarded the Bernard Harms Prize for your many contributions to the field of international economics. This prize is surely among the most notable awards that our profession can bestow. Its timing is also fortuitous, for it provides opportunity for us to examine how it can be that economists—who seldom agree on much—are substantially unanimous in supporting free trade, while governments generally tend to embrace protectionism?

Bhagwati: The disparity between economists’ viewpoints and political practice is indeed ironic. All but a small minority of mainstream economists in the English-speaking world are free-traders. Policy-makers, on the other hand, have surrendered willy-nilly in the last decade to the forces of protectionism. In the U.S., for instance, the 1988 Omnibus Trade and Competitiveness Act represents in my view the latest retrograde step in the direction of protectionism.

EEJ: If we reflect back to the half-century of liberalized U.S. trade policy, how can we account for the current shift to a protectionist stance?

Bhagwati: I would argue that the answer lies in two characteristics of the U.S. trade situation in the 1980s: panic and petulance.

The panic came from two major sources: the overvaluation of the U.S. dollar, and the dramatic rise of the Pacific nations in the world economy. Both pressed hard on the international trade sector, and contributed to what I call the “diminished giant” syndrome in the U.S.

The petulance came from the notion that the problems faced by U.S. industries in competition with foreign suppliers—especially Japan, but also other successful exporters from the Far East—were due to the underhand, inscrutable, even illegal, “unfair trading” practices pursued by these nations. The result was the view that the U.S. had to bash its foreign competitors by taking them through the “fair trade” wringer, by changing procedures so as to make unfair trading findings easier to establish. The objective has further been to compromise Presidential discretion in the matter of trade policy; hence Presidents have tried to maintain open markets for the last half century, even when Congress leaned toward trade protectionism.

EEJ: Didn’t Britain similarly experience a “diminished giant” status at the end of the 19th century which also produced protectionist pressures?

Bhagwati: The parallel with the British experience is dramatic. The end of the Napoleonic wars and the coming of the Industrial Revolution saw Britain emerge as the unchallenged leader among nations. Subsequent to the Second World War, which substantially destroyed the industrial capacity of Europe and Japan, the United States emerged as the world’s leader. And, to continue the analogy, just as Britain could not seriously hope to maintain its premier status once other countries industrialized, so the U.S. could not hope to retain its superior status when other nations regained or established their industrial potential.

The diminution in Britain’s preeminence in the world economy led to a rise in protectionist sentiments and to demands for an end to Britain’s unilateral embrace of free-trade principles. Now the United States is similarly experiencing protectionist pressures. The present-day

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sentiments on trade policy in the United States have been aimed mainly at the newly successful rivals. In the 19th century the United States and Germany were to Britain what the Pacific nations were in particular—were to the United States today.

EEJ: How do you account for the great emphasis in contemporary policy discussions on the notion of "fair trade" as opposed to free trade?

Bhagwati: Advocacy of fair trade in the United States today is more reflective of the psychological mood of a nation losing hegemony in the world economy and of a national perception that the success of our competitors, especially the Japanese, is in part a function of their inability to compete. The notion that other countries are trading unfairly, coupled with the "diminished giant" syndrome, is what underlies the calls for aggressive trade legislation, tougher and more restrictive interpretations of unfair trade practice, "hardball" international negotiations, and confrontational tactics in general. This is evident in the 1988 Trade Act; it also explains, well the capture of the countervailing-duty and anti-dumping mechanisms by protection-seeking interests.

EEJ: Did the rise of the dollar also play a role in present day neo-mercantilist sentiment?

Bhagwati: Indeed it did! The rise of the dollar was the consequence of the expansionary fiscal and monetary policy mix in the United States and the enormous influx of foreign funds into this economy. The result was a squeeze on its trade sector. Export and import-competing industries had to contract relative to the non-trade sectors. The consequence was their deepening distress which, in turn, fueled the demands for protectionism.

EEJ: Does this "get tough" loan and means approach to our trade policy by Congress, in effect, signal the end of the more cooperative approach we have come to expect in past decades?

Bhagwati: Not entirely. The Omnibus Trade and Competitiveness Act of 1988 does reflect a unilateral determination of what is "unfair" in other countries' trading policies. But, there has also been an enhanced effort at multilateral negotiations by launching the Uruguay Round under GATT auspices. This is a more statements-based approach in the sense that it seeks to further American interests in a fashion consonant with the interests of the world trading regime. Its modality is to secure concessions in favor of U.S. exports by extending GATT-type rules to new sectors, such as services and agriculture, which are largely outside the "rule of law" today, and in which the U.S. expects to export successfully. This is an ongoing process at Geneva that will await outcome in 1990.

EEJ: Is this sort of policy schizophrenia likely to be confusing to our trading partners?

Bhagwati: Absolutely! The disturbing reality is that the new Trade Act builds into itself several new features, each small but all adding up to a larger picture that will remove the "fair trade" processes to harass foreign suppliers with whom our producers compete on our home ground, and foreign producers on their home ground, by bilaterally pressuring them and their governments into unsealing more U.S. exports. Its effect may well be explosive: rather than catalyse to U.S. legislation itself will remain as a pentastiel threat and a pernicious example on the books. I am afraid it will be providing a sorry reminder of the folly that politics, finding on panics and piety, can produce adverse effects. The spread of folly by example is also something we do not appreciate enough. Our 301 practice has already been adopted by the European Community, just as U.S. import-restricting changes have often taken a cue from the European practices, such as and dumping. There is a Gresham's Law here, as everywhere: bad legislation spreads faster than good legislation.

EEJ: Let me thank you for the most enlightening conversation, especially for spelling out some of the less known specifics of the new trade legislation. There are, of course, many more aspects to your international trade arguments, especially those which are technically sophisticated that we have not been able to address. So I will close by simply referring our readers to your very successful and readable recent book, aptly entitled Protectionism.

REFERENCES


Persistence Effects in Labor Force Participation

Robert S. Gay and William L. Wascher*

INTRODUCTION

Much of the recent research on aggregate labor supply functions has sought to explain cyclical fluctuations in employment and unemployment by focusing on the dynamic aspects of the participation decision. The purpose of this paper is to distinguish empirically two facets of participation dynamics that are of particular interest because they imply quite different interpretations of labor market fluctuations. The first is the notion that workers time their participation to coincide with periods of high real wages. In this view of labor supply, which underlies equilibrium business cycle models, cyclical fluctuations in employment and unemployment are primarily voluntary responses of workers to transitory movements in real wages. A second facet of participation dynamics turns on the notion that workers' current labor force status is heavily influenced by their work experience in the recent past. In this view, short-run increases in employment lead to longer-term increases in participation as workers remain in the labor force because they become committed to consumption standards and their associated contractual costs, accumulate human capital and form attachments to careers, and face adjustment costs associated with leaving and reentering the labor force. These persistence effects in contrast with the timing hypothesis, would lead to a secular increase in labor supply and involuntary unemployment during cyclical downturns.

The timing hypothesis rests on the presumed importance of intertemporal substitution among labor supply decisions over the life cycle. That is, consumption of leisure in the current period is presumed to be highly substitutable with leisure (and goods) in other periods. Thus, movements in the current real wage relative to expected future real wage rates would generate large short-run responses in labor supply. Supporting empirical evidence on short-run elasticities, however, has been inconclusive. In one seminal study, Lucas and Rapping (1969) did find a fairly high elasticity of labor supply with respect to temporary wage changes for the period 1930-65. Their empirical work was based on the assumption that expectations about future wages and prices, which play a key role in the model, are formed adaptively and thus are not directly observed. Their estimates for elasticities with respect to permanent wage changes was also consistent with a vertical long-run supply curve. However, another study by Akerlof (1982) recalculated the Lucas and Rapping model for the period 1930-76 using wage and price expectations generated from explicit forecasts for a system of equations implied by a national expectations solution to the labor market model and the results generally do not support the intertemporal substitution hypothesis. From this evidence and other studies using panel data on individuals' labor supply decisions, he concludes that the temporary wage elasticity probably is weakly positive, although he allows that a larger elasticity for married women cannot be ruled out.1

1 There are, however, several reasons to believe that longer term perspectives play a major role in labor supply decisions. First, high transactions costs incurred by the jobseeker in finding a job and by the employer in training new workers may impede intermittent participation. Second, employed workers tend to accumulate human capital or valuable work habits, thereby increasing the probability of keeping their current jobs or of finding another one and raising the return to work relative to leisure. Third, certain incentives that spur greater participation among young persons (such as cohort effects) may carry over