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The Prophecies of the Naysayers – Assessing the Vision of the Protectionists in the U.S.-Canada Debate on Agricultural Reciprocity, 1846-1854

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Debates over proposals to liberalise international trade are often heated and acrimonious. They are often argued, in part, on the basis of projections of market conditions after the proposed liberalisation. These argument are often important in influencing trade policy decisions, yet their accuracy is seldom assessed after liberalisation takes place. As a result, the projections may be more influential than they should be. This paper examines the projections of protectionists in the debate surrounding a proposed reciprocity agreement between the United States and British North America over the period 1846-1854 as a case study. The protectionist prophesies on both sides of the border were found not to be supported by the evidence from the subsequent period of reciprocity. A number of reasons for the inaccuracy of the projections are identified.

Keywords: agriculture, protection, reciprocity, trade agreement

Introduction

Historians often complain that the lessons of history are ignored. Sometimes, however, the lessons of history are difficult to extract from the record of events. One example may be the *cachet* that continues to be attached to protectionist arguments despite the general acceptance of the benefits of more open systems of international trade. While it is understandable why vested interests that perceive that they have something to lose from trade liberalisation will fight to prevent that loss from occurring, it is harder to understand why their arguments are accepted by the public and decision makers[1]. Even after over fifty years of the General Agreement on Tariffs and Trade (GATT) and the World Trade Organisation (WTO), the international trade landscape is still littered with trade barriers and new encumbrances continue to arise, particularly in the form of non-tariff barriers and through the strategic use of contingent protection mechanisms[2]. Proposals for new regional trade agreements are met with a flurry of protectionist activity[3] while WTO negotiations face cleverly disguised protectionist arguments from both developed and developing countries[4]. One (but certainly not the only) reason why protectionist arguments are so persuasive, however, is that they are seldom directly refuted.

There are a number of reasons why one so seldom sees the arguments of protectionists refuted. Part of the reason is that protectionists long ago lost the intellectual battle regarding the “general good” arguments surrounding trade liberalisation/protection[5]. Attempts are still made, however, to *dress up* protectionism in *welfare enhancing clothing* (e.g. over environmental or labour standards) to give it intellectual credibility but, in general, protectionist arguments are made on a different level[6]. In other words, protectionist arguments are made on a sectoral, industry or enterprise level – i.e. so many jobs lost, firms relocating, factories closing, etc. Claims of expected losses of these types are difficult to refute. They can only be refuted *ex post* to a change in the trading regime.

Protectionist arguments are presented when a change in the international trading regime is being proposed. They are meant to forestall the proposed change. If the arguments of protectionists are persuasive, the change in international trading regime does not take place. As a result, the prophesies/projections of the protectionists cannot be tested *ex post* because there has been no change in the international trade regime. Hence, protectionists’ claims can be made with impunity[7]. Only if the change in the international trade regime is actually accepted and implemented is it possible to examine the *ex ante* claims of protectionists.

Even when a change in the international trading regime takes place, the protectionists arguments may not be examined to discern if they represented an accurate portrayal of the state of the sector, industry or enterprise in the *post* change environment. In part, the lack of interest in examining the projections of the protectionists once liberalisation has been accomplished is that for those interested in liberalisation, the battle has already been won. There is nothing to be gained from such an examination in relation to the particular issue that was being debated prior to the change. However, the failure to carry out these examinations may make it easier for protectionists to bring forth similar arguments the next time trade liberalisation ends up on the policy agenda.

Protectionists, of course, might have an incentive to undertake an assessment if they could be assured that the result would support future cases. Given how seldom such assessments are actually undertaken, one may be drawn to the conclusion that the projections made by protectionists may not, in general, be confirmed.

One of the problems with providing an assessment of protectionists' projections is that they are very difficult to do. Changes in trade regimes take time to work their way through the economy. Often, new trade regimes have pre-specified phase in periods so that the effects of a change are not fully manifest for ten or fifteen years. A large number of shocks to economic systems will take place during the period over which the changes to the international trade regime are being implemented. As a result, it is very difficult to impose *ceteris paribus* conditions so that the effects of the change in the international trade regime can be isolated from the other economic forces at work. In particular, the *general equilibrium* nature of the problem presents a significant challenge for economic modelling.

The gains from trade liberalisation are expected to arise from the movement of resources out of relatively less efficient industries into more efficient industries – changes in international trade patters only follow changes in resource use. Economists' ability to model the movement of resources among sectors is only poorly developed and, as a result, most computable general equilibrium (CGE) models either capture only the first round effects of trade liberalisation – before resources begin to move among sectors – or "use *ad hoc* specifications for functional relationships"[8]. Given the difficulties associated with isolating the effects of trade liberalisation and modelling the liberalisation process, it is probably not surprising that so few evaluations are undertaken. Further, the CGE models tend to be developed on a very aggregate level while protectionist projections are often made on an individual product or market basis[9]. This suggests that examining protectionist arguments will have to be done on a commodity-by-commodity basis.

Undertaking an evaluation of protectionist arguments on an individual commodity basis, however, can be a significant task. First, the current array of tradable goods is vast and not all products can be examined leading to the possibility of selection bias. Further, there is no place where protectionist statements are conveniently collected so that a considerable effort would have to be expended in acquiring a representative sample of views. On the other hand, not to make the effort is to leave protectionist predictions untested and open for further unchallenged use[10]. Given the apparent importance of protectionist pressure in trade policy making[11], a preliminary effort to establish whether the approach is feasible is warranted.

Reciprocity Between the United States and British North America as a Case Study

One way to make this type of research more tractable is to find a proposal for trade liberalisation that is limited in product scope – thus limiting the array of goods to be examined. One successful attempt to liberalise trade that was limited in product scope was the agreement on reciprocity in agricultural products that was negotiated in 1854 between British North America and the United States and remained in force until 1866. The list of products to which reciprocity was extended was comprised of only forty-two items[12]. Of the forty-two products on the list of reciprocity items, sixteen were very minor commodities with values of trade less than £10,000[13]. The list of 26 products includes the main tradable agricultural products such as grains, flour, livestock, meat, seeds, fish, poultry, eggs, hides and pelts, furs, butter, timber and lumber and sheepskins.

The reciprocity treaty has some other attributes that made it particularly attractive to study. Reciprocity meant the immediate elimination of tariffs rather than the phase down of tariffs that is typical in modern trade agreements. This means that the effects on trade flow are immediate, reducing to some extent the *ceteris paribus* problems associated with liberalisation that takes place over a long phase-in period. There is also good consistent data on trade flows both prior to the reciprocity agreement being signed and for the first three years it was in force[14] – when the majority of, at least, the first round effects on trade flows would be expected given the immediate elimination of tariffs on reciprocity items. The early post agreement years were also politically stable and exhibited moderate economic growth, conditions where economic actors could be expected to act upon opportunities provided by the removal of trade barriers.

In the latter period of the reciprocity era, the Civil War in the United States destabilised domestic politics and moved its economy away from equilibrium. Britain's apparent support of the Confederate States had a detrimental effect on relations between British North America and the United Stares. These events increased business risk and likely inhibited investments in trade related activities. The agreement was unilaterally terminated by the United States in 1866.

While either side in a trade debate may have an incentive to mislead their audience, there is no way to know their true motivations. Hence, not to impute motives to protagonists, their statements must be taken at face value – i.e. that they believe what they are saying. If they are wrong in their assessment of the future, the question that then arises is; why?

On a commodity specific basis, protectionism must rest on an expectation of financial loss that is the result of an assessment of the differences between the two economies prior to liberalisation. Perhaps the most obvious basis for an assessment of this nature is the relative prices of similar products in the two national markets. The evidence from the protectionist arguments surrounding reciprocity appears to support this hypothesis.

The protectionist's perception is that, as the industry or firm is located in the *high priced* country, there will be an inflow of less costly imports leading to a decline in prices. Firms will be forced to exit and the industry will shrink. On the surface, this scenario appears logical and consistent.

The protectionists' perception of current market conditions may, however, be incorrect. There are at least five reasons for having a false perception of the pre-liberalisation transnational business environment. The first is that the relative prices may not be as perceived. That is, the protectionist has imperfect information and the industry/firm does not actually operate in the high cost country once prices plus transportation costs are accurately accounted for.

Second, there is an implicit assumption made by protectionists that the *low cost* country can increase its production sufficiently at current costs to flood the importer's market and drive prices down. It may be, however, very expensive for the exporting country to bring additional resources into the *low cost* industry. In this case, rather than large amounts of increased exports, the "low cost" industry finds that instead there is an increase in prices. Producers in the exporting country benefit at the expense of their consumers.

Third, goods may not be competitively priced in the importing country. In other words, the prices in the importing country reflect not only costs but also an additional premium due to the existence of market power. A reduction in tariffs may well lead to a decrease in price but only a reduction in profits rather than bankruptcy. There will be no exit of firms or major loss of jobs in this case.

The fourth reason stems from the faulty perception that the envisioned differences in costs apply to the entire range of commodities produced by an industry and that these differences will not change over time. While it is the specialisation in production that provides the gains from trade, it is often perceived that this will occur through the wholesale bankruptcy of entire industries (e.g. that the meat packing industry will disappear). In many cases, however, it is the specialisation within an industry's range of goods where the gains from trade can be made.

The fifth reason why the protectionist vision may be incorrect is that there can be sufficient market expansion occurring to accommodate both domestic and extra foreign supplies. In this case the domestic industries may grow less than if they were protected but there would be no significant loss of existing jobs or bankruptcies.

Hence, there are several reasons why the protectionist vision may be wrong. Of course, the vision may also turn out to be correct. *Ex post*, once an agreement has been implemented, the resulting changes in economic activity will either support or reject the initial publicly espoused position. In the latter case, each of the possible reasons why the protectionist's vision was inaccurate would be supported by different economic events.

A correct vision by protectionists would be supported by the following set of stylised facts: - bankruptcies, reduced employment and reduced output in the importing country. If there was imperfect information on relative prices (Reason1), then the supporting evidence would be: - no significant change in trade or changes in trading patterns contrary to those predicted. If expansion in the exporting country is difficult (Reason 2), then one would observe: - price increases in the exporting country. When market power exists and goods in the importing country are not priced at cost (Reason 3), one would expect: - decrease in prices in the importing country but no bankruptcies and only limited loss of employment. If liberalisation leads to within industry specialisation and intra-industry trade (Reason 4), then there will be: - increased trade volumes within the trading category, no decrease in employment and output or increases in bankruptcies. A general market expansion (Reason 5) means that: - market growth in the importing country exceeds the increase in imports. Data on all of these economic events is normally readily available, often historically. Thus, once the protectionist positions are identified and the change in the trade patterns tabulated, it is relatively straight forward to determine whether or not protectionists were correct, and in the cases where they were wrong, why they were wrong.

The protectionist arguments on both sides of the border are reported in detail in the Technical Annex. A few examples are presented here. In some cases, such as grains, the same arguments were made on both sides of the border simultaneously. For example, in a letter to the *New York Herald* it was claimed that:

> … the influx of Canadian grain will be so great (should the bill pass) that our growers will be forced out of the markets....[15]

In Canada, the prophesy for grain was that:

> Why the Canadian would have been driven out of the field by underselling.[16]

In the case of live animals, Mr. Brooks speaking in the debates over reciprocity in the legislature of United Canada stated:

> The theory (reciprocity)... might be a good one, but when put in practice, in the case of cattle, it was a most injurious one[17].

In the case of wool, Canadians were told to expect the worst.

> He would have been happy to hear that the hon. member explains what effect this resolution would have on creating a market for wool, a most important matter to the agriculturalist... he was convinced it would bring our agriculturalist in competition with farmers of the United States – a competition which could not be anything but ruinous[18].

For the most part, the protectionist statements were as straight forward as those presented above, asking for protection on the basis of threatened self-interest arising from increased competition for individual commodities. Further investigations, reported fully in the Technical Annex, show that none of the protectionist prophesies came to pass. The results of these investigations for eight major commodities to which reciprocity was applied are summarized in Table 1. The protectionist prophesies failed to be realised for all five reasons outlined above.

Table 1 Protectionist Prophesies for Major Reciprocity Commodities

Commodity	Origin of Protectionist Claim	Prophesy Not Fulfilled	
		Reason #	**Reason**
Grain	United States	Reason 5	Market Growth
		Reason 4	Intra-industry Specialisation
Grain	Canada	Reason 1	Inaccurate Relative Prices
Flour	Canada	Reason 3	Market Power
		Reason 4	Intra-industry Specialisation
Live Animals	Canada	Reason 1	Inaccurate Relative Prices
		Reason 4	Intra-industry Specialisation
Meat	Canada	Reason 4	Market Growth
Butter	Canada	Reason 1	Inaccurate Relative Prices
Cheese	Canada	Reason 5	Market Growth
Coal	United States	Reason 2	Constraints on increased supply
Wool	Canada	Reason 4	Intra-industry Specialisation

Note: No protectionist claims were identified for: seeds, vegetables, dried fruit, undried fruit, fish, eggs, hides and pelts, furs, marble, tallow, lard, ores, ashes, timber and lumber, firewood, plants, shrubs and trees, sheepskins, fish oil, or flax. References to protection for tobacco were found but were too vague to analyse.

Conclusions

Proposals for trade liberalisation are often, if not always, the subject of considerable debate. Both sides in these debates must base their arguments on a vision of market conditions after trade barriers are removed in the future. Forecasting the future, particularly after a major structural change such as the removal of trade barriers is a difficult task, and results are open to criticism. Given the complexities of the general equilibrium nature of trade liberalisation and lags in adjustments and implementation, *ex post* evaluations are also difficult. In the latter case, this often means that evaluations are not undertaken, in part because the arguments have already been won or lost. The end result is, however, that the claims made by parties active in the debate are not substantiated nor refuted. Given that these *ex ante* arguments may be persuasive in the debates, however, having information on their accuracy should be of interest.

The arguments of the protagonists of trade liberalisation tend to be couched in macro terms related to creation of jobs and increased economic growth. On a very practical level, projections of growth in exports of particular commodities are seldom made explicitly because they provide evidence that can be used by the opponents of liberalisation. On the other hand, protectionist arguments are often based on projections for particular commodities that are perceived to be at risk.

If protectionist arguments win the day and no liberalisation takes place, it is not possible to judge the accuracy of the arguments of either side. If liberalisation goes ahead, however, protectionist prophesies can be examined. In the case of the 1854 reciprocity treaty between the United States and British North America, the protectionist prophesies do not appear to have been fulfilled. Five reasons for this failure have been identified: inaccurate relative price information, constrains of expansion of supply, the existence of market power, intra-industry specialisation and market expansion. Those wishing to examine the statements of protectionists in future debates may wish to examine the prophesies in light of these reasons. Relative prices, constraints on the expansion of supply and the existence of market power in importing countries can be investigated relatively easily. The potential for intra-industry specialisation and market expansion post liberalisation will be more difficult, but not impossible to, forecast and argue effectively.

The examination of the reciprocity agreement of 1854 suggests that this avenue of research may be worth pursuing as a means to better assess the arguments of protectionists in debates over trade liberalisation. Of course, the prophesies of those arguing the case for liberalisation also need to be assessed.

Endnotes

1. Of course, some decision makers may eventually side with protectionists for political reasons even if they don't accept their arguments, but it is hard to believe that such cynicism extend to all, or even a majority of decision makers.
2. See W.A. Kerr, "Dumping – One of Those Economic Myths", *The Estey Centre Journal of International Law and Trade Policy*, 2 (2) (2001): 1-10, www.esteyjournal.com.
3. See, for example, W.A. Kerr, "NAFTA and Beyond: Challenges for Extending Free Trade in the Hemisphere", *The Estey Centre Journal of International Law and Trade Policy*, 3 (2) (2002): 224-238, www.esteyjournal.com.
4. A.L. Hobbs and W.A. Kerr, "First Salvoes: A Guide to the Opening Proposals at the WTO Negotiations on Agricultural Trade", *Agribusiness Paesaggio and Ambiente*, 4 (2) (2000): 97-108.
5. W.A. Kerr and N. Perdikis, *The Economics of International Business* (London: Chapman and Hall, 1995).
6. Leaving aside academic arguments such as the optimum tariff that are not easily transformed into trade policy.
7. Of course, the claims of those who support liberalisation also cannot be refuted if no change in the international trade regime takes place.
8. J.D. Gaisford and W.A. Kerr, *Economic Analysis for International Trade Negotiations* (Cheltenham: Edward Elgar, 2001): 22.
9. These modelling difficulties allow both sides in trade liberalisation debates to exaggerate the effects of the change in trade policy to support their cause (e.g. attributing all job losses observed in the economy in the period of liberalisation to the trade agreement or conversely, all increases in economic activity.
10. This is not to suggest that the claims of pro-liberalisation interests should go unchallenged. They need to be subject to the same degree of rigorous examination.
11. Kerr and Perdikis, *The Economics of International Business*, 43-57.
12. The task is also made simpler because the economy was less complex that today and the types of agricultural products that could actually be moved to distant markets given the available means of transport, storage methods and packaging were very limited.
13. A complete list of the reciprocity items as well as the criteria for limiting the number of products to be examined can be found in the Technical Annex to this paper. Additional insights into the negotiations surrounding the inclusion of products "unimportant" in international trade on the list of reciprocity items can be found in W.A. Kerr, "Creating a Free Trade Illusion: Some Economic Facades in the Canada-U.S. Reciprocity Treaty of 1854", *British Journal of Canadian Studies*, 1 (2) (1986): 323-324.

14. The sources of the trade data are the *Journal of the Legislative Committee of United Canada* and papers of the Colonial Office of the British government. A complete discussion of the data can be found in the Technical Appendix to this paper.
15. Letter to the editor of the *New York Herald*, 28 Jan. 1849 reported in "The Canadian Reciprocity Bill," *Daily British Whig*, Kingston, 29 Jan. 1849.
16. Statement by Mr. Smith in the debate on reciprocity, 2 Feb. 1849 in Gibbs, E. (ed.), *Debates of the Legislative Committee of United Canada* (Montreal: Centre de estude du Quebec, 1970): 448.
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The technical annex to this paper, pages 369-408, is available as a separate document.