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How Does Free Trade Become Institutionalized?
An Expected Utility Model of the Chrétien Era

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Abstract

This paper seeks to go beyond the question of 'why free trade?' and pursues issues related to the tendency for controversial free trade agreements to become institutionalized. In other words, why do opponents of free trade not mobilize to overturn it? Even more puzzling, why do opposition parties, which had opposed passage of free trade in the first place, not undo liberalization undertaken by their predecessors upon coming to power? Rather than seek reversal, it is not uncommon for free trade opponents, upon assuming control of the government, to deepen liberalization initiatives, hence serving to institutionalize the very policies they had decried vigorously.

Six sections make up this study. It begins with a statement of the basic puzzle and an illustration in the recent Canadian context. The second section is a theoretical discussion of opposition parties and free trade. An expected utility model, based on the limits of rent-seeking, is introduced in the third section to explain institutionalized free trade. The fourth section provides the background to the case at hand, that is, the evolution of free trade as a politico-economic issue in Canada. The fifth section applies the expected utility model to the superficially puzzling case of Canadian Prime Minister Jean Chrétien's dramatic about-face on the issue of trade liberalization after coming to power. Sixth, and finally, the contributions of the model are reviewed, along with directions for future research.

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Passage of the Canada-US Free Trade Agreement (CUFTA) in 1988 generated a great deal of activity in both the scholarly world and the theater of public policy. Scholarly interest in continental, and ultimately hemispheric, free trade grew steadily through the 1990s, stimulated by both the North American Free Trade Agreement (NAFTA) and the proposed hemisphere-wide Free Trade Area of the Americas (FTAA). While such stimuli keep analysis of trade policy fresh and interesting, they mask more enduring puzzles. One such conundrum turns on why free trade policies are passed in the first place. It has been demonstrated amply, for example, in the literature on public choice political economy that, while trade liberalization is beneficial in a Ricardian sense, it generates such likelihood of political backlash from entrenched special interests that the risk will be borne only under isolated conditions.

While interesting, the puzzle of "why free trade?" is of only antecedent concern here. Of more immediate interest is the question of *why controversial free trade agreements so often become institutionalized?* Why, for example, do opponents of free trade not mobilize to overturn it? Even more puzzling, why do opposition parties, which had opposed passage of free trade in the first place, not undo the liberalization undertaken by their predecessors upon coming to power? Logic would dictate that opposition parties, whose own rise to power may well have been aided by attacks on trade liberalization, would seek to gratify their protectionist constituents. Instead, it is not uncommon for these free trade opponents, upon assuming control of the government, to deepen liberalization initiatives, hence serving to institutionalize the very policies they vigorously had decried.[1]

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[1] A caveat regarding our use of the term *institutionalized* is in order. We consider a policy – free trade or protectionism – to be institutionalized if a powerful constituency a) mobilizes for retention of that policy and b) is successful over a period of a number of decades. We do not mean to imply that the institutionalized policy is *permanent* or invulnerable to change over the long term. Indeed, institutionalized policies do change, as the example of Canada's

This seemingly strange phenomenon is not so unusual. The 2002 election of Brazilian President Luis Inacio Lula da Silva, a long-standing opponent of free trade with the United States, should have spelled doom for the FTAA initiative – at least as far as Brazil was concerned. Instead, however, Lula has indicated a willingness to continue FTAA negotiations (Williamson 2003). In the United States, an important sea change in US trade policy occurred with the passage of the 1934 Reciprocal Trade Agreements Act (RTAA). While the RTAA was opposed by the largely protectionist Republican Party during the 1930s, by the post-war era, the Republicans had become so enamored of trade liberalization that the party became, and remains, the standard bearer for free trade. Finally, of immediate interest here is the Liberal Party of Canada. Like his predecessor, John Turner, the Liberals' mercurial leader, Jean Chrétien, was an ardent opponent of continental free trade. As leader of the opposition in the early 1990s, he campaigned strongly against the proposed NAFTA, vowing not to honor its provisions if the agreement became law. Yet, upon ascending to the premiership, Chrétien failed to make good on his threat. Instead, the Chrétien Administration has supported hemispheric free trade strongly and is at the forefront of the movement to institutionalize the FTAA.

With a focus on the dynamics that cause formerly protectionist opposition parties to support free trade agreements (and indeed free trade in general) upon acceding to power, this article seeks to explain why free trade becomes institutionalized. We expand on the so-called limits of rent-seeking model (Lusztig 1998; 2004; Lusztig, James and Kim 2003) and construct an expected utility model to explain the volatility of former opposition parties on

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rejection of protectionism in the 1980s suggests. Thus, while we focus on the static nature of institutionalized policies, we recognize that there is an implicit (long-term) dynamic element. As Gourevitch (1986) and Rogowski (1989), among others have pointed out, variables such as war, depression, technological innovation, or shifts in the dominant mode of production all can affect the incentive structures of the societal forces that mobilize in support of an institutionalized policy.

the issue of trade liberalization. Since it is a recent and under explored case, Canada serves as an excellent real-world example to illustrate our argument.

Opposition Parties and Free Trade

In parliamentary systems of government, the imperative to govern obviously places obligations on parties and leaders absent during their tenure on the opposition benches. In presidential systems, where the distinction between government and opposition is not as stark, the party that controls the executive branch nonetheless finds itself with a very different political calculus than that of the other party or parties, the power base of which is axiomatically restricted to the legislative branch.

Lake (1988) suggests that this distinction in presidential systems leads to fundamentally different preferences for free trade. He conceives of the apparatus of the state as divided into a *representative element* (principally Congress, although it includes agencies susceptible to bureaucratic capture, such as the US Department of Agriculture) and a *foreign policy executive*. The representative element of the state is most attentive to local or constituent interests. These interests, known as rent-seekers, are likely to be successful in dissuading their representatives from eliminating or reducing extant levels of import protection.[2] The logic is spelled out in endogenous tariff theory, which holds that locally concentrated producer interests (which bear considerable and manifest costs upon losing domestic market shares to foreign competitors) will be more intensely preferential on issues of trade than will

[2] We employ Conybeare's (1983) classic definition of rent-seeking as the attempt to use the power of the state to transfer, rather than create, wealth. A rent is defined as the return on a factor of production in excess of its opportunity cost.

be more dispersed consumers, the benefits to whom will be comparatively modest and latent.[3]

By contrast, Lake argues that the foreign policy executive – the president and high-ranking officials from agencies charged with articulating and executing foreign policy – is less vulnerable to pressure from rent-seeking producers. The foreign policy executive, unlike the representative element, has a mandate to advance the *national* interest. Since the national interest does not coincide with the narrow interests of any one set of domestic actors, domestic actors will enjoy less influence with the foreign policy executive. The logic here is clear from US trade history. The United States became a free trading nation only after it abandoned Congressional tariff making in 1934. Indeed, the Reciprocal Trade Agreements Act of that year effectively transferred tariff-making authority to the foreign policy executive, with the result being a gradual reversal of the effects of the 1930 (Smoot-Hawley) Tariff Act. The transformation that began in 1934 remains to this day, manifested more contemporaneously in the Fast-Track Authority mechanism, now referred to as Trade Promotion Authority.[4]

Uslaner's (2000) argument is similar. He suggests that, because free trade is the policy of winners, the party that controls the executive branch (the winning party) will have a preference for free trade. The logic is that economic prosperity and political success generate a symbiotic relationship. The party that advocates free markets is more likely to be entrusted to control of the executive branch because it will have a better track record of economic

[3] For more on the logic of endogenous tariff theory see Olson (1965), Tullock (1967), Krueger (1974), Becker (1983), Lavergne (1983) and Rowley and Tollison (1988).
[4] While space does not allow for a full articulation of these procedures, they work according to a common logic. Congress grants the executive branch authority to negotiate, within a specific time frame, foreign trade agreements that are subject to little or no Congressional oversight. For more on this point, see Destler (1995).

stewardship. It is therefore no coincidence that the Republican Party – free trading throughout the postwar era – has been more successful in presidential elections than the Democrats, who abandoned free trade between the late 1960s and the early 1990s.

Taken together, Lake (1988) and Uslaner (2000) suggest an executive branch/governing party bias in favor of free trade. If we left the discussion at this point, our puzzle would disappear. Parties oppose free trade while in opposition, but support it while in government. Chrétien merely conformed to this pattern in reversing his position on NAFTA. Things, however, are not quite so simple. First, direct observation tells us that the mere act of governing does not ensure that free trade will emerge. History is replete with examples of protectionist governments. Indeed, rent-seekers would have no rents to protect if governments had not supplied them in the first place. Second, as Uslaner (2000) points out, parties are not free agents when it comes to articulation of policy preferences. They have constituents, many of whom would be alienated by major policy reversals. In Uslaner's (2000, 349) words: "This is the downside of "issue ownership." Parties can become the captives of those who back them most fervently." Indeed, we need look no further than endogenous tariff theory to recognize that rent-seekers themselves represent an important qualification to the idea that a party is free to switch its trade policy preferences simply by virtue of assuming control of the executive branch.

Thus, while the logic articulated by Lake (1988) and Uslaner (2000) is sound, there is a missing dimension: how do parties achieve the policy maneuverability to permit them to shift their trade policies upon gaining control of the executive branch without alienating their core (rent-seeking) constituents? Clues to the answer, we argue, lie in the limits of rent-seeking model.

The Limits of Rent Seeking

The limits of rent-seeking model begins with the premise that rent-seekers do not represent a monolithic population. Instead, two ideal-typical classifications of rent-seeker can be distinguished. One group, *inflexible rent-seekers*, produces in sectors that suffer comparative disadvantage. Whether due to insufficient domestic supplies of relevant factor inputs (land, labor or capital), technological obsolescence, or unfavorable logistical circumstances (climate or geography), these producers are not capable of competition in global markets. As committed protectionists, without state-supplied rents (import barriers or subsidies), inflexible rent-seekers could not maintain their domestic market shares and would be forced to cease operations.[5]

By contrast, *flexible rent-seekers* seek state-supplied rents out of preference, not necessity. Such producers face no insuperable obstacles to successful competition, either at home or abroad. While competitive at least theoretically, flexible rent-seekers still prefer the security of state-supplied rents to the uncertainty borne of global competition. Like idle teenagers on an allowance, flexible rent-seekers could, if circumstances necessitated, get off the metaphorical couch and go to work. For flexible rent-seekers, this sort of adjustment is not always easy. Typically it entails product innovation, rationalization of product lines and personnel and greater investments in research and development. To retain domestic market

[5] The model developed here will not include a more fine-grained sectoral analysis. It is clear that industry characteristics – reliance on overseas markets, factor mobility, industrial landscape issues such as oligopoly and the like – will impact upon policy making. For example, Japan's Liberal Democratic Party, which played a dominant role for many decades, received strong political support from farmers and therefore shied away from reducing rents in the agricultural section despite strong international pressures to open the market in the agricultural section. Such sectoral complexities, however, are beyond the scope of the present investigation and do not create any intuition regarding bias within the expected utility model that is derived at a later point.

shares, quality control has to improve prices (and to some extent) profits must fall. To replace profits lost at home, such flexible rent-seekers will have to find compensatory markets abroad. This entails a commitment to advertising to gain a foothold in unfamiliar markets. Add uncertainty – producers cannot be absolutely sure that such adjustment will succeed – and the costs of adjustment lead flexible rent-seekers, all things being equal, to prefer the protectionist status quo.

Given that both flexible and inflexible rent-seekers pursue the same objective, the expansion or retention of state-supplied rents, they can be difficult to distinguish. Both have a strong incentive to portray themselves as inflexible. Indeed all rent-seekers claim, with different degrees of ingenuousness, that state-supplied rents are all that stands between them and economic collapse. For the government's part, at least *ex ante*, it becomes very difficult to determine who is lying and who is not. On the other hand, it is relatively easy to distinguish flexible and inflexible rent-seekers *ex post facto*, after governments have reduced rents. (We discuss why governments do so below.) Once rent-seekers recognize that the government is firm in its resolve to reduce rents below a critical threshold (variant by producer), flexible rent-seekers behave very differently than their inflexible cousins.

For inflexible rent-seekers, significant rent-reductions are a death sentence. Options are few. Some, recognizing the handwriting on the wall, will exit the marketplace voluntarily. Others, more committed and inclined to fight, will lobby for restoration of the status quo. Politically speaking, committed inflexible rent seekers will be disposed toward inflicting severe punishment on governments that reduce rents. However, governments that maintain their resolve ultimately find themselves with a strong hand to play; inflexible rent-seekers, whether committed or not, are culled from the market. The hardest core of the protectionist lobby falls to the cruel reality of economic mortality.

By contrast, flexible rent-seekers have a far different incentive structure in the face of significant rent-reductions. Once the government has demonstrated its resolve in the reduction of rents, flexible rent-seekers will waste few resources seeking to inflict political sanctions upon liberalizing leaders. Why? An alternative exists to all-out resistance (or meek acceptance). Rather than squander precious resources on a battle that is unlikely to be won, flexible rent-seekers will prefer to apply them towards the considerable adjustment costs outlined above. Moreover, because governments can be critical allies in the quest to secure market access abroad, flexible rent-seekers will have limited incentive to alienate liberalizing governments, leaving governments with greater trade policy maneuverability (see Staiger 1995).[6]

An Expected Utility Model of Institutionalized Free Trade

Whether to reverse or maintain a policy of trade liberalization is a government decision that can be modeled in terms of expected utility. While the answer may be complex, the question itself is a simple one: What is more likely to have greater value to the government in the foreseeable future – a return to protectionism or continuation of the regime of liberalization? To answer that query, the model begins with four basic assumptions.

First, self-interest is assumed in the form of a principal desire to remain in office –

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[6] Of course, the "death" of inflexible rent seekers as producers does not translate into their expiration as political players. However, the disappearance of an industry is unlikely to create a long memory among its former participants. The final victory of the passenger automobile, for example, did not produce voting blocs that tried to punish political leaders who refused to stand in the way of its proliferation. Those employed in "horse and buggy" industries moved on to other economic activities. The underlying point, which holds for both the preceding example and dislocation caused by trade liberalization, is that employment is not identity-related in the same way as, for example, occupation of a particular territory. Short-term economic losers adapt and change relatively quickly, all other things being equal. Thus political "life after death" for those experiencing dislocation should not be a major worry for a government considering trade liberalization.

an obvious carry-over from the limits of rent seeking approach model (Lusztig 1996; Lusztig and James 1996; Lusztig, James and Kim 2003). A corollary to this axiom is that, all other things being equal, decision-makers are anticipated to be risk averse. In other words, taking chances is not valued in and of itself.[7]

Second, a Chief of Government (COG) is assumed as the gatekeeper for decision-making on behalf of the government, that is, a single individual ultimately possesses authority to act for the state in at least a preventive role with regard to both domestic and foreign policy (Bueno de Mesquita 1981; Putnam 1988).

Third, the model is applied to a democratic political system that features brokerage parties in a plurality system. This axiom is important because calculations about tenability in office obviously change in kind rather than merely degree if a system like proportional representation is in place instead. An expected utility model could be constructed for that scenario as well, but such work is beyond the scope of the present exposition.

Fourth, and perhaps most obvious, is the assumption that an expected utility model is the optimal way in which to estimate the COG's decision based on self-interest. Expected utility sums up the costs and benefits of respective policy options, with components discounted by probability coefficients. In other words, expected utility is a cost-benefit approach that also builds in the probability of obtaining respective costs and benefits – effectively, a weighted summation. A simple example of two lotteries should be sufficient to bring out how this works. A choice between a certain $10 and a 0.5 probability of $5 is easy to make. The expected value of the first is $10 x 1.0 or $10, while the second yields 0.5 x $5

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7 Even an apparent exception, such as Prime Minister Brian Mulroney's reference to 'rolling the dice' with the Meech Lake Accord, can be explained in terms of perceived necessity. Mulroney's highly artificial and inherently vulnerable electoral coalition depended upon support from both the West and Quebec and he felt compelled to put forward a major constitutional initiative in order to *preserve* its viability. Thus, in electoral terms, Meech Lake might be regarded, for all of its drama, as a fundamentally defensive political measure.

or $2.50 – a clear difference in favor of the former of the two lotteries. As will become apparent, of course, both the value and probability of components in the expected utility calculus is uncertain and estimates rather than exact values appear in the equations.

What, then, are the factors that would enter into an expected utility model to predict the COG's choice of renewed protectionism versus continuing liberalization? The position here is that *politico-economic factors* combine to produce a decision. These factors, of course, can be expected to reflect an even wider range of considerations, such as preservation of culture, but ultimately everything comes down to the ability to maintain office in order to maximize whatever interests happen to be articulated. The discussion naturally moves forward to look at benefits and costs of the respective policies and finishes up with a brief formal summary.

Four factors emerge on the benefit side of the equation. These are, respectively, credibility, safety against left wing outbidding within the party itself, support from inflexible rent seekers, and macroeconomic benefits from re-employment in once-again protected industries. Each is explained in turn.

Perhaps most obvious by intuition would be the political benefits obtained from the general public's perception of consistency and honesty in policy articulation. This might be referred to as a credibility payoff, or 'c'. A reservoir of public trust exists at the beginning of any particular government, with inevitable losses to follow, so opportunities to augment its level are at least worthy consideration by the COG.

Safety against left wing outbidding, labeled 'l', is another benefit from a return to protectionism. Although the xenophobic far right also tends to oppose free trade in the current era of globalization, numerically speaking, the left counts for a lot more in this context. Any COG who renounces free trade can expect greater safety against (a) challenges from the left within his/her party and (b) public support for one or more left-wing parties that take a hard-line position against free trade.

Support from the ‘losers’ (i.e., inflexible rent-seekers) in the previous battle over free trade – referring to inflexible rent-seekers – is yet another anticipated benefit from reversal of the policy. This benefit will be designated as ‘i’. This factor taps into whatever desire might exist to be politically active among those who experienced dislocation as a result of free trade, regardless of their current role within the new economy. They might contribute money, votes or both to a government that reinstituted protectionism.

Finally, re-employment in the sectors hurt by the previous round of liberalization could be expected to occur. This factor, labeled ‘e’, would depend for its magnitude on the ability of the radically downsized or even terminated employers to increase operations back up to levels approaching those previously maintained under protection.

Four kinds of costs are entailed by reversal. These are, respectively, macroeconomic losses, reduced standing with the business community, potential right-wing outbidding, and decrements from retaliation by former partners to trade liberalization.

Macroeconomic losses, or ‘m’, are most obvious on the cost side. Free trade is well established as a contributor to overall efficiency. The political element enters in vis-à-vis the presumed impact on standard indicators of economic prosperity, such as growth, price stability and employment. Forfeit of the benefits of trade liberalization is sure to entail economic problems, through instability and other mechanisms, with a high likelihood of those difficulties being attributed to the conspicuous reversal in policy.

Analogous to support from inflexible rent-seekers on the benefit side is the cost entailed by reduced standing with the business community, or ‘b’. Business invariably reacts badly to economic shocks and a major reversal of policy in the direction of reduced efficiency would be certain to elicit opposition.

Right wing outbidding, designated as ‘r’, would be a highly likely side effect of policy reversal. This cost could take one of two forms. Either a centrist challenger could emerge from within the party or, just as dangerous, the party previously in power could re-energize its base in opposition to the would-be reversal of trade liberalization. Whether one or the other of these developments took place, neither would be welcome from the COG’s point of view.

Finally, one or more of the jilted trade partners might be expected to retaliate if faced with a reversal of policy. This cost, labeled ‘d’, refers to the decrement in cooperation with other countries as a result of renewed protectionism. Retaliation might take the form of severe protectionist measures or withdrawal of cooperation in other desired areas, in each instance with harmful effects on the COG’s overall position.

Benefits and costs as just described can be summed up in an expression for expected utility as per below:[8]

(1) $E_t(U_{COG}) = p_c c + p_l l + p_i i + p_e e - p_m m - p_b b - p_r r - p_d d$

where

$E_t(U_{COG})$ = expected utility for COG from reversal of trade liberalization

p_c = probability of public perceiving policy consistency

Each of the other probability coefficients is analogous to p_c. The expected utility for the status quo, $E_s(U_{COG})$, is zero. Thus the question about whether to reverse policy is based on

[8] In this expression, along with Equation (2), the events are not mutually exclusive so, to be complete, probabilities for compound events should appear. However, since several of the probabilities and events will drop out, ease of exposition causes us to wait until Equation (3) to show the single compound probability that survives.

whether the expected utility of doing so is greater or less than zero.

Some informed estimates can be made, at this point, for the magnitudes of the payoffs and probabilities for cases in general. The later section pertaining to the Canadian context will make use of knowledge from that case to obtain further estimates for the respective parameters.

Several of the probability values would appear to be close or equal to 1.0. On the benefit side, three probabilities look that way. To begin, the public almost certainly will give credit to the COG for policy consistency if the leader backs down on threats to reverse policy. If action is unambiguous, as in declaring an agreement null and void, then there should be no risk of misperception about the government's consistency with its previously asserted position against the liberalization of trade. Thus $p_c = 1$. The same can be said with respect to safety against left wing outbidding. A dramatic rejection of a pro-business community policy already in place via international agreement would be sufficient to dampen the enthusiasm of challengers from the left for some time, so $p_l = 1$. Similarly, conspicuous economic losers, namely, inflexible rent-seekers, would have enormous potential to function – at least for some time – as single-issue voters. Thus $p_i = 1$ also. On the cost side, both macroeconomic problems (e.g., dislocation and reduced confidence) and business community retaliation border on certainty, so $p_m = p_b = 1$.

This series of simplifications leads to the following revised version of Equation 1:

$$(2) \qquad E_t(U_{COG}) \qquad = \qquad c + l + i + p_e e - m - b - p_r r - p_d d$$

This expression remains complex, but another series of simplifications can be made in recognition of effects from the passage of time. More specifically, a useful estimate of expected value must recognize the *dynamics* of the payoffs and probabilities as well as comparative statics. With time, three payoffs and three probabilities can be expected to shift toward extreme values, which will be taken to approximate either 0 or 1 as appropriate.

Two of the payoffs, for consistency and safety against left-wing outbidding, will be heavily discounted with time. The reason is the same in each instance: the "coalition of minorities" that accumulates against the COG. Specifically, any government in power can expect attrition in support. Those who are disappointed with a given policy internalize that experience whereas beneficiaries are prone to move on to the next issue and simply expect more in return for their continuing loyalty (Mueller 1973). Thus policy consistency itself eventually may be seen as being 'stuck in a rut'; COGs know this and seek to re-invent themselves and their parties periodically, with varying degrees of success. Given this dynamic, preserving policy consistency becomes inherently less valuable with time and thus a significant decline is anticipated, i.e., $c \rightarrow c - c^*$, where $c > c^* > 0$. Similarly, support for protectionism may help to head off left wing outbidding, but even very important economic issues do not exhaust the opportunities for challenge in a world with significant "postmaterial" constituencies (Inglehart 1977). Thus it is expected that $l \rightarrow 0$ because challengers can and almost certainly will arise anyway, if a government and its COG survive long enough.

On the cost side of the equation, the most likely development is $r \rightarrow r_{max}$ (i.e., r's maximum potential value) and $p_r \rightarrow 1$. The reason is that, with a salient policy reversal toward the left, a right-wing challenge becomes both more probable and devastating. As time passes, excluded constituencies become more intensely opposed to the government and therefore ripe for higher campaign contributions and turnout rates at the polls. As might be expected with such developments, political entrepreneurs become more likely to mobilize on the right.

Taken together, the preceding simplifications produce a further revision of the expected utility equation:

$$(3) \qquad E_t(U_{COG}) \quad = \quad c - c^* - i + e - m - b - r_{max} - p_d d + p_{ed}(e - d)$$

The final component represents the probability of the compound event in which both macroeconomic gains from re-employment and losses from retaliation occur, i.e., p_e + + p_d + p_{ed} + = 1.

This completes the generic presentation and refinement of the expected utility model. In the next section, some background on the evolution of free trade in Canada will set the stage for application of the model in that context.

The Evolution of Free Trade in Canada

The roots of the partisan dimension to trade policy in Canada extend at least to the Trudeau years. As a noted Canadian nationalist, Pierre Trudeau embraced a philosophy of economic multilateralism that, similar to former Conservative Prime Minister John Diefenbaker, sought a counterweight to the enormous influence of the United States on the Canadian economy. The centerpiece of Trudeau's foreign economic policy was the so-called *third option*. The third option eschewed the status quo (the first option) or closer economic integration with the United States (the second option) in favor of limiting Canada's vulnerability to US influence. Operationally, the plan was to diversify Canada's export markets as well as to lessen Canada's reliance upon foreign direct investment. The third option came to symbolize the Liberal Party's quest to establish for Canada a foreign economic policy that minimized influence from the United States.

The third option found a receptive audience among left nationalists – concerned that Canada's national identity was increasingly indistinguishable from that of the United States – and protectionist rent-seekers fearful of import penetration from the massive economy to the south. On the other hand, the third option did not commit Canada to outright protectionism. The multilateral ethos of the third option obliged Canada to embrace trade liberalization as undertaken through the General Agreement on Tariffs and Trade (GATT), specifically the Tokyo Round, which ended in 1979.

The Tokyo Round, bitterly opposed by Canadian rent-seekers, resulted in a significant reduction in Canada's effective level of industrial import protection. Tariff levels were reduced by an average of 9-10 percent over an eight-year period, and Canada was obliged to accept a series of provisions limiting the use of non-tariff barriers (Canada 1983, ch.7; Finlayson and Bertasi 1992; Lusztig 2004, ch.5).

When Brian Mulroney became Prime Minister in 1984, he led the first Progressive Conservative majority government since Diefenbaker's victory in the 1958 general election. Clearly aware of his government's potential for interregnum status, Mulroney undertook two bold policy initiatives as a means of dislodging the Liberals as Canada's Natural Governing Party. First, to exploit the unpopularity in Quebec of Trudeau's 1982 Patriation Initiative, Mulroney brokered the Meech Lake Constitutional Accord, designed to allow Quebec to embrace the previous reforms with "honour and enthusiasm" (Mulroney 1984). Second, to ensure that the pro-Quebec constitutional stance did not alienate his party's core constituency in Western Canada, Mulroney tried to gratify a long-standing Western agrarian demand to dismantle the system of industrial protectionism that had hampered cross-border trade since the 1879 National Policy. Specifically, Mulroney tried to maintain support in

Western Canada through a free trade agreement with the United States.[9]

The danger was that, in seeking to balance the regional interests in his electoral coalition, Mulroney would antagonize economic ones. Specifically, the rent-seeking industrialists who had opposed the Tokyo Round tariff reductions were an important consideration for the electoral fortunes of the Conservative Party. Rent-seeking industrialists had supported the National Policy, helped defeat the continentalist Liberals in the free trade election of 1911, and had remained steadfastly protectionist throughout the 20th century. On the face of it, Mulroney's electoral calculus made little sense; the logic smacked of 'robbing Peter to pay Paul'.

In reality, the Tokyo Round tariff reductions had forced the sort of separation predicted by the limits of rent-seeking model. Both flexible and inflexible rent-seekers recognized that the status quo would be untenable in the aftermath of the Tokyo Round tariff cuts. Inflexible rent-seekers, helped out the door by the 'Great Recession' of 1981, were far less of a political force than they had been during the 1970s. By contrast, flexible rent-seekers, facing the prospect of increased import competition, actually began a campaign to realize continental free trade as early as 1982. Indeed, far from being obliged to enact free trade in defiance of the wishes of the traditionally protectionist Canadian business sector, the Mulroney government was pressured to liberalize trade by the very industrialists who had fought in vain to prevent the liberalizing effects of the Tokyo Round.[10]

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[9] For more on the trade-off between Meech Lake and the Canada-US Free Trade Agreement, see Lusztig (1996, ch.4) and Lusztig and James (1996).

[10] While the most sustained pressure came from the Business Council on National Issues, the about-face on the issue of trade was most pronounced on the part of the Canadian Manufacturers' Association and the Canadian Federation of Independent Business. Other important business federations to change their trade policy positions included the Canadian Chamber of Commerce, Canadian Association of Toy Manufacturers, Canadian Chemical

Meanwhile, the Liberal Party maintained its ideological opposition to free trade. Prime Minister John Turner was an open and defiant critic of the CUFTA. His political fate was sealed when, in spite of strong popular opposition to the CUFTA, the 1988 "free trade" election returned another Progressive Conservative majority government. Turner's successor, Jean Chrétien, a long-time member of Trudeau's cabinet, reinforced his party's antipathy to a liberal foreign economic policy. During the 1993 federal election campaign, Chrétien threatened to "tear up" the recently negotiated NAFTA (Farnsworth 1993). Indeed, as party leader, "he had fully accepted the critical Liberal position during the NAFTA debate and had given full rein to its most vocal critics in his party…." (Hart 2003, 423). Within three weeks of the 1993 election, however, the Chrétien government had made a dramatic about-face on the issue of NAFTA (Hart 2002, 397). Moreover, far from embracing the rhetoric of its pre-election protectionism, the Chrétien government entered into bilateral free trade accords with Israel, Chile and Costa Rica and has taken a leading role in the FTAA negotiations.

What accounts for the rapid shift in the Liberal Party's trade policy position? We use an expected utility model to explain this puzzle.

Why Did Chrétien Back Down? An Answer from the Expected Utility Model

Liberal governments, led by Chrétien since coming to power a decade ago, have not tampered with NAFTA and, to the contrary, continue to participate constructively in hemispheric initiatives toward further trade liberalization. Although superficially puzzling, application of the expected utility model will show why all of this makes sense from the

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Producers' Association, Machinery and Equipment Manufacturers' Association of Canada, and the Rubber Association of Canada (see Lusztig 2004, ch. 6). For more on the free trade business lobby of the early 1980s, see Cameron (1986), Langille (1987) and Doern and Tomlin (1991).

standpoint of self-interest. Chrétien plays the role of COG and, from his point of view, the calculation of expected utility can be simplified further on the basis of contextual knowledge about Canadian politics.

With regard to potential re-employment among inflexible rent-seeking industries – one of just two remaining benefits in Equation 3 – the past decade is not encouraging. Over and beyond NAFTA, or other trade agreements involving Canada, stands globalization. This is manifested most directly in the WTO; in other words, even those within inclinations to return to the 'good old days' of something like the National Policy would find more obstacles than the interruption of their industries through NAFTA, even if it ever was repealed. Renewed investment in inefficient industries also would go against risk aversion – it would require the heroic belief that the federal government would re-institute protection in a sustained way *and* that the level of support offered by Ottawa would be enough to offset the increasing pressure from global, not just regional, competition. For such reasons it is reasonable to assume that both the likelihood of substantial re-employment in previously protected industries under renewed protectionism would be minimal and that benefits accruing would be small as well. Thus $p_e e$ is re-labeled as e_{min}, taken to be marginally above zero.

With respect to trading partners, the special role of the US comes to the fore in terms of a possible reversal of policy. Given the US's overwhelming capabilities and an obvious interest in discouraging other partners from revoking agreements, it is reasonable to infer that, in relatively short order, $p_d \rightarrow 1$ and $d \rightarrow d_{max}$ would occur. The US stands far above Canada in terms of relative capabilities, across the board, and is in constant negotiations with other states and international organizations around the world. Hence the US' ability and willingness to act on behalf of its reputation is taken to be at the maximum.

One further and ironic simplification comes in relation to the costs imposed by a potential right-wing challenge. While Chrétien stood by NAFTA, a sustained and ultimately successful right wing challenge came anyway – in the form of a fiscally conservative Finance Minister, Paul Martin, with his eyes set on the Prime Minister's office.[11] It is possible the Chrétien, who won three elections, might have retired anyway, but there is no doubt that the intense challenge from Martin did not encourage him to stay around as Prime Minister. Thus it becomes valid to eliminate r_{max} from the equation.

After the preceding adjustments are made, the final version of the equation, which assesses the position of Chrétien as Prime Minister in the era after the 1993 election, appears below:

$$E_t(U_{Chrétien}) = c - c^* + i + e_{min} - m - b - d_{max} \quad (4)$$

At this point it is useful to take the model back out of notation and into the substance of the case. In order for the choice of renewed protectionism to be viable, the benefits obtained from credibility at some reduced level (i.e., $c - c^*$), the support of inflexible rent seekers (i) and minimal employment created through resurrecting their industries () would have to *exceed* the costs created by macroeconomic dislocation and inefficiencies (m), bad relations with the business community and intense retaliation from the US (d_{max}). Given the relative power of the business community and US government alone as actors, that would seem to dwarf the political clout of even a very committed support group of inflexible rent-seekers

[11] This development reinforces the speculation earlier that, if reversal had occurred, a left-wing challenge might have come about anyway. Even a left-of-center position on trade might not be enough to dissuade, for example, a challenge that emphasized issues such as the environment, the perception of excessive foreign penetration of the economy or a range of others.

that, with certainty, has far less to offer in terms of overall resources. In addition, the employment benefits created by renewed activity in subsidized activities might have some short-term impact, but inefficiency and economic turmoil would appear certain to argue against reverting back to protectionism when these factors are weighed against each other. This would leave the remaining increment in credibility as the margin of difference if, somehow, the expected utility from reversing trade liberalization exceeded that of the status quo.

Risk aversion deals the final blow to a return to protectionism. The benefits of the policy change would have to clearly exceed the status quo, now understood as (relatively) free trade, in order to justify taking action. It would require an extraordinary suspension of disbelief to think that the benefits clearly would exceed the costs as just described – if anything, the reverse would seem rather likely

Conclusion: Not So Puzzling After All

When previously protectionist governments come to power and fail to change course on trade policy, which should not prove surprising when benefits and costs, along with the probabilities of receiving them, are considered in a comprehensive way. More is at work than just saying "free trade works, so leave things alone". The inability to obtain free trade except under circumstances that reward its purveyors in a decisive way, along with the inability to restore protectionism after free trade is in place, both reflect the important role played by self-interest and risk aversion among COGs. Chrétien, both before and after coming to power, looks like an archetypal case.

While not every factor in the generic expected utility equation will operate in the same way across all cases, the nuances are worthy of further investigation for both social scientific and policy-related reasons. In sum, an expected utility calculus, with components based upon the limits of rent-seeking model, seems like a promising avenue to explore when it comes to explaining cases of institutionalized trade liberalization.

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