

# I

---

## *Introduction*

On November 21, 1882, the American labor movement abandoned its unified support for high tariffs. The momentous decision came after Frank K. Foster, an early leader of the American Federation of Labor (AFL), gave a rousing speech at the Federation's annual convention in Cleveland, Ohio.<sup>1</sup> According to Foster, high tariffs increased profits for employers in protected industries, but did nothing to increase workers' wages. "'Protection' does not protect labor," he explained, as "the rate of wages depends upon other causes than the tariff."<sup>2</sup> Foster went on to warn that employers used the benefits of "full protection" to form monopolies and crush labor unions. Trade protection, he told the convention, "only served to concentrate wealth in the hands of the few, to the disadvantage of the many."<sup>3</sup> Although many of the labor union leaders in attendance represented workers in tariff-protected industries, the Federation voted 17–1 to terminate its endorsement of trade protectionism. At the turn of the century, the AFL's Secretary-Treasurer looked back and explained, "we cannot afford to take a position on the tariff question, for our experience of the injury it wrought to the old Federation in 1882 is a sufficient lesson."<sup>4</sup>

Although the Federation ended its support for high tariffs, some American labor unions vehemently supported trade protection. For example, the steelworkers' union frequently appeared before Congress alongside their employers, lobbying in favor of the tariffs that protected the steel industry from foreign imports. In fact, the iron and steel workers

<sup>1</sup> The speech took place at the annual convention of the Federation of Organized Trades and Labor Unions, which changed its name to the American Federation of Labor in 1886.

<sup>2</sup> Federation of Organized Trades and Labor Unions 1882, 11.

<sup>3</sup> Federation of Organized Trades and Labor Unions 1882, 11.

<sup>4</sup> Letter from P.J. McGuire to Samuel Gompers, quoted in Foner 1998, 94.

were incensed over the Federation's 1882 decision not to support high tariffs and formally withdrew from the organization in protest.<sup>5</sup> As the union's President, John Jarrett, explained to the U.S. Senate in 1883, "Our organization is strongly a tariff organization, from the fact that we know that we do get better wages on account of the tariff."<sup>6</sup> However, the same Senate hearing also heard testimony from the textile workers' union, which denied the benefits of high tariffs. According to the union, high tariffs protected capital in the product market, but left workers unprotected in the labor market, where competition from immigrant workers held down wages. When asked about the benefits of high tariffs, the union's leader, Robert Howard, replied, "The benefit? Looking at the wages here compared with the wages in England I cannot see any benefit ... [manufacturers] will go over to Canada and bring over hordes of French people here to work in our mills at 50 or 75 cents a day."<sup>7</sup> While employers in the steel and textile industries consistently supported high tariffs, workers in these industries did not automatically join their employers in support of the same international trade policy.

This story presents a puzzle, the answer to which has the potential to reshape the way we think about economic history, as well as the political economy of contemporary globalization. Specifically, under what circumstances will workers actually share the same trade policy preferences as their employers? Although such capital-labor disagreement has shaped economic policy debates throughout the past two centuries, extant political economy theories are unable to explain the causes and cures of such class conflict. Canonical works in political science and economics predict that workers will automatically share the same trade policy preferences as their employers, and that capital and labor will therefore join together in favor of the same trade policy reforms.<sup>8</sup> When scholars do predict capital-labor disagreement over economic policy, they tend to envision economy-wide class conflict, and therefore offer no explanation for workers who do join their employers in support of the same policies.<sup>9</sup> In direct contrast, this book demonstrates that this conventional wisdom is based on a flawed theory of wage determination as well as a distorted history that ignores major instances of class conflict.

This book argues that labor's trade policy preferences depend on a previously omitted factor: the presence or absence of "profit-sharing institutions." Profit-sharing institutions are a set of rules that govern

<sup>5</sup> McNeill 1887, 292.

<sup>6</sup> United States 1885, 1, 122.

<sup>7</sup> United States 1885, 655.

<sup>8</sup> Brock and Magee 1978; Baldwin 1985; Gourevitch 1986; Frieden 1991.

<sup>9</sup> Rogowski 1989; Hiscox 2002.

*Introduction*

3

wage negotiations and create a credible link between an increase in profits and an increase in workers' wages. Profit-sharing institutions therefore entail more than just the existence of labor unions; the profit-sharing institutions at the heart of this book include formal union recognition, explicit agreements that wages will rise along with profits, and industry-wide wage contracts. For example, American steel workers in the late nineteenth century built an industry-wide labor union, gained formal recognition from their employers, and negotiated a sliding wage scale that explicitly indexed their wages to the profitability of the steel industry. When such profit-sharing institutions are in place, I predict that workers will be more likely to agree with their employers concerning international trade policy. However, when profit-sharing institutions are absent, I predict that workers will be more likely to disagree with their employers concerning trade policy.

In establishing the central importance of profit-sharing institutions for the political economy of trade, this book answers three related questions. First, how do profit-sharing institutions influence workers' trade policy preferences? This book demonstrates that, all else being equal, profit-sharing institutions make workers more likely to support the trade policy favored by their employers. Second, what explains the origin and evolution of profit-sharing institutions? This book describes the process through which wage bargaining and industrial conflict generates incentive for the creation of profit-sharing institutions. Third, what broader impact do profit-sharing institutions have on trade policy outcomes and international relations? This book argues that profit-sharing institutions lay the political foundation for cross-class coalitions of capital and labor in favor of the same trade policy, and thus create powerful interest groups that influence actual trade policy outcomes.

This book systematically tests my theory with a multi-method approach that includes qualitative case studies as well as large-N statistical analysis. The case studies explore trade politics in the United States from 1877 to 1945, Britain during the repeal of the Corn Laws in the 1840s, and Argentina during the development of import-substitution industrialization in the 1940s. In each of these cases, the field's conventional wisdom holds that workers joined their employers in support of the trade policies that benefitted their industries of employment.<sup>10</sup> In direct contrast, this book presents in-depth archival research that demonstrates that workers in each case frequently disagreed with their employers concerning international trade policy. Moreover, it demonstrates that my theory of profit-sharing institutions parsimoniously

<sup>10</sup> Rogowski 1989; Hiscox 2002.

explains this previously unrecognized variation in capital-labor conflict. Combined, these case studies demonstrate the generalizability of my theory across more than one hundred years, protectionist and liberalizing trade policy reforms, three continents, economies with four different types of factor endowments, and numerous political regimes.

This book complements these case studies with two quantitative tests of my theory. First, it tests my argument that profit-sharing institutions and workers' trade policy preferences have an important influence on trade policy outcomes. In order to do so it utilizes an original dataset on American labor union density to explore U.S. Senate voting on trade policy in 1945. The analysis demonstrates that U.S. senators were more likely to support free trade when lobbied by a cross-class coalition of capital and labor in favor of free trade. In contrast, when manufacturers lobbied without the assistance of their workers they were unable to influence senators' trade policy voting. Second, it uses data from 28 manufacturing industries, in 117 countries, from 1986 to 2002 to explore my theory's main causal mechanism – the link between trade policy and workers' wages. The analysis demonstrates that when workers lack bargaining power they are completely unable to capture a share of profits in the form of wages. In all of the above ways, this book challenges both the empirical and theoretical conventional wisdom regarding the political economy of trade.

Although this book focuses specifically on the political economy of international trade, my theory of profit-sharing institutions has broad implications for the study of many other economic issue areas. Contemporary political economy debates tend to assume that the benefits of various economic reforms are automatically shared between employers and their workers. This assumption pervades the study of economic globalization and shapes the way many scholars understand the politics of everything from international trade to foreign direct investment, and from exchange rate policy to immigration. This assumption is equally present in domestic policy debates concerning issues as diverse as education reform and the privatization of industry. In short, both domestic and international political economy debates often assume that workers will automatically benefit from any development that increases their industry's profitability. This book challenges this common assumption and argues that the degree to which workers benefit from – and join their employers in support of – economic policy reforms depends crucially on domestic labor market institutions.

Overall, this book makes four important contributions to the field of international political economy. First, it shows that the field's conventional wisdom overlooks major historical instances of trade policy

## Introduction

5

disagreement between workers and their employers. Second, it establishes that the neoclassical models traditionally used in the political economy literature systematically exaggerate the benefits that workers receive from economic policy reforms. Third, it demonstrates that profit-sharing institutions are a previously omitted variable that determine workers' trade policy preferences, as well as their tendency to join their employers in support of the same trade policy. Fourth, it demonstrates that changes in profit-sharing institutions laid the political foundations for major trade policy reforms, such as the liberalization of American trade policy following World War II. For all of these reasons, scholars must think differently about domestic labor market institutions to understand the political economy of international trade.

### CURRENT EXPLANATIONS

The political economy literature is dominated by the Ricardo-Viner (R-V) and Heckscher-Ohlin (H-O) models of international trade.<sup>11</sup> The R-V model assumes that there are two factors of production – capital and labor – both of which are unable to move between industries. According to this model, a trade policy that benefits a specific industry automatically leads to increases in both profits and wages. Based on the rational choice assumption that actors will hold a preference for the trade policy that benefits them economically, this approach predicts that capital and labor employed in the same industry will always share the same trade policy preferences.<sup>12</sup> As Gourevitch argues, international trade “is by no means a cleavage that brings capitalists and workers to confront each other. Rather, it joins the two groups together in conflict against another cross-class coalition.”<sup>13</sup> For example, capital and labor employed in an import-competing industry, such as the contemporary U.S. steel industry, are both predicted to favor trade protection. In a similar way, capital and labor employed in an export-oriented industry, such as the contemporary Bangladeshi garment industry, are both predicted to favor free trade. Simply put, this popular model describes a world in which class conflict is theoretically impossible.

The H-O model assumes that there are three factors of production – capital, labor, and land – all of which are able to easily move between industries.<sup>14</sup> According to the H-O model, the distributive effects of trade

<sup>11</sup> Frieden 1988; Rogowski 1989; Hiscox 2002.

<sup>12</sup> Frieden 1991; Rodrik 1995; Frieden 1999; Lake 2004.

<sup>13</sup> Gourevitch 1986, 47.

<sup>14</sup> The original H-O model is based on only two factors of production – capital and labor – and therefore predicts that these two classes will always disagree with one another concerning trade policy. See, Stolper and Samuelson 1941.

policy depend on whether or not a country has relatively abundant or scarce supplies of capital, labor, and land. When a factor of production is scarce it automatically benefits from protectionist trade policies, whereas when a factor of production is abundant it automatically benefits from trade liberalization. The H-O approach therefore predicts that capital and labor will share the same trade policy preferences when both represent either scarce or abundant factors of production. Rogowski argues that when “both capital and labor are scarce ... both are harmed by expanding trade and, normally, will seek protection.” In the opposite scenario, when both capital and labor are abundant, “expanding trade must benefit both capitalists and workers [both of whom] should favor free trade.”<sup>15</sup> When capital and labor do not share the same level of abundance or scarcity, the H-O model predicts that all workers will join together in opposition to the trade policy supported by capitalists. The H-O approach therefore suffers from two different problems. First, the model cannot explain trade policy disagreements between workers in different industries, thus rendering it difficult to explain variation in class conflict across sectors. Second, when applied to countries in which capital and labor are both either abundant or scarce, the model predicts a world devoid of class conflict. For example, Rogowski and Hiscox both use the H-O model to incorrectly predict class harmony in the U.S. case discussed below.<sup>16</sup>

How do scholars choose between these two trade models? According to Hiscox, the applicability of these models depends on an economy’s level of inter-industry factor mobility. When both capital and labor mobility is high, the predictions of the H-O model are more likely to be accurate, whereas the predictions of the R-V model are more likely to be accurate when both capital and labor mobility is low.<sup>17</sup> But why should we assume that the inter-industry mobility of capital and labor must vary together? In this vein, other scholars have explored the specific-factors (SF) model, which assumes that capital is specific to its industry of employment while labor is fully mobile between industries. According to this model, a

<sup>15</sup> Rogowski 1989.

<sup>16</sup> Rogowski and Hiscox agree that late nineteenth-century America had scarce supplies of capital and labor. Both scholars therefore use the H-O model to predict that capital and labor joined together in support of protection, and are thus unable to explain the prominent instances of capital-labor disagreement discussed in Chapter 4. Importantly, this shortcoming cannot be remedied by simply re-coding the factor endowment of the United States during this period. If capital were scarce and labor abundant – or vice versa – the H-O model would over-predict the extent of disagreement between capital and labor. See, Rogowski 1989; Hiscox 2002.

<sup>17</sup> Hiscox 2001.

## Introduction

7

trade policy that benefits a specific industry will automatically increase profits for capital employed in the industry. The same trade policy will automatically increase nominal wages for all workers in the economy, but the overall effect of trade policy on real wages will depend on workers' consumption patterns. If the cost of the products that workers consume increases more than workers' nominal wages, then their real wages will decrease and they will oppose the trade policy reform. If these costs increase less than workers' nominal wages, then their real wages will increase and they will support the trade policy reform. The SF approach therefore allows for the possibility that workers will disagree with their employers concerning trade policy, but generally predicts that workers' trade policy preferences are ambiguous and indeterminate.<sup>18</sup> Since the SF model lacks clear predictions, the R-V and H-O models tend to dominate research on the political economy of international trade.<sup>19</sup>

Although scholars using “new” new trade theory (NNTT) have recently made important contributions to our understanding of the political economy of trade, this novel approach assumes that the benefits of trade policy are automatically shared with workers.<sup>20</sup> NNTT argues that only a small fraction of firms in export industries are actually productive enough to export. When trade expands, less-productive firms leave the market and highly productive firms increase output and expand. Overall, this leads to an increase in productivity throughout the industry, as less productive firms are replaced by more productive firms. According to NNTT, this increased productivity then leads to an increase in wages throughout the industry. Despite NNTT's innovative approach to heterogeneous firms, it still predicts that an increase in labor demand automatically leads to an increase in wages. In other words, NNTT is similar to the R-V and H-O models in omitting profit-sharing institutions and potentially overestimating the wage increases that workers receive from trade policy reforms.<sup>21</sup>

<sup>18</sup> Alt and Gilligan 1994. While the SF model allows for the possibility that workers will disagree with their employers concerning trade policy, it cannot explain the causal logic of the capital-labor conflict discussed below. As demonstrated throughout this book, such conflict is predominately motivated by workers' concerns regarding competition in the labor market.

<sup>19</sup> Gourevitch 1986; Rogowski 1989; Frieden 1991; Hiscox 2002; Milner and Kubota 2005; Rudra 2008; Oatley 2011; Chaudoin et al. 2015.

<sup>20</sup> Melitz 2003; Helpman et al. 2004.

<sup>21</sup> As Owen demonstrates in a recent study of foreign direct investment, NNTT also tends to ignore workers' concerns about unemployment, see Owen 2015.

While early research on the political economy of trade focused on the policy preferences of large groups (e.g. capital and labor), more recent scholarship uses these trade models to explore the trade policy preferences of individual people. This literature tends to accept the H-O and R-V models as accurate portrayals of how trade policy affects wages, and then identifies additional variables that influence trade policy preferences, such as home ownership,<sup>22</sup> patriotism,<sup>23</sup> education,<sup>24</sup> consumer prices,<sup>25</sup> risk tolerance,<sup>26</sup> as well as concerns for national economic performance,<sup>27</sup> fairness,<sup>28</sup> cultural ‘westernization,’<sup>29</sup> and labor solidarity.<sup>30</sup> In this way, the literature has often focused on demonstrating that individual trade policy preferences are determined by “non-economic” factors. In contrast, this book suggests that before we rule out an economic basis for trade policy preferences, we should study the domestic institutional conditions under which the predictions of the H-O and R-V are likely to hold.<sup>31</sup>

When scholars challenge the distributional predictions of the H-O and R-V models, they tend to focus on specific developments related to contemporary globalization such as regional production sharing,<sup>32</sup> trade in services,<sup>33</sup> or skill-biased technology.<sup>34</sup> Implicit in these works is the argument that the H-O and R-V models correctly predicted the distributional consequences of international trade until recent changes altered the functioning of specific areas of modern economies. In contrast, this book argues that the uncertain connection between profits and wages is a generalizable characteristic of economic distribution, and one that applies to trade politics in the nineteenth century as well as the political economy of trade today.

The trade policy preferences derived from the H-O model also play a central role in the literature on the relationship between trade liberalization and democratization. A large body of literature has developed in recent years that explores both how democratization affects a country’s

<sup>22</sup> Scheve and Slaughter 2001.

<sup>23</sup> O’Rourke et al. 2001.

<sup>24</sup> Mayda and Rodrik 2005; Hainmueller and Hiscox 2006.

<sup>25</sup> Baker 2005.

<sup>26</sup> Ehrlich and Maestas 2010.

<sup>27</sup> Mansfield and Mutz 2009.

<sup>28</sup> Ehrlich 2010.

<sup>29</sup> Margalit 2012.

<sup>30</sup> Ahlquist et al. 2014.

<sup>31</sup> For recent work that supports an economic basis for trade policy preferences, see Ardanaz et al. 2013.

<sup>32</sup> Chase 2003.

<sup>33</sup> Chase 2008.

<sup>34</sup> Hicks et al. 2013.



## Introduction

9

trade policies, as well as how changes in trade policy affect the probability of democratization. According to one argument, democratization enfranchises unskilled workers who then lobby the government for trade liberalization because of the automatic wage increases that workers receive from free trade.<sup>35</sup> According to the reverse argument, trade openness leads to democratization in developing countries because free trade automatically increases wages for unskilled workers who then use their increased incomes to lobby the government for democratic reform.<sup>36</sup> Central to the arguments running in each direction is the H-O model and the idea that the benefits of trade policy reform are automatically shared with workers.<sup>37</sup>

In these ways, the neoclassical trade models provide the underlying foundations for the literature on the political economy of trade. Despite new developments in trade theory, the literature has not explored how the distributional consequences of trade are filtered through domestic labor markets. In contrast, this book follows the insight that “economic laws ... work out differently under different institutional conditions.”<sup>38</sup> In other words, profit-sharing institutions help explain the missing politics to the political economy of international trade. As will be made clear below, my theory of profit-sharing institutions has broad implications for how we understand the history of international trade as well as the political economy of contemporary globalization.

### STRUCTURE OF THE BOOK

The book proceeds as follows. Chapter 2 develops my theory, which argues that we can understand workers’ trade policy preferences by analyzing how the effects of trade are filtered through domestic labor markets. Trade policy directly increases profits, but whether or not these increased profits lead to an increase in wages depends on the outcome of wage bargaining between capital and labor. Since such bargaining is plagued by numerous uncertainties and enforcement problems, workers often doubt their ability to capture a share of increased profits and therefore tend to disagree with their employers concerning trade policy.

<sup>35</sup> Stokes 2001; Weyland 2002; Milner and Kubota 2005; O’Rourke and Taylor 2006; Chaudoin et al. 2015.

<sup>36</sup> Giavazzi and Tabellini 2005; Lipset 1959; López-Córdova and Meissner 2005; Rudra 2005.

<sup>37</sup> For the argument that trade liberalization increases income equality, lessens demands for redistribution, and therefore reduces elite resistance to democratization, see Acemoglu and Robinson 2006.

<sup>38</sup> Schumpeter 1994, 32.

Further, these same bargaining uncertainties also lead wage negotiations to occasionally collapse into costly strikes and lockouts. As labor becomes more powerful, such industrial conflict becomes increasingly costly and generates growing incentive for capital and labor to find ways to increase cooperation. Under such circumstances, capital and labor rationally create profit-sharing institutions which permit capital to credibly commit to increase wages along with profits. In short, when profit-sharing institutions are present, I predict that workers are more likely to share the same international trade policy preference as their employers.

Chapter 3 presents the research strategy for testing my theory empirically, using both quantitative and qualitative methods. Chapter 4 uses qualitative methods and original archival research to explore American trade politics during the late nineteenth century. This chapter explains the rise and fall of profit-sharing institutions, as well as the effect of such institutions on workers' trade policy preferences. First, it explores the relationship between profit-sharing institutions and the trade policy preferences of workers in the American textile industry hub of Fall River, Massachusetts. The analysis begins with a description of textile workers who lacked profit-sharing institutions and disagreed with their employers about the benefits of high tariffs. The chapter then shows how these workers slowly increased their bargaining power and established profit-sharing institutions with their employers. Following the creation of profit-sharing institutions, the textile workers changed their trade policy preferences and came to share their employers' support for high tariffs.

Second, it presents a similar analysis of workers in the American steel industry center of Pittsburgh, Pennsylvania. The analysis begins with a description of how profit-sharing institutions were established in the steel industry, and thus led steelworkers to join their employers in support of high tariffs. The chapter then shows how technological change decreased workers' bargaining power and contributed to the decline of profit-sharing institutions. Following the termination of profit-sharing institutions, the steelworkers changed their trade policy preferences and came to disagree with their employers' support for high tariffs. Overall, this chapter presents a structured, focused analysis that demonstrates the effect of profit-sharing institutions on workers' trade policy preferences.

Chapter 5 then uses a mix of qualitative and quantitative methods to explore the relationship between profit-sharing institutions and American trade policy outcomes. First, it uses qualitative methods to explore the effect of profit-sharing institutions on the trade policy preferences of the Congress of Industrial Organizations (CIO) during the 1930s and