Societal Approach to Trade Policy

- **Premise: Government objectives and policies grounded in the material interests of social actors.**
  - A well-specified societal explanation of trade policy requires answers to two questions:
    1. Who wants what? (theory of policy preferences)
    2. Who gets what? (theory of political influence)
- **Who wants what?**
  - Look to International Trade Theory. Identifies winners and losers, conditioned on the degree of domestic factor mobility.
    1. Immobile Factors and Specific Factor models (short- to medium-run approaches helpful in analyzing *interest group* divisions on trade)
    2. Mobile Factors model (long-run approach helpful in analyzing *class/partisan* divisions on trade)

When does the short-run or long-run apply?

- Short-Run
  - Certain trade pressures are short-term in nature (e.g., a sharp increase in imports caused by a dramatic exchange rate shock, like the Asian currency crisis).
  - Certain trade policies are meant to be short-term (e.g., anti-dumping laws) responsive to short-run trade pressures
  - Politics of such trade policies should involve *interest groups*, not factors/classes, via the immobile and specific-factor models.
- Long-Run
  - Certain trade pressures have a long-term character (e.g., entrance of China and other LDCs into the world economy).
  - Certain trade policies have a long duration (those established by international agreement or treaty; entrance of China into WTO).
  - Politics of such trade policies should involve *factors/classes* via the mobile factors (Stolper Samuelson model).
  - Political parties exist beyond the immediate election and therefore parties and party leaders have longer time horizons.

Other "Anti-Protection" actors:

- **Trade and trade policy has "indirect" effects that create other supporters of free trade:**
  - Export industries harmed by foreign retaliation.
  - Firms using foreign imports as inputs (about ½ of US imports are "intermediate goods", i.e, inputs).
  - Importers and retailers (e.g., GAP, Toy R Us).

Who organizes to get what they want?

- **Collective Action Theory**

  a. group size (e.g., small vs. large groups. Note that individual consumers are not the only people harmed by protection – see above).

  b. group asymmetry (e.g., concentrated industries vs. industries with many equal-sized firms).

  c. selective incentives (private benefits facilitate organization)

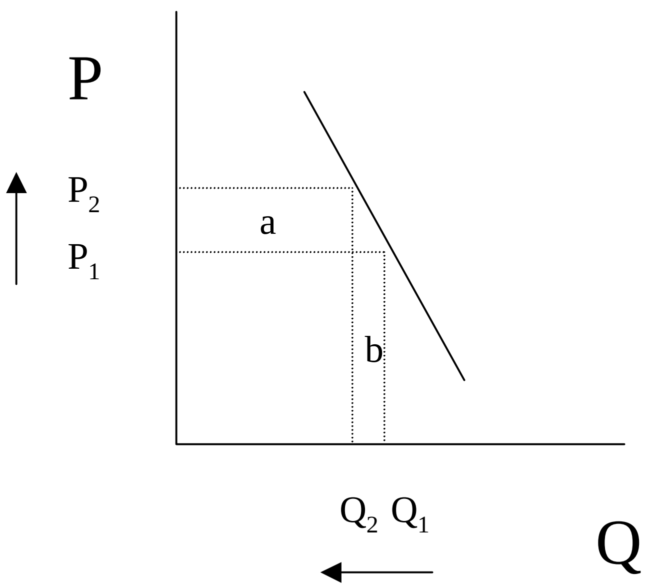
Other factors that affect collective action

- **Effects of political institutions**
  - Delegation from legislature to executive (Alt and Gilligan) or in Parliamentary systems with large electoral districts (Mansfield and Busch) require interest groups to build larger "majoritarian" coalitions.
  - Reciprocity: Int'l trade negotiations based upon mutual concessions motivate exporters to organize for free trade
- **Price elasticities of demand and supply**
  - The more inelastic demand, the greater the incentive to lobby for protection (Figure 1).
  - The more inelastic supply, the greater the incentive to lobby for protection (Figure 2).

Figure 1: Elasticity of Demand and Incentives for Import-Competing Industries to Lobby for a Tariff

Inelastic

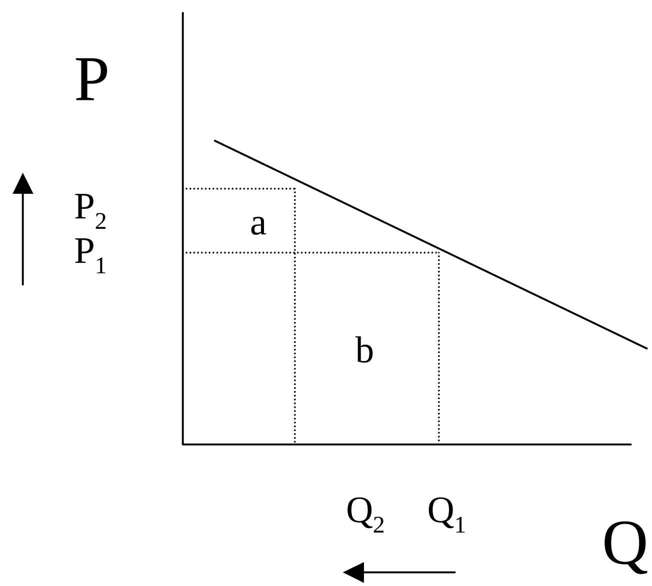
a > b



<u>High Incentive</u>: Tariff raises price (P_1 to P_2) and quantity demanded falls less than proportionately. Industry can earn rents when demand is inelastic.

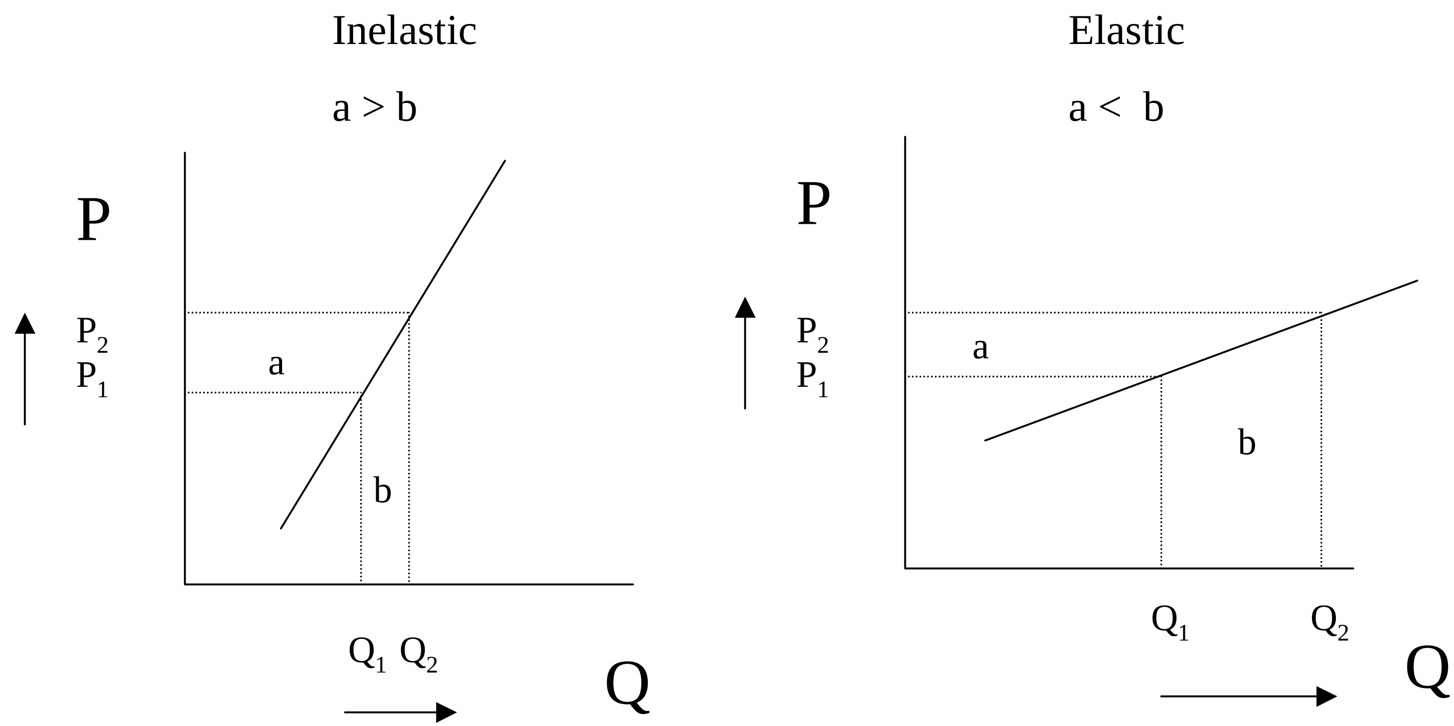
Elastic

a < b



<u>Low Incentive</u>: Tariff raises price (P_1 to P_2) but quantity demanded falls more than proportionately. Industry cannot earn rents when demand is elastic (e.g., when there are close substitutes for the protected good).

Figure 2: Elasticity of Supply and Incentives for Import-Competing Industries to Lobby for a Tariff



<u>High Incentive</u>: Tariff raises price (P_1 to P_2) and quantity supplied increases less than proportionately. Existing firms in the industry can earn rents when supply is inelastic.

<u>Low Incentive</u>: Tariff raises price (P_1 to P_2) but quantity supplied increases more than proportionately. Rents are dissipated with the arrival of new entrants.

Figure 3: Who Wants What? Who Organizes?

Who wants what?	*Who organizes to get what they want?*
International Trade Theory Provides systematic information on the distributional impact of trade policy. Identifies winners and losers (coalition patterns) conditioned on the degree of domestic factor mobility. Immobile Factors and Specific Factor (short to medium-run models helpful in analyzing interest group conflicts over current trade policies, e.g., sectoral agreements in the Uruguay Round). Mobile Factors model (long run approach helpful in analyzing partisan divisions and trade agreements with labor-abundant countries (e.g., NAFTA)	**Collective Action Theory** --group size (e.g., small vs. large groups) --group symmetry (e.g., concentrated industries vs industries with many equal-sized firms) --selective incentives (role of private benefits in facilitating group organization)
Anti-protection groups --exporters harmed by foreign retaliation --firms using foreign imports as inputs --Importers and retailers (GAP, Toy R Us).	**Structure of political institutions** --Larger political jurisdictions require interest groups to build larger coalitions (Alt and Gilligan, Mansfield and Busch). --Reciprocity in int'l trade negotiations motivates exporters to organize (Bailey, Goldstein and Weingast).
	Price elasticities of demand and supply --The more inelastic demand is for a good, the greater the incentive for producers to lobby for protection. --The more inelastic he supply of a good, the greater the incentive for producers to lobby for protection