Lecture 7: Domestic Politics of Trade

Benjamin Graham
Today’s Plan

• Housekeeping
• Reading quiz
• Domestic Politics of Trade
Housekeeping

• Homework 2 due next Thursday (September 25).
  • Late papers not accepted.
  • Will go up on my website this afternoon

• Midterm October 2
  • Midterm review guide (part 1) will go out Friday.
Reading Quiz (1)

• Strategic Trade Policy is generally promoted as a response to what?
  • A) trade sanctions
  • B) economic sanctions
  • C) perfect competition
  • D) imperfect competition
Reading Quiz (2)

• Which of the following statements is accurate:
• A. The US provides more protection for domestic sugar producers than (almost) any other country
• B. The US provides less protection for domestic sugar producers than (almost) any other country
• C. The US provides more protection than most of the world, but US prices are lower than European and Japanese prices.
Reading Quiz (3)

- Which of the following were part of Trade Adjustment Assistance provided under the George W. Bush administration?
  - A. Wage insurance
  - B. Health insurance
  - C. Housing (i.e. homeowners insurance)
  - D. A&B
  - E. B&C
  - F. All of the Above
Understanding Sources

• Groombridge article is published by the Cato Institute
  • Libertarian think tank

• How does the sugar industry justify US sugar policy?
• Doesn’t cost taxpayers anything (tariffs & Quotas instead of subsidies)
• Provides stable prices (no shortages)
• Creates jobs
• Unfair competition (subsidies) in Mexico & China
• Lower prices wouldn’t reach consumers anyway
Concentrated vs. Diffuse Interests

- Concentrated Interest: A small group of people, each of whom care a lot
- Diffuse Interest: A large group of people, each of whom care a little

- In a democracy, concentrated interests often prevail over diffuse interests.
Ricardo-Viner vs Stolper-Samuelson

• Stolper-Samuelson
  • locally scarce vs. locally abundant factors

• Ricardo-Viner
  • Exporting industries vs. import-competing industries

• These overlap some, but...

• In developing countries, exporting industries are often those that employ high-skilled workers (i.e. owners of human capital)
  • Sometimes owners of human capital and physical capital (in the right industries) benefit more than unskilled workers (in the wrong industries)
Rogowski (1987)

- Predicting political cleavages regarding trade
- Owners of locally scarce factors vs. owners of locally abundant factors
- Example: “Marriage of Iron and Rye”
  - Germany in late 1800s
  - Capital scarce, land scarce, labor abundant
  - So industrialists & landed gentry imposed tariffs and repressed labor
- Example: Britain in the late 1800s
  - Capital and labor abundant, land scarce
  - Industrialists and labor unite
  - Push free trade, expand suffrage, reduce power of landed gentry
Interest Groups: Factors of Production vs. Industries

- Labor unions represent owners of labor, i.e. workers
- Chambers of Commerce represents owners of capital
- Various agricultural lobby groups represent owners of land

- We also see lobbying at the industry-level
  - For example, when the auto industry lobbies for protection, it is often both unions and company owners doing the lobbying (i.e. both labor and capital).
  - Same with the coal industry -- both miners and mine-owners

- Either way, trade protection happens at the product level
Factors of Production and Interest Groups

- Owners of locally-scarce factors of production often seek protection for products that use that factor intensely.
- Import-competitive industries also seek protection as industry groups.
- Anti-trade interests seek subsidies for domestic production, tariffs on foreign imports, or quotas on foreign imports.
- These policies benefit owners of the locally scarce factor of production and import-competitive industries.
- The policies harm consumers and/or taxpayers across the country.
- Bonus points if beneficiaries are concentrated in a swing state:
  - Michigan and Ohio (cars)
  - Pennsylvania (Steel)
  - Florida (Sugar)
Who benefits from tariffs on the import of foreign t-shirts into the US?

• A. Unskilled U.S. workers generally
• B. Owners of U.S.-based T-shirt manufacturing facilities
• C. U.S. Consumers who buy t-shirts
• D. Hipster entrepreneurs who buy bulk t-shirts, print snarky things on them, and resell them
• E. A&B
• F. A, B, & D
• G. All of the Above
Logic of Trade Protection

• Jobs will be protected
  • In the protected industry, and in its suppliers and ancillary industries
    • Example: Auto parts producers would go under if GM goes under
• Foreign competition is in some way “unfair,”
  • Foreign subsidies, or lax labor and environmental laws
• Trade displacement has cultural costs as well economic ones
  • Protecting “traditional” industries
Industrial Policy

- Industries are hard to start
  - May only become globally competitive later
- Government’s pick an industry, subsidize it, and protect it
  - Subsidies and protection are supposed to be temporary
  - “infant industries”
- The goal: create a globally competitive industry that no longer needs subsidies
- The risks: Governments are bad at “picking winners”
  - Temporary protections become permanent
  - What incentive do firms have to wean themselves from government help?
Japan did it pretty well

• 1950s, Japan exported textiles, low-tech products; by 1970s and 1980s, Japan was exporting cars, ships, etc

• Ministry of Economy, Trade, and Industry (METI): Selects industries to receive trade protection, R&D subsidies, low interest loans, tax breaks, etc.

• Debates remain, but generally viewed as quite successful

• Many other countries have been much less successful
  • Lots of corruption
The Story of Airbus

- In the early 1970s Germany, France, Britain, and Spain all chipped in to create a (heavily subsidized) European airplane manufacturing industry
  - $13.5 billion of direct subsidies in first 20 years
- By the early 1990s, Airbus had an operating profit and was starting to pay back government loans

- Worth it? Probably.

- Huge WTO dispute between Airbus and Boeing
  - But that’s for a later class
The Making of the US Farm Bill

- Subsidies across a variety of crops
- Also includes foodstamps, school lunch subsidies, etc.
- The Coalition:
  - Rural states (crop subsidies)
  - Urban states (food stamps, school lunch subsidies)

- Domestically, who bears the costs of these subsidies?
Free Trade Agreements: One Way Trade Policy Liberalizes

• Concentrated interests oppose opening US markets to imports defeat the diffuse interests who would benefit
  • i.e. producers in import-competiting industries defeat consumers
• There are also concentrated interests that want access to foreign markets.
  • Producers in xporting industries
• Free trade agreements harness these concentrated interests in favor of reciprocal free trade agreements
  • I’ll let your goods in if you let mine in.
The Union Argument Against FTAs
But... this is how they might come around
Free Trade Agreements: Korea

• The Korean FTA was signed in 2007, but was not ratified by the Democrat-controlled Senate’
  • Main opposition: Labor Unions
• Obama administration renegotiated the deal, got a better deal regarding the Auto industry
  • Got the United Auto Workers on board
  • Ratified easily in 2011
Free Trade Agreements: Colombia

• Signed in 2006, but not ratified until 2011
  • Again, major opposition was US labor unions
• Negotiations focused on improving labor rights in Colombia
Free Trade Agreements: Terms of Trade?

• In both the Colombia and South Korea cases, the smaller country wanted it more.
  • The U.S. is Colombia’s largest trading parter, but Colombia accounts for less than 1% of US trade

• The party that wants a deal more ends up giving up more
  • For example, South Korea had to let US autos into South Korea 5 years before tariffs will be lifted on Korean autos into the US