POLITICAL ECONOMY OF TRADE POLICY

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Outline

- Introduction
- Economic self-interest approach
- Social concerns approach
- Median voter model
- Lobbying
- Empirical paper: can we explain politician's voting behaviour?
- Discussion

Literature

- Baldwin, R.E. (1989) The political economy of trade policy. The Journal of Economic Perspectives, vol. 3.4, p. 119-135

- Markusen, J.R., Melvin, J.R, Kaempfer, W.H. and Maskus, K.E. (1995) The political economy of trade policy. Chapter 8 in: International trade: Theory and evidence. McGraw-Hill, p. 324-340

- Owen, E. (2017) Exposure to offshoring and the politics of trade liberalization: Debate and votes on free trade agreements in the US House of Representatives, 2001-2006. International Studies Quarterly, vol. 61, p. 297-311

Introduction

- **Economic theory: Trade is good for welfare**

- **Reality: countries are engaged in all sorts of trade policies and international negotiations**

- **This is actually difficult for economists to explain**

- Politicians don't know what they are doing
- Politicians follow public opinion
- Political economy of trade policy

Trade policy

"International trade is a subject where the advice of economists is routinely disgarded" (Baldwin, 1989)

"The compelling case for free trade carries hardly any weight among people who really matter" (Krugman, 1997)

Markusen (chapter) "The analysis developed in this chapter may lead students to wonder why we do not see an even more pervasive use of trade policy"

Political economy of trade policy

- **Large differences between theories of free trade and actions of politicians**

- **Public choice economics**
  - Study of governmental decision making behaviour using economic models
  - Indirect: factors influencing voting behaviour of politicans

- **Two main sets of factors**
  - Economic self interest approach
  - Social concerns approach

Economic self interest approach

- **Personal gains/losses decide whether trade policy is supported or not**

- **Under costless redistribution and voting**
  - Free trade selected

- **But free trade often not selected**
  - Costs of redistribution and voting (+ decreasing gains)
  - Free rider problem
  - Common interest groups
  - Psychology: greater weight attached to loss than to gain of similar size
  - "Don't buy foreign"

New trend in the US

BE AMERICAN. BUY AMERICAN.

Reasons to buy american products

- The job creation equation
- American manufacturing = more jobs
- Recycling dollars
- Keeping America beautiful
- Environmental conservation
- Human rights
- Democracy
- Foreign outsource elimination
- Poverty
- Financial growth

http://www.madeintheusa.com/blog/2014/03/10-reasons-buy-american/

Social concerns approach

- **Trade policies**
  - Concern for welfare of certain groups in society
  - To promote national and international goals
  - (Trade policy reflects political ideology?)

- **Concerns for groups in society**
  - Conservative welfare function
  - Income distribution goals
    - Trade policy is redistributive in nature
    - But are trade policies the best option here?
    - First and second best policies

US income inequality and globalisation not directly linked
The Financial Times. (Aug. 26, 2011): Opinion and Editorial: p10.
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http://www.ft.com/home/us

Full Text:

From Dr Jacob A. Jordaan.

Sir, It is good to see that Jeffrey Sachs agrees that globalisation has brought substantial benefits to many low and middle-income countries, notably China (Letters, August 24). However, his new contribution misses out two key elements.

First, trade based on comparative advantage always creates winners and losers. For the US, trade with China creates gains for high-skilled labour and losses for low-skilled labour, caused by the fact that China's comparative advantage is currently largely based on intensive use of low-cost, low-skilled workers. However, the overall welfare gains from trade for the US outweigh the losses that low-skilled workers experience, suggesting that welfare redistribution can address this problem.

It is here where the difference with Scandinavian countries and their income redistribution programmes becomes apparent, as these countries simply do not accept the levels of income inequality that exist in the US. Therefore, there is no direct link between income inequality in the US and globalisation, other than that globalisation reinforces existing levels of income inequality in this country. Whether income inequality is addressed is an internal matter for the American political system, but trade produces sufficient welfare gains for the US to compensate the losses of low-skilled labour.

Chapter by Markusen

- **Public choice economics**
  - Study of governmental decision making behaviour using economic models
  - Decision maker & utility maximizer

- **Key assumption: politician wants to be re-elected**

- **Median voter model very useful**
- **Why relevant for trade policies?**
  - Trade policies have redistributive effects
  - (Capital versus labour, high versus low-skilled labour)
  - (Import-competing versus exporting industries)
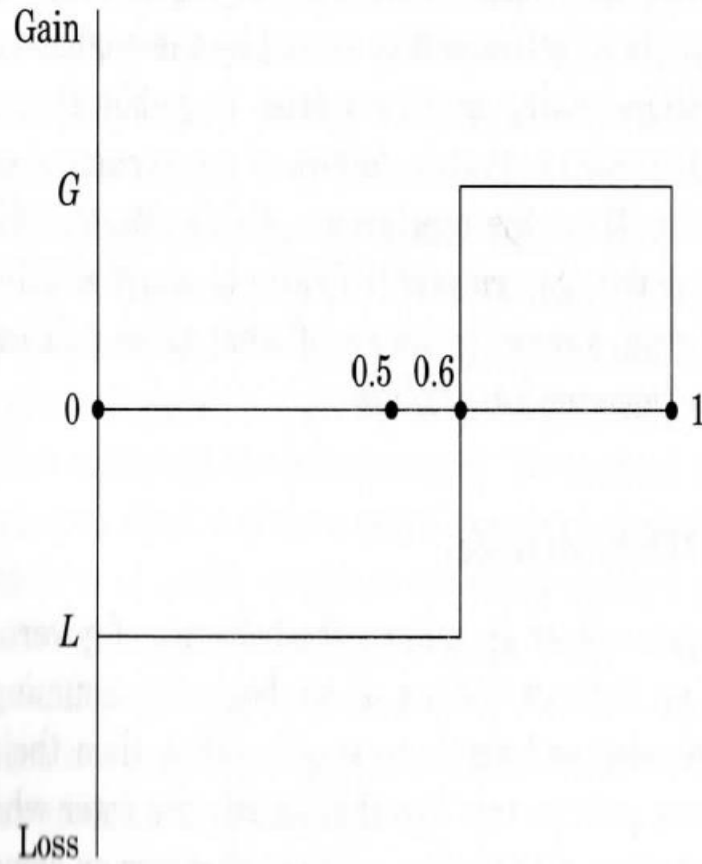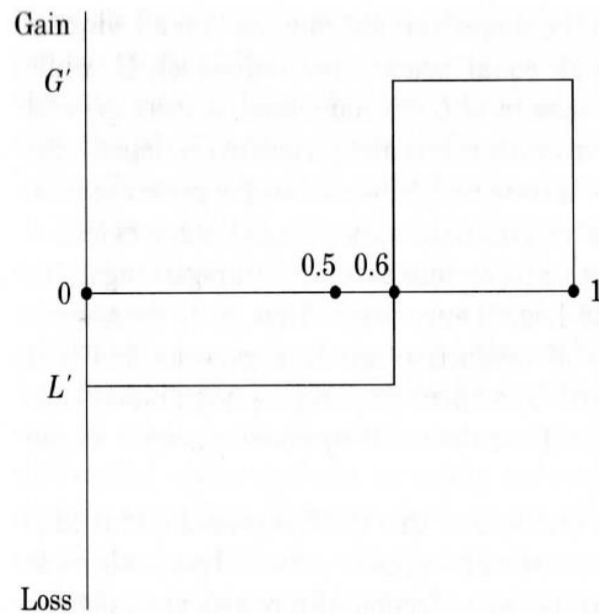
Median voter model

FIGURE 19.1
Median voter choice.

Decision making problems (1)

No incorporation of intensity of preferences

328 *III: Trade Policy*

Gain
G'

0.5 0.6

0   1

L'

Loss

FIGURE 19.2
Preference intensity problems.

0.4 Gains > 0.6 Losses

But politician will reject policy

Logrolling

• Way for minority groups / special interest groups to get the policy that they want

TABLE 19.1
Gains from logrolling

	Gain or loss to individual			
	A	B	C	Net
Issue 1	+20	−5	−5	+10
Issue 2	−5	+20	−5	+10
Issue 1&2	+15	+15	−10	+20

TABLE 19.2
Losses from logrolling

	Gain or loss to individual			
	A	B	C	Net
Issue 1	+20	−15	−15	−10
Issue 2	−15	+20	−15	−10
Issue 1&2	+5	+5	−30	−20

A and B give 5 to C to compensate, A and B gain

Smoot-Hawley tariff 1930
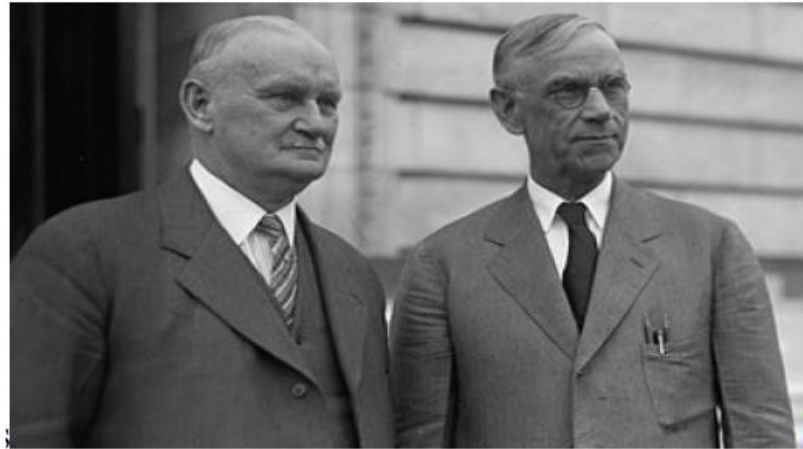
Congressman Willis
Hawley, Oregon

Senator Reed Smoot,
Utah

The Economist, Dec 18th 2008

Protectionism

The battle of Smoot-Hawley

A cautionary tale about how a protectionist measure opposed by all right-thinking people was passed

EVEN when desperate, Wall Street bankers are not given to grovelling. But in June 1930 Thomas Lamont, a partner at J.P. Morgan, came close. "I almost went down on my knees to beg Herbert Hoover to veto the asinine Hawley-Smoot Tariff," he recalled. "That Act intensified nationalism all over the world."

Of all the calls on Hoover not to sign the bill, perhaps the weightiest was a petition signed by 1,028 American economists. A dozen years later Frank Fetter, one of the organisers, recalled their unanimity. "Economic faculties that within a few years were to be split wide open on monetary policy, deficit finance, and the problem of big business, were practically at one in their belief that the Hawley-Smoot bill was an iniquitous piece of legislation."

Background and log rolling

- **1920s several attempts to help agriculture sector**
- **President Coolidge vetoed these attempts**
- **1928 Democratic president Hoover took office**
  - Promised to help the sector
- **Hawley chairman of the House Ways and Means Committee**
- **All kinds of meetings, much broader than agriculture sector**
- **House bill raised 845 tariff rates, on manufacturing and agricultural activities**

Further log rolling

- **Bill to the Senate**
- **Smoot chairman of the Finance Committee**
- **Senators who thought that their constituents lost out in the Bill started asking for increased tariffs as well**
- **Discussion changed**
  - From agriculture versus industries to
  - Classic vote-trading among unrelated goods
- **Senate's bill contained 1,253 changes**
- **Compromise: 890 tariffs increased, 235 tariffs cut**
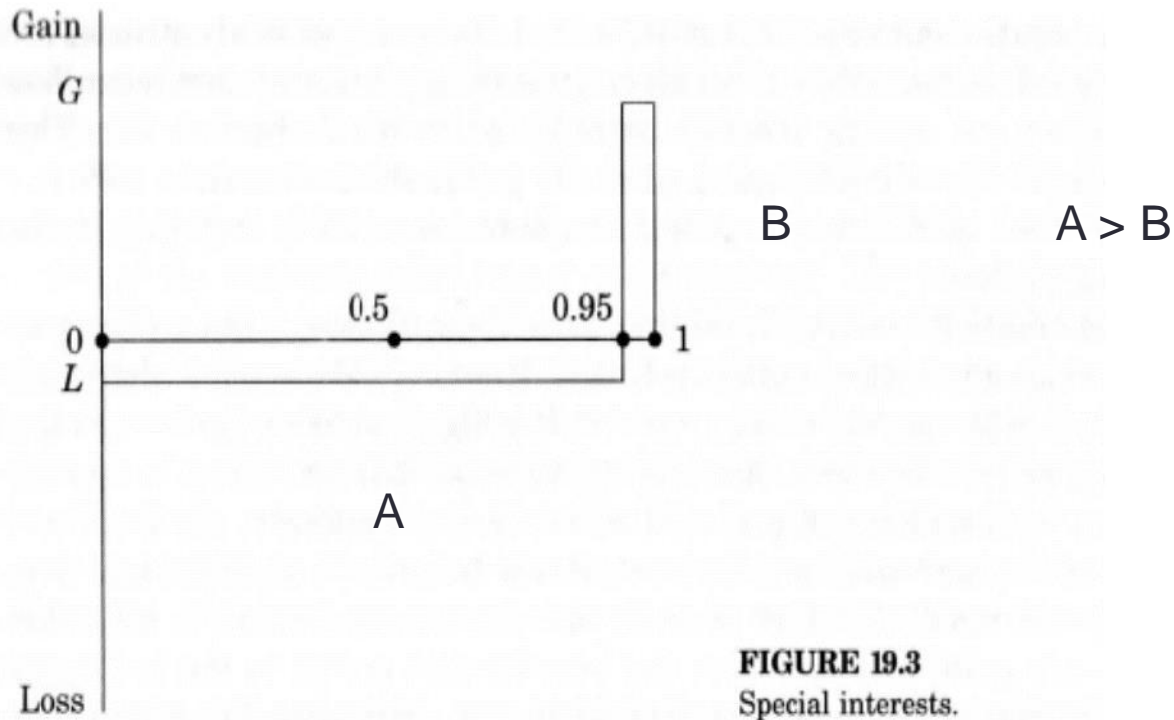- **Led to strong worsening of trade relations with other countries**

Decision making problems (2)

- Rational ignorance and abstention (no voting)
- Free rider problem
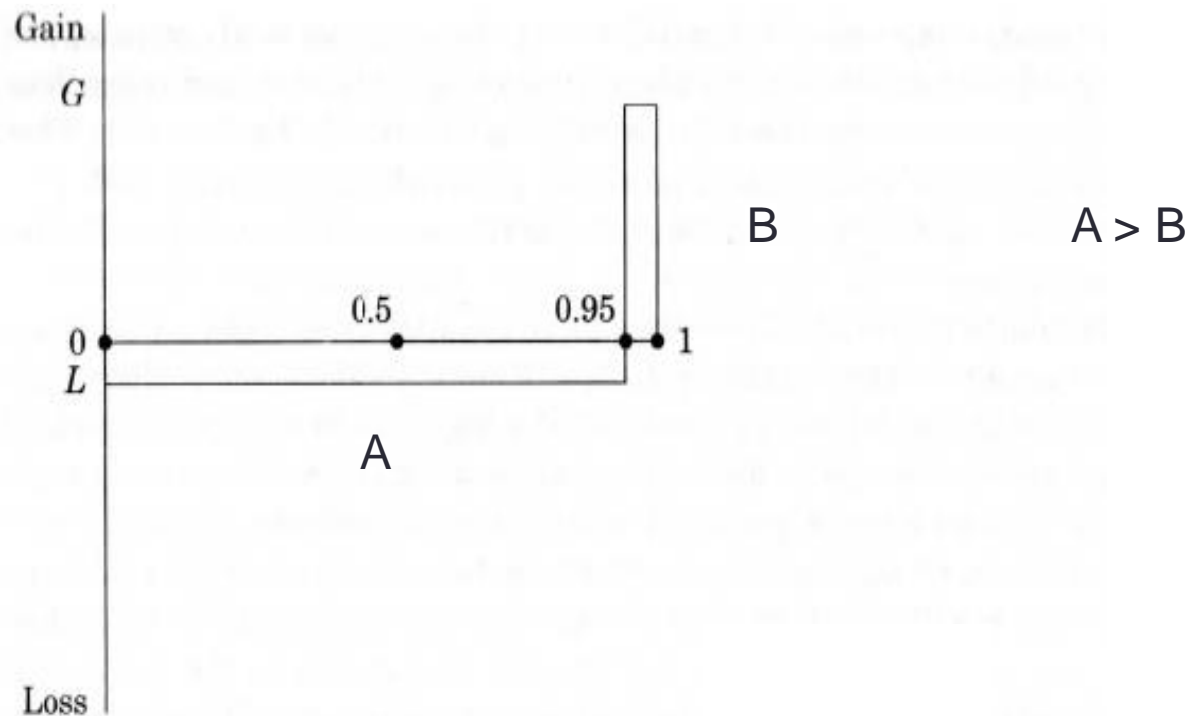
Decision making problems (3)

• Interest groups / lobbies

FIGURE 19.3
Special interests.

Why do we have lobbies?

- Solve free rider problem for interest groups
- Funding for politicians
- Rent seeking
- Solve for incomplete information

Interesting website

- **Corporate Europe Observatory**

- "Exposing the power of corporate lobbying in the EU"

- https://corporateeurope.org/

- https://corporateeurope.org/researching-corporate-lobbying-eu

- In the US lobbying has been a commonly accepted process

- At EU level, this is rapidly developing

Number of lobby organisations

Graph generated: 17/03/2018
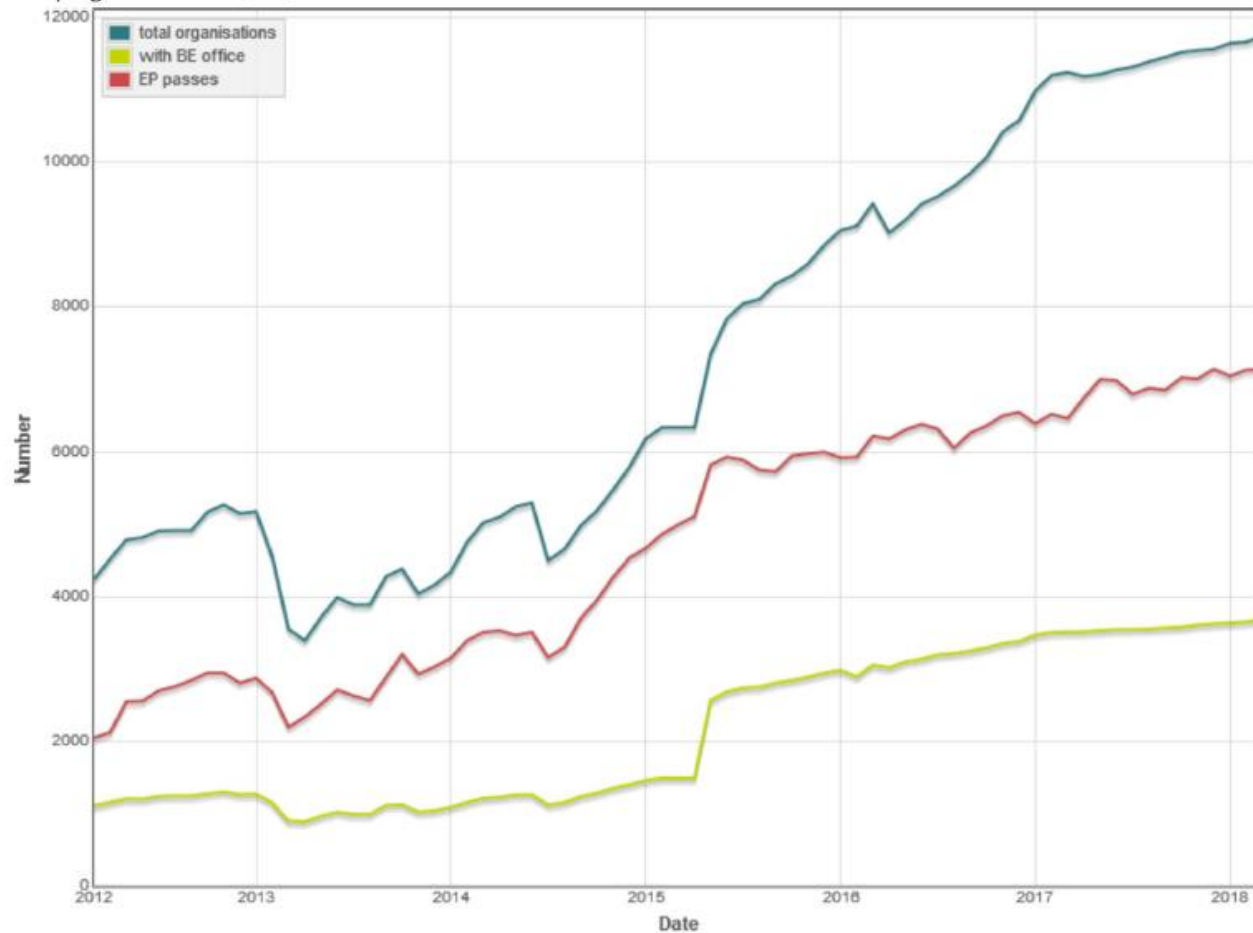
30,000 lobbyists and counting: is Brussels under corporate sway?

From mobile phone charges to nations' interests, these shadowy agitators are estimated to influence 75% of European legislation

Power point: the European parliament is subject to intense pressure from corporate interests, and many MEPs use their inside knowledge to take up lucrative lobbying positions when they quit. Photograph: Michele Tantussi/Getty Images

Graph generated: today
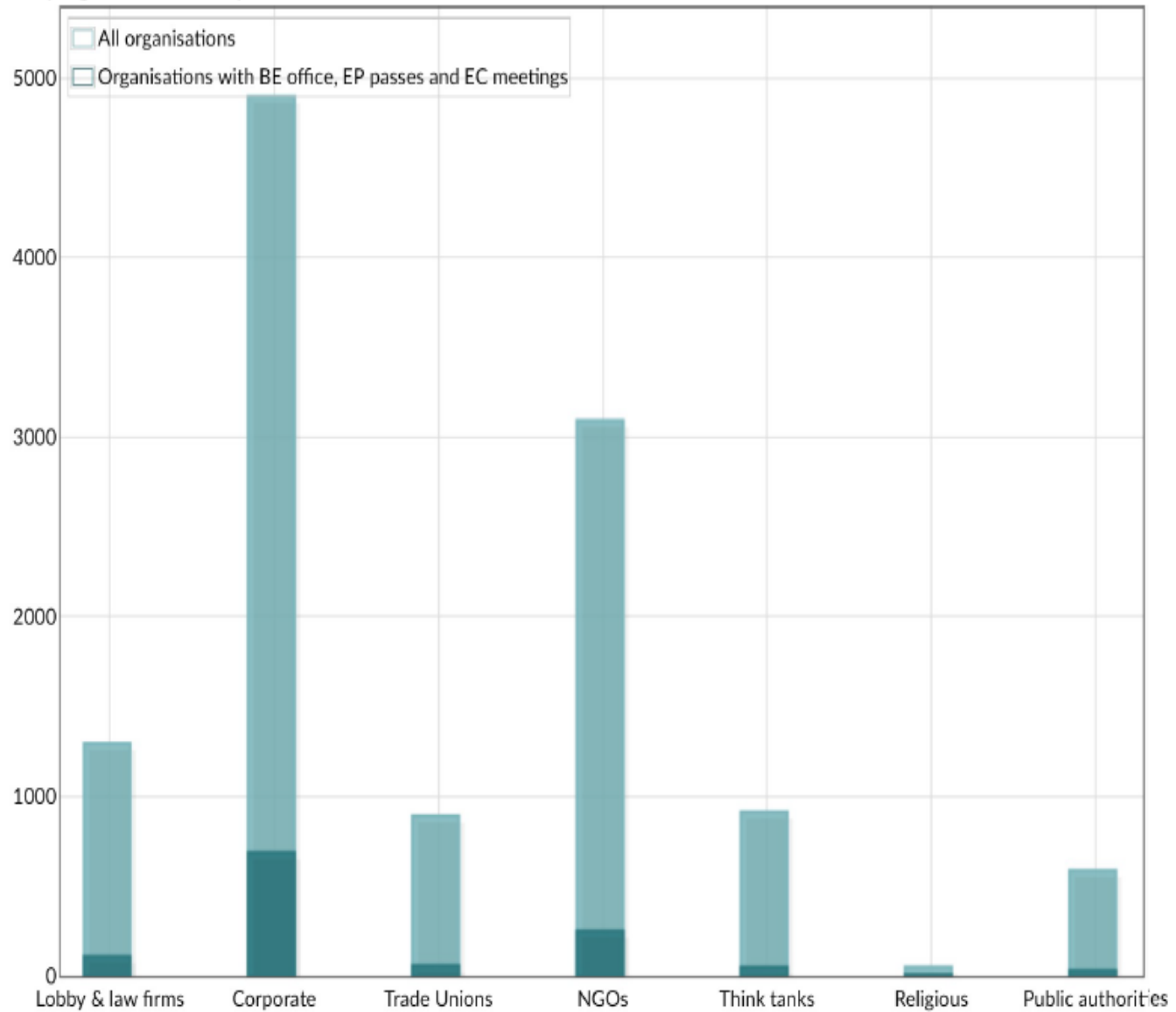
Top ten lobbyists
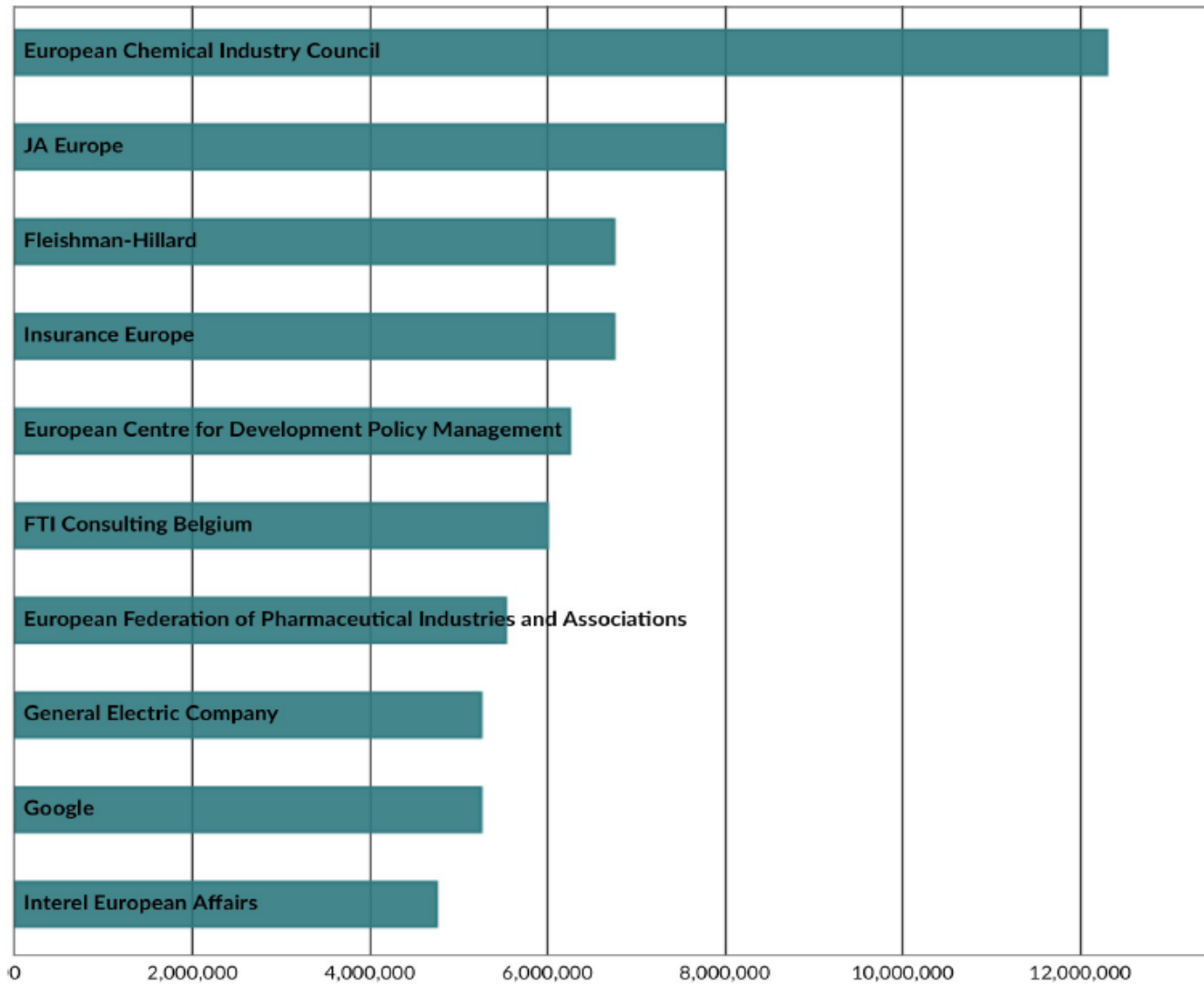
Politicians become lobbyists

RevolvingDoorWatch is a database of commissioners, MEPs and officials who have gone through the revolving door into lobby or industry jobs. Lobbyists who have taken jobs with the EU institutions are also featured. These cases raise big questions about whether the EU institutions are robust enough in recognising and acting upon the risk of conflicts of interest. Contact us [mailto:revolvingdoorwatch@corporateeurope.org] if you have info about new cases or follow #revolvingdoors

Decision making problems (4)

Effect of uncertainty

Suppose government considers trade liberalisation

40% export industry

60% import competing industry

Export industries gain

Import competing industries 1/3 will start to export
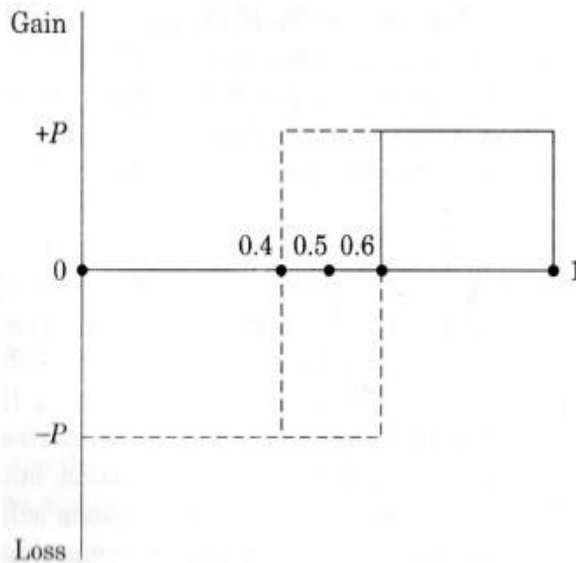
Policy should be adopted

FIGURE 19.4
Uneven distribution of uncertainty.

Uncertainty (cont.)

- **Import competing industries**
- 1/3 will gain
- 2/3 chance to lose out
- Whole group expected gain -1/3
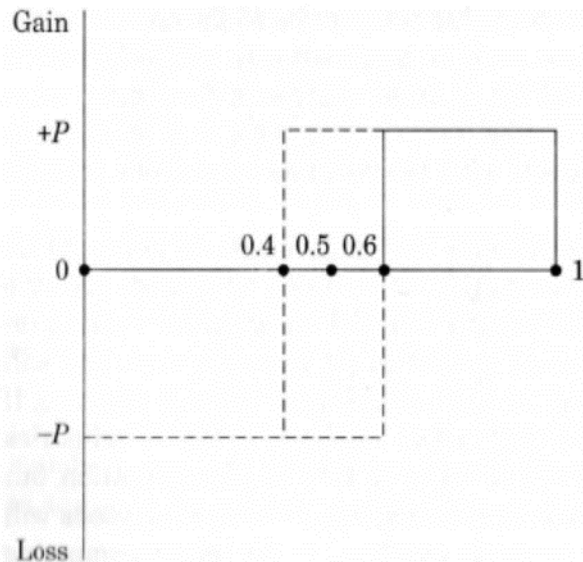
FIGURE 19.4
Uneven distribution of uncertainty.

Status quo bias agaist trade liberalisation

Exampe why reciprocity in trade negotiations is often necesarrry: gains need to be large enough

Empirical evidence

- **Main contribution: trade policy is endogenous!**

  = dependent variable

- **Huge implications**

- **Empirical research challenging**
  - Historical analysis, case studies
  - Associations between protection and political and economic variables, geographic concentration, institutions, etc.
  - Voting behaviour of politicians

Recent empirical study

- **Exposure to offshoring and the politics of trade liberalisation by Erica Owen**
- **Interesting study on factors that influence politician's voting behaviour**
  - Several votes in American House of Representatives on Free Trade Agreements
- **Link to earlier trade theories**
- **Adds two important new elements**
  - Link between trade liberalisation and Foreign Direct Investment in the form of offshoring
  - Occcupation and tasks in addition to industry interests and factors of production

Offshoring and jobs

- **Outsourcing of tasks has been going on for a long time**
- **Offshoring is the same, but then across international borders**
- **Rapidly increasing in scale**
- **Growing diversity of activities**
  - Remember the growing importance of trade in services
- **Value chain of a firm more and more internationally fragmented**
- **Increasingly jobs and occupations are affected rather than (parts of) industries or factors of production**
- **Also increasingly higher skilled jobs are at risk**
  - For instance head accountant and assistants
  - Head accountant can offshore asistants' work

How to analyse this

- **Median voter model**: politician wants to be re-elected
- **Needs to find balance between positive effects of trade and negative effects among specific interest groups**
- **Traditonal elements**
- **Heckscher-Ohlin = specific factors**
  - For instance skilled versus unskilled labour
- **Ricardo = productivity differences between sectors**
- **New element**
- **Offshorability (or tradability) of tasks**
  - Tasks that are not location specific and do not require face-to-face contact
  - These are likely to be subject to competition from foreign labour
  - Occupation-based lobbying is becoming more prevalent

Research questions

H1: *Legislators with a larger share of their constituency vulnerable to offshoring will be less likely to vote in favor of trade liberalization.*

H2: *Legislators with a larger share of their constituency vulnerable to offshoring will be more likely to discuss the costs of trade for labor during debates on liberalization.*

Cases analysed

Table 1. Votes on FTAs in the House of Representatives

Bill	Vote	Date
TPA, House version	215–214	12/6/2001
Chile	271–156	7/24/2003
Singapore	271–155	7/24/2003
Australia	314–109	7/14/2004
Morocco	323–99	7/22/2004
DR-CAFTA	271–215	7/28/2005
Bahrain	327–95	12/7/2005
Oman	221–205	7/20/2006

TPA Trade Promotion Authority; power to President to negotiate reciprocal agreements with partner countries

Control variables by district

- Offshorability = workers in offshorable + highly offshorable jobs / labour force
- % of skilled workers (comparative advantage)
- Employment share in export industries
- Employment share in import-competing industries

- Republican dummy
- Unemployment %
- Region dummies
- Past corporate contributions
- Past labour contributions

Table 2. Analysis of votes on free trade

	1	2	3	4	5
	FTAs+TPA		No TPA	All bills	% Free trade
% Offshorable	−0.069***	−0.083***	−0.077***	−0.045***	−0.795***
	(0.021)	(0.023)	(0.024)	(0.010)	(0.249)
% College	0.038***	0.034***	0.037***	0.034***	0.565***
	(0.007)	(0.008)	(0.008)	(0.005)	(0.101)
Log share employment in exports	−0.091	0.007	−0.110	0.037	1.066
	(0.103)	(0.114)	(0.106)	(0.052)	(1.176)
Log share employment in imports	−0.220**	−0.321***	−0.181	−0.204***	−3.047**
	(0.110)	(0.122)	(0.118)	(0.059)	(1.390)
Republican	3.113***	2.477***	2.895***	1.328***	23.248***
	(0.120)	(0.188)	(0.126)	(0.051)	(1.222)
Unemployment	−0.089**	−0.144***	−0.108***	0.017	0.122
	(0.037)	(0.041)	(0.037)	(0.021)	(0.423)
West	0.815***	0.831***	0.763***	0.432***	7.109***
	(0.139)	(0.156)	(0.148)	(0.077)	(1.794)
Midwest	0.454***	0.254*	0.365**	0.413***	6.559***
	(0.134)	(0.149)	(0.142)	(0.073)	(1.730)
South	0.813***	0.347**	0.773***	0.252***	4.422***
	(0.133)	(0.156)	(0.139)	(0.068)	(1.625)
% Past corporate contributions		3.974***			
		(0.441)			
Log % past labor contributions		−0.018			
		(0.037)			
108th					4.355
					(2.909)
109th					−8.016*
					(4.585)
Observations	3407	2985	2978	10536	1317
Log likelihood	−1444.0	−1219.8	−1294.5	−5207.3	NA
χ^2	783.1	692.0	650.2	1822.4	NA
BIC	3026.2	2591.7	2716.9	10729.5	11750.5
% Correctly predicted	82.4	83.3	81.7	74.3	NA

Models 1–4 are logit regressions with vote fixed effects suppressed. Model 5 is an OLS regression. Robust standard errors in parentheses. *$p<0.1$, **$p<0.05$, ***$p<0.01$.

Additional analysis

- Is there also effect on the language and arguments that politicians use in the debates?

- Keywords: workers, jobs, offshor*, outsourc*, white-collar, exporting jobs, shipping jobs

- Text analysis of the transcripts

- Rate of labour speech = number of labour keywords / total number of words

Table 4. Regression analysis of labor speech

	1	2
% Offshorable	0.237***	0.238***
	(0.073)	(0.075)
% College	−0.077***	−0.077***
	(0.029)	(0.030)
Republican	−0.738	−0.775*
	(0.473)	(0.454)
Log share employment in exports	−0.485	−0.480
	(0.385)	(0.391)
Log share employment in imports	−0.314	−0.333
	(0.435)	(0.432)
Unemployment	−0.011	−0.012
	(0.108)	(0.111)
Midwest	1.755**	1.771**
	(0.686)	(0.696)
West	0.572	0.575
	(0.672)	(0.687)
South	0.911	0.902
	(0.684)	(0.697)
Constant	−5.369***	−5.528***
	(1.743)	(1.693)
Observations	3156	403
Log likelihood	−2239.8	−1129.6
BIC	4713.3	2361.3

Model 1 estimated with selection model. Robust standard errors in parentheses. *$p < 0.1$, **$p < 0.05$, ***$p < 0.01$.

Main points

- **Trade policy becomes endogenous**
- **Economic self interest and social concerns approaches**
  - Provide explanations for sub-optimal policy choices
- **Median voter model: trying to explain policy choices**
  - Intensity of preferences
  - Rational ignorance and abstention
  - Effect of lobbies
  - Status quo bias
- **Empirical evidence**
- **H-O, Ricardo, tradability of tasks**
- **Politicians clearly vote according to interest of constituents**
  - Although trade liberalisation increases overall welfare!

Discussion point

Endogenous policy making makes it easier to understand policy choices but more difficult to identify their effects?

Discussion point

The EU should strongly limit the presence and actions of lobby organisations in Brussels

Discussion point

The growing tradability of occupations / tasks changes the debate on globalisation and trade liberalisation