Political Economy of Trade Policy

PK

The optimal tariff argument


Exports

Foreign offer curve

Slope = price

Slope = true marginal cost
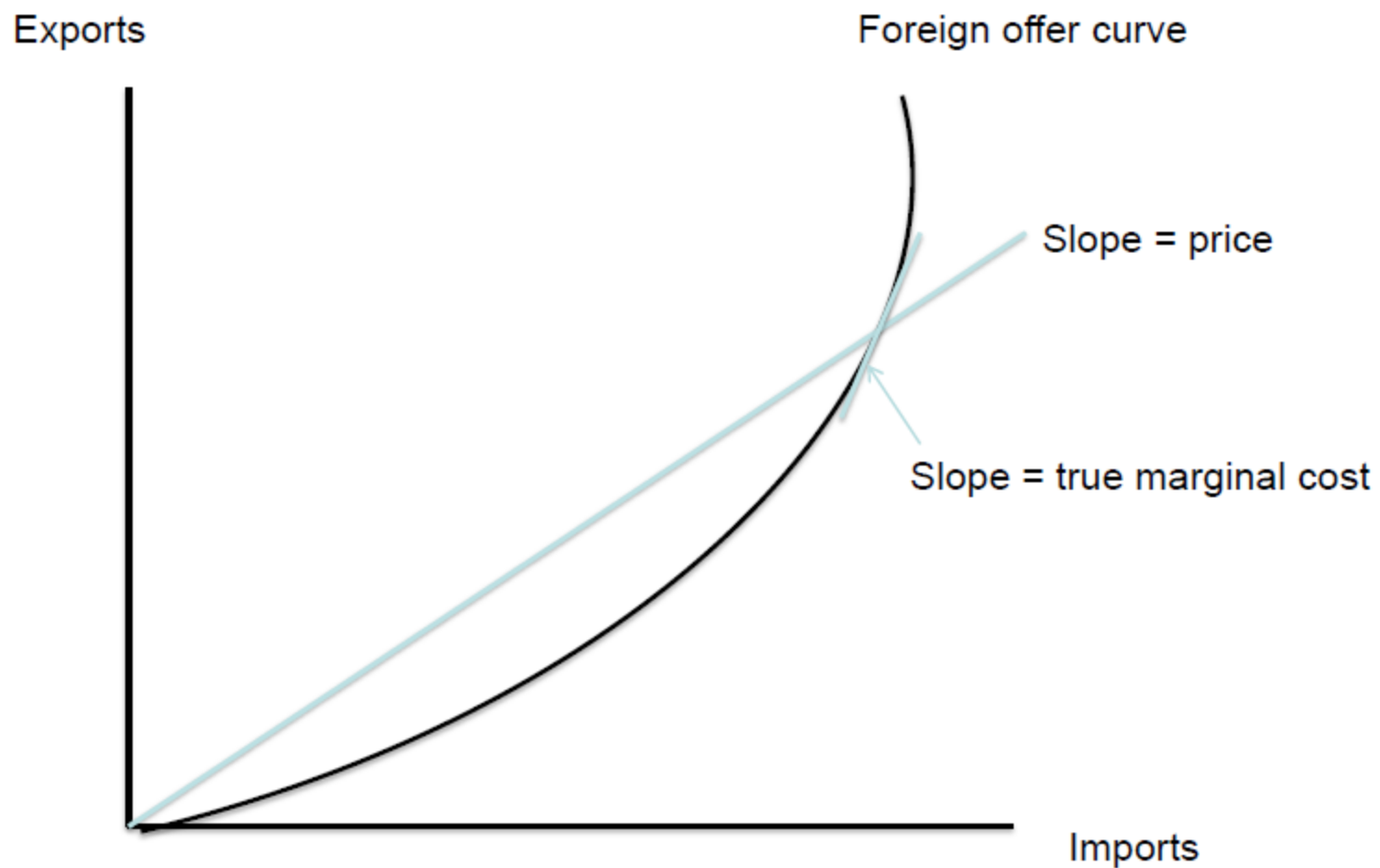
Imports

The optimal tariff argument: a country that is "large" can affect its terms of trade: the more it exports, the lower the price of its exports relative to its imports.

This implies that the true social cost of a unit of imports is higher than its market price, because the volume of additional exports required to buy that unit of imports reflects both the direct cost and the deterioration of terms of trade

So optimal policy would drive a wedge between the world relative prices and domestic – a tariff or export tax

But …. This is optimal only if the foreigners don't react. Unilateral optimal tariffs can lead to "optimal tariff warfare", which makes both countries worse off

This is one possible justification for international trade negotiations. Is "GATT-think" really driven by optimal tariff considerations?
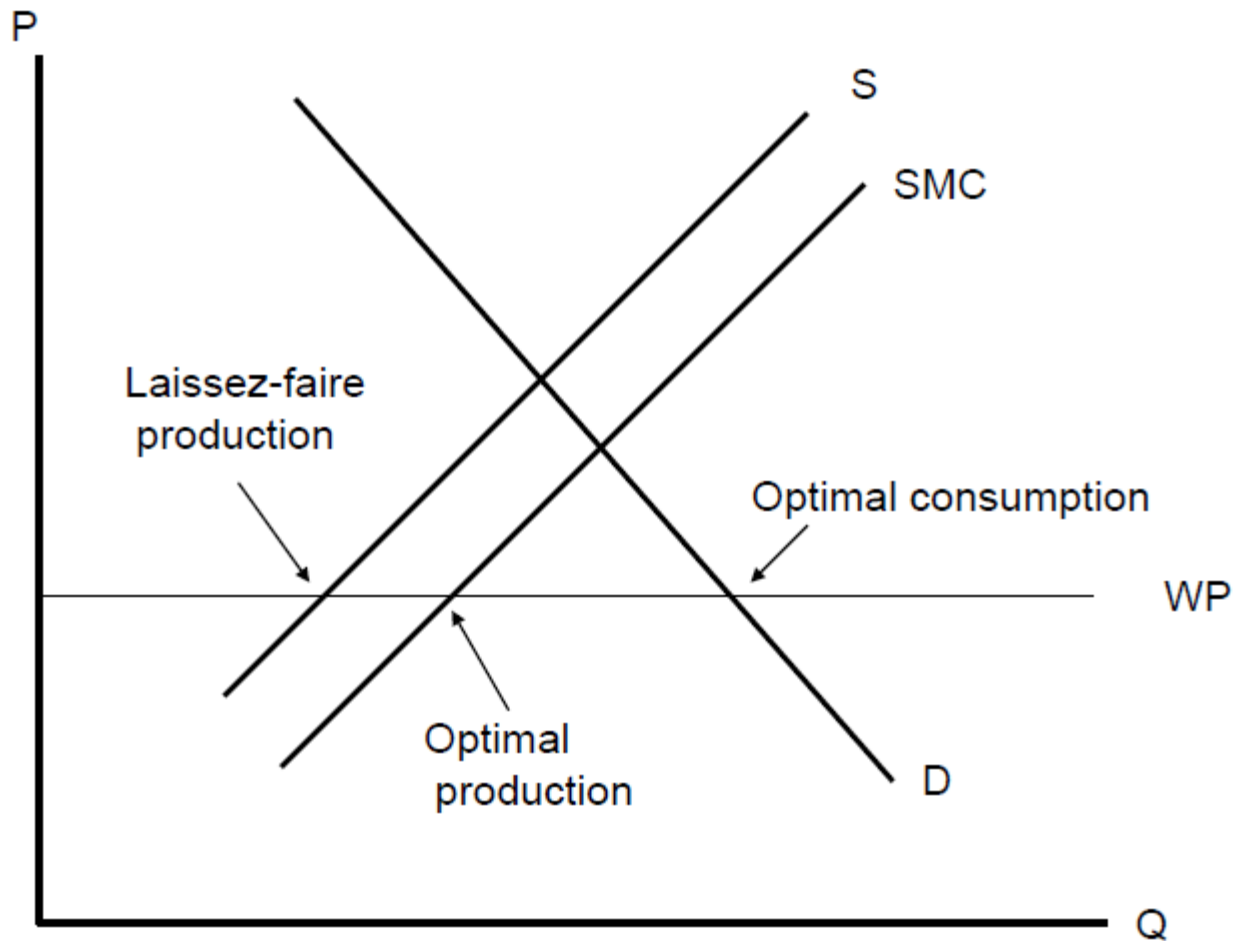
Domestic distortions and optimal policy

Implications: *if* domestic distortion leads to smaller social marginal cost than private,

1. Laissez-faire leads to suboptimal output

2. Production subsidy can lead to optimal output

3. Tariff can move output in "right" direction, but only by distorting cons.

4. Trade policy is second-best answer

When distortion is in factor markets, production subsidy becomes second best, trade policy third best (import quotas fourth best, etc.)

Harry Johnson: Second-best policies are usually recommended by third-best economists working for fourth-best politicians …

Trade policy is good ground for empirical political science because it has a natural, one-dimensional metric

Two kinds of question: changes in policy toward more or less protection; pattern of protection across industries
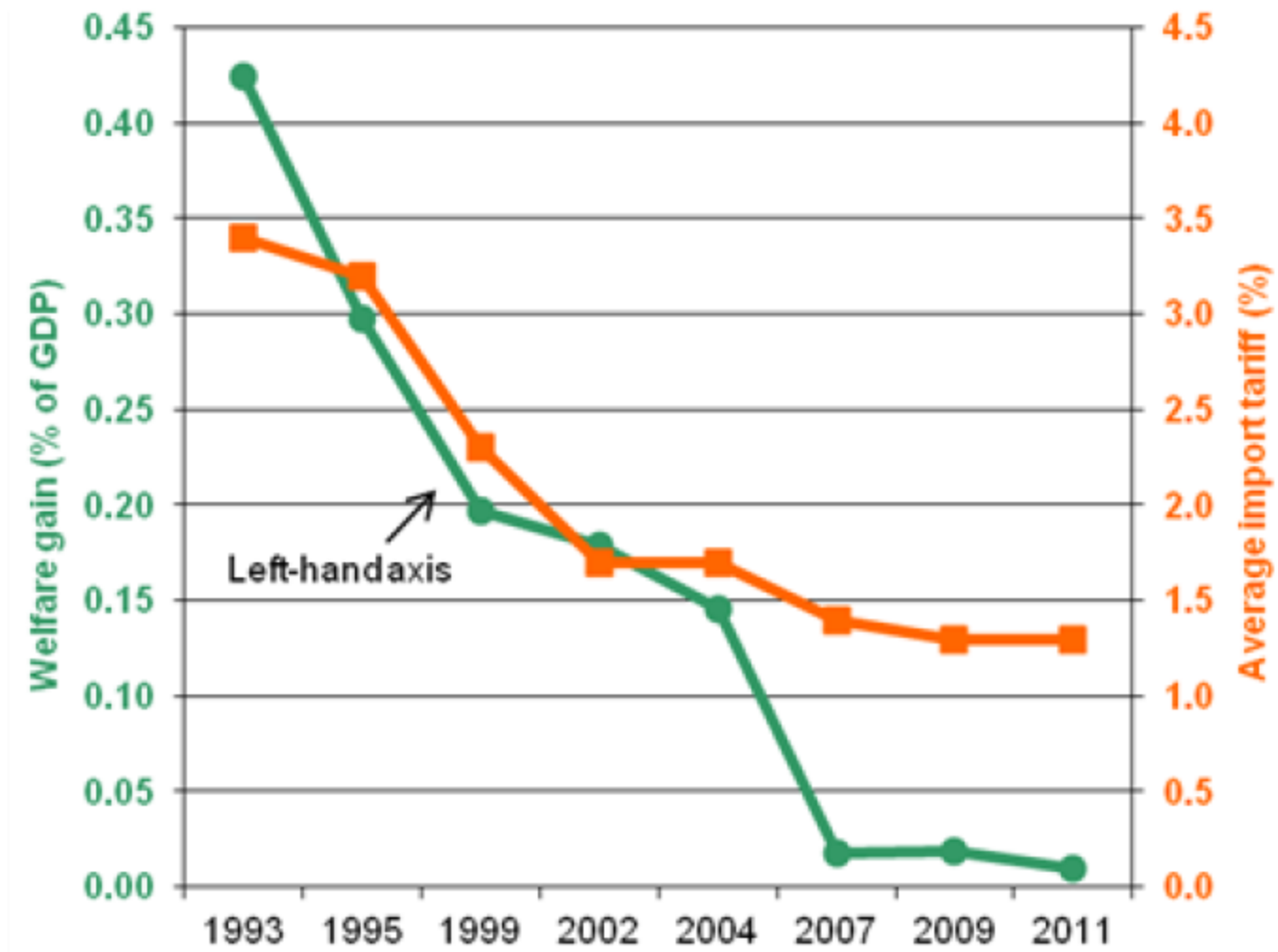
What kind of economic model? Stolper-Samuelson or Ricardo-Viner (specific factors)?

Just in case you were wondering …
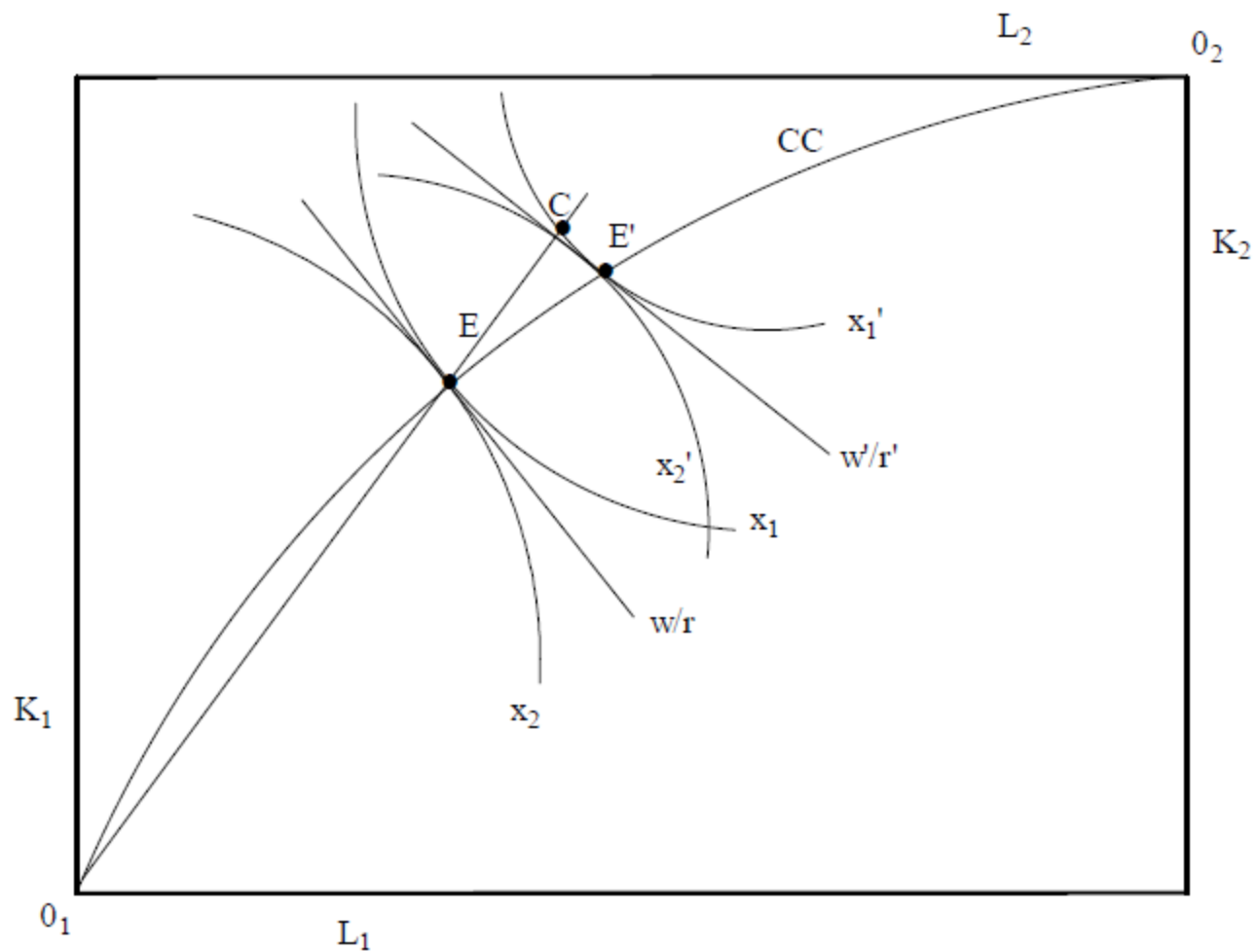
Figure 3. A tariff on product 1 and factor prices

FIGURE ES.1 Tariff rates and estimated welfare gains have fallen over the life of the report,

Table ES-1
Economic welfare gains from liberalization, 1991.

(Million dollars)

Sector	Economic Welfare Gain
Simultaneous liberalization of all significant restraints[1]	18,976
Individual liberalization:	
Textiles and apparel[2]	15,845
Maritime transport (Jones Act)	3,086
Dairy	847
Sugar	657
Peanuts	353
Meat	177
Nonrubber footwear	170
Watches, clocks, and parts	101
Ball and roller bearings, and parts	45
Pressed and blown glass, n.e.c.	44
Costume jewelry and costume novelties	42
Machine tools	31
Cyclic organic crudes and intermediates	24
Frozen fruit, fruit juices, and vegetables	13
Ceramic wall and floor tile	12
Personal leather goods	7
Electronic capacitors	5
Leather gloves and mittens	2
China tableware	2

TABLE ES.2 Welfare gains from liberalization of significant import restraints in 2015, relative to the model's baseline projection (millions of dollars)

Sector	Change in economic welfare
Simultaneous liberalization of all significant restraints	2,602
Liberalization of individual sectors	
Food and agriculture	
Ethanol	1,513
Dairy	223
Tobacco	63
Sugar	49
Canned tuna	16
Textiles and apparel	514
Other manufacturing sectors	
Footwear and leather products	215

Political economy arguments:

Mancur Olson: political action is a public good

Organized small groups

Classic example: sugar, with around 1000 cane producers
 and 100 million or so households as consumers

Political influence, campaign contributions, causing bias toward
 producer interests

International negotiations

A small tariff increase

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Consumer loss

Producer gain

Revenue gain

Distortion losses

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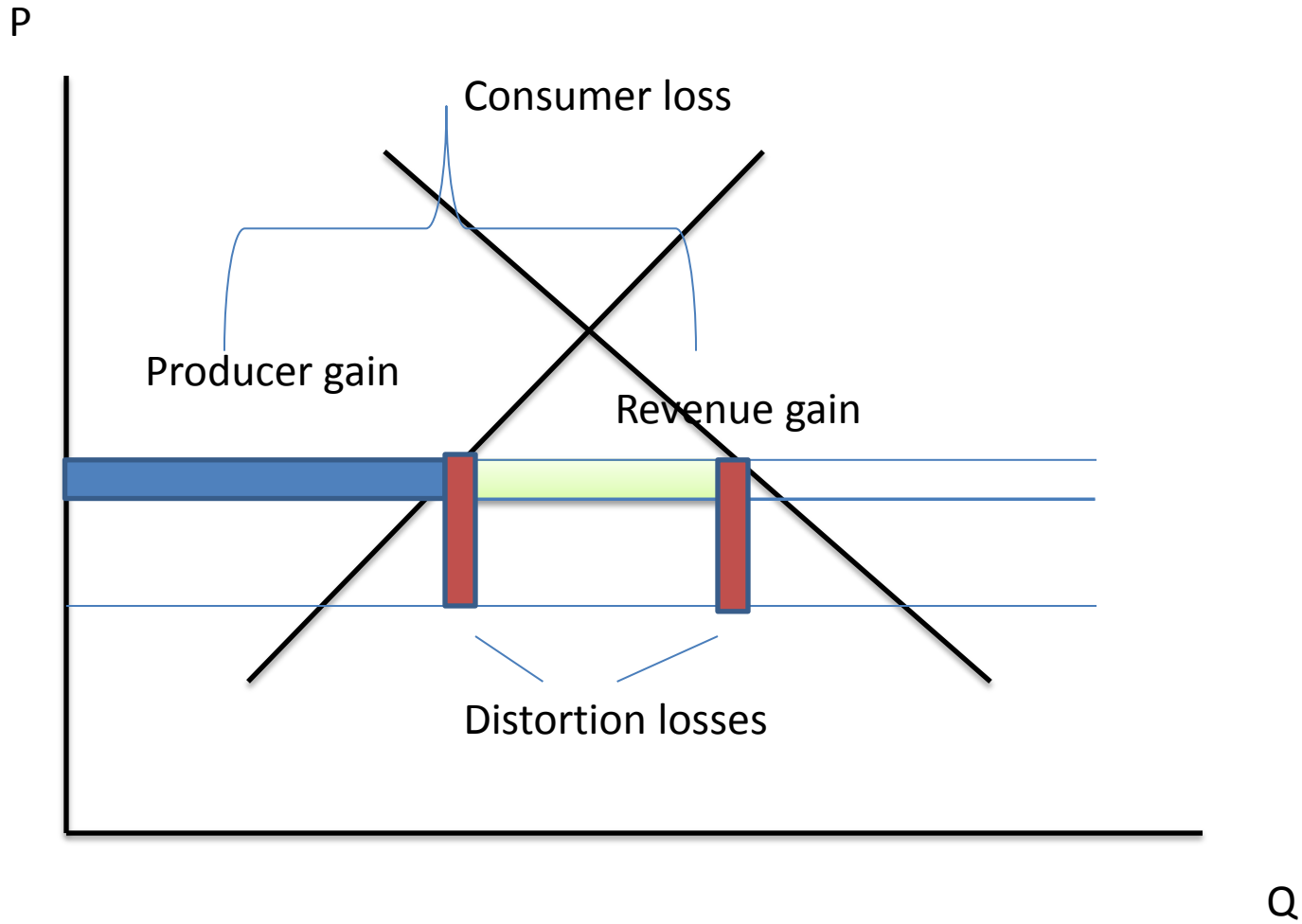
Overall, net loss – but not necessarily if producer gain has higher weight

Rodrik's point: suppose you want to help garment workers. You could:

1. Give them money
2. Subsidize garment employment
3. Subsidize garment production
4. Protect garments with a tariff
5. Protect garments with an import quota giving foreigners the licenses

These are in increasing order of economic inefficiency. Why are they also in increasing order of actual occurrence?