

Why Countries Restrict Trade

KOM, Ch 10, selected pages:

- What benefits from free trade are not captured in the partial equilibrium model? **<a: Economies of scale, incentives to innovate, productivity via better firms exporting, reduction of rent seeking; Also: increased competition, variety.>**
- The textbook mentions only two arguments against free trade: terms of trade and market failure. Can you think of others?
- How does the theory of the second best provide reasons that tariffs may be beneficial? How does it also provide reasons why tariffs are not the best policy in such cases? **<a: In the presence of a distortion, where production or consumption choice are not optimal due to, say, an externality, a tariff may be beneficial by providing an offsetting distortion. But in such cases, a tariff is not the first-best policy, because it creates two distortions (production and consumption, or supply and demand), and while one of these may usefully offset a distortion, the other makes matters worse. An intervention targeted at the distortion would be preferable.>**
- What is the “median voter theory,” and why does it seem not to explain protection? **<a: If two parties each try to satisfy a majority of voters, and if voters’ opinions are arrayed along a line, then by choosing the policy favored by the median voter, they will get all the votes on the 50% of the voters on one side. If they choose a policy at all away from the median voter, then their opponent can win by choosing a policy somewhere between them and the median.>**

Baldwin & Magee, “Is Trade Policy for Sale? Congressional Voting on Recent Trade Bills,” 2000.

- By what mechanisms do theorists suggest that political contributions result in votes for and against trade liberalization? **<a: Interest groups provide campaign funds and politicians in return provide policies that increase the economic rents of those interest groups. One economist’s version has politicians setting their policies, and the interest groups then try to influence who is elected. Another has interest groups offering a menu of contributions based on the policies that will be chosen, and politicians decide both policy and contributions from that menu. Political scientists tend to reject that contributions buy favors, but say that they buy access and therefore the opportunity to persuade the legislators.>**
- Do businesses and labor groups in the US tend to contribute in favor of protection or in favor of free trade? What theory of international trade fits best with these orientations, and why? **<a: Businesses tend to favor free trade, while labor groups tend to favor protection. This fits with the Heckscher-Ohlin Model of trade, which suggests that in a labor-scarce country like the US, labor will be hurt by trade and capital will be helped. >**

- When did the US first grant China MFN status? What was the decision regarding this that Baldwin and Magee used congressional voting on? **<a: In 1980, by Carter. The vote in 1994 was whether to disapprove President Clinton’s recommendation to renew MFN for China. It was defeated easily.>**
- What were the three Congressional votes studied by Baldwin and Magee, and how would the outcomes have differed if there had been no contributions at all from either labor or business? Which side – labor or business – had the greater effect on the voting? **<a: Labor added more votes against trade than business added in favor, for both NAFTA and the WTO. Since both passed, however, this suggests that if neither side had contributed, the outcome would have been even more in favor of trade, and thus would still have passed. However, the passage margins were small enough that if only business contributions had been absent, NAFTA would have failed. The WTO passed by a wider margin, and would have survived the absence of business contributions. No effects on MFN for China, so here they didn’t matter.>**
- What do they estimate as the “price” of one congressional vote against NAFTA or the WTO? **<a: \$352,000 for NAFTA; \$313,000 for the WTO.>**
- Were campaign contributions the only thing that mattered for congressional votes on these trade issues? **<a: No. Other variables reflecting the interests of constituents played a significant role, such as proportion of less educated workers, degree of unionization, employment in export versus import-competing sectors. And more important were the broad policy views of the legislators.>**

Magee, “Why Are Trade Barriers So Low?”:

- Does the main “political economy” model for explaining tariffs say that politicians care only about campaign contributions? **<a: No; they balance these against their perception of welfare of society.>**
- Why does Magee give only partial credit to GATT negotiations in explaining the fall of tariffs since the 1930s? **<a: Because a lot of reduction (in the US) happened before the GATT, largely due to the combination of inflation and specific tariffs. And because much other liberalization (e.g., India, China, and FTAs) was done unilaterally or otherwise.>**
- How do the following terms or concepts figure in explanations for why trade barriers are low: free riding; peace; imported inputs; non-tariff barriers? **<a: Free riding: beneficiaries of protection free ride on the lobbying of others, and therefore lobby less than they otherwise would. Peace: trade liberalization is viewed as lessening the likelihood of international military conflict, and this objective adds to the benefits of liberalization that politicians value. Imported inputs: protection hurts the users of imported inputs, who therefore lobby in favor of liberalization. Non-tariff barriers: protection is actually higher than measurement of only tariffs would suggest, because NTBs are more restrictive than tariffs.>**

Krugman, “Wonking Out: Two Cheers for Carbon Tariffs,” 2021.

- Why would Krugman favor a carbon tariff even if it were as economically harmful as a tariff usually is? **<a: Because the costs of tariffs are trivial compared the risks of climate change, and they are needed to pressure countries into taking action. Also, it would discourage industry from fleeing carbon regulation and taxes by moving to countries (China) with laxer policies.>**
- Why does he discuss the economics of the value added tax? **<a: Because the issue there is the same, and is better understood. A border adjustment is necessary for the VAT to make sense and level the playing field.>**
- A carbon tariff set equal to a domestic carbon tax makes sense, but what if the domestic policy is regulation, not tax? **<a: It still makes sense, to offset the increased cost due to the regulation. But deciding its level is much harder.>**
- Why does he give only two cheers, not the usual three? **<a: Because the carbon tax levels the playing field for domestic producers relative to imports, but not for exporters relative to foreign producers.>**

Ponnuru, Ramesh, "The Politics of Trade Favor Trump in 2024," *Washington Post*, March 5, 2023.

- Does Trump promise more tariffs? **<a: Absolutely.>**
- What does he claim tariffs will do? **<a: End trade deficits, bring back American jobs, and raise massive revenue.>**
- Why are two of his claims contradictory? And why are all proven wrong by experience **<a: If tariffs reduce trade, they won't raise revenue. And the tariffs he did use had none of those effects.>**
- Does the public favor tariffs? **<a: No. Polls say they find trade “an opportunity,” especially Democrats.>**
- Why do politicians favor tariffs? **<a: Biden supports unions, who are protectionist; nobody want to be soft on China; and both parties want the votes of “white people from industrial states without college degrees” who implicitly (and validly) are vulnerable to trade.>**
- Will there be lots of new tariffs? **<a: This says no, because Congress lacks the votes, and even Trump does not follow through on all he promises.>**

Optional to Read:

Deardorff & Stern, “Introduction” to *Constituent Interests and U.S. Trade Policies*, 1998.

- In the US government, who tends to be more protectionist and who more free-trade oriented: the President or Congress? Why? **<a: As explained by Baldwin, the President tends to be more free-trade oriented because he has foreign policy objectives in mind, while the Congress is more inclined to serve their constituents by providing import protection and seeking market access.>**
- By what means and how successfully do “constituent interests” influence trade policy? **<a: They use both time and other resources, applied both to elected**

officials and bureaucrats. The authors contributing to the volume seem to disagree on the extent to which they get what they want, however. And sometimes (as in auto VERs – called here VRA – and subsequent FDI) what they want has unintended side effects that they regret.>

- What are some of the constituent interests that care about trade policy other than those participating directly as producers for export and in competition with imports? **<a: Financial services, environmentalists, human rights activists, human rights activists in addition to labor unions, the trade law bar, and the media.>**