

Welcome Back!

Applications: Trade

Rich Nielsen

Turning our focus to international economics

Clear(est?) intersection of international and domestic politics

- ▶ Trade impacts domestic producers and consumers
- ▶ Liberal IR theory closely tied with ideas from trade politics

Domestic and international institutions shape policies

Important role of global and regional institutions:

- ▶ Facilitate bargaining among states with diverse domestic interests

Outline

- ▶ International Trade Patterns
- ▶ Trade Barriers and Domestic Politics
- ▶ International Institutions and Trade
- ▶ Rodrik “Trading in Illusions”
Is free trade good for poor countries?

International Trade Patterns

Why do countries trade what they trade?

Absolute advantage:

- ▶ Ability to do something better than others

Comparative advantage:

- ▶ Nation gains by specializing in producing and exporting what it makes most efficiently relative to the efficiency it could achieve in making other things.

Free trade allows states to benefit from comparative advantages, focusing on efficient industries and importing the rest.

Trade protection is costly to consumers.

> 200 Billion cost of steel trade protection in the US since 1970. Textbook p 295.

International Trade Patterns

Heckscher-Ohlin trade theory

- ▶ Characterizes states in terms of national **factor endowments**
 - ▶ Material and human resources they possess

- ▶ Basic **factors of production**:
 - ▶ Land (essential for agricultural production)
 - ▶ Labor (unskilled labor)
 - ▶ Capital for investment (machinery, equipment and financial assets)
 - ▶ Human capital (skilled labor)

- ▶ Relative endowments determine comparative advantage, and comparative advantage determines what states export and import.

International Trade Patterns

Industrial countries: rich in capital and skilled labor

- ▶ Export goods using these endowments

Developing countries: rich in land, raw materials or unskilled labor

- ▶ Export agricultural products, minerals, and labor-intensive products like textiles

International Trade Patterns

More to the story?

Intra-firm and inter-firm trade in global supply chains.

Economic links encourage trade (e.g., Euro as a shared currency)

Non-economic factors influence trade patterns (geography, diplomacy):

- ▶ Trade between hostile nations is risky.
- ▶ Governments pursue economic ties with allies.

International Trade Patterns

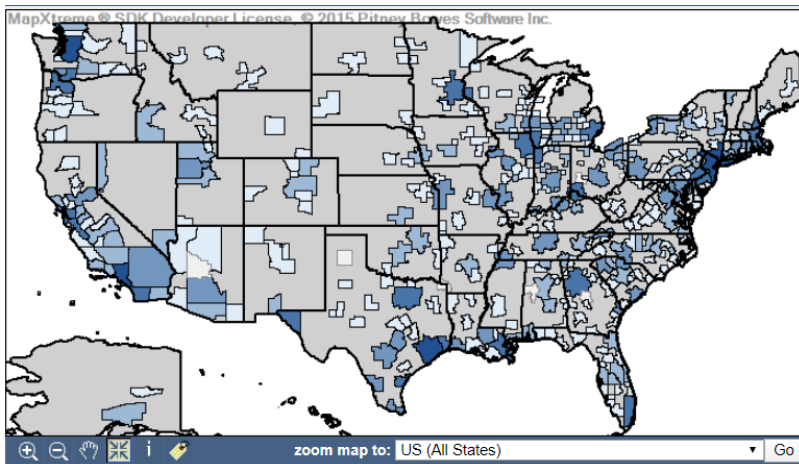
But does it make sense to think of countries as the units?

Take a moment to visit this website and look up the metropolitan area you grew up close to

<http://tse.export.gov/metro/SelectReports.aspx?DATA=Metro>

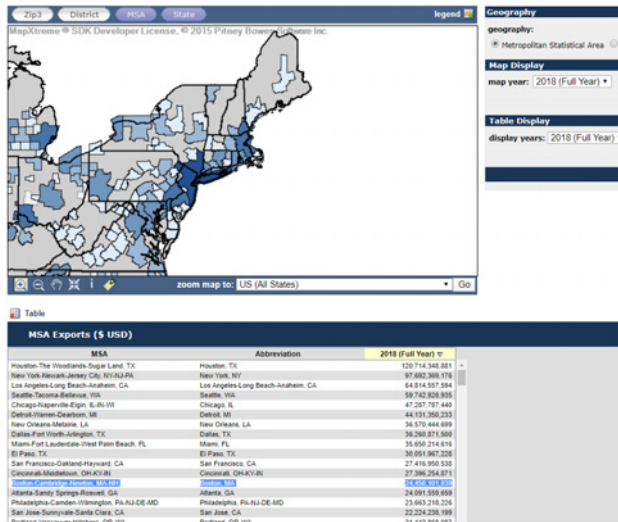
If you are not from the US, look at Boston.

Where in the US benefits from exports?

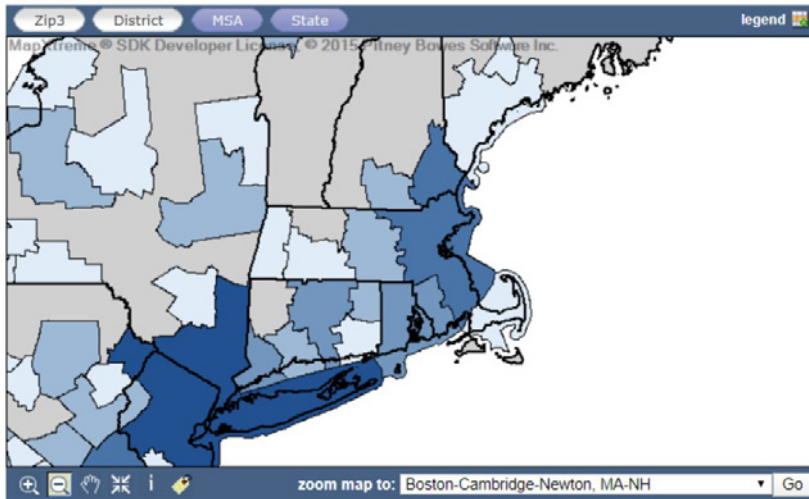


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Where in the US benefits from exports?



Where in the US benefits from exports?



International Trade Patterns

Governments try to address the interests of:

- ▶ Corporations
- ▶ Consumers
- ▶ Farmers
- ▶ Bankers

The politics of trade is in part about who wins and loses.

Outline

- ▶ International Trade Patterns
- ▶ **Trade Barriers and Domestic Politics**
- ▶ International Institutions and Trade
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Is free trade good for poor countries?

Trade Barriers and Domestic Politics

Key terms:

Protectionism: specific measures to shield domestic producers from imports

Trade barriers: impediments to the import of foreign goods

- ▶ **Tariff:** Tax on imports levied at the border and paid by the importer
- ▶ **Quota:** Limits quantity of a foreign good to be sold domestically
- ▶ **Non-tariff barriers to trade:** regulations targeted at foreign goods

Trade liberalization over time

Under mercantilism, trade was not free. (think US colonies forced to buy tea)

Trade liberalization:

- ▶ Begun in 1850s by Britain and other industrial states

Most major economies were open and trade grew rapidly

WWI to WWII: 30 years of crisis, though “trade with the enemy” persists.

- ▶ Trade liberalization restarted under U.S. leadership (1945).

Liberalization leads to globalization after 1980.

Since 2008, growing skepticism about further liberalization (Greece debt crisis, Brexit).

Why Do Governments Restrict Trade?

Trade barriers reflect domestic concerns

- ▶ Barriers assist national producers
- ▶ But cost consumers more

Most direct cost of protection is to consumers of the protected good.

Why Do Governments Restrict Trade?

Redistributive effect:

- ▶ Income redistributed from domestic consumers
- ▶ Protected domestic industry benefits

Protectionism reduces society's ability to use resources most effectively

Winners and Losers in International Trade

Protection creates above normal profits for protected industry:

- ▶ Artificially restricts competition and supply

But three groups lose from trade protection:

- ▶ Consumers of the imported good
- ▶ Exporters
- ▶ Politicians punished by upset citizens

But if there are more consumers than producers, shouldn't democracies select free trade?

Economic Interests and Trade Policy

Three leading theories of trade-policy interests.

- ▶ Stolper-Samuelson (general factors) approach
- ▶ Ricardo-Viner (specific factors) approach
- ▶ Firm-based approach (“new, new trade theory”)

Stolper-Samuelson

Trade benefits owners of factors of production used to produce exported goods

- ▶ in Heckscher-Ohlin theory, this will be the abundant factor

Artificially restricting trade hurts owners of **abundant** factors

Stolper-Samuelson

In the US unskilled labor is scarce

US imports labor-intensive goods

- ▶ Protection restricts importation of these products
- ▶ Raises domestic demand for unskilled labor

Protection helps American unskilled workers (who “own” the scarce factor)

- ▶ Protectionism benefits the scarce factor of production
- ▶ Protection hurts the abundant factor

Stolper-Samuelson

Owners of scarce factors favor protectionism

- ▶ → Owners of abundant factors favor trade

Stolper-Samuelson theorem refers to very broad groups (e.g., unskilled vs. skilled labor)

But, most demands for protection come from specific industries (e.g., farmers or steel)

Ricardo-Viner

Ricardo-Viner theorem: asks why whole industries often act together

- ▶ Some factors of production are specific to particular industries
- ▶ They are “sticky” – hard to move across industries, even if they are the same “factor”

Workers interests flow from her sector of the economy (not the factor she owns)

Firm-based trade theory

New new trade theory: why do only a small number of firms engage in exports?

- ▶ Largest, most productive firms in an industry want free trade
- ▶ Smaller, less productive firms in an industry want protection

Workers interests flow from her specific firm's interests (not the sector or factor she owns)

Whether SS or RV or NNTT best explain trade preferences depends on how **mobile** factors of production are (For more information, see more advanced classes on “International Political Economy”).

Collective Action in Trade Policy

Trade protection helps some groups

- ▶ But it harms the economy as a whole....so why protection?

Policy institutions responsive to **concentrated groups** which causes them to be favorable to protection

Collective Action in Trade Policy

Logic of collective action: small groups are more effective than large ones

- ▶ Small groups make free-riding difficult
- ▶ Benefits can be excludable

The logic of collective action favors supporters of protection

- ▶ Example: sugar subsidies in the US
 - ▶ Benefit sugar farmers (small group)
 - ▶ Harm American sugar consumers (large group)

Cohesive and powerful interests: likely get more government support

Domestic Institutions

Political institutions tied to narrow interests likely favor protection

Institutions that respond to broad national pressures are favorable to trade

Average democracy is approximately 25% more open to trade than the average autocracy

But even in democracies, there are strong pressures for protection.

Example: Senate “over represents” agricultural producing states

Partisan features of government affect trade policy

Strategic Interaction at International Level

Governments consider other states' likely responses

If China puts a tariff on the US, what should the US do?

International trade bargaining can resemble a Prisoner's Dilemma.

- ▶ Both sides better off reducing trade barriers
- ▶ But concerns of cheating reduce cooperation

Overcoming Problems of Strategic Interaction

Factors facilitating cooperation:

- ▶ Small numbers or hegemonic stability
- ▶ Information
- ▶ Repeated interaction
- ▶ Linkage politics

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Institutions in International Trade

Institutions can:

- ▶ Set standards of behavior
- ▶ Monitor and enforce compliance
- ▶ Reduce transaction costs
- ▶ Reciprocity/concessions granted by one government matched by another

Institutions in International Trade

The **World Trade Organization (WTO)** succeeded the **General Agreement on Tariffs and Trade (GATT)** in 1995.

- ▶ Enormously successful in reducing trade barriers

Most favored nation (MFN) status:

- ▶ Extend the same concessions provided to all other nations

Institutions in International Trade

How does the WTO encourages cooperation:

- ▶ Collect information about trade policies
- ▶ Standard for monitoring
- ▶ Dispute resolution

WTO members have an equal vote

- ▶ But large states generally dominate negotiations

Institutions in International Trade

Similar institutions at regional levels:

- ▶ **European Union:** started in 1958 with 6 members; now holds 27 (?) in a single market
- ▶ **North American Free Trade Agreement (NAFTA):** US, Canada and Mexico
- ▶ **Mercosur (the Southern Common Market):** Argentina, Brazil, Paraguay and Uruguay
- ▶ Many others listed on pp 328-329 of the text: GCC, ASEAN, ECOWAS, etc.

Institutions in International Trade

Regional agreements:

- ▶ Some praise them
- ▶ Others criticize: de facto restricts trade with non-members.
- ▶ “broader-deeper trade-off” in international institutions.

Globalization critics: complain the WTO privileges international corporations

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Conclusion

Trade policies are controversial:

- ▶ Within a country (domestic)
- ▶ Among countries (international)

National trade policies determined by:

- ▶ Economic interests
- ▶ Political institutions
- ▶ Interactions with other nations

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17.41 Introduction to International Relations
Spring 2023

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