IPE Generals Notes – International Trade

I. Realist/power-based explanations

- *Hegemonic stability theory*
    - Kindleberger (1973): A stable FT system is a public good → leads to PD as far as supply. A hegemon (equal to Olson's privileged group) can/will bear costs of the regime (i.e., 'defection' by other states) in order to reap the income benefits of FT → *benevolent hegemony*.
    - Gilpin: *interested-based hegemony* – Asymmetric benefits to hegemon, so bears costs.
    - Krasner (1976): structure of international trade is determined by the interests and power of states acting to maximize national goals. Four major states interests (political power, aggregate national income, economic growth, and social stability) are affected by openness.
        - Costs/benefits of free trade are asymmetrically distributed. Hegemonic distribution of potential economic power is most likely to result in an open trading structure. Why?
            - Openness increases national income and growth (the latter when hegemon is ascending and holds relative size/technology leads). Openness also increases the hegemon's political power, since its opportunity costs of closure are smaller (large states are more insulated from trade, smaller states more vulnerable → hegemon can use threats of closure as leverage in political arena). Finally, the hegemon is more insulated than others in terms of social stability (again, less exposure to trade). All of this makes it in the interest of the hegemon to have FT, and it enables the hegemon to bear the costs.
        - Findings: trade system does not move in lockstep with shifts in potential power → Krasner looks to exogenous shocks, "lock-in" effects, and institutions as the reason why trade regimes persist even when power structures change.
    - RANT: Yet, despite lack of evidence, Krasner reasserts that power and state interests are the underlying factors structuring the international trade system. Does he confuse economic size/strength with power? This works for origins of post-WWII regime, but how to explain persistence over time, evolution of institutions, etc.?

    - Keohane/Snidal: K-group can substitute for hegemon.

- *Polarity/security externalities* (Gowa 1989): Income gains that motivate FT are also the source of security externalities that impede it. By increasing income, trade increases military capabilities of a country. Since benefits of FT are uneven, this has potential to upset the balance of power → key is great powers' concern for relative over absolute gains.
    - Security externalities mean that military alliances are the natural basis for FT agreements (even if your allliance partners benefit relatively more than you from FT, your security is enhanced).
    - BUT: in multipolar system, threats of exit and exploitation by alliance partners remain (stronger incentives for altruism) → so, bipolar system advantaged in terms of likelihood of a FT zone emerging among alliance partners.

- *Strong vs. weak state arguments*
    - Katzenstein (1978): state/society relations determine foreign economic policy (domestic structure matters) → state 'strength' in relation to society influences policy.
    - Krasner: state strength is issue-specific → US a strong state in monetary policy, weak in trade → sparked debate about whether or not this is true. Goldstein says US policymakers' adherence to FT ideology makes it stronger than Kranser argues in trade; Frieden says bankers' role in influencing policy makes US weaker than generally thought in monetary policy.
    - Gowa (1988): difficulty of collective action plays a key role in trade vs. monetary policy → specific nature of various public goods, not state-society relationship, is a more powerful explanation for power structures that determine economic policy outcomes.
    - RANT: Weakness of this literature, as Haggard points out, is that it is overly static, assuming constancy of 'strength' over time → capability of executive, power of interest groups, nature of issues can change over time.

II. Interest-based explanations ('demand-side')

- *Basic economic theorems about trade and factors*
    - Stolper-Samuelson (SS): in two factor world with complete domestic factor mobility, trade liberalization lowers real income of one factor (scarce) and increases real income of the other (abundant). Implication: trade lobbying occurs along factor lines.
    - Ricardo-Viner (RV): factors are industry-specific (even in long-run), so trade liberalization benefits all factors in an export industry, while hurting all factors in the import-competing industry. Implication: trade lobbying occurs along industry lines.
    - Heckshер-Ohlin (HO): if there are two factors of production, a country will export goods intensive in its abundant factor, and import goods intensive in its scarce factor → combined with SS, leads to predictions about who prefers FT vs. protection.

- *Rogowski* – changing exposure to trade creates political cleavages based on factor endowments and the stage of development.
    - Stolper-Samuelson: benefits of trade accrue absolutely and disproportionately to a country's abundant factor → abundant factors FT, scarce factors protectionist.
    - See IPE summaries for more detailed argument.

Four types of factor endowments and effects of expanding exposure to trade

	Land-Labor Ratio	
Stage of Development	**High**	**Low**
Advanced economy (capital rich)	Abundant: capital, land Scarce: labor Conflict: class	Abundant: capital, labor Scarce: land Conflict: urban, rural
Backward economy (capital poor)	Abundant: land Scarce: capital, labor Conflict: urban, rural	Abundant: labor Scarce: capital, land Conflict, class

- *Grossman & Helpman* – politicians maximize welfare based on campaign contributions from special interets and welfare of voters. This results in tradeoffs between interest-group demands against alienation of voters that results from implementation of protectionist policies that hurt aggregate social welfare.
    - Outgrowth of classic Stigler-Peltzman model, where politicians max a political support function when setting economic policies.
    - In GH, industries with higher import demand or export supply elasticities will have smaller deviations from FT. Political strength of the interest groups and state of the economy are also factors.
    - Goldberg & Maggi find GH to be empirically correct in US, but welfare concerns outweigh contributions in politicians' utility functions.

- *Magee* – tests to see whether SS or RV is empirically correct in US. SS would be true if: 1) capital favored FT and labor preferred protection (cleavage along factor lines, not industry); 2) each factor was unanimous in choice of FT or protection; 3) each factor's policy choice was independent of its position as export- or import-competing.
    - Findings: 1) capital and labor in an industry nearly always have a common position on trade → evidence against SS and for RV; 2) capital and labor across industries are NOT unanimous in their trade preferences; 3) capital supporting FT had positive trade balances; capital opposing FT had negative trade balances → evidence against SS and for RV.
    - SO…evidence refutes SS relative to RV…BUT, authors do not reject SS completely, since it is a long-ru proposition, while trade policy in the US is a short-term phenomenon (trade bills up for renewal every 5 years) → SS a useful guide to long-run pattern in US since WWII.

- *Trefler* – endogenous protection, rather than prior theories which treat liberalization as exogenous. Higher levels of import penetration lead to greater protection. In US, modeling trade protection endogenously shows that its restrictive impact on imports is 10x what we find when modeling it exogenously.

- *Milner* – Given similar economic situations (economic difficulties, declining hegemony) in 1920s and 1970s, why less protectionism in 1970s?
  - Rejects argument that US hegemony had not declined "enough" in 1970s, argument that GATT prevented rising protectionism, and argument that domestic institutions (RTAA) prevented rising protectionism.
  - Rather, Milner looks to a different 'level of analysis' to find the answer. She argues that rising international economic interdependence *changed interests* of key domestic actors in favor of maintaining FT. Internationalization of firms dampened protectionism, even in hard times.
    - Fear of foreign retaliation, fear of trade diversion, increase in cost of imported factors of production, and intra-industry rivalries (internationally vs. domestically-oriented firms) are all reasons why internationally-oriented firms become pro-FT rather than protectionist.
    - Milner finds that, even within industries, internationalization of the firm mattered for its preferences over FT.
  - Other factors mattered (GATT, different IMS, etc.), but domestic-level changing interests key.

- CW explanation for protectionism: tariff benefits concentrated among import-competing producers, while costs of FT diffused among other producers and consumers → former find it easier to organize to influence policy (standard Olsonian argument).

- RANT: interest-based literature assumes direct line from interests to policies → need to incorporate role for institutions as aggregation/filtering mechanisms for interests. Still, I find these strongly appealing, especially over the long term (i.e., institutions may lead to 'sticky' outcomes, but over time, interests will come to be reflected in institutions).

III. Institutional explanations ('supply-side')

- *Alt & Gilligan* – AG propose a three step process for explaining how trade policy is formed. The problem for 'trading states' is to weigh aggregate, external effects (welfare) against internal, distributional effects. Three key questions:
  - Given the stakes of an issue (trade), who will organize to act politically? Emphasis on <u>collective action problems</u> (Olson).
  - What explains the stakes? Emphasis here on <u>factor endowments and specificity/mobility</u> (Rogowski).
  - How does the nature of <u>domestic political institutions</u> affect the compostion and strength of trade policy coalitions?

  - <u>Key points</u>: Ignoring institutions confuses interests with outcomes [my criticism from above]. Ignoring economic variables (factors) leaves one unable to understand the stakes of trade policy. Most importantly, institutions affect collective action in ways that differ/interact with factor mobility (see various complicated charts).

- *RTAA literature* – institutional explanation:
  - RTAA enabled Congress to break out of sub-optimal equilibrium ('universal logroll') by delegating power to the president. Hiscox calls this the 'magic bullet' theory:
    - Lohmann and O'Halloran – President represents single, universal 'district' which accounts for diffuse benefits of FT, rather than Congressional catering to special interests in favor of tariffs.
      - But, Congress will only delegate completely to president when he is from the same party, else the Delegation and Accommodation Game). So, policy more protectionist under divided government. In divided government, president seeks to accommodate minimum number of legislators (based on party and economic conditions in districts) needed to pass FT legislation.

- *Parties and trade policy* – McGillivray: party discipline affects which industries receive tariff protection from foreign imports. Trade protection here is redistributive in order to maximize politicians' electoral prospects.
  - Highly disciplined parties in majoritarian systems offer trade policies favorable to voters in marginal districts. So, electorally consolidated industries in marginal districts get protection (while 'safe' districts get the shaft).
  - Majoritarian systems with low party discipline → tariff protection favors large, electorally dispersed industries. Industries concentrated in marginal districts are least favorably protected (while 'safe districts' get the goodies).
  - RANT: ignores the entire institutional discussion we had above, so relevant only where trade policy made in Congress. Also, what about parliamentary (PR) systems? McG does say she'd expect PR systems to see protection aimed at core supporters (since all votes matter, not just marginals). Finally, what's the evidence that trade is the core issue driving voters' decisions, or that protection can be 'timed' so that voters remember when they go to the polls?

IV. Endogenizing Institutions (interests endogenous to institutions, and vice versa)

- *RTAA literature*
  - *BGW* – Argue that <u>political institutions, by structuring trade policy conflict</u>, provide divergence between 'conventional wisdom' (see above) on trade policy and empirical outcomes of relatively FT. They argue that the RTAA, by allowing president to negotiate reciprocal tariff reductions, generated gains for (and political support from) export interests.
    - Reject 'workload' and 'lessons of Smoot-Hawley' explanations for <u>establishment</u> of RTAA. Rather, they make a Democratic 'lock-in' argument: Democrats chose form of RTAA (reciprocal reductions) to solidify support from export interests and ensure sustainability of RTAA against future Republican majorities.
    - Reject 'abdication' and 'agenda-setting' (Haggard, allowing president to shape trade policy to his own ideological, bureaucratic, and international interests) explanations for <u>effect</u> of RTAA. By changing relative strength of interest groups, the RTAA ensured its own durability. Exports became more important, leading Congressional actors to change their preference toward FT → 'endogenous process of tariff reduction.' Bundling of domestic and foreign tariff reductions was the key mechanism that changed the interest balance of power (two-dimensional problem, rather than single).

  - *Irwin & Kroszner* – Institutions and changing relative strength of interests together resulted in shift to FT → RTAA increased the incentive of exporters to organize collectively. <u>Combination</u> of new institutional structure and change in size of the competing interest groups (pro, anti-FT)
    - BGW only looked at period after 1953, when both parties supported FT. IK want to explain shift in Republican position to pro-FT → no evidence of ideological shift, learning by Republicans, or Cold War foreign policy reasons for embracing FT.
    - RTAA created incentives for exporters to organize by lowering the costs relative to protectionist interests. Coupled with changing relative power due to booming exports post-WWII, this shifted the balance of constituent interests and led Republicans in Congress to shift their policy positions in favor of FT.

  - *Hiscox* – RTAA was not the 'magic bullet' → rather, it has been sustained only because exogenous international shocks ensured sufficient strength for FT interests over time within both US parties. RTAA could fall if calculus of interests changed.
    - Both the 'hand-tying' and 'Democratic lock-in' arguments are wrong. Rather, the historical coincidence of several factors (exogenous positive shock to US exports, shifts in US comparative advantage, growing divisions in Republican electoral base) enabled RTAA, a Democratic creation, to survive in the 1940s and 1950s.
      - <u>Weakness of hand-tying argument</u>: Lohmann & O'Halloran most advanced 'hand-tying' argument, but wrong: voting post-Smoot Hawley shows no evidence of 'learning' → RTAA vote was just as partisan. Also, SH bill wasn't

    - a 'universal' logroll (49-47 in Senate, 245-175 in House). Finally, not all presidents are more pro-FT than Congress.
    - Weaknesses of Democratic lock-in argument: BGW fails, because it would conclude that a Republican victory in Congress should result in a major shift away from RTAA to a new floor median in favor of higher protection. However, what actually happened was Republicans become *more* pro-FT and Democrats becoming *less* pro-FT.
- Thus, neither of these arguments can explain the decline in partisanship in trade votes in Congress, or the growing divisions over trade within the two parties. Rather, these can be best explained by shifts in preferences of party constituencies based on factor specificity:
    - Pre-WWII, Republicans' core supporters (industry) wanted protection, but post-WWII the export boom changed their position. In 1950s-1960s, increased competition from Europe/Japan and shifting support base (to cities) for Democrats shifted their party's trade position.
    - Also, decline of party cohesion over time → new coalitions could emerge to undermine RTAA (today's fast-track debate).
- Key strength here is ability to explain change over time: 'magic bullet' theories suggest progression away from partisan cycling over trade policy, but Hiscox argues that we might actually see its return as constituencies' interests continue to change over time.
- REPLY TO EARLIER RANT: I like Hiscox's argument, because it shows a leading role for economic interests, but also considers institutions and explains change over time.