Explaining Gradualism in Trade Liberalization: A Political Economy Approach

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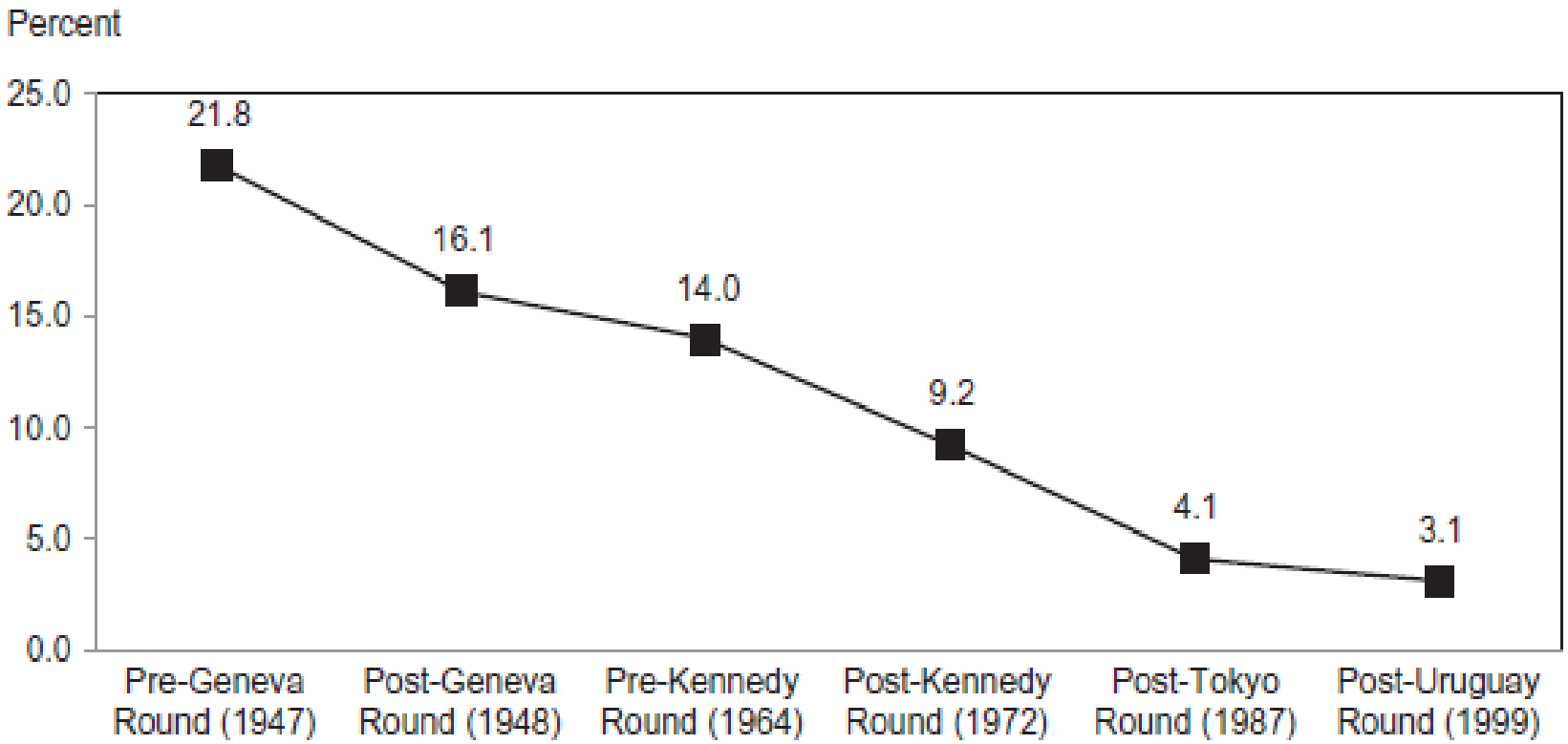
Average tariffs for U.S., Western Europe, and Japan



Source: Bown, C.P., Irwin, D.A., (2017) "The GATT's Starting Point: Tariff Levels circa 1947," in Assessing the World Trade Organization: Fit for Purpose?, M. Elsig, B. Hoekman, and J. Pauwelyn eds., Cambridge University Press, forthcoming, fig. 1

The Questions

1. Why would liberization not be immediate? Why proceed in stages?
2. What are the frictions preventing free trade?

Related Literature

Export sector

- Benefits of trade integration to consumers (Devereau 1997)
- Exporters increasingly dependent on trade via capacity accumulation (Chisik 2003)

Import-competing sector

- Convex adjustment costs as workers leave import-competing sector (Mussa 1986); Furusawa & Lai similar for repeated game
- Gradual reductions improve welfare when there's a minimum wage (Mehlum 1998)
- Workers lose specialized skills as they leave (Staiger 1995)

Limitation of punishments to 'withdrawal of equivalent concessions' generates gradualism (Zissimos 2007)

- MRC?

Politics: Motivation

Is there a *fundamentally* political economy explanation for gradualism?

- i.e. a story that doesn't hinge on specific nature of trade
- The hope: lessons could be applied to other issue areas

Politics: Mechanism

Inefficient tariffs maintained through the lobbying of import-competing industries

- BUT ability to maintain protection reduced by shocks to political support
  - a key politician losing an election or committee position
- Immediate loss of protection / rents *can* $\Rightarrow$ erosion of future political power and accompanying protection
- Demonstrate with a dynamic model of political economy

Preview of Results

None yet :(

Timeline

Within each period, taking initial wealth as given

1. Lobby/firm makes investments in technology and politics
2. Election occurs (reduced form)
3. Government chooses tariff (τ_t)
4. Production takes place, workers are paid (profits realized)
5. Tariff revenue is distributed and consumption takes place (not explicitly modeled)

Economy

- Small country ('home') and Rest of World (ROW, *)
- Separable in three goods: X and Y (traded) and numeraire
- Demand identical for both goods in both countries
  - $d_X = \nu - \beta \cdot P_X$
- Supply: $Q_X(P_X) = A(m)Fl$
  - Home net importer of X, net exporter of Y

Home levies τ on X, Foreign levies τ^* on Y

- $P_X = P_X^W + \tau$ and $\pi_X(P_X)$ increasing in τ

Non-tradable specific factor (F) motivates political activity

Political Structure

In Home country (foreign is passive):

- Non-unitary government
  - Members re-elected each period
  - Composition impacted by lobby's investment
  - Sets tariff by majority rule
- A Single Lobby
  - Represents import-competing sector, X

"Government"

Decision determined by complex process. Reduced form:

$$W_G = CS_X(\tau) + \gamma(e,\theta)\pi_X(\tau) + CS_Y(\tau^*) + \pi_Y(\tau^*) + TR(\tau)$$

- $CS_i(\cdot)$: consumer surplus
- $\pi_X(\tau)$: profits of import-competing industry
- $\pi_Y(\tau^*)$: profits of exporting industry
- $TR(\tau)$: tariff revenue

"Government"

$$W_G = CS_X(\tau) + \gamma(e,\theta)\pi_X(\tau) + CS_Y(\tau^*) + \pi_Y(\tau^*) + TR(\tau)$$

- γ: weight on import-competing industry profits. Determined via election, influenced by
  - e: lobbying effort
  - θ: uncertain element in electoral process

Assumption 1

$\gamma(e,\theta)$ is increasing and concave in e for all $\theta \in \Theta$.

Lobby

Lobby chooses effort to maximize:

$$\max_{e_t, m_t} \sum_{t=0}^{\infty} \left\{ A(m_t) \cdot F \cdot l_t(P^W + \tau(e_t)) - l_t - m_t - e_t \right\}$$

$$\text{s.t.} \quad W_t \geqslant 0, \; m_t + e_t \leqslant W_{t-1}$$

where

- m_t: Investment in productivity
- l_t: Labor
- e_t: Lobbying effort
- τ: home tariff on good X
- W_t is total wealth