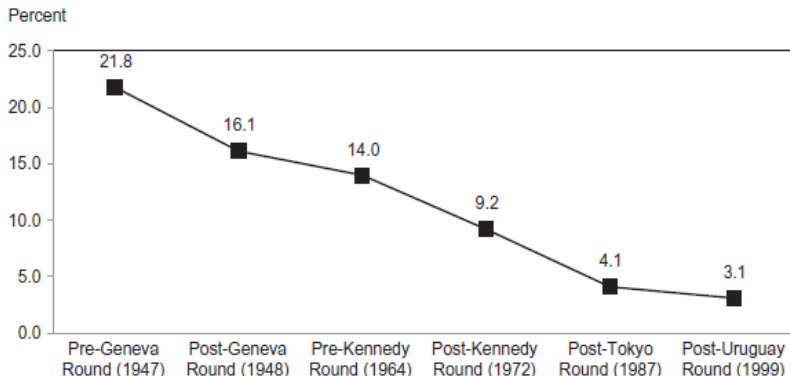


# Explaining Gradualism in Trade Liberalization: A Political Economy Approach

Kristy Buzard  
Syracuse University  
kbuzard@syr.edu

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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

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# Timeline

Taking trade agreement tariff and anti-dumping duties as given,

1. Import-competing firms lobby DOC/ITC to renew AD duties
2. Uncertainty is resolved
3. DOC/ITC decide whether to renew duties
4. Private actors make production, consumption decisions



# Economy

- ▶ Two countries: home and foreign (\*)
- ▶ Separable in three goods: X and Y (traded) and numeraire
- ▶ Demand identical for both goods in both countries
- ▶ Supply:  $Q_X^*(P_X) > Q_X(P_X) \forall P_X$ ; symmetric for Y
  - ▶ Home net importer of X, net exporter of Y

Home levies  $\tau$  on X, Foreign levies  $\tau^*$  on Y

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

Non-tradable specific factors motivates political activity

# Political Structure

In Home country (foreign is passive):

- ▶ Dept. of Commerce
  - ▶ Can
  - ▶ Susceptible
  - ▶ Modeled
- ▶ 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”

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

- ▶  $\gamma(e, \theta)$ : weight on import-competing industry profits
  - ▶  $e$ : lobbying effort
  - ▶  $\theta$ : uncertain element in G's preferences

## Assumption 1

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

# Lobby

Lobby chooses effort to maximize:

$$\{1 - \Pr [\text{AD Renewal}]\} \pi(\tau^a) + \Pr [\text{AD Renewal}] \pi(\tau^{ad}) - e$$

- ▶  $e$ : Lobbying effort
- ▶  $\tau^a$ : home import tariff under trade agreement
- ▶  $\tau^{ad}$ : home import tariff equivalent under anti-dumping duties

Note: In Staiger (1995), gradualism breaks down in workers can organize