International Political Economy (SOCS-SHU 222)

A SOCIETY-CENTERED APPROACH

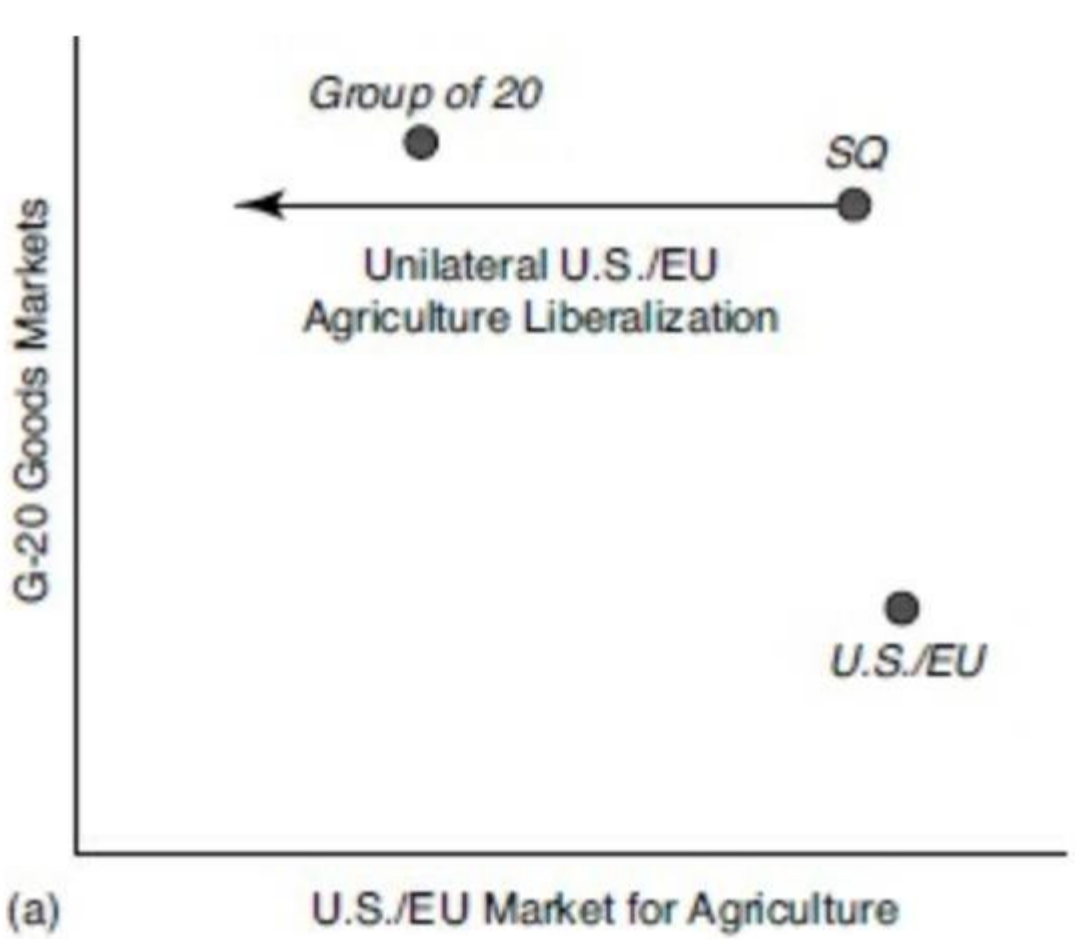
TO THE POLITICS OF TRADE

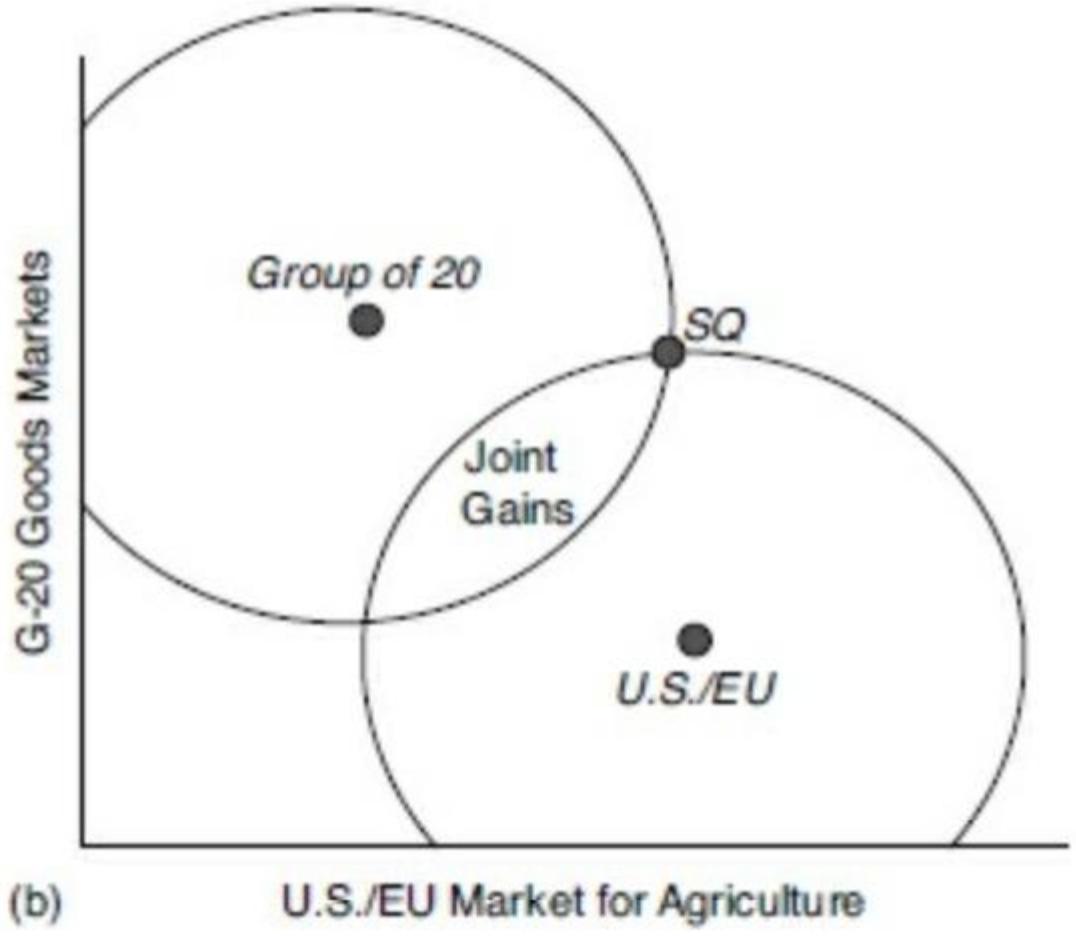
Instructor: JING QIAN

Logistics

- Check your attendance record on Brightspace
- MCQ assignment clarification
  - Brightspace Submission —— Graded (must be on-time!)
  - Google Form Submission —— Collection and Distribution (anytime)
  - Suggestion: Submit Google Form, and submit the email copy to Brightspace
  - 1st MCQ Waiver: Either Brightspace OR Google Form submission counts.
- News Report Analysis Presentation begins Feb 23 (after Spring Festival)
  - Check schedule: https://jingqian.org/IPEclass/schedule
  - More on Wednesday

Let’s continue


Group of 20
SQ
Unilateral U.S./EU
Agriculture Liberalization
U.S./EU
G-20 Goods Markets
U.S./EU Market for Agriculture
(a)


Group of 20
SQ
Joint
Gains
U.S./EU
G-20 Goods Markets
U.S./EU Market for Agriculture
(b)

PD Example from the book

- Trade Liberalization between the European Union and G-20

		European Union: Liberalize	European Union: Protect
G-20	Liberalize	***L,L*** ***I***	***L,P*** ***II***
	Protect	***P,L*** ***IV***	***P,P*** ***III***

Preference Orders:
G-20: ***P,L*** > ***L,L*** > ***P,P*** > ***L,P***
European Union: ***L,P*** > ***L,L*** > ***P,P*** > ***P,L***

Where does state's trade policy preference come from???

A Society-Centered Approach to the Politics of Trade

READING ASSIGNMENT:

Oatley Chapter 4

Suggested (not required) further reading:
Rogowski, Ronald. 1987. Political Cleavages and Changing Exposure to Trade. *American Political Science Review* 81 (4):1121-1137

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Plan

- Distributional consequences of trade
- Stolper-Samuelson Theorem
- Sector model (vs. Factor model)
- Societal cleavages
- The role of political institutions

Overview

- Trade has distributional consequences
- Trade policy is shaped by the government's responses to the demands of different interest groups
- Government responses to interest groups are shaped by POLITICAL INSTITUTIONS

Factor Incomes & Class Conflict

- Simplest version:
  - labor v. capital
  - (workers v. owners of capital)

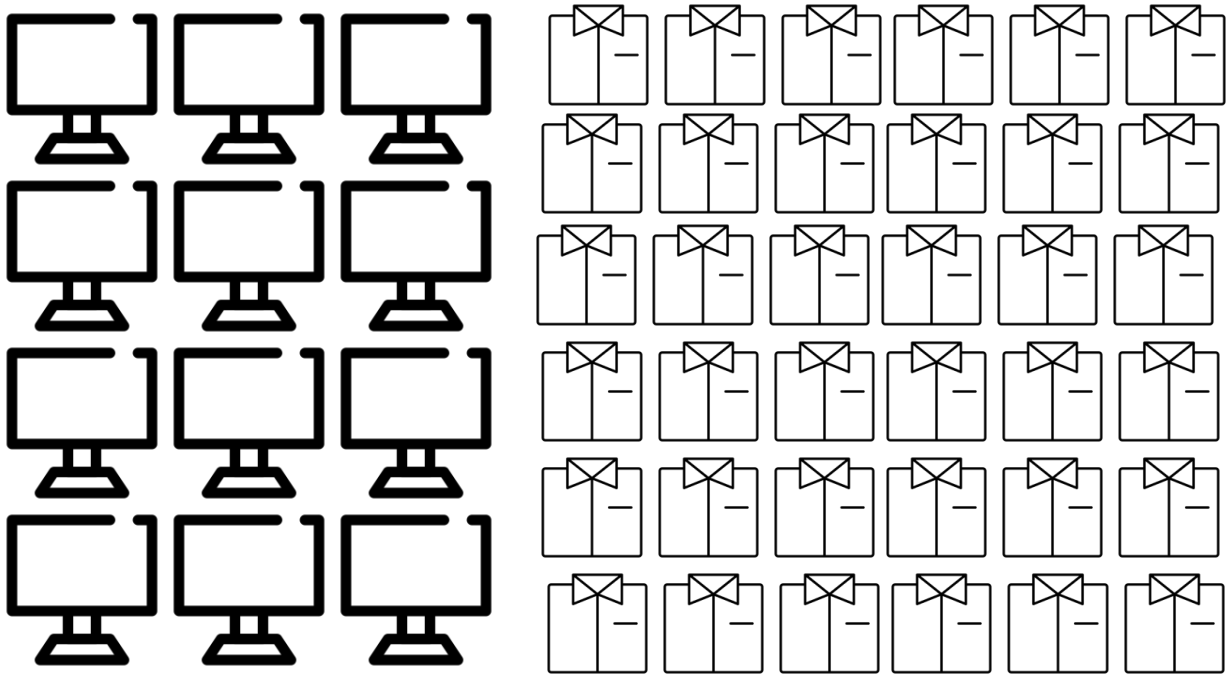
Vs.

- Recall from the last class:
  - countries have a comparative advantage in producing goods requiring their ABUNDANT FACTOR

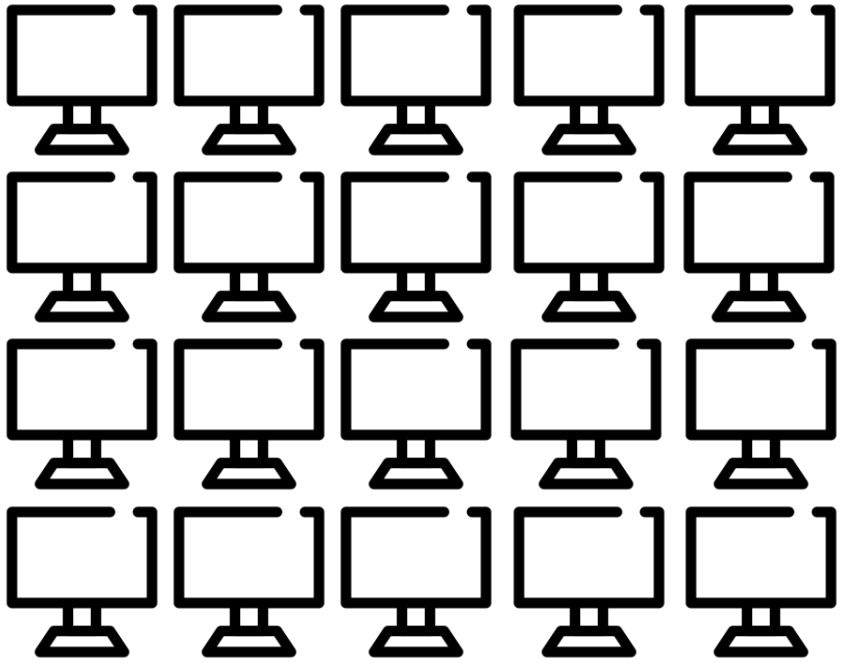
- There are
  - capital-abundant countries &
  - labor abundant countries

United States

No Trade (closed economy)



Open Trade(full specialization)



United States

No Trade
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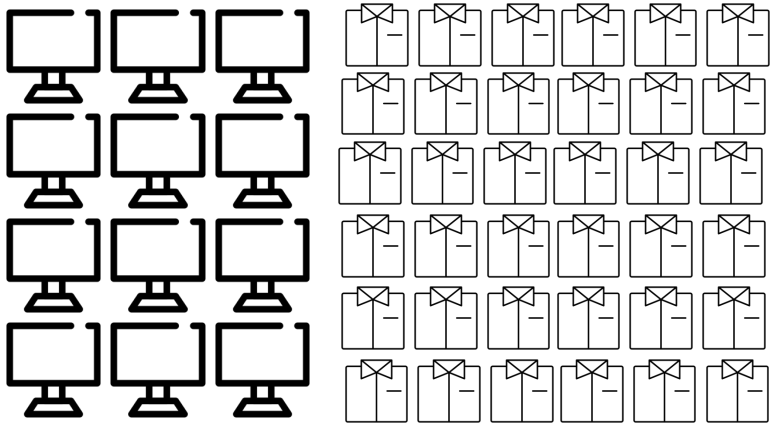

Open Trade
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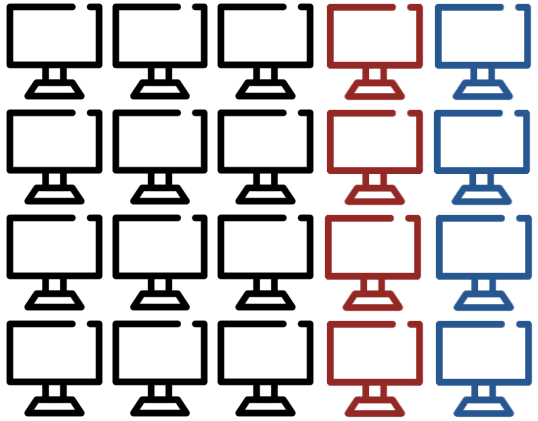
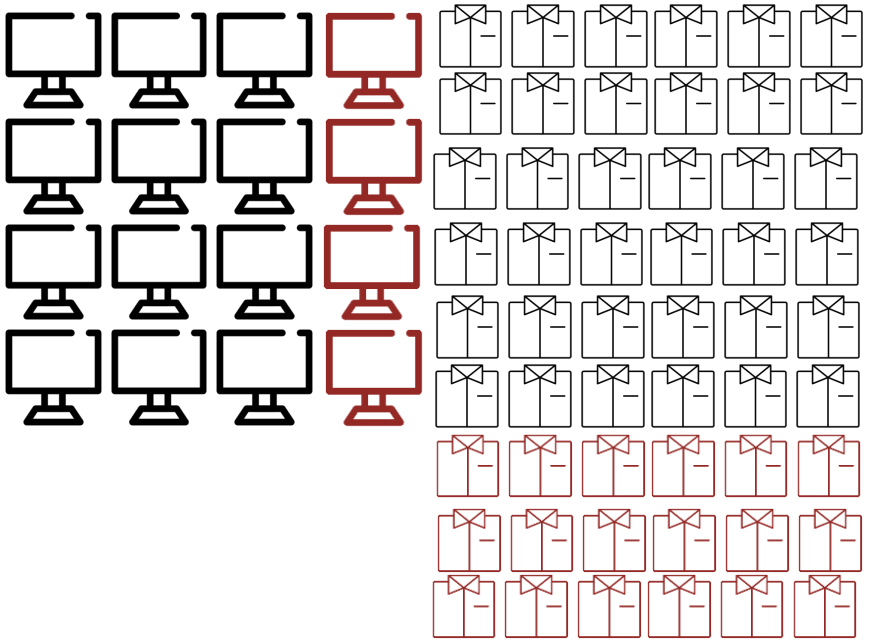


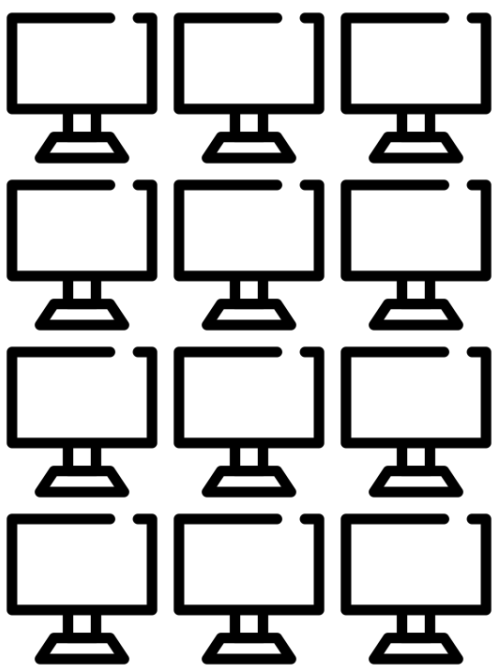
Trade w/ China
(computers for shirts)



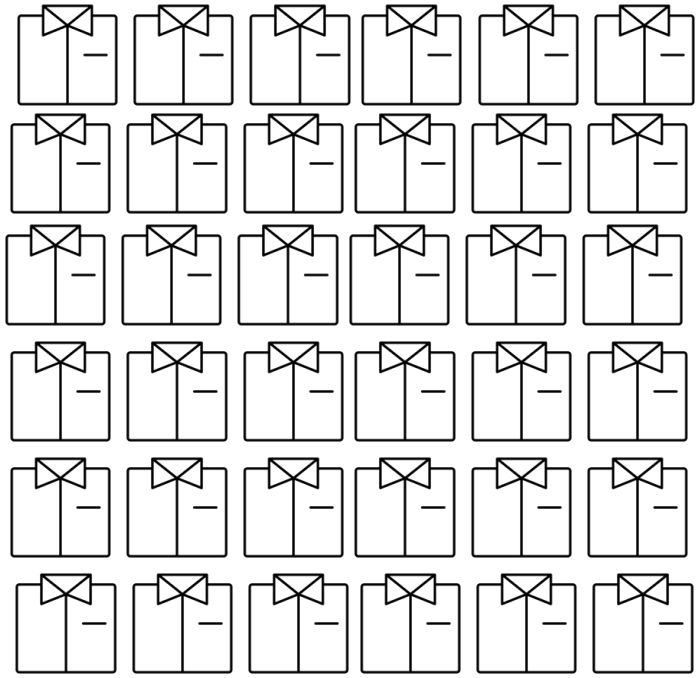
more computers
&
more shirts

United States

No Trade (closed economy)

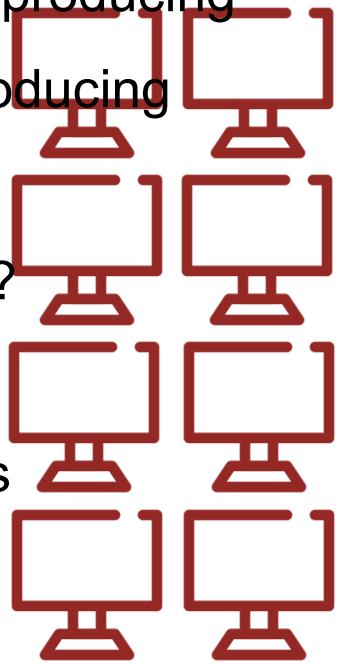


Open Trade (full specialization)



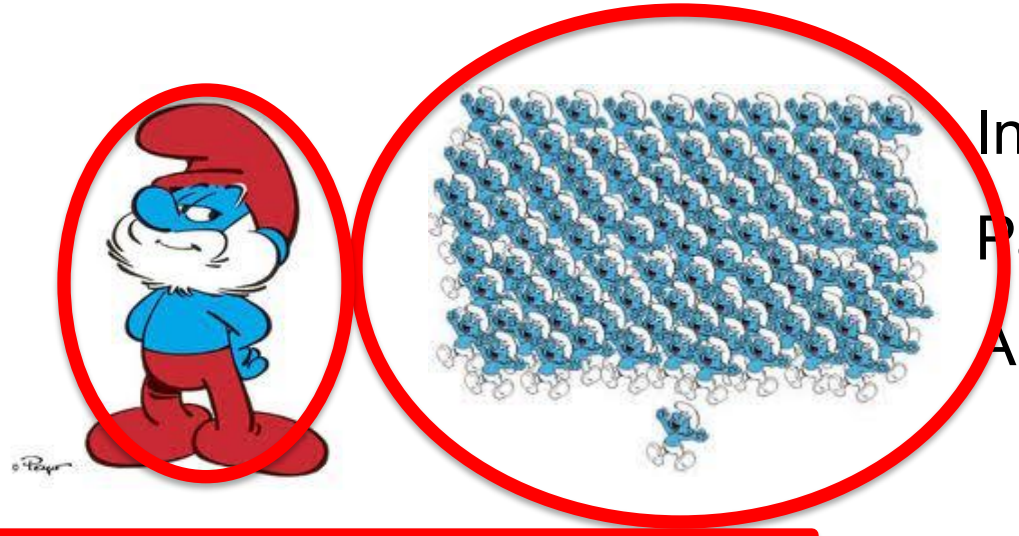
Open Trade

- Move from producing shirts to producing computers
- Who gains?
  - Capital
- Who losses
  - Labor



In the factor mode, trade causes…

- Income of the ABUNDANT factor to RISE
- Income of the SCARCE factor to FALL



In a closed economy (autarky),

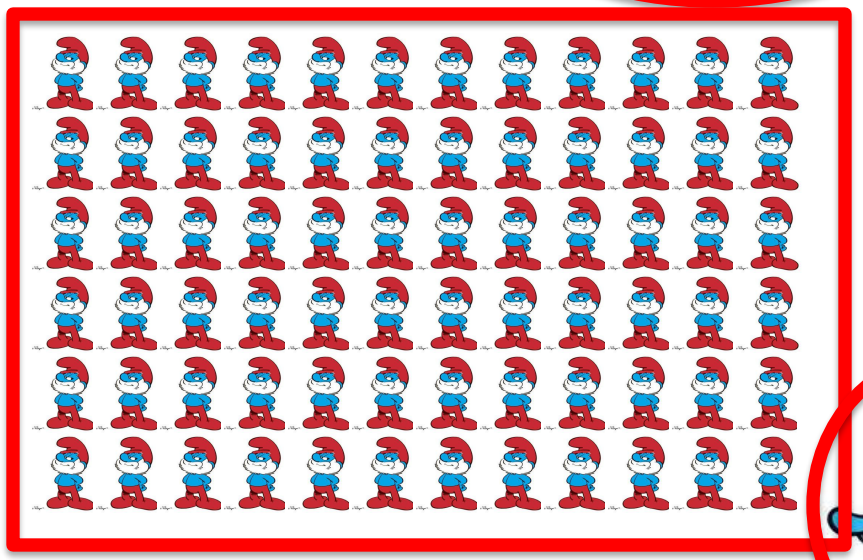
Papa Smurf is in high demand.

And he has a lot of cheap labor.

WINNERS FROM TRADE!

LOSERS FROM TRADE!

But imagine there's another country out there with lots of "Papas" and only one regular smurf.



Meanwhile, the demand for regular smurf-goods (worldwide) goes way up (and so does their price.)

If the 1st country trades, the supply of Papa-goods (for the 1st country) goes way up (and the price way down)

Labor Abundant Country

Absent trade

- “Capital” is relatively scarce in a country like China, so the “rent” can be enormous
- Labor is cheap, so wages are low

By opening up to trade

- Capital “rents” will fall until they equal the (rising) rate of return in trading partner countries
- Wages will rise until they equal the (falling) wage in trading partner countries

Capital Abundant Country

Absent trade

- Capital is abundant, so returns are low
- Labor is relatively scarce in a country like Switzerland, so wages can be enormous

By opening up to trade

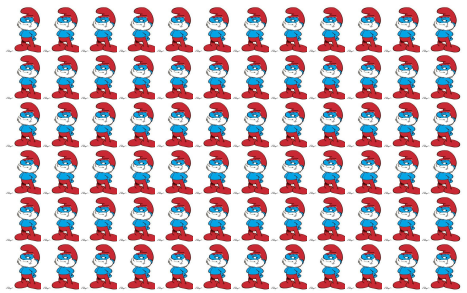
- Return to capital will rise until it equals the (dropping) rate in trading partner countries
- Wages will drop until they equal the (rising) wage in trading partner countries

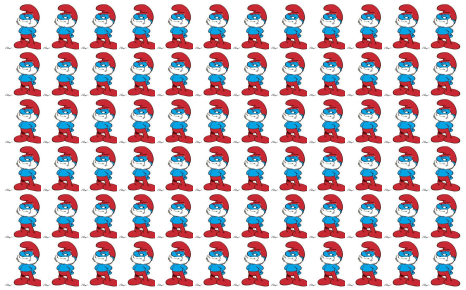
Stolper-Samuelson Theorem

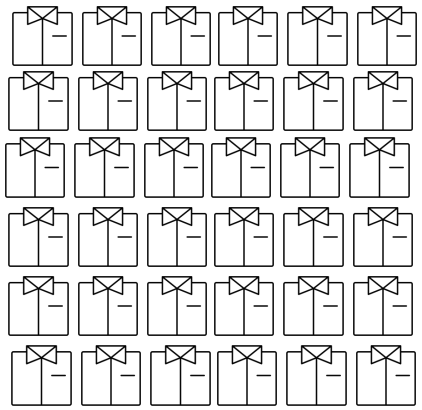
- Factor-price equalization
- The tendency for trade to cause factor prices to converge
- The scarce factor is a LOSER!

WAIT!

Are the doors big enough in the factor model?







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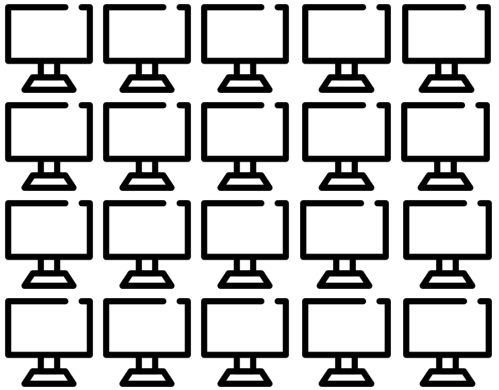
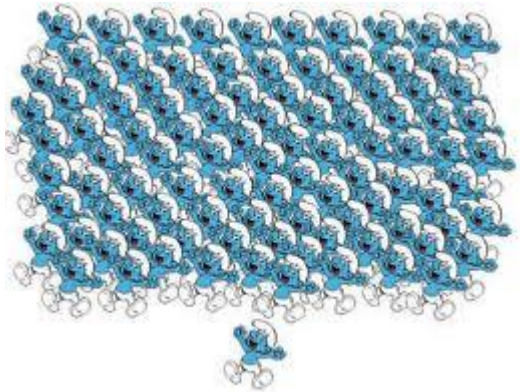
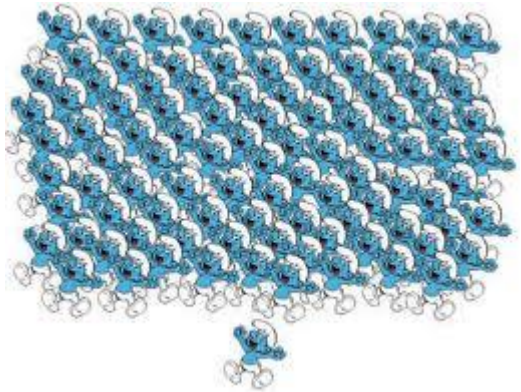






Factor Mobility

- =The ease with which labor and capital can move from one ***industry*** to another
- We have implicitly assumed that capital and labor are highly MOBILE
  - ❑ All capital is the same
    - (computers, car factories, etc…)
  - ❑ All labor is the same
    - (shoe-makers, furniture-makers, steel-workers, etc…)
- But what if factors are highly ***SPECIFIC?***

Factor Model

Sector Model

Sector Incomes & Industry Conflict

- It's really about computers, shoes, … your INDUSTRY or "sector"
- Suppose "Factor Mobility" is low
- Incomes of labor AND capital in the same SECTOR (industry) rise and fall together
- Now, we do not completely abandon the factor model:
- We still use the factor model to tell us which INDUSTRIES (or SECTORS) benefit from trade, however,…
- **LABOR & CAPITAL EMPLOYED IN INDUSTRIES THAT RELY INTENSIVELY ON SOCIETY'S ABUNDANT FACTOR **BOTH** GAIN FROM TRADE**

Advanced Industrial Countries

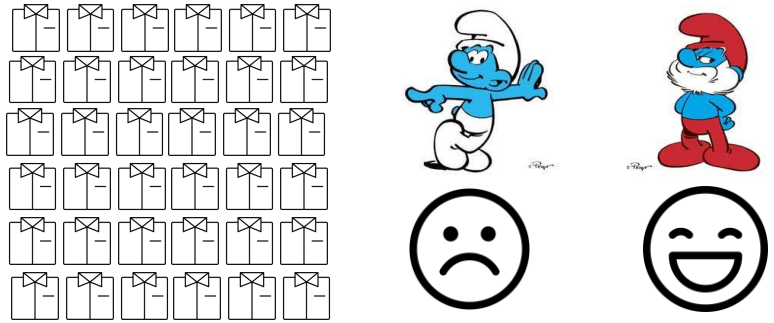
- Capital abundant, so…
- Capital AND labor employed in ***capital***-intensive industries both ***gain*** from trade
- **➔The export-oriented SECTOR**
- Capital AND labor employed in ***labor***-intensive industries both ***lose*** from trade
- **➔The import-competing SECTOR**

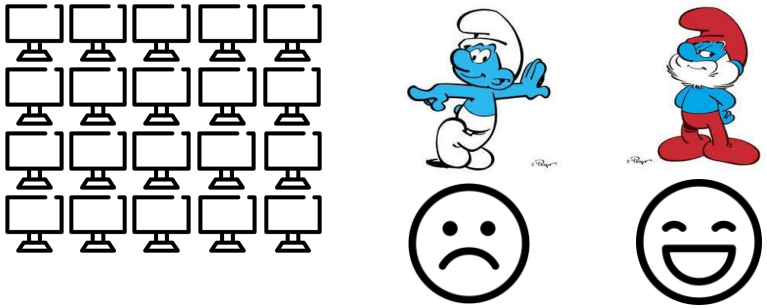
Developing Countries

- Labor abundant, so…
- Capital AND labor employed in _____-intensive industries both ***gain*** from trade
- **➔The export-oriented SECTOR**
- Capital AND labor employed in _____- intensive industries both ***lose*** from trade
- **➔The import-competing SECTOR**

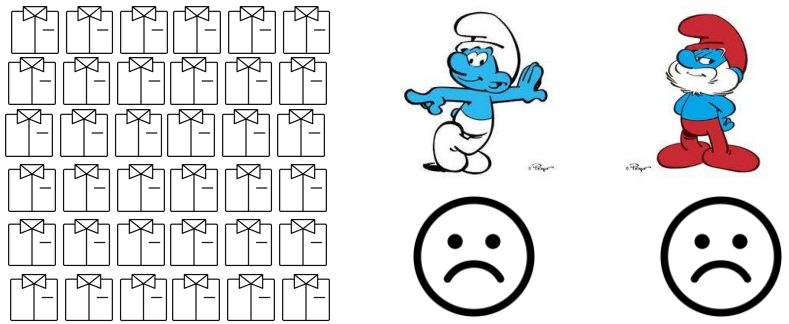
The United States Opens to Free Trade

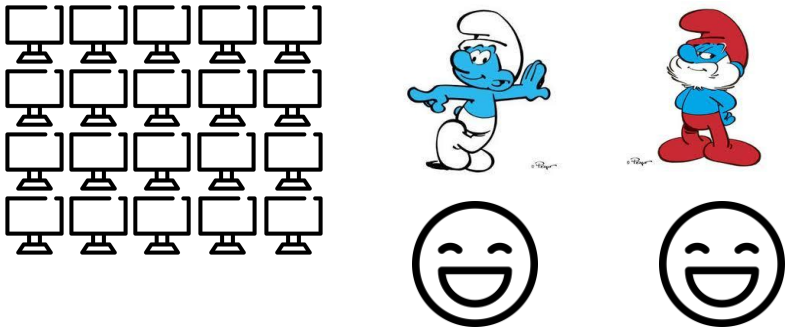
Factor Model





Sector Model





What Do We Do About Losers

- Protect them?
  - Tariffs, barriers to trade, subsidies
- Compensate them?
  - Training?
  - Retirement packages?
- Repress them?
  - Dictatorship – repression?
  - Democracy – tyranny of the majority?
- The answer depends on their size, their political resources, and the political institutions

Size

- The logic of collective action
- Large-size, more “free-riding” – benefits are disbursed across a large group
- Small size – benefits are concentrated!


MEXICO
USA
Coca-Cola
REFRESCO
CONT. NET. 355 ml
ORIGINAL TASTE
Coca-Cola
240


VS
Mexican
American
Real
Cane Sugar
High-Fructose Corn
Syrup
Coca-Cola
ORIGINAL TASTE
330 мл

The Logic of Collective Action Helps to Understand…

1. Why *producers* *not* *consumers* dominate trade politics
   - Why US soda is flavored with "fructose"
   - Consumers are large & homogeneous group (questions?)
2. Why trade politics have a tendency towards protectionism
3. Why governments rarely liberalize trade unilaterally (last week's PD!!)
   - Unilateral action helps consumers (who may not even notice)
   - Unilateral action hurts import-competing sector ("sucker's payoff)
   - Bilateral action hurts import-competing sector BUT ALSO HELPS export-oriented sector! (L,L from PD yesterday)
   - And the winning side of the "suckers' payoff"?
     - Protects import-competing sector & helps export-oriented sector (only consumers – who don't notice – are hurt)

Institutions Over Time in the US

- Congress passes Smoot-Hawley in 1930
- **Single-member districts** (narrow interests located in district/state) + logrolling in Congress ➔ lots of protectionism
- President – national interest? (Not really – **ELECTORAL COLLEGE** – Pennsylvania steel???)
- Still, President can rise above logrolling
- **Reciprocal Trade Agreements Act** (1934): Congress delegates to the President the authority to reduce tariffs by as much as 50% in exchange for equivalent concessions from foreign governments
- **US Trade Representative** (1962) – Responsible for trade policy (reports to President & Congress) – moved trade policy away from the State dept (short-run foreign policy goals)
- **Fast-track** (1974)– President negotiates trade agreements that Congress can approve/disapprove but cannot amend or filibuster

To think about the influence of political institutions,

let's go back to the simple factor model

More Fun with Factors and Institutions

Rogowski, Ronald. 1987. Political Cleavages and Changing Exposure to Trade. *American Political Science Review* 81 (4):1121-1137.

3 factors: land-labor-capital

- Considers the land-labor ratio
- High land-labor ratio ➔ land-abundant, labor-scarce
- Low land-labor ratio ➔ labor-abundant, land-scarce
- Define “advanced” economies as capital-abundant

Figure 1. Four Main Types of Factor Endowments

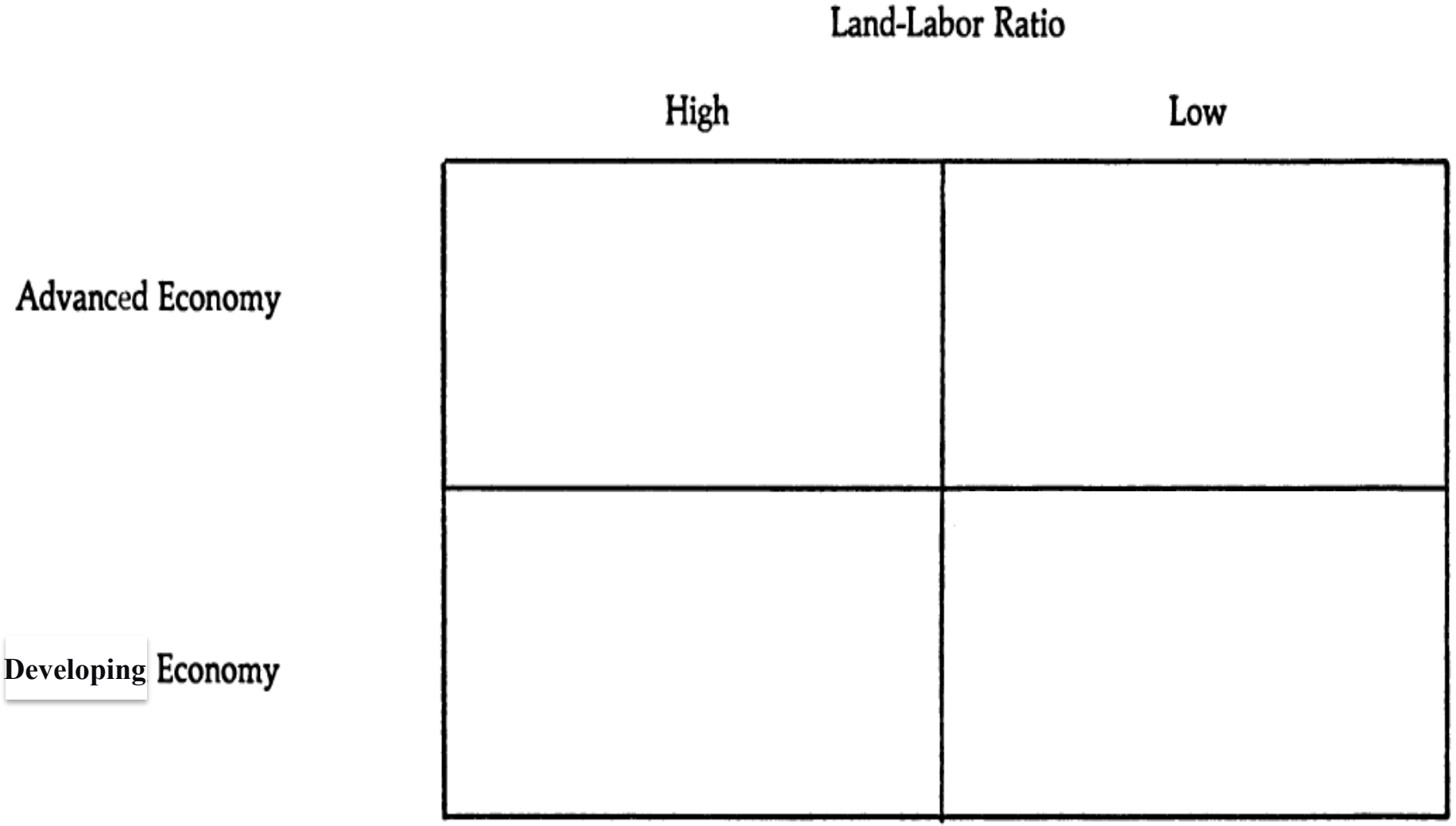


Figure 2. Predicted Effects of Expanding Exposure to Trade

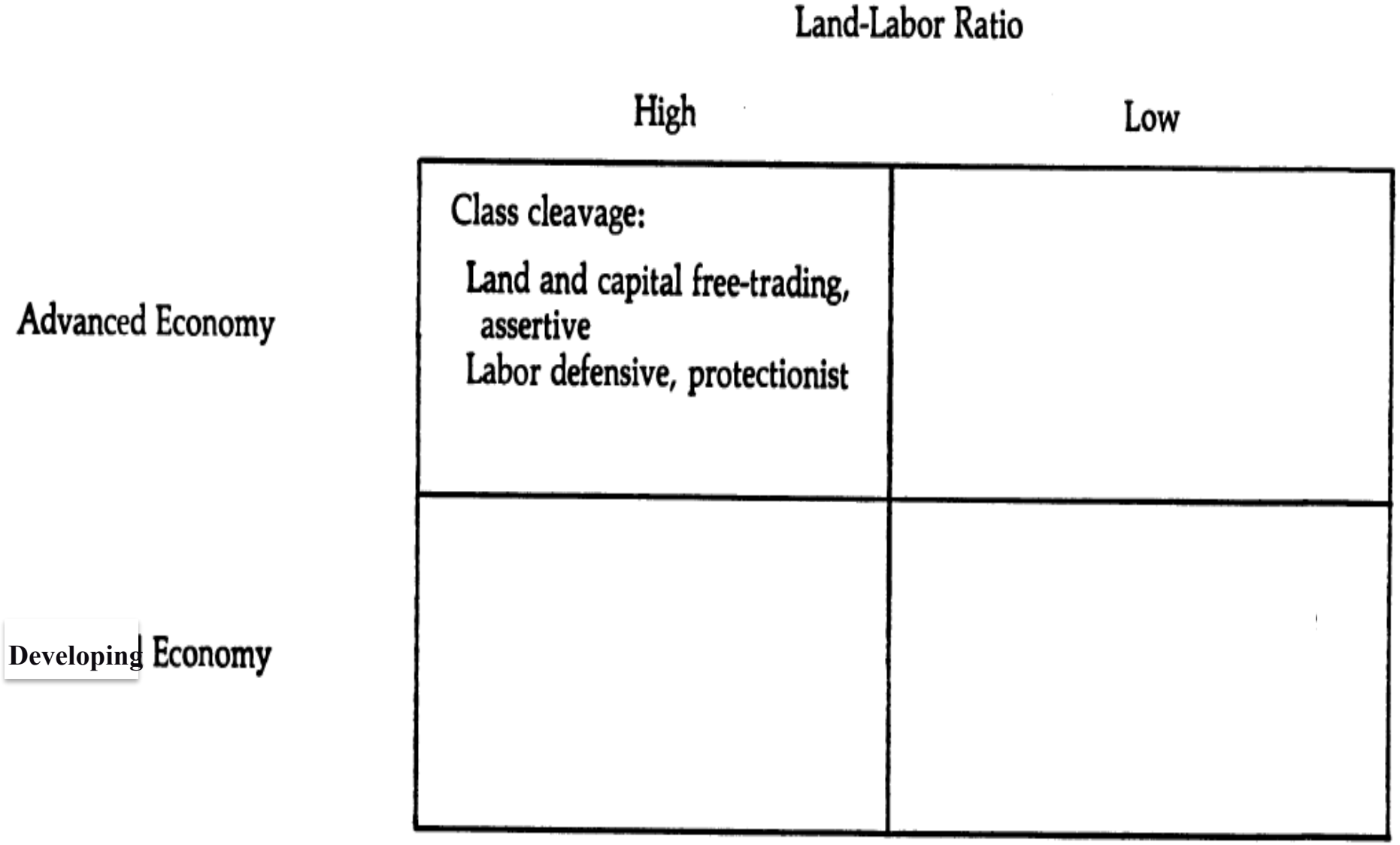


Figure 1. Four Main Types of Factor Endowments

	Land-Labor Ratio: High	Land-Labor Ratio: Low
Advanced Economy	Abundant: Capital, Land Scarce: Labor	Abundant: Capital, Labor Scarce: Land
Developing Economy	Abundant: Land Scarce: Capital, Labor	Abundant: Labor Scarce: Capital, Land

Figure 2. Predicted Effects of Expanding Exposure to Trade

	Land-Labor Ratio: High	Land-Labor Ratio: Low
Advanced Economy	Class cleavage: Land and capital free-trading, assertive Labor defensive, protectionist	Urban-rural cleavage: Capital and labor free-trading, assertive Land defensive, protectionist (Radicalism)
Developing Economy	Urban-rural cleavage: Land free-trading, assertive Labor and capital defensive, protectionist (U.S. Populism)	Class cleavage: Labor free-trading, assertive Land and capital defensive, protectionist (Socialism)

What Happens with the Great Depression?

- Globalization suddenly halts and reverses
- Winners from Globalization suddenly take a huge loss
- Losers from Globalization gain political power
- Different political outcomes result in different types of societies:

Smoot-Hawley, Great Depression

Figure 3. Predicted Effects of Declining Exposure to Trade

	Land-Labor Ratio: High	Land-Labor Ratio: Low
Advanced Economy	Class cleavage: Labor gains power. Land and capital lose. (U.S. New Deal)	Urban-rural cleavage: Land gains power. Labor and capital lose. (Western European Fascism)
Developing Economy	Urban-rural cleavage: Labor and capital gain power. Land loses. (South American Populism)	Class cleavage: Land and capital gain power. Labor loses. (Asian & Eastern European Fascism)

Let's Simplify and Make Some Predictions of Our Own…

- 2 factor model:
  - Capital & Labor

- Suppose:
  - LABOR controls government under DEMOCRACY
  - CAPITAL controls government under AUTOCRACY

Back to 2 Factors (ignoring collective action problem)

	Democracy	Authoritarian
Capital abundant	???	
Labor abundant		

Back to 2 Factors (ignoring collective action problem)

	Democracy	Authoritarian
Capital abundant	Labor loses from trade but has political power➔ protectionism	
Labor abundant	???	

Back to 2 Factors (ignoring collective action problem)

	Democracy	Authoritarian
Capital abundant	Labor loses from trade but has political power➔ protectionism	???
Labor abundant	Labor wins from trade & has political power ➔ free trade	

Back to 2 Factors (ignoring collective action problem)

	Democracy	Authoritarian
Capital abundant	Labor loses from trade but has political power➔ protectionism	Capital wins from trade & has political power➔ free trade
Labor abundant	Labor wins from trade & has political power ➔ free trade	???

Back to 2 Factors (ignoring collective action problem)

	Democracy	Authoritarian
Capital abundant	Labor loses from trade but has political power➔ protectionism	Capital wins from trade & has political power➔ free trade
Labor abundant	Labor wins from trade & has political power ➔ free trade	Capital loses from trade but has political power ➔ protectionism

Thank You!

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Take-away

- Factor model:
  - abundant factor wins, scarce loses
- Sector model
  - both factors in an abundant-factor-sector win
  - both factors in a scarce-factor-sector lose
- Stolper-Samuelson Theorem
- What do we about losers?
- Relative abundance/scarcity may shape political conflict
- Political Institutions matter