Endogenous Politics and the Design of Trade Institutions

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   - Government objective function

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- carefully distinguish between dynamics induced by exogenous and endogenous politics for
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  - tariff caps with escape clause
- examine escape clause design when both exogenous and endogenous forces are present

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  - Points to real-world design of WTO Agreement on Safeguards
  - May explain why escape clause has fallen out of use

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Two countries: home and foreign (*)

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  - Home net importer of X, net exporter of Y

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Non-tradable specific factors motivate political activity

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3. **Tariffs are Applied**
   i. Given political pressure, governments choose applied tariff levels

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- Assume γ, γ^* is private info of each government

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   - Call lobby's optimal effort choice e^L

$$e^L = \max_e \pi(\tau(\gamma(e))) - e$$

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Once agreement is set, cooperation enforced by repeated-game punishments conditioned on history, history + DSB signal

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  - Here distortion is wasted resources in lobby formation

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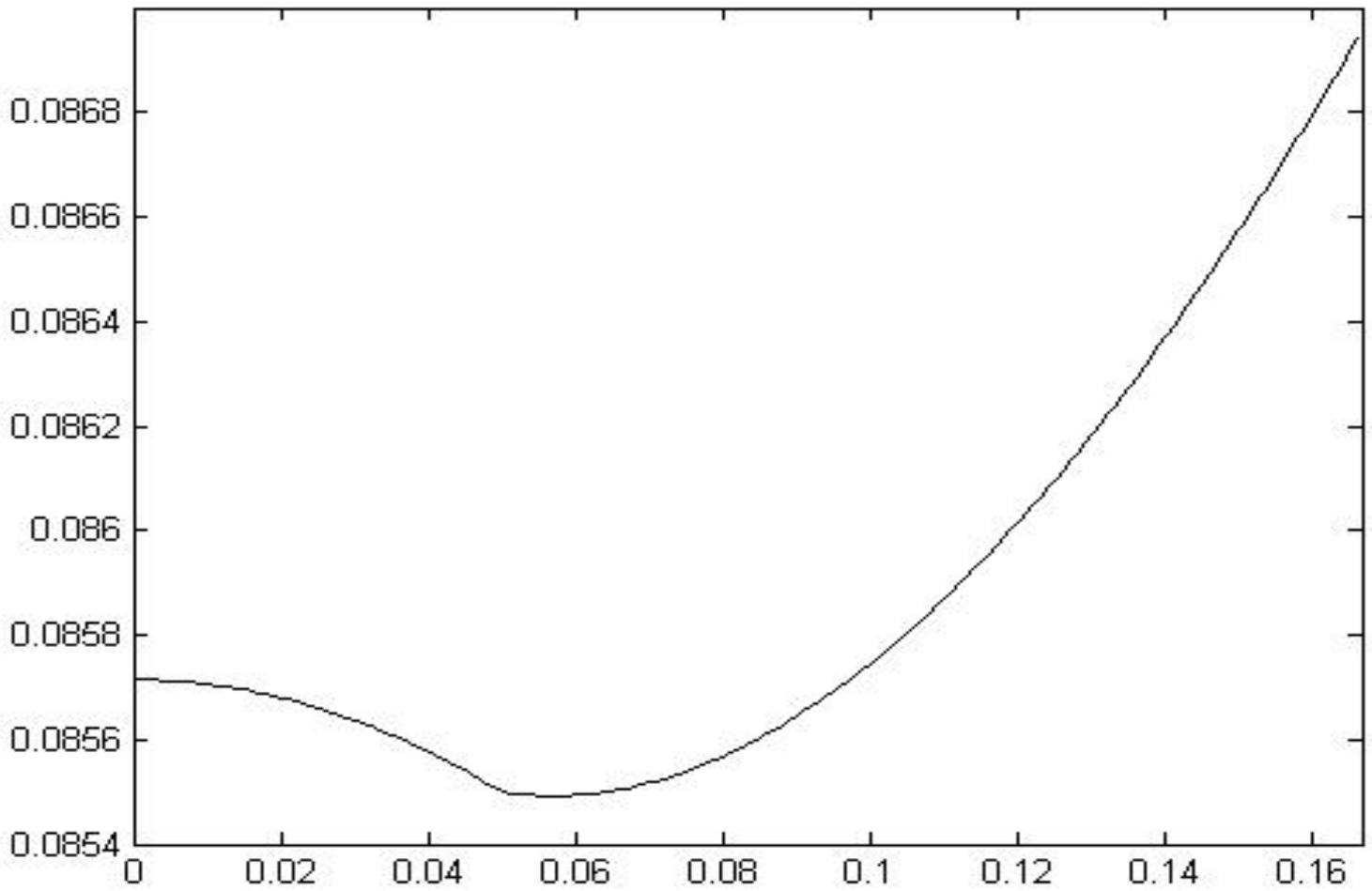
- If weights must sum to 1, welfare no longer monotonic in γ

Objective Function



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- γ endogenous: Governments will not set applied tariffs strictly below the bound level. They may use the weak tariff binding either to encourage and/or restrain endogenous political pressure.

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▸ Repeated Game Intuition

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  - Only way to prevent this is with some cost of using escape clause

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  - (If lobby's preferred tariff $\geqslant$ escape clause binding, gov't experiences high γ, no need to lie)

If γ is only endogenous, escape clause causes problems, provides no benefits

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Ineffectiveness of Political Criterion for Escape Clause

Assume $\gamma(s, e) = \gamma(s) + \gamma(e)$. If an escape clause conditions on $\gamma(s, e)$ and $\gamma(s^L) < \gamma(s^H) < \gamma(e^L)$, the lower "normal" tariff binding will never be applied.

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May explain why escape clause has fallen out of use

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- can help us think about optimal design of trading insitutions
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- provides additional general explanation for tariff caps

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- High tariffs, no lobbying, no trade disruptions

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