

Endogenous Politics and the Design of Trade Institutions

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 - ▶ Government objective function

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 - ▶ base case with tariff caps
 - ▶ 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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 - ▶ Here distortion is wasted resources in lobby formation

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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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- ▶ Lobby chooses effort to maximize profits, $\pi(\cdot)$, net of lobbying effort, e
- ▶ 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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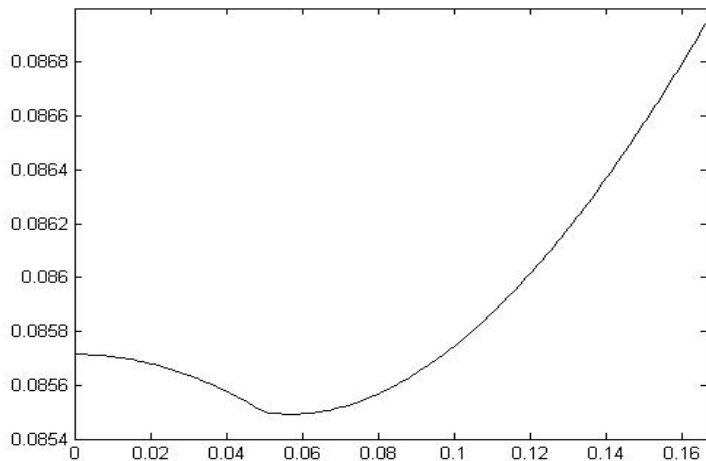
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- ▶ If weights must sum to 1, welfare no longer monotonic in γ

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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 - ▶ Escape clause is designed to allow higher applied tariff when realization of γ is high
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- ▶ Can improve self-enforcement
- ▶ Incentive compatibility becomes an issue

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Incentive compatibility

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- ▶ γ is private information
- ▶ We want truthful revelation, but truth-telling must be in the best interest of each gov't
- ▶ Gov't can exploit TOT externality by reporting high γ even when γ is low
 - ▶ Only way to prevent this is with some cost of using escape clause

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When γ is *only* endogenous:

- ▶ Benefit of escape clause from exogenous case is gone
- ▶ Assuming lower binding is set to maximize political welfare, escape clause encourages inefficiently high lobbying effort / protection
- ▶ (Incentive compatibility still an issue, but often not the central one)

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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 institutions
- ▶ demonstrates that TAs can be used to discourage lobbying activity in general
- ▶ provides additional general explanation for tariff caps

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- ▶ High tariffs, no lobbying, no trade disruptions

▶ Go Back

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