Endogenous Politics and the Design of Trade Institutions

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   - Exogenous vs. endogenous politics

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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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  - 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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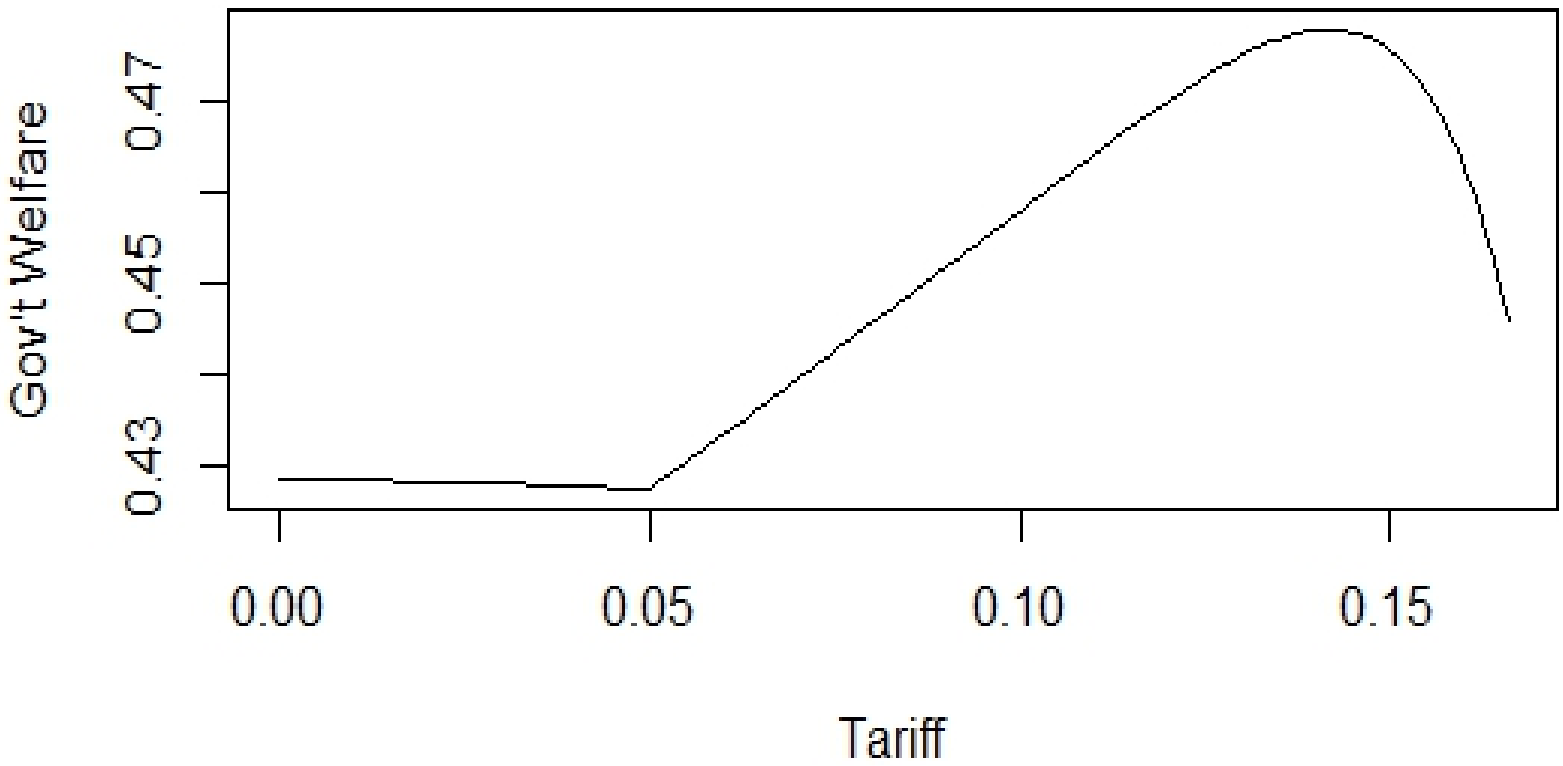
Objective Function



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- Achieve same results with simpler model
- Endogenous politics in a wider range of questions
- Can have both endogenous / exogenous at the same time
  $\Rightarrow$ unify the exogenous and endogenous politics literatures

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  - Lobby's incentive constraint is harder to satisfy as δ increases

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Lobby: solve for lowest effort ($\overline{e}_b$) that breaks this constraint

- pay $\overline{e}_b$ if it's less than gain from T periods of trade-war profits

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- High tariffs, no lobbying, no trade disruptions

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- In general, gov't prefers cap because lobby will 'fill in' for low shock up to gov's optimal level of γ

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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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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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  - This seems to be what the WTO actually *does*

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May explain why escape clause has fallen out of use

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- can nest established results and provide new insights
- can answer questions about optimal design of trading institutions more fully
  - provides additional general explanation for tariff caps
  - helps explain the structure and enforcement of the WTO Safeguards measure

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