Commerce

J2P216 SE: International Cooperation and Conflict
March 17/18, 2016

Reto Wüest

Global Studies Institute
University of Geneva

Outline

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3. Gartzke (2007)
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The theory of comparative advantage:

The theory of comparative advantage:

- Actors engage in foreign trade to realize benefits of specialization (division of labor)
- Principle of comparative advantage implies that country gains most by specializing in producing and exporting what it produces most efficiently
- Comparative advantage $\neq$ absolute advantage

The Heckscher-Ohlin trade theory:

The Heckscher-Ohlin trade theory:

- Principle of comparative advantage suggests that countries produce and export what they do best and import what they cannot make very well themselves
- Heckscher-Ohlin trade theory argues that factor endowments determine what countries produce and export and what they import
- Country exports goods that make intensive use of its (relatively) abundant resources, and it imports goods that make intensive use of its (relatively) scarce resources

- Foreign trade allows country to follow its comparative advantage, which increases the efficiency of domestic production
- States at war do not trade
- Because states lose gains from trade when they go to war, the gains from trade become part of the cost of war

Class Presentation

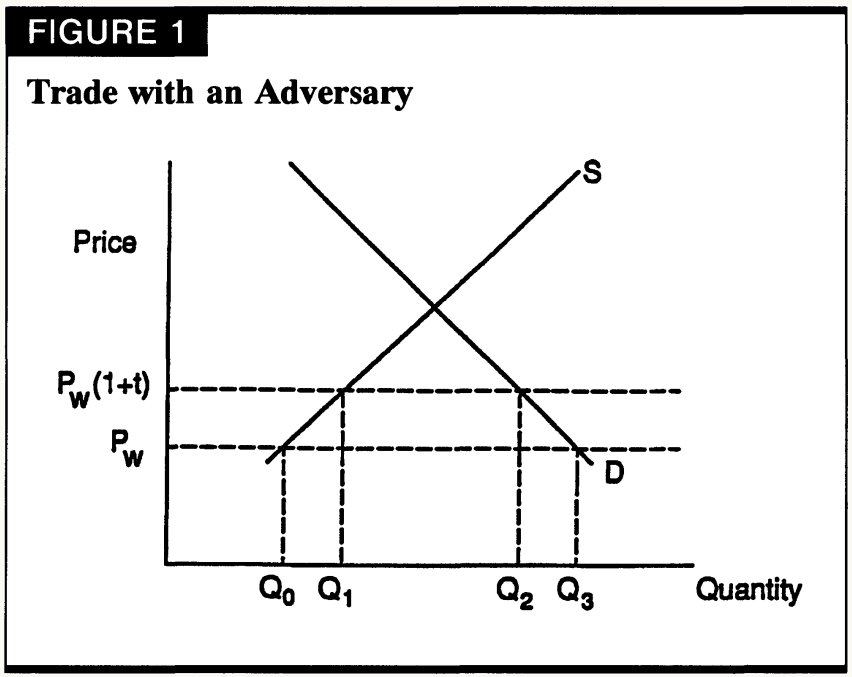
Fabienne to present on Gowa and Mansfield (1993), "Power Politics and International Trade"

Gowa and Mansfield (1993): "Power Politics and International Trade"

What Is the Main Argument?

- Probability that a state uses force against other states depends on its military power
- Trade increases efficiency, which frees economic resources for military use
- Because trade enhances the military power of trading partners, it produces security externalities
- Trade with an adversary produces negative security externality and trade with an ally produces positive externality

Domestic market for a good that can also be imported at its world price from an adversary



Source: Gowa and Mansfield (1993, 409)

- Private marginal cost of import $\mathrm{P_W}$ (world price)
- Domestic output $\mathrm{Q_0}$, domestic demand $\mathrm{Q_3}$, import $\mathrm{Q_3 - Q_0}$
- Because of negative externality, marginal social cost of import $\mathrm{P_W}(1 + \mathrm{t})$
- Tariff t can correct security externality

The standard optimal tariff game

$$\mathrm{T} > \mathrm{R} > \mathrm{P} > \mathrm{S}$$

A1 \ A2	C	D
C	R, R*	S, T
D	T, S	P, P

Source: Gowa and Mansfield (1993, 409)

- Infinite-horizon game
- Grim trigger strategy sustains cooperation if

$$\underbrace{\mathrm{R}/(1-\delta)}_{\text{discounted sum of co-operative payoffs}} \geq \underbrace{\mathrm{T}+\delta\mathrm{P}/(1-\delta)}_{\text{sum of the one-shot gain from defection and the discounted sum of punishment payoffs}}$$

or

$$\delta \geq (\mathrm{T}-\mathrm{R})/(\mathrm{T}-\mathrm{P})$$

Tariff game between adversaries

- Because of negative security externality, a state incurs a marginal social cost from free trade that matrix above does not reflect
- Social cost that state i incurs is represented as a fraction (w_{ij}) of the payoff that adversary j receives

		S j: C	**S** j: D
S i	C	$\mathrm{R_i} - w_{ij}\mathrm{R_j}$, $\mathrm{R_j} - w_{ji}\mathrm{R_i}$*	$\mathrm{S_i} - w_{ij}\mathrm{T_j}$, $\mathrm{T_j} - w_{ji}\mathrm{S_i}$
	D	$\mathrm{T_i} - w_{ij}\mathrm{S_j}$, $\mathrm{S_j} - w_{ji}\mathrm{T_i}$	$\mathrm{P_i} - w_{ij}\mathrm{P_j}$, $\mathrm{P_j} - w_{ji}\mathrm{P_i}$

Source: Gowa and Mansfield (1993, 410)

Tariff game between allies

- Because of positive security externality, a state receives a social benefit from free trade that matrix above does not reflect
- Social benefit that state i realizes is represented as a fraction (w_{ij}) of the payoff that ally j receives

		S j: C	**S** j: D
S i	C	$\mathrm{R_i} + w_{ij}\mathrm{R_j}$, $\mathrm{R_j} + w_{ji}\mathrm{R_i}^*$	$\mathrm{S_i} + w_{ij}\mathrm{T_j}$, $\mathrm{T_j} + w_{ji}\mathrm{S_i}$
	D	$\mathrm{T_i} + w_{ij}\mathrm{S_j}$, $\mathrm{S_j} + w_{ji}\mathrm{T_i}$	$\mathrm{P_i} + w_{ij}\mathrm{P_j}$, $\mathrm{P_j} + w_{ji}\mathrm{P_i}$

Source: Gowa and Mansfield (1993, 411)

Compare the incentive compatibility constraints of the three games

- Standard tariff game:

$$\delta \geq \frac{\mathrm{T} - \mathrm{R}}{\mathrm{T} - \mathrm{P}}$$

- Tariff game between adversaries:

$$\delta_i^* \geq \frac{\mathrm{T_i} - w_{ij}\mathrm{S_j} - (\mathrm{R_i} - w_{ij}\mathrm{R_j})}{\mathrm{T_i} - w_{ij}\mathrm{S_j} - (\mathrm{P_i} - w_{ij}\mathrm{P_j})}$$
$$\delta_i^* > \delta$$

- Tariff game between allies:

$$\delta_i^{**} \geq \frac{\mathrm{T_i} + w_{ij}\mathrm{S_j} - (\mathrm{R_i} + w_{ij}\mathrm{R_j})}{\mathrm{T_i} + w_{ij}\mathrm{S_j} - (\mathrm{P_i} + w_{ij}\mathrm{P_j})}$$
$$\delta_i^{**} < \delta$$

The influence of polarity:

- Extent to which allies trade freely depends on the discount factor δ_i^{**}
- $\delta_i^{**} = f(r_j)$ and $\frac{df(r_j)}{dr_j} > 0$, where r_j is the risk that ally j will leave alliance and join an alternative one
- Risk of exit is higher in multipolar than in bipolar systems
- Consequently, allies in a multipolar system discount future benefits from open markets among them more than allies in a bipolar system

Gowa and Mansfield (1993): "Power Politics and International Trade"

What Evidence Do the Authors Provide?

Gowa and Mansfield test two hypotheses:

1. Fewer trade barriers exist within than across alliances
2. Intraalliance free trade is more likely within bipolar than within multipolar systems

They regress (the log of) the value of exports by state i to state j in year t on

- a dummy variable measuring whether a bilateral alliance exists between i and j in $t-1$
- a dummy variable measuring whether a multilateral alliance exists between i and j in $t-1$
- (the log of) the GNP of i and (the log of) the GNP of j in $t-1$
- (the log of) the population of i and (the log of) the population of j in $t-1$
- (the log of) the distance between i and j in $t-1$
- a dummy variable showing whether i and j are at war in $t-1$

Gowa and Mansfield (1993): "Power Politics and International Trade"

What Evidence Do the Authors Provide?

- Results mostly confirm hypothesis that bilateral and multilateral alliances have positive effect on bilateral trade flows
- Results also confirm hypothesis that the magnitude of the effect of alliances on trade is more pronounced during bipolar periods than during multipolar periods

Class Presentation

Océane to present on Gartzke (2007), “The Capitalist Peace”

Gartzke (2007): "The Capitalist Peace"

What Is the Main Argument?

- Two necessary conditions for war:
  - States must be willing and able to compete
  - States must be unwilling or unable to resolve differences diplomatically
- Competition can be zero-sum (e.g., territory) or nonzero-sum (e.g., policy)

Gartzke (2007): "The Capitalist Peace"

What Is the Main Argument?

Capitalism (economic development, free markets, similar interests) causes peace

- Development leads to common interests, which leads to less conflict over policy
- In developed economies, resources that can be conquered become less important (in contrast, intellectual and financial resources become more important)
- Developed states are clustered, and territorial disputes mainly arise between contiguous states
- Therefore, development leads contiguous states to be less likely to experience conflict

Gartzke (2007): "The Capitalist Peace"

What Is the Main Argument?

But . . .

- Greater economic, social, and political integration of developed states increases their incentive to influence policies of other states
- Developed states are richer and their military resources are not absorbed by territorial conflict
- Therefore, developed states are more willing and more able to engage in conflicts (over policy) far from home

Gartzke (2007): "The Capitalist Peace"

What Is the Main Argument?

- Differences over policy or resources do not lead to war if states can resolve them diplomatically
- States have incentives to bluff, which hinders diplomatic solution
- Making threats is costly for financially integrated economies because it can turn investors away to safer places
- Therefore, as markets reveal information, financial integration leads to less conflict

Gartzke (2007): "The Capitalist Peace"

What Evidence Does the Author Provide?

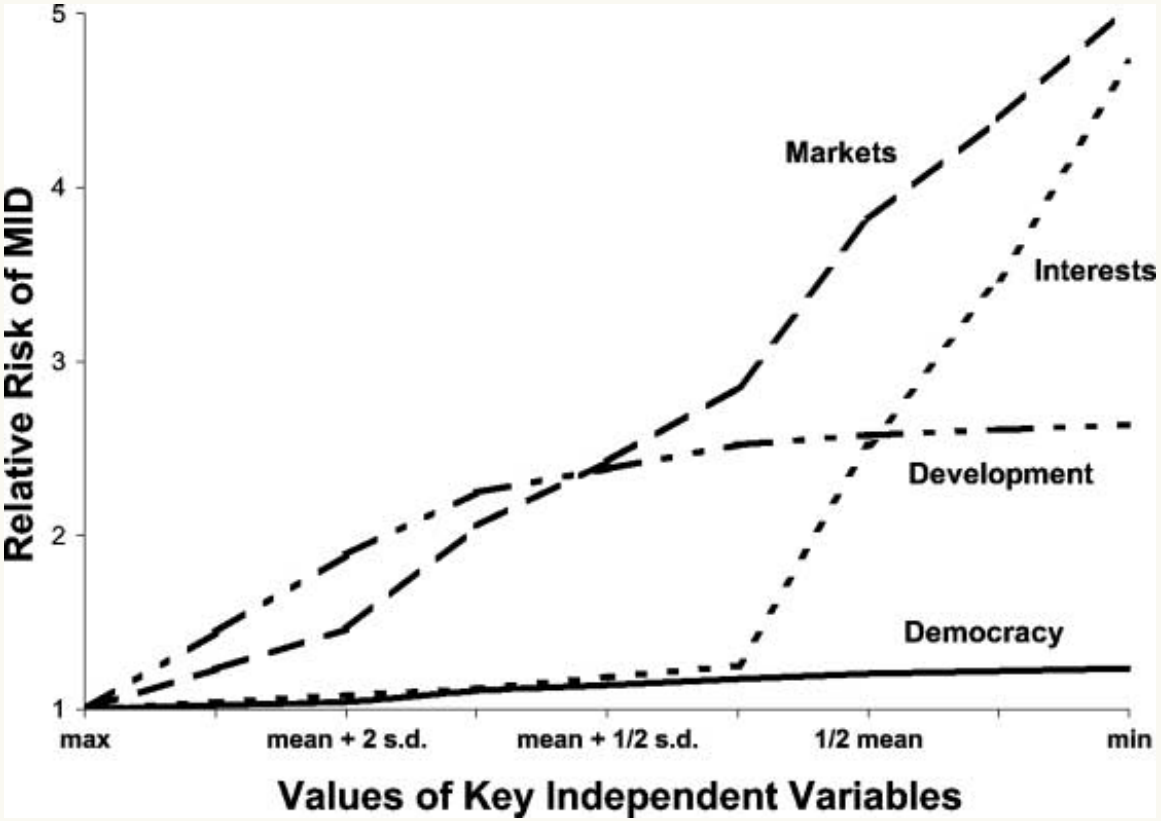
Gartzke regresses militarized interstate disputes on

- a measure of democracy
- a measure of capital liberalization
- a measure of trade dependence
- a variable measuring GDP per capita
- an interaction between GDP per capita and contiguity
- a measure for preference similarity (based on votes in the UN General Assembly)
- a set of control variables

Gartzke (2007): "The Capitalist Peace"

What Evidence Does the Author Provide?

FIGURE 1 **Relative Risk of a MID for Values of Democracy, Markets, Development, and Interests (Risk Relative to Maximum Value for Each Variable. Source: Table 2, Model 5)**



Source: Gartzke (2007, 179)

Gartzke (2007): "The Capitalist Peace"

What Evidence Does the Author Provide?

- Results show that while development increases likelihood of disputes between states, it decreases likelihood for disputes between neighbors
- Results also show that states with similar interests and financially integrated states are less likely to experience disputes