



# POLI 150: Trade & Protectionist Preferences

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## Today's Class

- International Trade
- Preferences Over Trade Policy
- Next Class: Finance, Investment, and Monetary Policy



# Puzzles of Trade

- Why is trade beneficial?
- Why do states restrict trade?
- Who wins and who loses from trade?



## Trade & Productivity

- Specialization has great benefits
- The division of labor increases productivity in terms of how much one unit of labor produces
- Adam Smith's pin factory
- What does this theory assume? Access to markets!



# International Trade & Advantage

- Specialization also applies to international trade
- States have *comparative advantages* in producing some goods
- Actors should focus on the thing that they do best
- Economically, the most efficient system relies on every actor specializing in their comparative advantage and no barriers to free trade



## How Advantage is Identified

- **Hecksher-Ohlin theory** specifies which goods different states will export
- States will export goods that use its most abundant *factors of production*
- Conversely, will import goods that are produced using factors that the state lacks



# Factors of Production

- **Land:** the input for agricultural production
- **Labor:** generally indicating ‘unskilled’ labor
- **Capital:** used for investment (i.e. machinery, equipment, and assets to employ these)
- **Human Capital:** labor for which the worker has invested in training



## Differing Endowments and Exports

- Different states have different levels of factor endowment
- For example, states with lots of land (19th c. US) will export farm goods
- Explains differences across countries and within countries over time
- Doesn't explain all trade patterns





## Summary of HO

- Specialization makes trade efficient
- States' factor endowments determine how they can specialize
- Export the goods that use abundant factors; import the goods that use scarce factors



# Protectionism

- Economic logic suggests that free trade is the most efficient system
- However, we see tons of trade restrictions by states all over the world and throughout history
- **Protectionism** involves placing barriers on trading

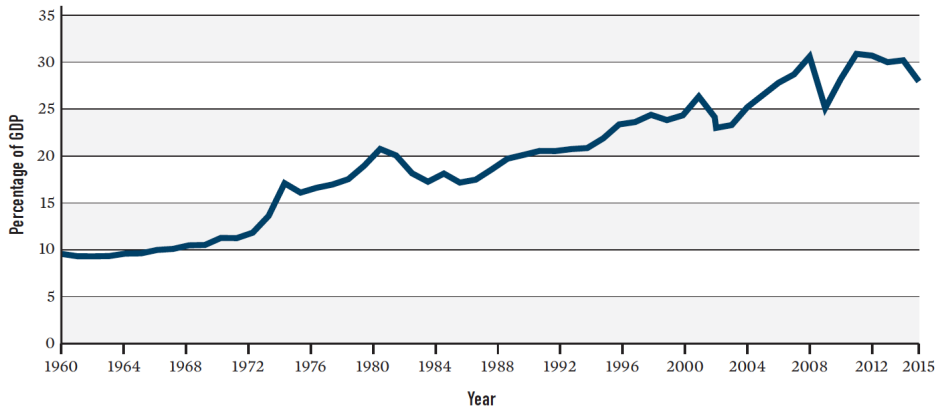


## Forms of Protectionism

- **Tariff:** a tax on imports that raises the domestic price of the good
- **Quota:** restriction on how much of a foreign good can be sold
- Other forms of protectionism are common such as “Buy American” laws



# US Protectionism





# Why Do Governments Restrict Trade?

- Public opinion of free-trade and economists hugely disagree
- Domestic politics largely drive trade restrictions
- There are costs and benefits to restricting trade, and they affect different parts of the economy differently



## Benefits of Protectionism

- Imports become expensive, so domestic can sell more products at higher prices
- This allows domestic companies to increase profits, raise wages, and hire more workers
- In sum, protectionism hugely benefits domestic producers



## Costs of Protectionism

- The benefits of protectionism come at a cost to other actors
- Prices rise!
- Economic inefficiencies
- Exporters fear retribution



# Who Supports Free Trade?

- Two leading theories of support for free trade
- **Stolper-Samuelson theorem:** based upon the factors of production
- **Ricardo Viner model:** based upon the sector of the economy
- Both help us make predictions about which actors will support free trade





- Protection benefits the scarce factor of production
- Those who benefit from protectionism will be more likely to support it
- If a land-scarce country restricts imports of farm goods, the domestic agriculture industry will benefit, and so farmers will support protectionism



- A sector-specific theory that notes that some factors of production are specific to their industry
- Capital in one industry may be very different from capital in another industry
- Actors in industries that face import competition will be protectionist, while exporting sectors will prefer free trade



# Capital Mobility?





# Predicting Trade Preferences

- Is Stolper-Samuelson or Ricardo-Viner the correct theory?
- Both (and modifications) help us predict and explain support for trade
- Appropriateness of the mobility assumption matters a lot



## Review of Trade Theories

- **Hecksher-Ohlin:** a state will export products that make use of its abundant factor of production
- **Stolper-Samuelson:** individuals that use scarce factors of production will support trade protectionism
- **Ricardo-Viner:** whether or not sectors benefit from trade protectionism will determine whether or not individuals support protectionism



## Japan

- Japan is abundant in capital, but has scarce land
- Huge tariffs on imported rice to protect the rice industry
- Other agricultural goods, especially fruit, are competitive exports



## Japan & Theories

- **Hecksher-Ohlin:** Japan should export capital-intensive goods and import goods that use land like farm goods
- **Stolper-Samuelson:** individuals who sell land-intensive goods should support protectionism
- **Ricardo-Viner:** rice farmers should support protectionism, while fruit farmers should oppose it