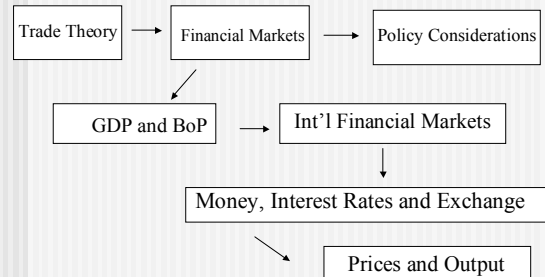


Chapter 9

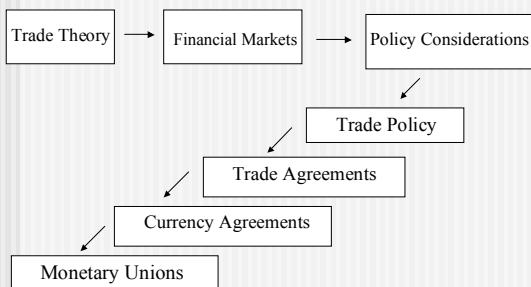
International Trade Policy Econ 136

Dr. Haight - Sum2010

Class Organization



Class Organization



What Economists say....

"If there were an economist's Creed, it would surely contain the affirmations: "I understand the Principle of Comparative Advantage" and "I advocate Free Trade." For 170 years, the appreciation that international trade benefits a country whether it is "fair" or not has been one of the touchstones of professionalism in economics. Comparative advantage is not just an idea both simple and profound; it is an idea that conflicts directly with both stubborn popular prejudices and powerful interests. This combination makes the defense of free trade as close to a sacred tenet as any idea in economics." --Paul Krugman

The Political Economy of Protectionism

- Market Failures vs. Government Failures
 - Market Failures occur when transactions that would be mutually beneficial do not occur
 - Imperfect information
 - Misaligned Incentives
 - Coordination Failures
 - Used as a justification for Government Intervention in the Market
 - The case for Entrepreneurs

The P.E. of Protectionism

- Not all regulation of industries, firms and markets works to the benefit of society as a whole!
- Special Interest Groups
 - Definition
 - How do Special Interests prevail over the common good?

Public Choice Economics

- AKA Political Economy
- Main idea - politicians are normal, rational people who seek to maximize their utility
- What's in a Politician's Utility Function?
 - Family, Power, Salary, Job Security, Fame, Service Ethic?
- To secure any or all of these, a politician must secure re-election

Special Interests and Protectionism

- An individual consumer cannot quantitatively feel the gains from trade - small and dispersed.
 - If benefits are small and well spread out for each individual item of trade, no collective action will occur!
 - Knowledge problem - do consumers really know?
- Industries may also not know the benefits...
 - Comparative advantage = exports
 - Exporters interested in OTHER countries' policies

Special Interests and Protectionism

- Special Interest groups are made up of the few who would benefit strongly from a policy change
 - Easy to coordinate, since there are only a few
 - Benefits, since only spread among a few, are huge
- Rent Seeking - What Special Interest Groups do

The Politician and Protectionism

- Special Interest “payments”
- Fine TV News!
 - “Winners” of protectionism are few and easy to identify, politicians can point them out
 - “Losers” may not even realize they are losing, are individually losing just a little bit, and are very hard to identify
- Good press and campaign donations mean re-election!

The Structure of Protectionism

- Who get protected?
 - Large Industries (Stronger, and politicians get better press) eg: Auto Industry
 - Industries with few producers (Concentrated group is easier to coordinate) eg: Sugar Producers
 - Intermediate Producers (Harder for consumers to notice a price difference) eg: Steel Industry
 - Unionized Labor (Employees are organized and will often vote as a block)

Evolution of Trade Policy

- Late 18th Century, tariffs were a convenient way to raise government revenue.
- Up to beginning of 20th century
 - Congress and the President could impose *any* tariff on *any* narrowly defined good imported from *any* country.
 - Major source of revenue came from tariffs.

Evolution of Trade Policy

- Percentage of Federal Revenue from Tariffs

Date	% of Federal Revenue
1789-91	99.6%
1850	91
1910	49.4
1920	4.9
1970	1.3

Source: U.S. Department of Commerce, Historical Statistics of the U.S.: colonial Times to 1970, Washington D.C.: U.S. Government Printing Office, 1975, pp. 1105-06

Evolution of US Trade Policy

- Started out as Revenue Generation for Gov't
- Alexander Hamilton recognized the ability to 'protect' industry from competition
 - Infant Industry Protection
 - Tariff of Abominations of 1828 - weighed heavily on Southern States - one cause of the Civil War

Evolution of US Trade Policy

- Smoot-Hawley Tariff of 1930
 - A high level of tariffs adopted by the U.S. in 1930 caused a large decline in world trade.
 - The general tariff structure in U.S. history – averaged 60%.
 - It led to retaliation by other nations.
 - It did not help the Great Depression.
 - The volume of world trade declined from \$3 billion in 1929 to less than \$500 million in 1933.

Evolution of US Trade Policy

- Reciprocal Trade Agreements Act of 1934
 - Tariff Reciprocity – U.S. will negotiate tariff reductions only in return for tariff reductions by trade partners.
 - U.S. trade policy transferred to President with authorization to negotiate trade agreements. Congress votes to approve and agreement cannot be amended.
 - Based on Most Favored Nation (MFN) principle - Any tariff reductions the U.S. agrees to with one country apply to same products of all other trade partners with MFN designation.

GATT and MTN's

- **General Agreement on Tariffs and Trade (GATT)**
 - An agreement reached in 1947 that established principles to govern international trade.
 - Until 1995, this organization administered multilateral trade agreements and settled trade disputes.
 - GATT changed world trade
 - It went from 23 contracting parties to more than 100.
 - Contracting parties covered more than 90% of world trade.
 - In order to become a contracting party, a country
 - Had to give MFN status to all other contracting parties.
 - Had to eliminate any quotas.

WTO

- Contracting parties would reduce tariffs by approximately 33 percent
- Remaining quotas and VER's would be phased out and converted to ad valorem equivalent tariffs
- No agreement was reached concerning rules governing government procurement.
- Doha - The latest round of initiatives
 - Addresses agricultural products, services, intellectual property. etc

Summary

- A country's international trade policies are measures that the country's government designs to affect its trade relations with the rest of the world.
- International trade can create losses for firms and workers in the industries that compete with imports.
 - As a result, firms and workers have an incentive to seek protection from imports.

Summary

- The theory of public choice states that politicians attempt to maximize their utility in the same way that consumers (firms) try to maximize their utility (profits).
- Industries or products receive high tariffs when the industry:
 - is large and important to the country.
 - is concentrated regionally or has few firms.
 - produces an intermediate product.
 - has a comparative disadvantage.

Milking Voters on the Farm

The MILC (Milk Income Loss Contract) program is a subsidy program intended to help dairy farmers. Under the program dairy farmers receive a federal subsidy whenever the price of milk in Boston falls below \$16.94 per hundredweight. The subsidy is applied to the first 2.4 million pounds of milk produced. This is roughly the annual production of a herd of 140 dairy cows. Most dairy farms in Wisconsin have about 75 cows. Wisconsin has 15,000 dairy farmers. In 2002 Wisconsin dairy farmers received \$413 million in subsidies from the MILC program.

Discussion Questions

1. Who benefits from the MILC program? Do people in other states derive much benefit from the MILC program?
2. If you knew that your taxes would increase by a few cents because Wisconsin dairy farmers have a subsidy, would you vigorously protest the action to your members of Congress?
3. Do you think that Wisconsin dairy farmers are likely to vote for members of Congress who support the MILC program?
4. Imagine that Representative Lisa Olson is a newly elected member of Congress. Her district is in the heart of Wisconsin's dairy land. She thinks that she can do a great deal of good for the people in her district and hopes to serve them for many years. She prides herself on being a fiscal conservative and dislikes what many people call "pork barrel" spending programs. Do you think Representative Olson will vote in favor of the MILC program? Explain your answer.