

Lecture 10
29 October 2009
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“In the United States, we borrow from China and other countries to finance our excess spending. But the more we borrow, the more we drive up interest rates. The dollar then gets overvalued. Foreign goods get cheaper. U.S. goods get more expensive. We import more and export less and the trade deficit goes up.”

<http://www.npr.org/templates/story/story.php?storyId=112902420> (On Blackboard)

Tariffs on Chinese tires example (posted on Blackboard)

<http://www.npr.org/templates/story/story.php?storyId=112933573>

- I. Intro
 - A. Graphs in additional lecture on hard-drive and in powerpoint for this lecture
 - B. Discuss midterm and criteria for grading - explain them
 1. Pts each for a good definition of realism, institutionalism, and feminism
 2. Pts for a discussion of the analytical levels of causes of war with an example of each
 3. Pts for dealing with important concepts in the appropriate manner.
 4. Pts for overall structure, organization, clarity of argument and simply your subjective sense of how good the writing was.
- II. Introduction to International Political Economy: the role of economics in interstate affairs
 - A. The Orthodox View of trade: economic relationships are inherently harmonious. "A rising tide floats all boats." A beneficent economic order.
 1. Both sides gain
 2. Also prevents war. "The web of trade would bind all the people of the world in the prosperity of peace" (Gilpin citing others in A&J, 243).
 - B. Economics SHOULD determine politics: governments should just get out of the way and let MNCs trade.
 - C. Contradiction of realist principles:
 1. What MNCs want matters more than what states want.
 2. Many MNCs have more power than many states
 3. MNCs create linkages that are costly to break and hence promote peace whether states want them to or not.
 4. Economic forces push states to seek absolute - not relative - gains. Corporations care about more profits regardless of how big other companies' profits are.
 - D. Assumptions
 1. Politics and economics are separate spheres. Agnostic about effects of trade on distribution of wealth.
 2. Fundamental harmony of economic interests among people and countries.
 3. Focus below level of state.
 4. Goal is the optimum use of scarce resources
 5. Future is one of global economic integration
- III. Free trade and "gains from trade" as well as costs
 - A. Basic problem: why buy higher-priced domestic good than a lower-priced foreign good?
 - B. Definition: the increase in total goods produced when countries specialize in producing those goods that they are best at producing, and then trade so they can consume what they want to consume.
 - C. Hypothetical example: On per worker basis: Japan better at producing cars and US better at producing rice.

"Per Worker Productivity"

| | Cars (units/yr) | Rice (tons/yr) |
|-------|-----------------|----------------|
| US | 1 or | 3 |
| Japan | 4 or | 1 |

- D. If retail costs reflect these production costs, then:
 - a) In US, car costs same as 3 tons of rice
 - b) In Japan, car costs same as 1/4 ton of rice

- c) Think of as "opportunity costs" – what does a person with rice have to give up to get a car? In US, one year of their life in a car manufacturing plant, during which they could have produced 3 tons of rice if they had stayed on the farm.
- E. Assume each country has 100 million workers. How many workers end up in each sector will depend on consumer demand (i.e., relative preference for cars vs. rice) – which will determine how much rice and cars are produced [Notice that shifts in consumer demand would lead to need for retraining of car workers to rice farming]:

"Closed Economy Production and Consumption"
(protectionism, no trade, 100 million workers in each economy)

| | Cars (units/yr) | Rice (tons/yr) |
|-------|--------------------------|--------------------------|
| US | 30 m (1 * 30 m workers) | 210 m (3 * 70 m workers) |
| Japan | 120 m (4 * 30 m workers) | 70 m (1 * 70 m workers) |
| World | 150 m | 280 m |

- F. What if we allow specialization and trade?

"Open Economy Production"
(free trade, 100 million workers in each economy)

| | Cars (units/yr) | Rice (tons/yr) |
|-------|---------------------------|---------------------------|
| US | | 300 m (3 * 100 m workers) |
| Japan | 400 m (4 * 100 m workers) | |
| World | 400 m | 300 m |

- Smart Japanese entrepreneur will produce cars, ship them to US, and trade them for rice. Why? Because she can get three tons of rice for each car in the US, but only 1/4 ton in Japan.
- Smart American entrepreneur will produce rice, ship it to Japan, and trade it for cars. Why? Because she can get four cars for each ton of rice in Japan, but only 1/3 of a car in US.
- Now assume World has more cars and more rice, and presumably can trade in ways that each will accept.
 - Assume terms of trade settle at 2 cars per ton of rice (both Americans and Japanese will find this advantageous) and trade of 80 m tons of rice occurs

"Open Economy Consumption"
(free trade, 100 million workers in each economy)

| | Cars (units/yr) | Rice (tons/yr) |
|-------|-----------------|----------------|
| US | 160 m (+130 m) | 220 m (+10 m) |
| Japan | 240 m (+120 m) | 80 m (+ 10 m) |
| World | 400 m | 300 m |

- b) Consumption in both countries is greater than was in closed economy
- G. Major groups affected by free trade (explained more below in discussion of protectionism):
- Consumers: benefit from free trade - lower prices and more variety of goods, but benefit is relatively small and spread over large number of actors so weak incentives to mobilize politically
 - Import-competing sector: harmed by free trade (loss of customers and therefore) loss of jobs; direct harm that is large for those currently employed in sector, so large incentives to mobilize politically
 - Export sector: benefit from free trade (increase in potential customers and potential increase in need for labor), but benefit is "latent" and therefore unlikely to mobilize political support
 - Government - depends on strategies used but influences revenues
- H. Costs of free trade
- Often significant, and potentially long-term, adjustment costs for particular sectors
 - Loss of jobs in import-competing sectors in one country – but corresponding and larger increase in jobs in export sector in other country
 - Noncompetitive import-competing sectors do "die", which is desirable from the economy's point of view since they are noncompetitive but may not be desirable from the point of view of workers in that sector
 - Autoworkers in US have to move from Detroit to central valley of California
 - Farmers in Japan have to move near car factories
 - Labor conditions may vary

- a) Conditions in factories are determined by legislation in country: if US agriculture regulation is lax, then as more people move to agriculture, more are harmed. Vice versa if Japanese labor regulations in factories are lax.
- b) Note, however, that free trade increases number of people harmed by those lax regulations but some pre-exist free trade (Japanese car workers are harmed before trade starts).
- 3. Loss of control over your economy – especially if in monopsonistic relationships
- 4. Environmental damage
 - a) Notice that have more cars – so more pollution from production in Japan (but cleaner in US) but more pollution from use of cars in both countries
 - b) Notice that have more rice – so more pollutants from fertilizers in US (but cleaner in Japan) and more overpopulation as people are healthier cause more food available

IV. Protectionism: If free trade is so great, why do states protect?

- A. Goods protected by US tariffs over 9 percent: canned tuna, frozen orange juice, ball bearings, rubber footwear, non-athletic women's footwear, ceramic tiles, costume jewelry, luggage and polyethylene resin.
- B. Four types of restrictions on trade:
 - 1. Quotas: directly limit number of goods that can be imported.
 - 2. Tariffs: limit goods by taxing them. Advantage is bring in government revenue.
 - 3. Subsidies: pay local producers to reduce production costs or subsidize exports directly.
 - 4. Nontariff (regulatory) barriers: product standards that favor domestic producers (intentionally or unintentionally). E.g.: safety standards, environmental standards.
- C. If all trade restrictions removed, estimated gain to American consumer of \$70 billion or 1.3% of US GDP. In 1929, Hoover called on Congress to pass protectionist trade bill - final version of which placed tariff increases on over 20,000 different trade items. In late 1940s, tariffs on manufactured goods ranged from 30 to 60%. Now down in 4 to 8% range and going down another 2-3% under Uruguay Round agreement.
- D. Trade protectionism: an example
 - 1. Flowers: Tariffs imposed in 1994 on Colombian roses of 34% and on Ecuadorian roses of 50%.
 - a) 1971 - 323 rose growers supply almost all of US market; 1994 - 213 growers supply about 50% of US market
 - b) 1971 - 1525 carnation growers; 1994 - 120 carnation growers
- E. And Gender matters too: See TariffsOnClothing.doc



The New York Times

- F. Endogenous tariff theory explanation of protectionism: protectionism reflects specific economic interests and power of different domestic actors effected by trade. Protectionism as result of internal domestic political pressures
 - 1. KEY EXPLANATION: People are both workers and consumers – they benefit from free trade as consumers and they benefit if they work in export sectors or are unemployed and could work in export sectors, but they are harmed by free trade if they work in import-competing sectors
 - 2. Import competing sectors and their workers - have to charge lower prices and maybe go out of business
 - 3. Export sectors and their workers - not inherently but because of reciprocity

4. Consumers - many, each of whom pays a slightly higher price on the good involved
 5. Government - tariffs. Until this century all revenues raised from these sources.
 6. Contradicts unitary actor model: What may not make sense for a country as a whole, may make sense for some subset of actors within that country. For example, if have a country that does not have an indigenous textile industry, is that country likely to have tariffs on textiles?
- G. Protectionism occurs even though against interests of "state as a whole" because of what domestic political forces are affected and mobilized by protectionism and free trade:
1. Consumers: small effect spread over many consumers, so won't be politically mobilized.
 2. Import-competing sectors: large effects over few employers and few employees, so have resources and will be mobilized.
 3. Export sectors: large effects over few employers and few latent people, so employers will be mobilized but workers won't
- H. Three other reasons for protectionism:
1. Strategic reciprocity: maintain protection until others remove theirs.
 2. Geostrategic reasons: avoid dependency on strategic materials, e.g., titanium for submarines.
 3. Dependency theory: protect new industries so they can develop.
- V. Other impacts of free trade.
- A. Loss of jobs
1. Productivity of labor (units produced per dollar of wage) not price influence decision
 2. Example of how lower wages need not mean higher/better productivity

| Scenario #1: | US | Mexico |
|-------------------------|-----------|----------|
| Wages | \$160/day | \$24/day |
| Days per car | 25 days | 250 days |
| Productivity (cost/car) | \$4000 | \$6000 |

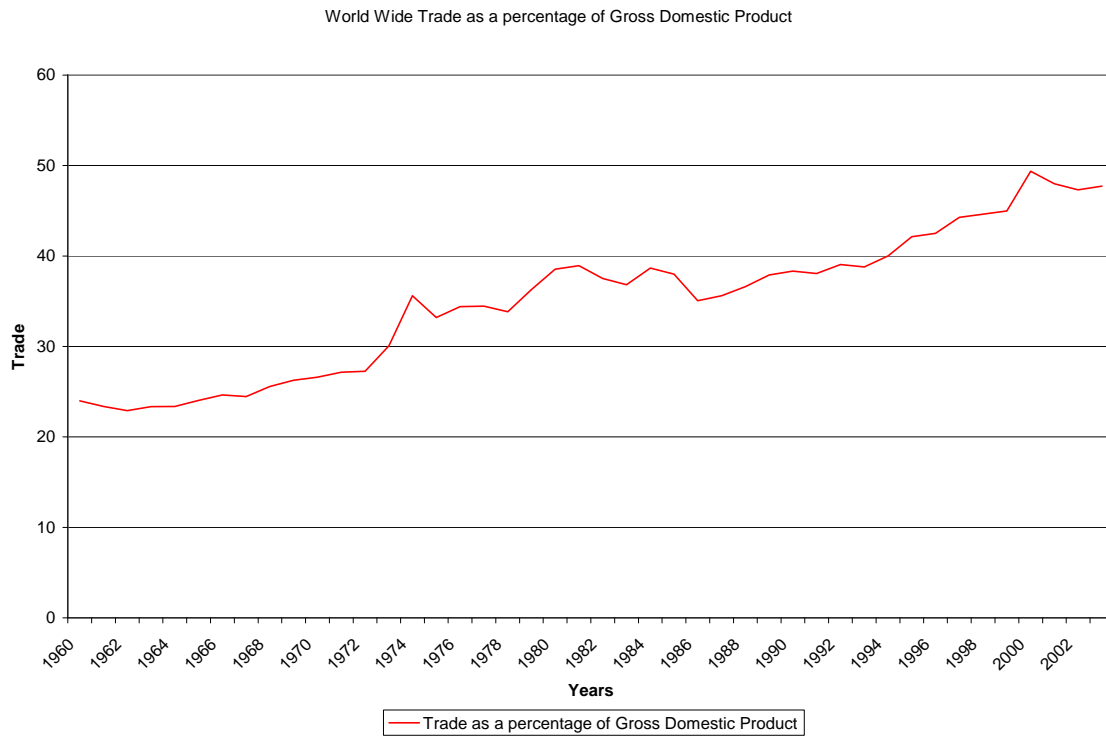
| Scenario #2: | US | Mexico |
|-------------------------|-----------|----------|
| Wages | \$160/day | \$12/day |
| Days per car | 25 days | 250 days |
| Productivity (cost/car) | \$4000 | \$3000 |

3. Example of how lower labor costs and lower environmental compliance costs still may not mean lower prices

| Other factors: | US | Mexico |
|--------------------------|--------|--------|
| Labor costs of car | \$4000 | \$3000 |
| Parts and materials | \$5000 | \$5500 |
| Transportation | \$100 | \$1100 |
| Environmental compliance | \$100 | \$0 |
| | \$9200 | \$9600 |

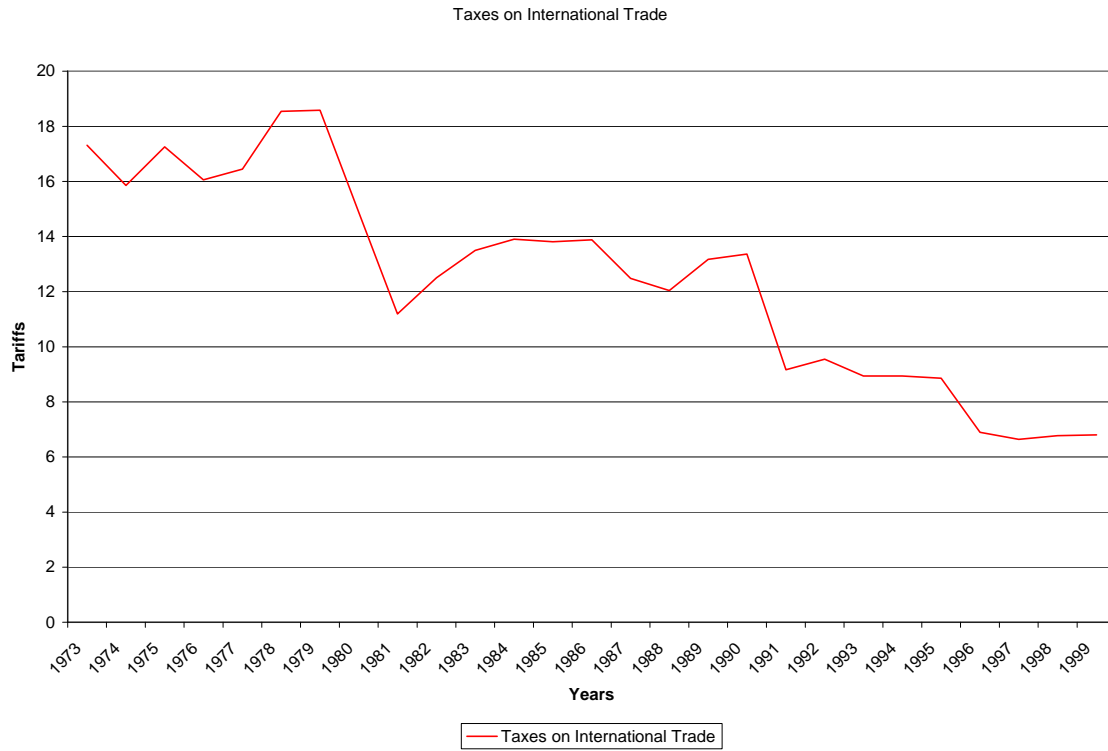
- B. Free trade and the environment: numerous and complicated impacts.
1. More efficient production: produce same amount of goods with fewer resources
 2. More production: growth in economy means more resources used
 3. Less stringent enviro enforcement: some factories may move to countries with less stringent enforcement
 4. More enviro concern: more jobs and lower cost goods mean greater real income and as real income rises so does environmental concern
 5. Only more efficient use of those resources that have prices but enviro goods don't
- VI. Conclusions
- VII. Appendix: Graphs

Graph I: Trade as a Percent of GDP. Source: (World Bank).



World Bank. *World Development Indicators*. World Bank, Accessed November 12, 2006, Available from <http://0-devdata.worldbank.org.janus.uoregon.edu/dataonline/>.

Graph II: Tariffs on International Trade. Source: (World Bank 2002).



World Bank. 2002. *The 2002 World Development Indicators CD-ROM Win*STARS Version 4.2*. International Bank for Reconstruction and Development/World Bank.