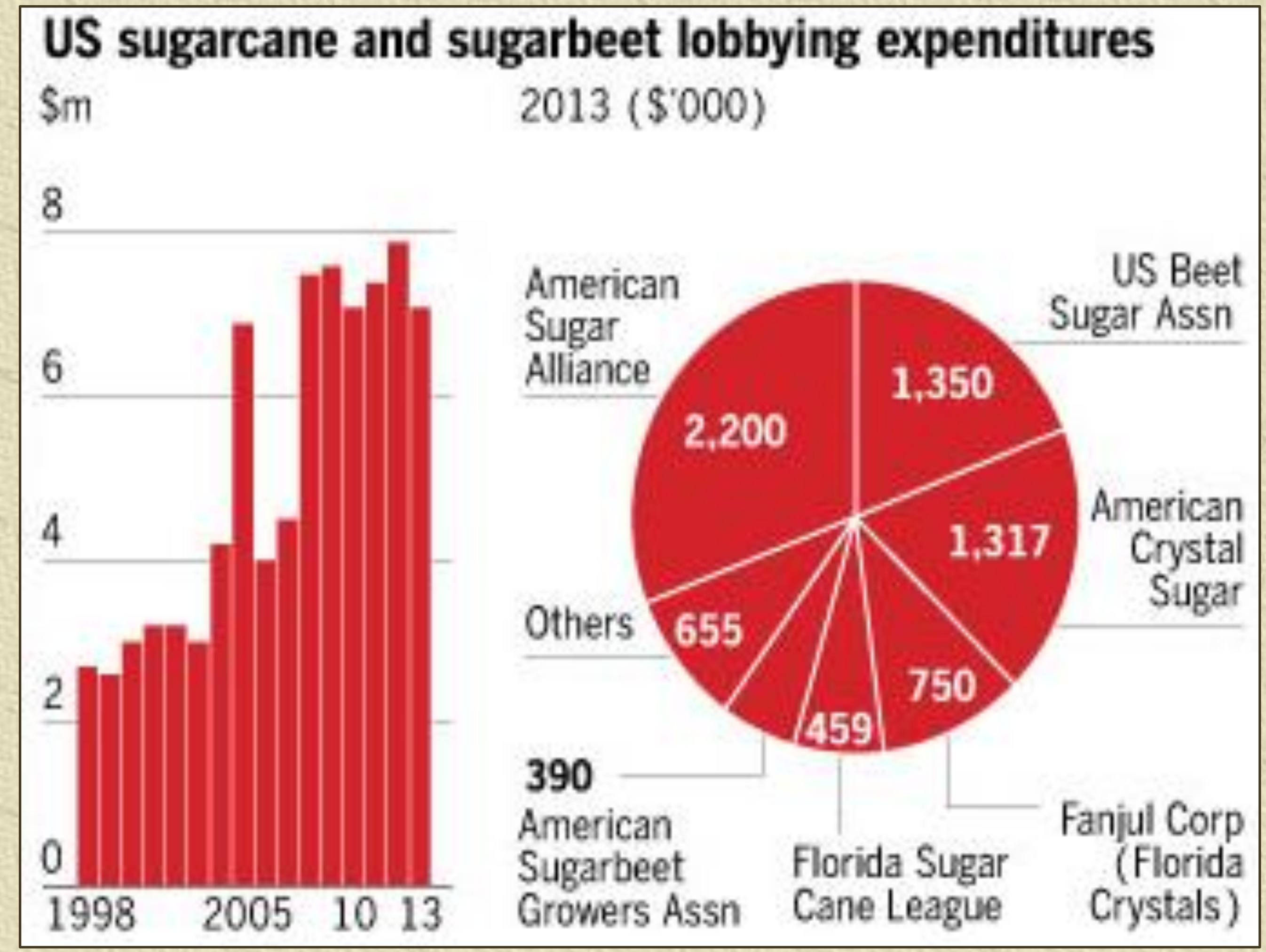
7. Government Intervention: Case for/against Trade

7.1 Case for free trade

- Short-run gains
- Long-run efficiency gains
- Political-economy argument
  - Policymaking captured by special interests / lobbying
  - Trade policy easier to pass than domestic tax/subsidy

Government Intervention: Case for/against Trade

- Case: US sugar lobby capturing policymaking

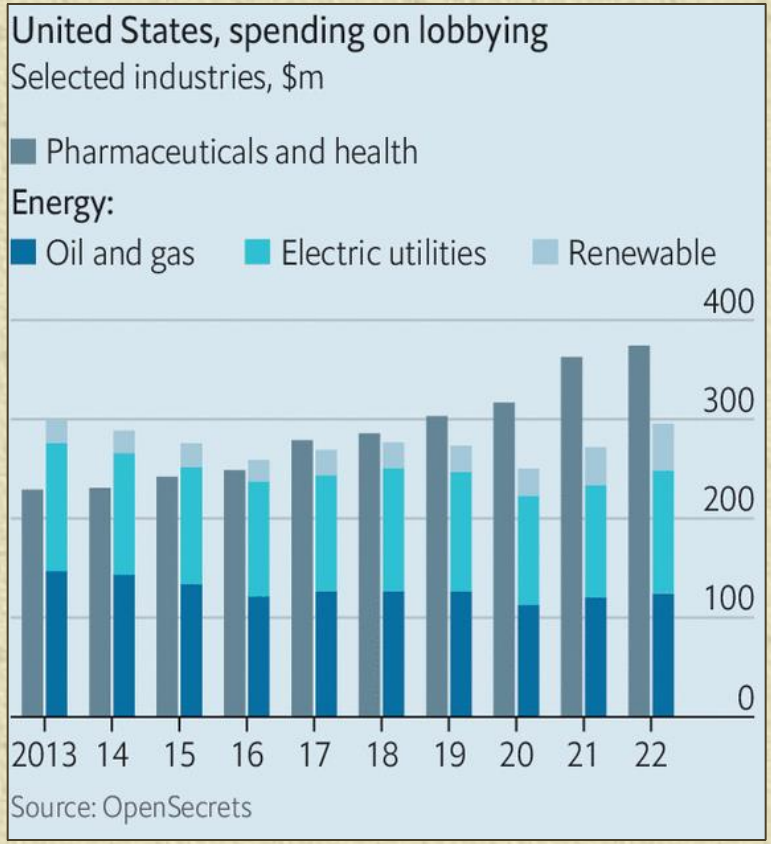


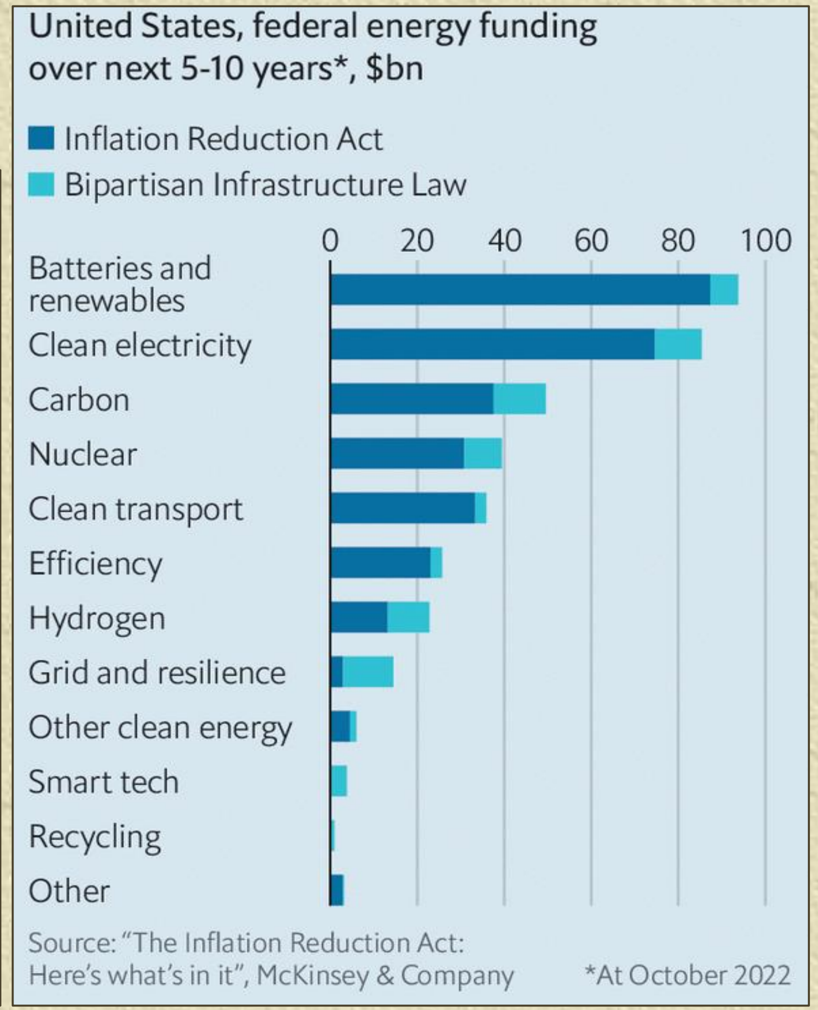
Meyer, G. and S. Kirchgaessner, "Commodities: A sweet deal", *Fin Times*, 15 Nov 2013, p. 7

US commodity groups support each other politically. US sugar industry unites southern cane and northern beet producers. Cane and beet can rot so they are processed into crystal sugar before traded and stored. US sugar program is aimed at processors not farmers: loans to processors; mkting quotas for dom sale; and an import quota. Industry argues that it is public interest to not depend on foreign countries…

Government Intervention: Case for/against Trade

- Industrial policy and lobbying





Economist, "Lobbying in America: Welcome to the green swamp", 15 Apr 2023, p. 53-4.

Government Intervention: Case for/against Trade

7.2 Case against free trade

- Case for policy intervention when mkts do not work
  - Theory of the 1st best: P = MSC = MSB = MC = MB
  - Theory of the 2nd best: case for intervention
    - External cost: MSC > P_W
    - External benefit: MSB > P_W
    - Imperfect competition: P_W > MC or MB
- Goods mkts do not function as per theory
  - Example: over-fishing
  - Example: agriculture is a non-trade concern, multifunctionality

Marginal social cost (MSC) is total cost society pays for production of an additional unit, whereas MC are private costs a producer faces to take another unit to market; marginal social benefits (MSB) are the value of benefits that come from the public consuming an additional good or service provided; MB are private benefits that accrue to the producers or consumers, measured as willingness to pay for the additional unit of the good

Government Intervention: Case for/against Trade

- L,K-mkt failures: factor mkt imperfection/immobility
  - L-mkt failure: wage inequality, high urban wage + unemploy
  - K-mkt failure: K-immobile scarce even where K-returns high
  - What causes these situations? What is appropriate policy?

- Institutions are weak
  - Courts, land title registry and related rule of law not enforced
  - Revenue collection agencies
  - Mkt support functions and regulatory agencies

8. Strategic Policy Intervention

Motivate:

What role trade policy played in development?

What is lost by giving up the right to use trade policy?

8.1 Developing country strategies

- Dual economy: symptoms of L,K mkt failure
- Infant industry argument: too much Q_A, too little Q_M
- Import substitution industrialization (ISI)

Strategic Policy Intervention

- ISI toolkit of the 1950s-80s strategy
  - Trade policy favoring manufacturing
  - Industrial policy: produce / buy local
    - Gov't defines strategy: heavy industry, K and tech-intensive sectors
    - State is the only domestic actor with resources to develop sectors
    - SOEs (state's share > 50%); mixed ownership - FDI thru joint venture
    - Gov't procurement of local goods and local content requirements
    - State intervention and high costs
      - Cross subsidy across state-owned sectors (energy to manufacture)
      - Investment for strategic sectors/ large-scale development
      - Close gov't – business relations
      - Close gov't – labor union relations

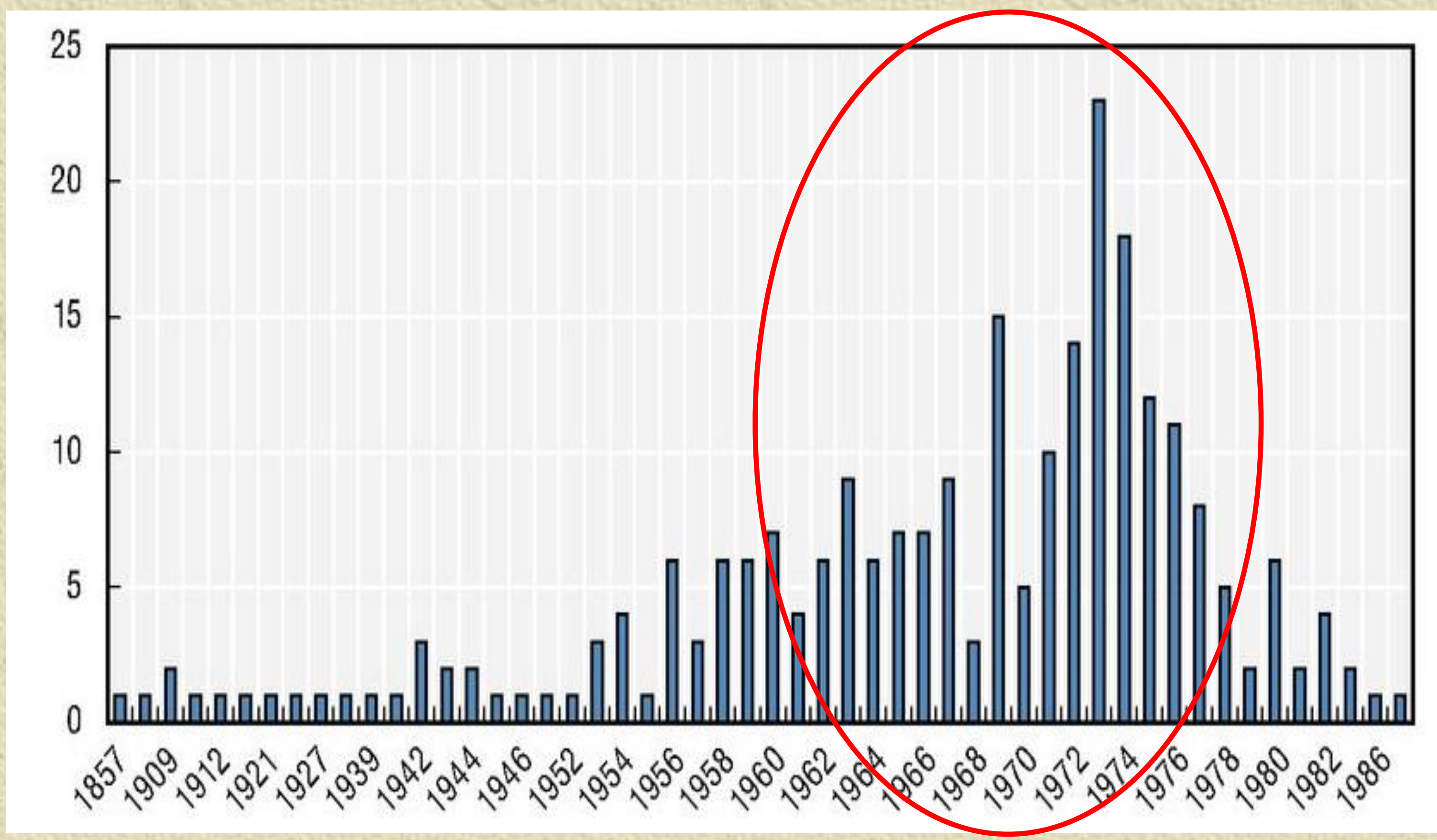
Strategic Policy Intervention

- Protective trade policy regime, 1960
  - High tariffs on import-competing goods (avg nominal protection)
    - Arg 131% Brz 168% Mex 61%
    - Chi 138% Col 112% Uru 21%
    - High rates on intermediate inputs which hurt production
  - Import quotas, licensing, local content requirements
  - Export taxes on commodity exports; exchange rate intervention

- Accommodating fiscal and monetary policy
  - Fiscal policy
    - Subsidies to reduce cost of inputs; tax breaks on manu production
    - Preferential interest rates to SOEs and targeted sectors/firms
    - Tax share from trade high and G > T
  - Monetary policy: loose MS to inflate away debt or monetize debt

Strategic Policy Intervention

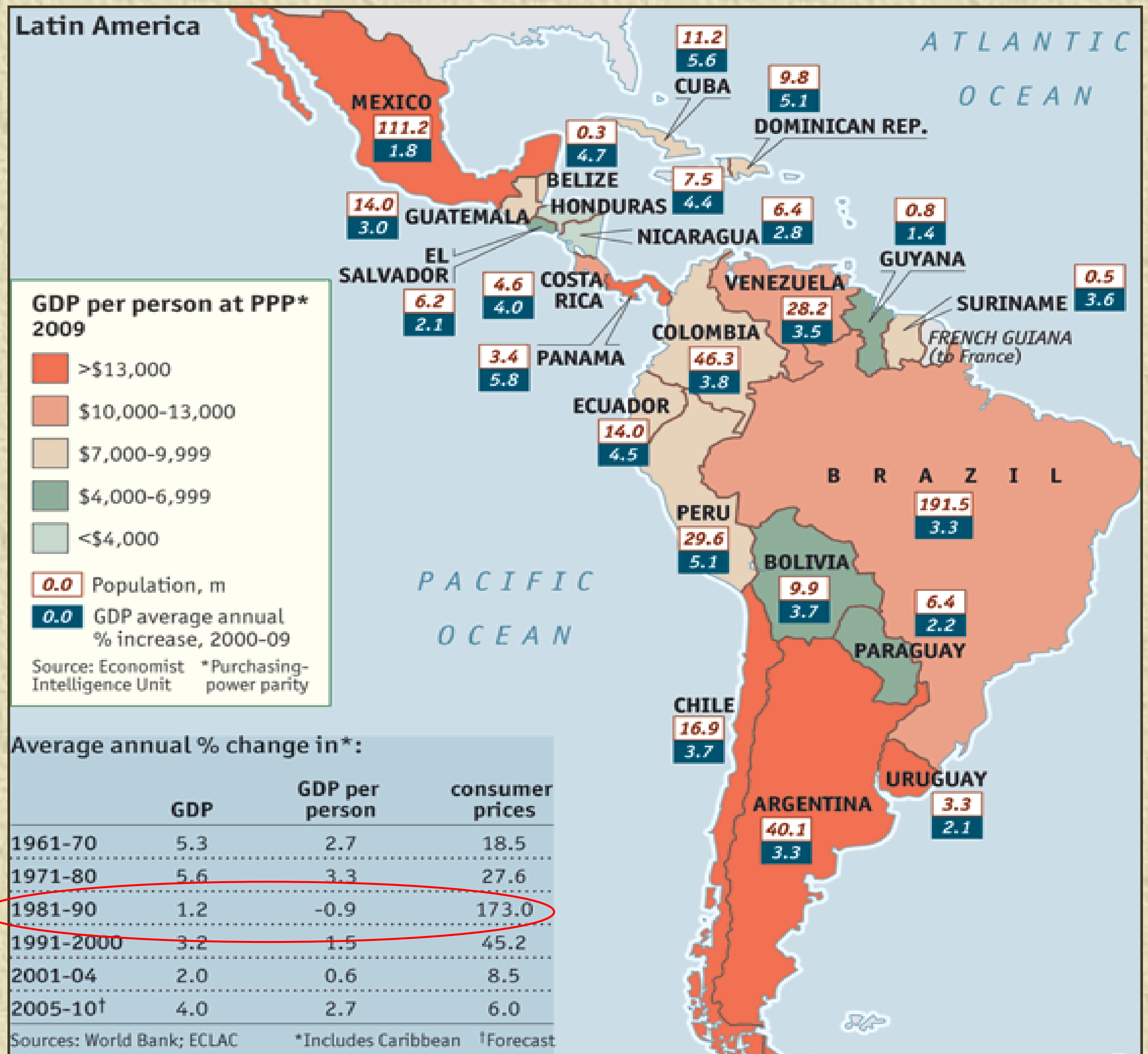
- State-owned enterprises and nationalizations
  - Case of Brazil



Source: OECD, *State-owned Enterprises in the Development Process*, 2015

Strategic Policy Intervention

- Latin America's macroeconomy, 1980s



Average annual % change in*:

	GDP	GDP per person	consumer prices
1961-70	5.3	2.7	18.5
1971-80	5.6	3.3	27.6
1981-90	1.2	-0.9	173.0
1991-2000	3.2	1.5	45.2
2001-04	2.0	0.6	8.5
2005-10†	4.0	2.7	6.0

Sources: World Bank; ECLAC *Includes Caribbean †Forecast

Source: *Economist*, "So near and yet so far", Special report on Latin America, 11 Sep 2010, p. 3

Strategic Policy Intervention

- Washington Consensus (IMF, WB, WTO): policy agenda of late 1980s-1990s
  - Return to mkt-based development (mkt mechanisms)
    - Remove price controls
    - Liberalize trade; X-led growth of non-traditional exports
  - Structural reforms and re-regulation:
    - Privatization, property rights and ↑ private sector's role
    - Foreign participation to ↑ investment
    - Ease of doing business: simplify regulations to ↑ competition
  - Sound MP and FP
    - Central bank independence: control inflation and mkt-based interest
    - More flexible exchange rates and rates that help export-led growth
    - Broaden tax base, reduce subsidies
    - Limit budget deficits; prioritize G on health, education, infrastructure

Strategic Policy Intervention

8.2 East Asian miracle: What was the strategy and what was trade policy’s role?

- Fast economic growth through
  - Market-based economies, but
  - Strategy of state intervention (not state planning)
    - Support infant industries
    - Promote exports
    - Mobilize savings and investment
- Comparison of E. Asia and Latin America

Strategic Policy Intervention

- Trade policy's role: Asia's miracle vs Latin America's ISI

	Asian experience	LA experience
% Δ GDP	1960-90s: Tigers @ 8-9% 1980-2010: China @ 10%	1960-1980: BZ at +5% 1980-2010: BZ at 3%; only Chile had 7%
Trade policy regime:	+ BOT (balance of trade)	- BOT until after 2000
Export regime	X-led: ↑ X as % GDP; export-led ISI X as %GDP > 100%; diversified X	↓ trade as % GDP BZ: lower trade as %GDP than developed
Import regime	Avg protection at 24%; More trade-openness; Managed trade: X-targets and trade-balancing requirements Low protection level of intermediate inputs	Avg protection at 46% Some sectors: PSE > 200% Reflects inward-orient ISI More restrictive of intermediate inputs because of BOT problems
Industrial and Macro Policy (Y = C+I+G): saving, investment, K-inflow, FP (G), MP (E)		
Consume, saving and investment policy	C low; aggressive saving, I policy; China: dom savings +40%; I/GDP = 50% (90% goes to SOEs who acct for ⅓ of GDP)	C high (60% of GDP); low save (< 20% of GDP); High dom + foreign debt; BZ: I (19% of GDP); FDI less welcome (nationalization)
K-inflows	High saving, I + foreign debt less problematic; FDI with conditions	Low savings → ↑ K-inflow esp if ISI is K-int; foreign currency loans → risk of BOP crises
MP and FP	G < T; MP to fix currency value	G > T; debt is monetized; foreign debt
Exchange rate	Undervalued currency → ↑ X	Overvalued + devaluation of local currency