

# International Trade

## This week's readings:

- Mansfield, Edward D. and Diana C. Mutz. (2009). "Support for Free Trade: Self-Interest, Sociotropic Politics, and Out-Group Anxiety." *International Organization* 63(3): 425–457.
  - Goodman, Peter S. (2016). "More Wealth, More Jobs, but Not for Everyone: What Fuels the Backlash on Trade." *New York Times*.
  - Rodrik, Dani. (2017). "Too Late to Compensate Free Trade's Losers." *Project Syndicate*.
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## Big questions:

- Does free trade benefit everyone?
- What are the distributional effects of free trade?

## Free trade: What is it and why do we care?

### Why do countries trade at all?

Different countries have different capacities for making things. It turns out that it is most efficient for each country to focus on what they're particularly good at (focus on their "comparative advantage"). There is an example at the back of this.

### What is "free" trade?

In order to protect domestic industry, a country can tax some imported products to artificially increase the price of imports. This is called a **tariff**. If trade between countries is not impeded by tariffs, we call this "free trade". Note: A tariff is paid by the importer, who must pass the cost on to consumers.

Tariffs are always bad for society as a whole because they raise prices and reduce the total amount of stuff that we can own. In economics speak, overall welfare is maximized if there is free trade.

### Why do some people want tariffs?

So why do some people want tariffs? Well, it turns out that the those who would lose their jobs because of foreign imports are not so happy about that situation. These people (and the businesses that employ them) will oppose free trade and ask for protective tariffs.

### Why is free trade not more common?

Despite this, we might wonder why it is that free trade is not more common if it provides benefits to nearly everyone. In fact, the problem is just that: Everyone benefits from slightly lower prices and slightly more stuff, but the **costs are concentrated** among the few people who lose their jobs.

## Embedded liberalism

Following World War II, the proportion of trade hindered by tariffs has gone down significantly. The rise of free trade was often coupled with the development of welfare states and social safety nets – a concept known as **embedded liberalism**, a term introduced by John Ruggie.

The idea was to **compensate** those harmed by openness, thus maintaining political support for it.

## The failure of embedded liberalism

Rodrik (2017) argues that while compensating losers seems like a workable fix, there is a “time-inconsistency” problem (aka a commitment problem): once trade agreements are in place, the incentive for winners to follow through on promises of compensation diminishes.

There’s also a snowball effect: The expansion of free trade can shift political power towards the beneficiaries, weakening the influence of the losers from trade. This means that winners from trade have difficulty credibly committing to compensation.

## What does this have to do with international relations?

In the first half of the class, we talked about the *second image reversed* (SIR): This is the idea that international relations influences domestic politics.

Trade is one of the main arenas in which SIR is observed: Agreements made between states on trade has a significant influence on domestic politics.

## A model of domestic politics?

In order to understand the influence of international affairs on domestic politics, we need a suitable model of how political decisions get made within countries. In broad strokes, such a model should consider:

- Who makes decisions? In the U.S., for example, political decisions can be thought of as made by the President and Congress. We’ll call these people **leaders**.
- What decisions do political leaders make? I’ll call this “**foreign policy**”.
- How are politicians selected or held accountable? In democracies, this is through elections. In other systems, this might be through elite bargaining or something. I’ll call this **leader selection**.
- Who chooses leaders or holds them accountable? Collectively, I’ll call the people who choose political leaders the “**selectorate**”.

If we think of politics as a system where leaders try to stay in power by pleasing the selectorate, we can analyze international relations by considering how foreign policy influences the selectorate.

## Trade and domestic politics

In the case of trade, we might wish to consider how trade policy helps or harms the selectorate. I summarize the main theories in Table 1.

## Economic conflict

Other countries might try to target their trade policy at the selectorate in order to pressure political leaders. For example, China imposed tariffs on Kentucky Bourbon to pressure Mitch McConnell.

## Implications of Interdependence

Globalization entails a deep level of interdependence across countries, not just in trade but also in capital flows, migration, and information.

This interdependence creates new vulnerabilities. In conflict, your opponent can threaten to impose tariffs on your goods or cut trade off completely.

The concept of **weaponized interdependence** (Farrell and Newman 2019) highlights how states can leverage their central positions in global networks to exert influence over others.

The recent focus on decoupling and derisking in international economic relations reflects a growing awareness of these vulnerabilities and a desire to reduce dependence on potential adversaries.

## The role of institutions

How do the coordinating and information-provision functions of international institutions influence trade politics?

- The World Trade Organization (WTO) tries to reduce uncertainty by establishing internationally recognized rules and principles. This transparency encourages trust and facilitates smoother international trade.
- When there are disputes, the WTO's dispute settlement mechanism enables countries to settle conflicts over trade practices—such as allegations of unfair subsidies or tariffs—in a rule-based environment rather than through unilateral or retaliatory measures.
- Multilateral trade negotiations under the WTO framework are designed to reduce ad hoc negotiations.

Most would agree that this has not been successful. The WTO barely works.

<b>Stolper-Samuelson</b>	<b>Ricardo-Viner</b>	<b>Mansfield-Mutz</b>
Trade changes the prices of factors <sup>1</sup> (like wages and returns on capital)	Some resources (like specific skills or equipment) are tied to certain industries.	Overall economic conditions matter to voters more than their personal situation.
When a country opens to trade, the owners of the country's abundant factor benefit, while those of the scarce factor are disadvantaged.	Sectors that are import-competing are disadvantaged, but those that are export competing benefit	Individuals vote based on whether policies will improve or harm the national economy—even if they do not experience the effects directly.
In the US, the abundant factor is capital, so free trade benefits owners of capital. Labor is a scarce factor, so owners of labor demand protection.	In the US, the manufacturing sector is disadvantaged (because of high labor costs), but hi-tech is advantaged (because of abundant skilled labor).	In the 2024 election, many older, wealthy voters voted for Trump despite doing relatively well under the Biden administration. This could be because of their perception of the overall economy.

Table 1: Comparison of Trade Theories

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<sup>1</sup> A factor of production is a resource that is used to make goods or services. For simplicity, we often think of just three factors: Labor (the work done by people); capital (tools, machines, buildings, investment); and land (actual land and natural resources)

## Illustrating comparative advantage

You have the misfortune of having to work with me on a group project. To complete the project, we must solve as many math problems as we can and type up the longest report we can.

Unfortunately for you, I'm pretty dumb, so while in one hour you can solve ten math problems or type fifteen paragraphs, I can only solve six math problems or type twelve words in an paragraphs.

Notice that you can do more of both tasks than I can in the same amount of time. You have an **absolute advantage** in both, but I nonetheless have a **comparative advantage**. For this reason, we should specialize to maximize our output.

## How do we find comparative advantage?

We can find comparative advantage by opportunity costs, which measures what you give up by doing something else.

### 1. My Opportunity Cost

- 1 math problem "costs" me the chance to type 2 paragraphs (since 6 math problems vs. 12 paragraphs is a 1:2 trade-off).
- 1 typed paragraph "costs" me the chance to solve 0.5 math problems (12 paragraphs vs. 6 problems is 2:1, or 1 paragraph =  $\frac{1}{2}$  problem).

### 2. Your Opportunity Cost

- 1 math problem "costs" you the chance to type 1.5 paragraphs (10 math problems vs. 15 paragraphs = 1:1.5).
- 1 typed paragraph "costs" you the chance to solve 0.66... math problems (15 paragraphs vs. 10 problems = 1:0.66).

Because I give up two paragraphs for each math problem while you only give up 1.5, you have a comparative advantage in solving math problems. But I give up only half a math problem for every paragraphs I type, while you give up two-thirds of a math problem. I therefore have a comparative advantage in typing, even if you are faster at it than I am.

## Specialization maximizes output

By specializing, we can maximize our output: If I type and you do math, in five hours, we would have 60 paragraphs and 50 math problems. But if we split our time equally, we would have 67.5 paragraphs but only 40 math problems.