



Chapter 11

Controversies in Trade Policy



Prepared by **Iordanis Petsas**
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by **Paul R. Krugman and Maurice Obstfeld**


Chapter Organization



- Introduction
- Sophisticated Arguments for Activist Trade Policy
- Globalization and Low-Wage Labor
- Summary

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Introduction



- Two controversies over international trade arose in the 1980s and 1990s.
 - In the 1980s a new set of sophisticated arguments for government intervention in trade emerged in advanced countries.
 - These arguments focused on the “high-technology” industries that came to prominence as a result of the rise of the silicon chip.
 - In the 1990s a dispute arose over the effects of growing international trade on workers in developing countries.

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Sophisticated Arguments for Activist Trade Policy



- There are two kinds of market failure that seem to be present and relevant to the trade policies of advanced countries:
 - Technological externalities
 - The presence of monopoly profits in highly concentrated oligopolistic industries

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Sophisticated Arguments for Activist Trade Policy



- **Technology and Externalities**
 - **Externalities**
 - Firms in an industry generate knowledge that other firms can also use without paying for it.
 - In high-tech industries firms face appropriability problems.
 - Example: In electronics, it is common for firms to “reverse engineer” their rivals’ designs.

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Sophisticated Arguments for Activist Trade Policy



- **The Case for Government Support of High-Technology Industries**
 - Subsidize the activity with externalities, not all activities in an industry.
 - For instance, R&D (as opposed to manufacturing) should be subsidized.
- **How Important Are Externalities?**
 - Externalities are hard to measure empirically.
 - Problems of appropriability at the level of the *nation* (as opposed to the firm) are less severe but still important even for a nation as large as the United States.

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Sophisticated Arguments for Activist Trade Policy



■ Imperfect Competition and Strategic Trade Policy

- In some industries where there are only a few firms in effective competition:
 - The assumptions of perfect competition will not apply.
 - Firms will make **excess returns** (profits).
 - There will be an international competition over the excess returns.
 - A subsidy from the government to domestic firms can shift the excess returns from foreign to domestic firms.

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Sophisticated Arguments for Activist Trade Policy



• The Brander-Spencer Analysis: An Example

- There are only two firms (Boeing and Airbus) competing, each from a different country (United States and Europe).
- There is a new product, 150-seat aircraft, that both firms are capable of making.
- Each firm decides either to produce the new product or not.

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Sophisticated Arguments for Activist Trade Policy



Table 11-1: Two-Firm Competition

		Airbus	
Boeing	Produce	-5, 100	0, 0
	Don't produce	100, 0	0, 0

Equilibrium outcome is A=0 and B=100: Airbus does not produce and Boeing produces.

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Sophisticated Arguments for Activist Trade Policy



Table 11-2: Effects of a Subsidy to Airbus

		Airbus	
		Produce	Don't produce
Boeing	Produce	-5 / 20	100 / 0
	Don't produce	0 / 125	0 / 0

A subsidy of 25 to Airbus given by Europe results in $A=125$, $B=0$.

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Sophisticated Arguments for Activist Trade Policy



- **Problems with the Brander-Spencer Analysis**
 - Insufficient information to use the theory effectively
 - The exact payoffs of the firms cannot easily be obtained.
 - Industries in isolation
 - A policy that succeeds in giving U.S. firms a strategic advantage in one industry will tend to cause strategic disadvantage elsewhere.
 - Foreign retaliation
 - Strategic policies are **beggar-thy-neighbor** policies that increase our welfare at other countries' expense.

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Sophisticated Arguments for Activist Trade Policy



Table 11-3: Two-Firm Competition: An Alternative Case

		Airbus	
		Produce	Don't produce
Boeing	Produce	-20 / 125	0 / 0
	Don't produce	0 / 100	0 / 0

Equilibrium outcome is $A=0$ and $B=125$; Boeing produces and Airbus does not.

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Sophisticated Arguments for Activist Trade Policy



Table 11-4: Effects of a Subsidy to Airbus

		Airbus	
		Produce	Don't produce
Boeing	Produce	5	0
	Don't produce	125	0

A subsidy of 25 to Airbus given by Europe results in A=5, B=5.

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Globalization and Low-Wage Labor



- The rise of manufactured exports from developing countries is one of the major shifts in the world economy over the last generation.
 - The workers who produce these goods are paid low wages and work under poor conditions.

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Globalization and Low-Wage Labor



- **The Anti-Globalization Movement**
 - It became a highly visible presence chronologically:
 - 1980s
 - Alleged threat of competition from Japan in the United States
 - Early 1990s
 - Substantial concern in both the United States and Europe over the effects of imports from low-wage countries on the wages of less-skilled workers at home.
 - Second half of the 1990s
 - Alleged harm that world trade was doing to workers in the developing countries.
 - 1999
 - Demonstrations disrupted the meeting of the World Trade Organization in Seattle.

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Globalization and Low-Wage Labor



Trade and Wages Revisited

- Activists argue that globalization makes workers in developing-country export industries worse off.
 - Example: Wages in Mexico's *maquiladoras* were below \$5 per day, and conditions were appalling by U.S. standards.
- Economists argue that despite the low wages earned by workers in developing countries, those workers are better off than they would be if globalization had not taken place.

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Globalization and Low-Wage Labor



Table 11-5: Real Wages

(A) Before trade		
	High-tech goods/hour	Low-tech goods/hour
United States	1	1
Mexico	1/8	1/2

(B) After trade		
	High-tech goods/hour	Low-tech goods/hour
United States	1	2
Mexico	1/4	1/2

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Globalization and Low-Wage Labor



Labor Standards and Trade Negotiations

- International trade agreements can improve wages and working conditions in poor countries by incorporating:
 - A system that monitors wages and working conditions and makes the results of this monitoring available to consumers.
 - Formal labor standards
 - They are conditions that export industries are supposed to meet as part of trade agreements.
 - They have considerable political support in advanced countries.
 - They are strongly opposed by most developing countries.

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Globalization and Low-Wage Labor



■ Environmental and Cultural Issues

- Environmental standards in developing-country export industries are much lower than in advanced-country industries.
- The incorporation of environmental standards in trade agreements can cause:
 - Improvements in the environment
 - Potential export industries in poor countries to shut down
- Globalization has led to a homogenization of cultures around the world.
 - Example: McDonald's is now found almost everywhere.

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Globalization and Low-Wage Labor



■ The WTO and National Independence

- Free trade and free flow of capital has undermined national sovereignty.
- WTO monitors not only the traditional instruments of trade policy, but also domestic policies that are de facto trade policies.

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Summary



- New arguments for government intervention in trade emerged in the 1980s and 1990s.
- In the 1980s the new theory of strategic trade policy offered reasons why countries might gain from promoting particular industries.
- In the 1990s a new critique of globalization emerged, focused on the effects of globalization on workers in developing countries.

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Summary



- There are two sophisticated arguments for activist trade policies:
 - Governments should promote industries that yield technological externalities.
 - Brander-Spencer analysis.
- With the rise of manufactured exports from developing countries, a new movement opposed to globalization has emerged.
 - Low wages paid to export workers.
