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Perspective

Trade Policy and Challenges in Strategic Trade Policy

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DESCRIPTION

Since the 1950s, ideas about trade policy and economic development have shifted dramatically. It was recognised both then and now that trade policy was central to the overall design of economic development policies. However, there was a broad consensus in the early days that trade policy for development should be based on 'import substitution.' This meant that domestic production of import-competing goods should be started and expanded to meet domestic demand under incentives provided by whatever level of protection against imports, or even import prohibitions, was required.

Import substitution in manufacturing was thought to be synonymous with industrialization, which was seen as the key to development. It is now widely accepted that an outer-oriented trade regime and fairly uniform incentives (primarily through the exchange rate) for production across exporting and importing competing goods improve growth prospects for developing countries significantly. What role did economic research play in the sea change in thinking, policy prescriptions, and political acceptance of the need for reform? What types of economic research best informed policymaking?

Over the last two decades, the focus of international trade research has shifted from trade policy to other types of trade frictions (eg, transportation, information and communication costs). The widespread belief that trade policy no longer matters is implicit in this development. This viewpoint is challenged by a critical examination of a large body of evidence on the effects of trade policy on economically significant outcomes. We concentrate on actual policy changes rather than hypothetical ones.

Trade policy challenges

We begin by discussing the methodological challenges involved in measuring trade policy and identifying its causal effects. The evidence on the effects of trade policy on a variety of outcomes is then discussed, including:

- aggregate outcomes such as trade volumes (and their price and quantity subcomponents), the extensive margin of trade, and static, aggregate gains from trade;
- firm and industry performance, such as productivity, costs, and markups;
- labour markets, such as wages, employment, and wage inequality; and
- long-run aggregate growth and poverty, secondary distortions, and misallocated resources.

We conclude that the perception that trade policy is no longer important stems in large part from the inability to precisely measure the various types of nontariff barriers that have largely replaced tariffs as the primary tools of trade policy. Better measurement is thus an essential prerequisite for future policy-relevant research. Despite measurement difficulties and a paucity of evidence on the impact of actual policy changes, existing evidence, when properly interpreted, points to large effects of trade policy on economically relevant outcomes, particularly when trade policy interacts with other developments, such as technological change. We identify areas and opportunities for additional research and draw lessons from the past for future studies.

CONCLUSION

The concept of strategic trade policy is the focus of this chapter. Strategic trade policy analysis is part of a larger research agenda that has been very active since the early 1980s. During this time, international trade economists have attempted to incorporate oligopoly and other forms of imperfect competition into formal analyses of international trade and trade policy in order to address important empirical regularities and policy concerns. Strategic trade policy is defined in the chapter as trade policy that conditions (or modifies) a strategic relationship between firms. According to this definition, the existence of a strategic relationship between firms is a necessary precondition for the implementation of strategic trade policy. The chapter discusses the basic game theoretic structure of strategic trade policy. It also

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emphasises the "third-market" model, in which rival oligopolistic exporters from two countries only compete in a third market. In this context, the chapter develops the basic strategic export subsidies model, as well as some of the more important qualifications and extensions. It presents the reciprocal markets model, in which oligopolistic firms compete in two countries.

International trade appears to be a subject where economists' advice is routinely ignored. Economists are nearly unanimous in their opposition to protectionism in general, but the recent increase in U.S. protection in sectors such as automobiles, steel, textiles and apparel, machine tools, footwear, and semiconductors demonstrates that economists lack political influence over trade policy. To examine the political economics of trade policy and the processes that lead to protectionism, two broad approaches have been developed. One approach emphasises the economic self-interest of political participants, while the other emphasises the importance of voters' and public officials' broad social concerns.