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Political support for trade policy in the European Union

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ABSTRACT

We adopt the Stigler–Peltzman model of policy-making as developed by Hillman for application to the politics of international trade, in which the government is represented by a political support function trading-off the industry rents stemming from protection against the losses accruing to the general population. As a starting point, we examine the economic impact of actual government action as revealed by the structure of protection, backing out the weights implied by the marginal welfare effects of the set of EU import tariffs across sectors. We build on Tyers' application of methods to international trade employing a numerical general equilibrium model of the EU. This captures direct marginal effects of sector-level protection on protected industries, indirect effects on upstream and downstream industries, and the effect on overall welfare. We then deconstruct the revealed weighting pattern along the lines of industry nationality and related industry characteristics.

1. Introduction

The EU is a major participant in world trade and one of the pillars of the international trading order centered on the World Trade Organization. However, while every bit as significant as those of the United States, the politics underlying European trade policy are considerably less studied. It is not hard to understand why this is the case. On the one hand, the politics are substantially more complex than those in the US. In particular, like the US, EU trade policy is constrained by both domestic and international politics. Yet unlike the US, there is a layer of sovereign political power lying between domestic political pressures and the final authority on trade policy. This makes lobbying itself fundamentally more complex. At the same time, and on the other hand, the politics of trade policy-making are also less transparent in the EU than in the US. Explicit lobbying behavior in the Union, for instance, is particularly difficult to track. Not only is there no open process of legislative hearings, but unlike in the US, campaign contributions in most EU countries are heavily restricted, if not forbidden, so that lobbying comes in much less observable forms. This is crucial because in standard endogenous protection models, the amount of lobbying directly translates into weights attached by government to industry interests. As government choice hinges essentially on the issue of trade-off between competing societal and private interests, these weights determine where the policy chips will fall.

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The complexity and lack of transparency in EU trade policy formation surely explains the considerably greater scarcity of theoretical and empirical analyses of the political economy of trade policy in the EU by comparison to that in the US.[2] Even faced with such difficulties, given the significance of the EU in the world trading system, a more systematic understanding of the politics underlying EU trade policy seems a worthwhile goal. This is the objective of this paper. While we do not attempt to deal comprehensively with the full complexity of EU trade policy making, we do develop a method to address the unobservability problem. We adopt the Stigler (1971)–Peltzman (1976) model of policy-making, developed by Hillman (1982, 1989) for application to the politics of international trade. In this class of model, the government is represented by a political support function trading-off the industry rents stemming from protection against the losses accruing to the general population.[3] We identify the ordering of preferences by examining the economic impact of actual government action as revealed by the structure of protection. Specifically, we build on work that shows how to back out the weights implied by the marginal welfare effects of a set of import policies.[4] We build in particular on the work of Tyers, who has applied these methods to international trade in partial (Tyers, 1990) and general equilibrium (Tyers, 2004).[5] Employing a numerical general equilibrium model of the EU, we estimate the direct marginal effect of sector-level protection on protected industries, the indirect effect on upstream and downstream industries, and the effect on overall welfare.[6] Once identified, these marginal effects allow us to econometrically estimate the apparent weights of industry in policymaking given the current tariff structure. We then deconstruct these weights along the lines of industry nationality and other related characteristics. Unraveling national preferences is particularly important in the EU context, because while the supply of regional protection obviously corresponds to the sum of individual national demands, the common trade policy in the EU and the complexities surrounding it conceal the interplay of private, national and aggregate regional interests.

We are obviously not the first to essay a study of EU trade policy. There are a number of solid narrative studies of European trade policy (e.g. Hine, 1985; Schuknecht, 1992). More closely related are a number of empirical studies rooted in one or another of the main approaches to the political economy of trade policy. The next section situates our analysis relative to these studies. Unlike these studies, our approach follows earlier work by Bruce Gardner (Gardner, 1983, 1987, 1989) and Rod Tyers (Tyers, 1990, 2004) who develop a method for identifying the political influence of groups implied by the distortions those policies produce. We believe this approach has a number of clear advantages. Perhaps most important, the effects of protection on overall welfare, as well as on specific sectors, are fully captured. Hence, the valuation of the marginal costs and benefits of protection more adequately takes into account the economy-wide repercussions of sectoral policies. The policy weights are also backed by data. Consequently, unlike previous empirical studies, the values we obtain for these weights tie in with theoretical expectations: revealed policy weights given to industry profits, in general, tend to be around 2 to 3 times that assigned to national income or welfare. As expected, above average weights correspond with above-average tariffs for import-competing product groups. In the context of a customs union such as the EU, we also find that nationality matters, so that industries important to certain Member States in terms of relative output shares, consistently acquire higher levels of protection. Finally, the agricultural bias of EU protection emerges as a by-product, in part, of a tendency to assign importance to the strength of intermediate linkages, with upstream industries receiving relatively lower tariffs for a given policy weight.

We have organized the paper as follows. Section 2 provides further background and motivation, anchoring the present exercise to the literature. In Section 3 we examine basic patterns of EU import protection. We start in Section 3.1 with a relatively standard political economy framework for testing the relationships between sectoral tariff variations and selected industry characteristics identified as important by theory. In Section 3.2, we then examine what drives the observed patterns by employing a computational model to produce estimates of the general equilibrium marginal income effects given the actual rates and pattern of protection and production across the EU. From these marginal estimates, we estimate econometrically the implied weights for individual sectors relative to the weight assigned to overall economic welfare. This allows a ranking of industries according to the assigned relative weights. In Section 3.3 we explore how national and EU-wide industry characteristics, especially the nationality of various industries, bears on the determination of the EU-wide industry coefficients. This provides some indication of the individual policy preferences of Member States. Finally, in Section 4 we offer last observations, and then conclude.

[2] In fairness, trade policy-making in the US is more complex and less transparent than we often think, and certainly more complex and less transparent than theoretical models and their empirical implementations often imply. As far back as Bauer, Pool and Dexter's (1963) classic analysis of trade policy-making in the mid- and late-1950s, it has been clear that lobbying, and its relationship to final government decisions, is considerably more complex than a straightforward exchange of cash for policy ("protection for sale"). Even in that context, essentially ad hoc decisions with respect to which sectors are organized and how to measure protection (to say nothing of effects on liberalization embedded in trade bills), renders claims of a tight link between theory and empirics dubious at best. That said, the additional layer of sovereign states between citizens and the trade policy-making authority is a substantial step up in complexity.

[3] The Grossman–Helpman (1994), protection for sale, model, by explicitly incorporating the lobbying decisions of organized groups, is a more complete model and has been the foundation of many theoretical and empirical advances in the political economy of trade policy. However, precisely because we lack information on this lobbying, we pursue an approach that does not require such information.

[4] This general methodology has been best developed in partial equilibrium, with application to agricultural economic policy (e.g. Gardner, 1983, 1987, 1989; Rausser and Freebairn, 1974; Sarris and Freebairn, 1983; Swinnen, 1994, 1996; Swinnen and de Gorter, 1998; Zusman and Amiad, 1977) as well as to indirect taxes in the public economics literature (e.g. Ahmad and Stern, 1984; Christiansen and Jansen, 1978). Theoretical foundations for this approach are found in: Zusman (1976); Ross (1984, 1985); and Beghin (1990). The volume by Rausser, Swinnen and Zusman (2011) is a convenient and up to date presentation of this material.

[5] In general, the partial equilibrium and general equilibrium computational literature has used numerical models to calibrate policy weights for use in numerical modeling. In contrast, here we use a numerical model to estimate raw marginal policy impacts, but then turn to econometrics for analysis of the pattern of revealed weights.

[6] We are not the first to recognize the importance of vertical production structures in the political economy of protection. Gawande and Bandyopadhyay (2000), in one of the first tests of the protection for sale model, developed this analysis and Gawande, Krishna and Olarreaga (2012) develop the analysis yet further. More directly related to our work here is the paper by Cadot, deMelo and Olarreaga (2004), who develop their analysis in a computational general equilibrium model.