



The Effects of Endogenous Protection on the Economic Landscape

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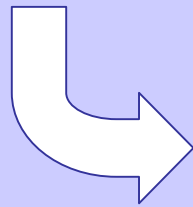
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Idea

Political Concerns

?

Economic Landscape



Trade Policy



The author studies the impact of political economy variables on the spatial distribution of industry building a model that relates two backgrounds.

Grossman and Helpman
(1994)

Martin and Rogers
(1995)



Idea

Short run: Political game



Capital factor is immobile



Capital owners engage in
Lobbying activity

Long run



Capital factor can move



Spatial distribution of economic
activity



The Framework: Assumptions

- ◆ Two regions: the small economy and the ROW (*)
- ◆ Two productive factors: Labour and Capital
- ◆ Two sectors:
 - The agricultural:
 - CRS
 - Perfect competition
 - Labour
 - Freely traded
 - The industrial:
 - IRS
 - Monopolistic competition
 - Labour and Capital
 - Costly traded

The Framework: Assumptions

- ◆ Preferences: Quasilinear utility function

$$U = c_A + \mu L n \left(\underbrace{nc^{\frac{\sigma-1}{\sigma}}}_{\substack{\text{Local} \\ \text{variety}}} + \underbrace{n^* \bar{c}^{*\frac{\sigma-1}{\sigma}}}_{\substack{\text{Foreign variety}}} \right)^{\frac{\sigma}{\sigma-1}}$$

numeraire
Local variety
Foreign variety

- ◆ The Iceberg trade cost:

➤ Domestic trade cost: $\tau = 1 + t$

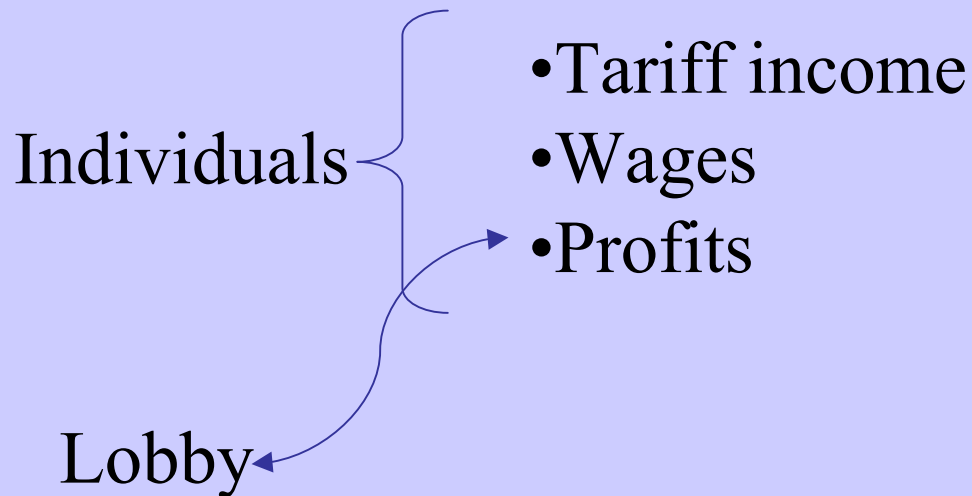
Endogenously determined



Tariff income

$$\bar{p} = \tau \frac{\sigma}{\sigma - 1} a_m^*$$

The Framework: Incentives



It chooses the optimal level of contribution maximising $V_g = W_g - C_g$

where the gross welfare is:

$$W_g = l_g + \sum_{i=1}^n \pi_i [p, P(\tau)] + \alpha_g [R(\tau) + S(P(\tau))]$$

Fraction of the voting population that owns capital and belongs to the lobby

The Framework: Incentives

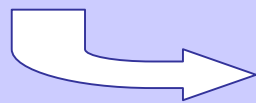
The Government:

$$G = C_g + aW(p, P(\tau))$$

The weight that the incumbent attaches to the society's welfare

The short run equilibrium

$$\frac{dC_g^\circ(\tau^\circ)}{d\tau} = \frac{dW_g^\circ(p^\circ, P^\circ(\tau^\circ))}{d\tau}$$



Locally truthful contribution schedule



They induce the Government to maximise: $aW + W_g$

Short run equilibrium: Predictions

- ◆ A Government that has a remarkable concern about the general welfare will avoid creating an excess burden.

- ◆ As α_g increases, also ϕ increases



The deadweight loss faced by the lobby increases

- ◆ At a lower mark up, the lobby is more worried about persuading the government to set a tariff.

- ◆ The government follows the Ramsey rule.

- ◆ The initial spatial distribution of firms may also affect the level of protection: ambiguity

The Long run equilibrium

Now → Capital can flow

The Long run equilibrium occurs when movements of capital stop.

The equilibrium division of industry:

$$s_n = -\frac{\phi}{(1-\phi)} + \frac{(1-\phi\phi^*)s_\mu}{(1-\phi)(1-\phi^*)}$$

The spatial distribution of expenditure:
small economy assumption

The Home Market effect {
The market access advantage
The market crowding disadvantage

$HME = f(\phi(a, \alpha_g, \sigma, \bar{s}_n))$

The Long run equilibrium: Predictions

Asymmetric trade costs

High level of protection creates a positive profit gap

Capital moves from the region with high level of freeness to one with high level of protection

$$\frac{\partial s_n}{\partial \phi} < 0 \quad \text{and} \quad \frac{\partial s_n}{\partial \phi^*} > 0$$

- ◆ A Government scarcely weights the general welfare.
- ◆ Owners of capital are few in number.
- ◆ The mark up of the firm is low.



Concluding remarks

The model

Determinants of trade policy and the spatial distribution of economic activity

New insights

- ◆ A low mark up leads the lobby to persuade the government to set a tariff.
- ◆ The initial distribution of industry may matter.
- ◆ Trade policy as a channel: *capital owners might make capital flow to look for protection*
 - Welfare effects ?
- ◆ Political variables may act as a dispersion force.