Lobbying, voting, and the political economy of trade: A structural estimation framework

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Abstract

A central puzzle in trade is that despite an almost universal consensus on the benefits of free trade, policymakers often favor protectionist policies. Political economy explanations of protectionism posit that policy-makers are politically motivated and grant protection in response to demands by privileged groups in society who hurt from trade. Most empirical contributions in the endogenous tariff tradition has relied on reduced-form estimates of parameters derived formally (or informally) from canonical political economy models of trade to explain the influence of the losers from trade. Yet recent developments in trade theory suggest that free trade is likely to benefit large and highly productive firms, and broader segments of the electorate. A new body of empirical literature incorporating these insights has followed. Yet most of the empirical approaches, old and new, provide partial understanding of trade politics and do not put enough theoretical capital on the line. Building on insights from Grossman and Helpman (1996) and Melitz (2003) we develop a political economy model of trade politics where political candidates choose and enact policies to earn the support of informed and uninformed voters in the shadow of lobbying activity by heterogenous firms, concentrated and diffused interests whose economic wellbeing is affected positively or negatively by free trade. Our modeling strategy allows us to derive analytical predictions of party competition, voting, incentives to lobby and policy choices under different institutional settings. Using data from the U.S. we structurally estimate the model and construct counterfactual scenarios of changing party competition under economic shocks of different magnitudes. Our theoretical lens helps understand the the ebb and flow of trade policy over the many decades, including the political consequences of the China shock.

Keywords: Political economy, trade policy, lobbying, voting, heterogeneous firms

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