Identity Politics and Trade Policy

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What's Going On?

- Why the sudden shift to economic nationalism in US, Europe: anti-trade, anti-immigration, anti-EU?
- We propose to link these trends to shifts in social identification
  - Changing landscape of identity politics
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- We propose to link these trends to shifts in social identification
  - Changing landscape of identity politics
  - In particular, rise of populism
- Goal of this paper: Introduce "identity politics" into a familiar political-economy model of tariff formation
  - Study endogenous shifts in self categorization triggered by changes in economic conditions (esp. rising income inequality due to trade or technology) or by political opportunism that accentuates racial and ethnic differences

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  - Groups (e.g., social class, family, religion, ethnicity, football club) are source of pride and self-esteem
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  - Self image enhanced by the status of the groups to which people imagine themselves belonging
  - But also source of cognitive dissonance that arises from differences
  - Self categorization: Individuals choose the set of groups with which they identify (endogenous!)
    - No permission needed
    - No coercion

Our Approach

- In Economics: Akerlof and Kranton (*QJE*, 2000)
- Closest to our approach is Shayo (*APSR*, 2009)
  - Defines a social identity equilibrium: individual behaviors consistent with social identity, social identities consistent with social environment, social environment determined by individual behaviors

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- We imagine electoral competition à la Lindbeck and Weibull (1987), Dixit and Londregan (1996), Grossman and Helpman (1996) that yields pliable policies that maximize utilitarian welfare.
  - Here, "welfare" includes both material and psychosocial components!
- Individuals differ by socioeconomic class and (later) by ethnicity. They choose whether to identify with their socioeconomic group, their ethnic group, and/or "the broad nation"
- Changes in the environment induce continuous policy changes as long as the identification pattern remains the same ... but discrete policy responses when identification patterns change

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- Quasi-linear materialistic utility: $v_i = c_{Xi} + v\left(c_{Zi}\right)$
- Two psychosocial components of utility:
  - Pride from group membership, associated with "status" of group: average material well-being
  - Dissonance costs of group membership, associated with personal distance from average group member

The Politics

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- If the distribution of ideological preferences is common to different groups, the instrumental policies converge to those that maximize aggregate utilitarian welfare
  - Now "welfare" includes material and psychosocial components
  - Add up across individuals; find policy that maximizes this sum
  - Look for social identity equilibrium à la Shayo
  - [Note: Can readily handle different distributions of ideological preferences $\Rightarrow$ policy maximizes weighted sum of utilities.]

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  - Similarly, all skilled (and only skilled) individuals identify as elite
- Who identifies as National?
  - Here we mean a broad group that includes all other nationals; not a narrow group that includes only certain "real" nationals
  - Endogenous: compare status benefit with dissonance cost

The Maximand: Socioeconomic Classes

- World price and domestic price of X equal one; world price of Z equals q; domestic price is $p = q\,(1 + t)$
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- Psychosocial utility components for j, $j \in \left\{h, \ell\right\}$ from identification with own social class and (possibly) broad nation:

$$A_j^{\varepsilon} + \alpha \nu_j\left(p, q\right) + \mathbb{I}_j^b \left\{ A_j^b + \alpha^b \bar{\nu}^b\left(p, q\right) - \beta_j^b \left[\nu_j\left(p, q\right) - \bar{\nu}^b\left(p, q\right) \right]^2 \right\}$$

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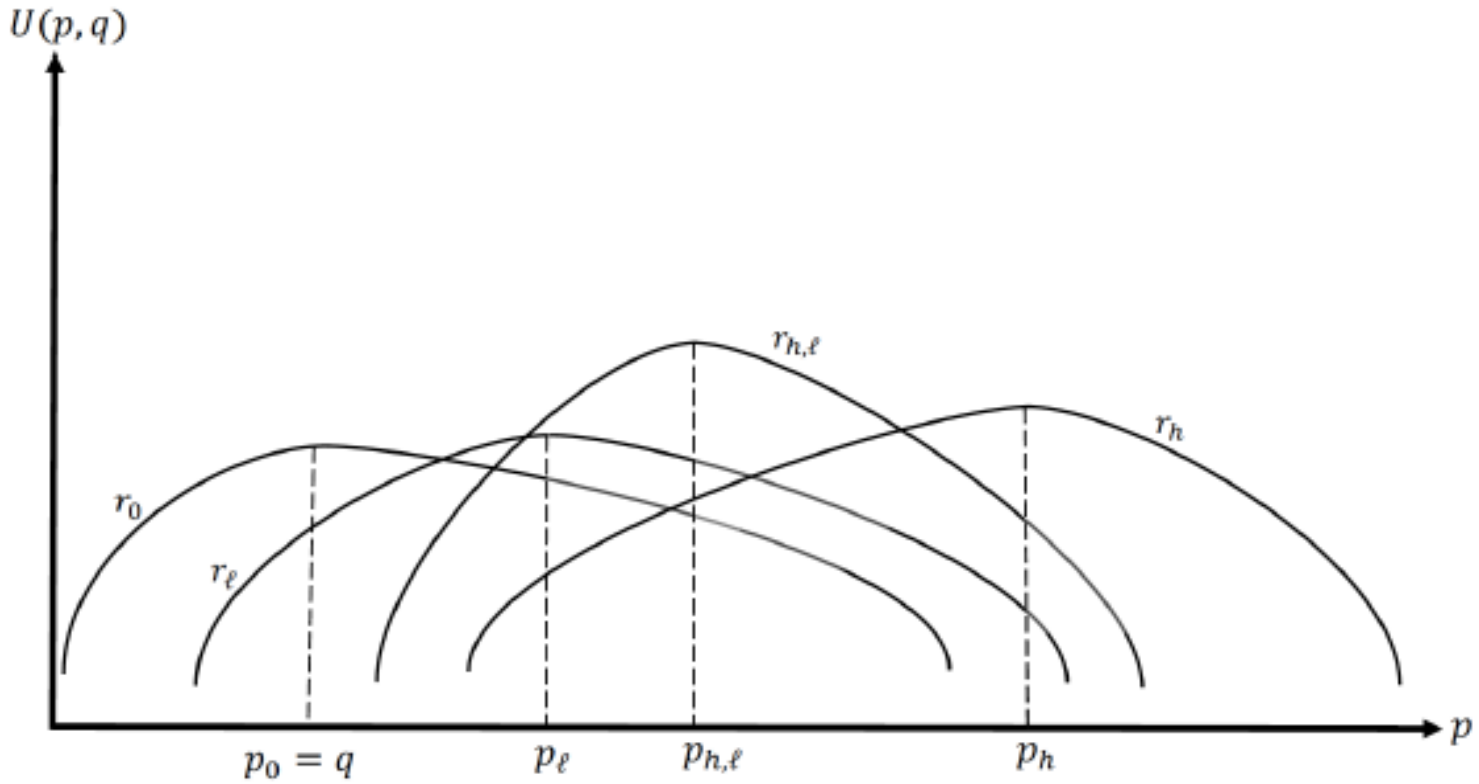
- Utilitarian welfare $U\left(p, q\right)$ equals:

$$\begin{aligned}
&\lambda_h A_h^{\varepsilon} + \lambda_\ell A_\ell^{\omega} + \left(1 + \alpha\right)\left[Y\left(p\right) + T\left(p, q\right) + \Gamma\left(p\right)\right] \\
&+ \lambda_h \mathbb{I}_h^b \left\{A_h^b + \alpha^b\left[Y\left(p\right) + T\left(p, q\right) + \Gamma\left(p\right)\right] - \beta_h^b \left(1 - \lambda_h\right)^2 \left[\delta\left(p\right)\right]^2\right\} \\
&+ \lambda_\ell \mathbb{I}_\ell^b \left\{A_\ell^b + \alpha^b\left[Y\left(p\right) + T\left(p, q\right) + \Gamma\left(p\right)\right] - \beta_\ell^b \left(1 - \lambda_\ell\right)^2 \left[\delta\left(p\right)\right]^2\right\}
\end{aligned}$$

Equilibrium Policy

- Competition for votes leads parties to tariff that maximizes $U(p, q)$ subject to self-caterogization constraints
- Draw $U(p, q)$ for each possible identification regime: r_0, r_h, r_ℓ, $r_{h,\ell}$
- Outcome is global max of $U(p, q)$, because ...self-categorization constraints always satisfied at this point



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- When individual identifies with broad nation, wage inequality is costly
  - Altruism, but for selfish reasons
  - Protection reduces dissonance costs
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Proposition

Suppose that $\beta_h^b > 0$ *and* $\beta_\ell^b > 0$. *If neither skill group identifies with the nation, the equilibrium tariff is zero. Otherwise, it is positive.*

Comparative Statics: Heightened Sensitivity to Social Differences

Proposition

Suppose that skill group i identifies with the nation in some initial political equilibrium ($\mathbb{I}_i^b = 1$) and that a change in β_i^b does not induce a change in the identification regime. Then an increase in β_i^b generates an increase in the equilibrium tariff rate.

Comparative Statics: Technical Progress

- Model factor-augmenting technological progress: π_h, π_ℓ
  - Neutral or skill-biased technological progress widens wage gap: increases marginal desirability of tariff to alleviate dissonance
  - Technological progress often will increase marginal efficiency cost of tariff, which affects aggregate material welfare and aggregate status from identification

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- Despite apparent ambiguity, Hicks-neutral technological progress induces higher tariff rate.
- Skill-biased technological progress?
  - Tariff rises if $w_h'' \leq 0$; e.g., Leontief technologies in both sectors
  - Tariff rises if both $w_h'' > 0$ and $w_h'' > 0$; e.g., Cobb-Douglas technologies in both sectors
  - These are sufficient conditions, not necessary

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    - Change in marginal benefit of tariff depends on $\delta''(p)$, i.e., how elasticity of wage gap wrt tariff changes with p
- If import demand becomes less elastic as price falls and if responsiveness of wage gap to price rises as price falls $\Rightarrow$ tariff will increase

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- What is Populism?, Jan-Werner Müller defines populism as anti-pluralist, elite-critical politics with a moral claim to representation ("...populists do not just criticize elites; they also claim that they and only they represent the true people ...")
  - Populism is a particular form of identity politics
  - Populism classifies the elites as "them" and the everyman as "us"
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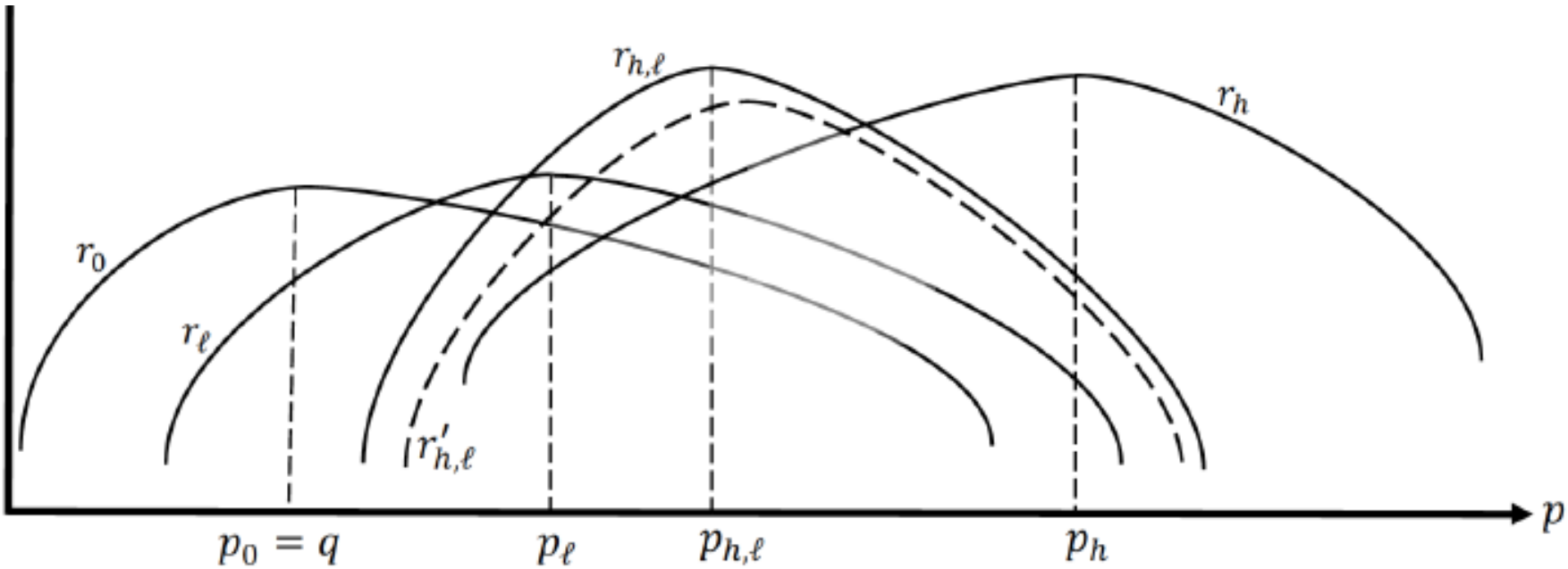
  - Populism classifies the elites as "them" and the everyman as "us"
  - Populism seeks to justify policy in the name of the people (i.e., "us")
- Consider a shift in the economic or poltitical environment that induces the working class to identify more narrowly than before:
  - No longer consider the elites to be "real nationals"
  - Could be caused by increase in inequality, due to SBTC or globalization

Populist Revolution: Effects on Trade Policy

- Intially, everyone identifies broadly with the nation: $r^\circ = r_{h,\ell}$
- Then working class ceases to identify broadly, instead identifies only narrowly with others in the same social class: $r^\circ \longrightarrow r_h$
- p rises discretely iff $p_h > p_{h,\ell}$



Condition for Rise in Protection

- $p_h > p_{h,\ell}$ if and only if

$$\beta_h^b \alpha^b (1-\lambda_h)^2 > \beta_\ell^b \left(1+\alpha+\alpha^b \lambda_h\right) \lambda_h$$

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  - Satisfied for $\lambda_h = 0$, violated for $\lambda_h = 1$
  - More likely when β_h^b is high relative to β_ℓ^b and λ_h is small
  - If $\beta_h^b = \beta_\ell^b = \beta^b$ and $\alpha = \alpha^b = 0.1$, the tariff rate jumps upward when the elite are less than 7.7% of the population

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- Envy of out-groups
  - Social psychology literature suggests that individuals may envy those in out-groups with higher status
  - If ceasing to identify with broad nation causes working class to envy the elites, then range of λ_h for which tariff jumps upward is larger.

Ethnic/Racial Identification

- Societies have many cleavages: wide menu of identity choices.
- One of these sociocultural distinctions has become increasingly salient in recent elections in the United States and Europe, namely that perceived along ethnic and racial lines
    - Perhaps due to political opportunism?

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- We extend the model to allow for an ethnic majority M and an ethnic minority m, as well as three skill levels: h, ℓ, k
  - Third skill group affords greater flexibility in aligning ethnicities and socioeconomic standing with interests in trade policy
  - Introduce a third sector (services) intensive in use of low-skilled workerse

Model with Three Factors and Three Goods

- Three goods: X, Z, S
  - X, Z produced by h, ℓ as before, X is h-intensive
  - S is a nontraded service produced by k-type workers
  - Material well-being is $c_X + v\left(c_Z, c_S\right)$ or $w_i\left(p\right) + T\left(p, q, p_S\right) + \Gamma\left(p, p_S\right)$

Identification Patterns

- Individuals with ethnicity j and skill level i may identify with others of their same ethnicity ($\mathbb{I}_i^{j,j} = 1$) or not ($\mathbb{I}_i^{j,j} = 0$), they may identify with others in their same social class ($\mathbb{I}_{i,i}^{j} = 1$) or not ($\mathbb{I}_{i,i}^{j} = 0$), and they may identify broadly with the nation ($\mathbb{I}_i^{j,b} = 1$) or not ($\mathbb{I}_i^{j,b} = 0$)
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- Dissonance costs now have two components: (i) as before, distance in space of material well-being given by $\beta\left(\nu_i - \bar{\nu}^g\right)^2$; (ii) distance in "ethnic space" for individuals with ethnicity j who identify with some group g is $\beta^e\left(E^j - \bar{E}^g\right)^2$
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  - Assign "ethnic values": $E^M = 1$ and $E^m = 0$ for purposes of measuring ethnic distance from average in a group (WLOG)
- Status benefit from identifying with ethnic group j is $\alpha^e\left(\sum_i \lambda_i^j \nu_i\right)/\lambda^j$; benefit from identifying with social class i is $\alpha\nu_i$; benefit from identifying with the nation is $\alpha^b \sum_i \lambda_i \nu_i$

Comparative Statics: Ethnic/Racial Salience

Imagine that salience of ethnic distance, β^e rises, perhaps due to opportunistic behaviors by politicians (although this not modeled)

- This affects cost of identification with social class and with nation
- But no interaction with trade policy
- Marginal costs and benefits of protection unchanged for every group

Proposition

Suppose that a change in β^e does not induce a change in identification regime. Then the equilibrium tariff rate is not affected.

Comparative Statics: Ethnic/Racial Salience

- An increase in β^e may lead to a narrower identification pattern
- Changes in identification will affect preferences over tariffs

Proposition

Suppose that β^e rises and that the import good Z and nontraded services S are gross complements in demand. If the least-skilled workers (k) of any ethnicity cease to identify with the nation or with their social class, the rate of protection jumps upwards. If the middle-skilled workers (ℓ) of any ethnicity cease to identify with the nation and if their wage is at least as great as the economy-wide average, then the rate of protection jumps upward.

Concluding Remarks

- Voter preferences and behavior:
  - People do not always vote their narrow economic interests
  - Voters have concern for others, *but not all others*.
  - Social identity theory consistent with these observations.
- Model incorporating social identity necessarily requires many specific choices:
  - We are not wedded to the details specified here, e.g. determinants of benefits and costs of identification
  - We do believe that changes in identification (from whatever cause) generate changes in policy preferences, which in turn affect policy outcomes via the political process.
  - Could apply to additional issues: immigration policy? growth-friendly policies?
  - Larger question: What determines salient divisions in society (potential identity groups) and characteristics of prototypical member?