

POLI 243: International Politics of Economic Relations
Second Midterm Examination Notes

Chapter 12: Canada's National Policy

- Background:
 - Trade liberalization and growth of liberalism in mid 1800s
 - Industrialization boosts production capacity and floods market with commodities – pushing prices down and triggering protectionism
- Election of 1878:
 - Failure of Liberals to re-open free trade with the US
 - Tories win platform by advocating protectionism for Canadian business – the National Policy
 - John A. Macdonald, previous supporter of free trade, now pushes for protectionism – demonstration of Individual level characteristic
- Characteristics of the National Policy:
 - Three main elements:
 - Protective tariffs
 - Protect the industrialists and major industry in Ontario
 - Infrastructure development
 - Strengthen the farmers out West with creation of Canadian Pacific Railway (CPR)
 - Immigration and settlement of Western provinces
 - Grow domestic population to increase demand as well as production capabilities
 - Elements working in conjunction
 - Tariffs protect east while immigration develops gross domestic demand while infrastructure strengthens cross-transportation
- Implementation weakness of the National Policy:
 - Tariffs protect industrial goods but do not make the market competitive and therefore are market inefficient
 - Settlement policies fail as immigrants stay in industrialized cities like YYZ and YUL. Net emigration of population highlights failure.
 - Construction of CPR creates monopoly on transportation – High prices and lower supply
- System Level Analysis: Limited Choices
 - Because Canada is tied to the US, American policies constrain available Canadian options
 - With rejection of trade by US Senate, Canada faced two options:
 - Remain open while the States closed trade
 - Retaliate by closing trade as well – tariff war
 - Breakdown of international free trade happened in the same manner as its development – ad hoc and without clear structural implementation

- A few countries like Britain chose to remain open due to nature of its economy
 - Developed as the trading powerhouse between former colonies and the rest of the world. Closing trade meant closing its biggest strength
- Systemic environment re: tariffs. Not used to leverage deal from States, rather a move to incubate domestic environment from shrinking markets.
- Systemic environment re: CPR. Built as a way to further independence from the States.
- Systemic environment re: immigration. Grow the home market to make up for the lost export market

- Domestic Level Analysis: Sector Cleavages
 - Stolper-Samuelson approach suggests landowners (farmers) to support free trade while industrialists support protectionism
 - However, Sector-Specificity approach highlights protectionist advocacy in urban areas as well as industrialists
 - Rural area segments into two groups:
 - East: Capital-intensive producers (cattle, dairy, poultry)
 - West: Land-intensive producers (wheat and grain)
 - Eastern farmers, along with industrialists, are capital-intensive and thus create majority call for protectionism
 - Domestic environment re: tariffs (SEE ABOVE)
 - Domestic environment re: CPR. Creation of monopoly and associated problems
 - Domestic environment re: immigration. Little support for new immigrants results in net emigration to the States from Canada.

- Bureaucratic Level Analysis: Tariff as Source of Revenue
 - Government stuck between cutting costs or increasing revenues
 - Tariffs created as an alternate source of revenue
 - Ad valorem tariff rates: proportional value tax/tax per unit
 - Proportional relationship between revenue and price of goods
 - Easy alteration of tariff rates and minimum rate
 - Flexibility to adjust the ad valorem tariffs led to continued use of tariff well after downturn of 1870s
 - Bureaucratic environment re: tariffs (SEE ABOVE)
 - Bureaucratic environment re: CPR. Possible Keynesian action to counter the downturn. Spending government investment on a large-scale project increases employment and hopefully spurs spending to bring Canada out of downturn.
 - Bureaucratic environment re: immigration. Increase revenues through tax by growing population

- Individuals and Ideas: Unpopularity of Liberalism

- Initial promise of liberalism to improve economic conditions worldwide failed after boom during the 1860s ended
- Nations fall back on old practice of protectionism with Macdonald merely adapting to a changing environment
- Political skill of Macdonald explains the long duration of the National Policy despite high cost of CPR, net emigration and continued use of tariff
 - Ability to hold together different interests across the country
- Liberal Party Adoption of National Policy
 - Liberal victory in 1896 but did not remove the tariff, thus drawing fire from Tories accusing hypocrisy
 - Slight reduction in tariff rates to maintain support from western voters but maintenance of tariff to maintain support from industrialists
 - Liberals re: tariffs. (SEE ABOVE)
 - Liberals re: CPR. Creation of Crows Nest Pass agreement in 1897 to lower prices for prairie provinces.
 - Liberals re: immigration. Dramatic increase of average annual expenditure on immigration resulted in change from -1.5% immigration in 187-1881 to 15.1% in 1901-1911
 - Re-oriented advertising to attract farmers coupled with rise in commodity prices and attraction of profits

Chapter 15: Canada's Reciprocity Election of 1911

- Background:
 - Western farmers demand free trade following growth of sector
 - Quebec division by economic and imperial issues
 - British arms race with Germany pulling former colonies into the race – Quebec opposition vs. Ontario support
 - Laurier and the Liberals hold secret negotiations with the US and create the Reciprocity Treaty in 1910
 - Lower tariffs on agriculture
 - Give Americans access to Canadian market in return for Canadian agriculture accessing the American market
 - Announcement in Parliament of Treaty stuns Tories and Liberals gain ~130 seats held by the farmers
 - Swift retaliation and opposition by Ontario industrialists spreads to other industrialists across the nation
 - Do not want to compete with the US in “middleman industry”
 - Industry that processes raw material into end-user goods
 - Laurier departs to London
 - Accused of selling out by the Tories in his absence
 - Francophones accusing him of selling out to British
 - Creation of coalition by Tories and Francophones

- System Level Analysis: Opportunity to Liberalize Trade
 - Three main factors
 - Mixed trends in tariffs
 - US willingness to negotiate trade
 - Changing relationship with Britain
 - Tariff trends:
 - Escalating spiral of tariff rates and complexities since 1870s
 - As a result, reciprocity was developing on a system level
 - We trade X and Y. You lower tariff only on X and I lower tariff only on Y.
 - US willingness to trade:
 - Stabilizing economic conditions opened a window of opportunity to establish a vital link with the US – one of the two largest economies internationally
 - Volatile changes in tariff rates within the US. Republicans favour high rates, Democrats favour lower rates
 - Early 1910, US proposes trade negotiations which sparks the Reciprocity Treaty
 - Changing relationship with Britain
 - Lord Chamberlain tariff reforms would give Canada preferential access to the British economy
 - Defeat of reform opened trade from many other nations, causing Laurier to cut historic ties and move towards the US
- Domestic Level Analysis: Shifting Support for Protectionism
 - Stolper-Samuelson Theorem highlights factor-based cleavages but fails to explain Laurier's loss
 - Strong factors of production – the farmers – prefer free trade
 - Weak factors – the industrialists – will seek protection
 - Despite Laurier's support of the farmers, he still lost the election
 - Sector-Specific approach shows urban opposition
 - Sectors tied to abundant, factor-intensive productions will seek free trade
 - Sectors that have scarce factor-intensive productions will seek protection
 - Look at ratio of input : output
 - Industrialists: scarce factors since no need for land = protectionism
 - Dairy/cattle producers: scarce factors of capital-intensive production = protectionism
 - Grain/wheat: abundant factors of land = free trade
- Bureaucratic/Individual/Idea Level of Analysis
 - No government opposition to free trade since tariff revenues were very high and not entirely seen as vital

- Minister of the Interior – Sir Clifford Sifton – under Laurier highlights reluctance to compete with the US in middleman industry, opposes deal
- Matter of nationalism and patriotism, used by Tories, undermines the deal
- Explaining the failure of the Reciprocity Treaty
 - System Level: US & British policies matter to Canada
 - Domestic Level: Understanding the sector cleavages
 - Individual Level: Laurier's strategy in dealing with the various interest groups and his timing (or lack thereof)

Chapter 22: South Korea Opts for Export-Oriented Industrialization

- Background:
 - Post WWII, trade was initially weak despite existing framework
 - Kennedy Round negotiations of GATT (General Agreement on Tariffs and Trade) opened up trade, lowered tariffs and expanded the systemic environment
 - Less developed economies decide to take advantage of growing globalization and leverage trade to grow the economy
 - South Korean focus on trade development and exports
 - 1945: raw materials/commodities
 - 1980: High capital/industrial goods
 - East Asian success vs. Latin America highlights the importance of trade policy
- Import-Substitution Industrialization (ISI):
 - Limit/block import of industrial goods so domestic demand will stimulate domestic production
 - Provides short burst of industrialization but long-term weakness
 - Most common in economically developing nations
 - Initially following strongly by South Korea between 1950 and 1963
 - Criticisms of ISI:
 - Market failure to ensure socially optimal P & Q_T
 - Higher price = forced transfer of income from consumers to industrial sector
 - Price distortion affects other sectors through domino effect.
 - Price of steel increase causes price of automobiles to increase, decreasing its competitiveness.
 - No guarantee of profits being re-invested in industry
 - Possible leakage of profits
 - Industry dependence on government protection, weakening international competitiveness
 - Blocked imports may create shortage that cannot be met by domestic production
 - Shortage in production may have domino effect and create production bottleneck

- Social losses associated with rent-seeking
 - Firms expending unnecessary resources trying to participate in ISI program
 - Weak FOREX market due to protectionism
 - Borrowing of USD to fund development but defaulting on loan to due excessive appreciation of the dollar
- Export-Oriented Industrialization (EOI):
 - Industrializing by exporting
 - Tailor production and plants to serve the export market, not the domestic
 - Gearing goods and services to be export-grade
 - Exploits economies of scale
 - Requirement of suppliers to be competitive
 - Pressure to re-invest profits
 - Criticisms of EOI:
 - Economic future dependent on an independent economy
 - Time crucial: need relative weakness of domestic economy compared to global economy
 - Game Theory trade weakness and requirement to target the right sectors
 - If all states go EOI, then individual success rate is lowered
 - Price drops due to flooding of exports on international market, hurting profits
 - However:
 - Could be viewed in microeconomic case of perfect competition
 - All states providing a commodity like steel – homogenous product
 - Many competitors moves price to socially optimal level dictated by global demand – states are price takers
 - States with less effective factors of production in steel will be pushed out of market
 - They will seek to leverage key factors of production and benefit from gains of trade through EOI of a strong factor
 - Assumption of open markets and free trade – no retaliation by other states
 - Requires heavy initial CAPEX vs. ISI
 - But creates long-run efficiency and PPC yield
- Importance of strategic trade policy
 - Government support of key factors of production (land, labour, capital, enterprise)
 - Entrance during low competition period
 - Strategic application of EOI, not blanket liberalization

- Transition from ISI to EOI:
 - Implementation of new economic policies through five main steps:
 - Exchange rate policy
 - Currency devaluation
 - Domestic investment policy
 - Trade liberalization
 - Export incentives
 - Exchange rate policy:
 - Elimination of different exchange rate to match international rates
 - Currency devaluation:
 - Set value at more “realistic” rate – compare official rate to black market rate
 - Devaluing currency boosts export attractiveness
 - Domestic infrastructural investment
 - Investments in education and infrastructure
 - Interest rate discrimination
 - High interest rates to consumers to encourage savings
 - Low interest rates to exporters to stimulate growth
 - Trade liberalization
 - Specific tariff reductions to import capital and production inputs
 - Export incentives
 - Export subsidization
 - Fund to support small firms entering international market
 - Export associations
 - Discount energy prices for exporters
 - Modified tax policies

- System Level and Regional Analysis of EOI Transition:
 - Growth of international export opportunities
 - Regional strength of East Asian economies
 - Mutual support within East Asia
 - Japanese specialization in high-end goods allows South Korea to export basic models
 - Conflicting analysis by N. American analysts:
 - South Korean development to get out of Japanese shadow
 - Close, post-war relationship between US and S. Korea ensured steady flow of FDI to support industrialization
 - System Level analysis does not portray which way the policy would move whereas Domestic Level highlight the decision to switch to EOI

- Domestic Level Analysis: Strong State/Weak Society?
 - Growing strength of the state allowed greater intervention in the economy
 - Creation of the Economic Planning Board (EPB), KOTRA (trade promotion agency) and Korean Development Institute
 - EPB controlled tariffs, trade policy and the government budget without going through legislature

- Eliminated risk and uncertainty in the market
 - Government control over the banking sector to direct capital flows
 - Legacy of the Korean War: no agricultural elite due to dispersion of large landowners – removed opposition to EOI
- Bureaucratic Level Analysis: Power of the Ministry of Technology and EPB
 - Creation of hierarchy within the government and streamlining of bureaucracy
 - Creation of the Ministry of Trade and Industry to monitor exports and foreign markets
 - Central bank answered to Ministry of Finance
 - MoF answered to MoTI
 - Therefore, MoTI controlled central bank
 - Creation of EPB from old Ministry of Reconstruction
 - Control of budgeting and economic planning

Chapter 22: Canada and the Free Trade Agreement with the U.S.

- Background: Historical Parameters of the US-Canada Relationship
 - Several explorations of free trade following failure of Reciprocity Treaty
 - Bilateral agreements in 1935/1938
 - Auto Pact in 1965
 - Production integration with Canada in return guaranteeing production of a certain percentage within Canada
 - Canada initiates talks in the 1980s: chapter will focus on analysis *why*
 - Possible impact of economic downturn making trade attractive
 - Worry about losing access to American market
 - Canadian firms seeking to achieve higher economies of scale
- Fears of New Protectionism
 - Recent failure of GATT as states like S. Korea take the commanding heights of the international market through EOI
 - Somewhat controlled by GATT through allowance of tariff retaliation
 - Growth of non-tariff barriers (NTBs)
 - Five main types of NTB
 - Specific limitations on trade
 - Quotas
 - Licenses
 - Embargoes
 - Customs and Administrative Policies
 - Documentation
 - Fees
 - Valuations
 - Standards
 - Quality standard disparities

- Government participation
 - Subsidies
 - Countervailing duties
 - Domestic assistance
 - Charges on imports
 - VAT
 - Border tax
 - Admin fees
- Canadian fear of GATT stalling at Uruguay Round
 - Led to direct talks to the US
- Canadian Attitude Toward the U.S.
 - Perspective largely dominated by those held by Mitchell Sharp
 - View as vulnerable to the States “sleeping elephant”
 - Need to pursue multilateral trade strategies
 - 1980s, capital flows into the US threatened protectionism and sparked investments to move away from Canada and into the US
 - Despite attempt to create independence, there exists strong interdependence as biggest trading partners
- Canada Initiates Talks
 - Seeking to secure access to previously blocked exporters
 - Precedents for multi-level talks on various sectors
 - Initial discussion in recreating an “Auto Pact” in other sectors despite asymmetry in the deal
 - Continued