

Identity Politics and Trade Policy

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What's Going On?

- Why the sudden shift to economic nationalism: anti-trade, anti-immigration, anti-EU?
- We propose to link this to shifts in **social identity**
 - Changing landscape of **identity politics**
 - In particular, rise in **populism**
- Goal of this paper: Introduce “**identity politics**” into political-economy model of tariff formation
 - Focus on the **level** of protection
 - Study endogenous shifts in **self categorization** triggered by changes in economic conditions (e.g., rising income inequality due to trade or technology) or by political opportunism that accentuates racial and ethnic differences

Social Identity

- **Social Identity** is the element of an individual's self-concept that derives from **perceived** membership in relevant social groups
- In social identity theory (e.g., **Tajfel and Turner**, 1979)
 - Person's sense of who he/she is based on his/her group membership(s)
 - Groups (e.g., social class, family, religion, ethnicity, football club) are source of pride and self-esteem
 - Self image enhanced by the **status** of the groups to which people **imagine** themselves belonging; but also source of cognitive dissonance that arise from differences
 - **Self categorization**: Individuals **choose** the set of groups with which they identify (**endogenous!**)
 - No permission needed
 - No coercion
- In Economics: Akerlof and Kranton: (*QJE*, 2000; *Identity Economics*, 2010)

Our Approach

- Closest to our approach is Shayo (*APSR*, 2009)
 - Defines a **social identity equilibrium** in which individual behaviors are consistent with social identity, social identities consistent with the social environment, and the social environment is determined by individual behaviors
- Imagine electoral competition à la Lindbeck and Weibull (1987), Dixit and Londregan (1996) or Grossman and Helpman (1996) that leads to pliable policies that **maximize utilitarian welfare**
 - Here, **welfare** includes **both material well-being and psychosocial components**
 - For robustness we also examine median voter outcomes
- Individuals differ by socioeconomic class and by ethnicity, and they **choose** whether to identify with their socioeconomic group, their ethnic group, or the nation
- Changes in the environment induce continuous policy changes as long as the identification pattern does not change, but **discrete** policy responses when the identification pattern changes

The Environment

- Begin with a simple structure: two skill levels and no ethnic divisions
 - Later extend to three skill levels (polarization?) and an ethnic division along majority-minority lines
- Small country, Heckscher-Ohlin production structure
 - Two goods: Z and X (import-competing and exportable)
 - Two factors: h and ℓ (skilled and unskilled)
 - Normalize the population to equal 1, with fractions λ_h, λ_ℓ
 - Assume that Z is intensive in unskilled workers
- Quasi-linear materialistic utility: $v_i = c_{X_i} + v(c_{Z_i})$
- Two psychosocial components of utility:
 - **Pride and self-esteem** 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

- Political competition
 - Two political parties, distinguished by (exogenous) ideological platforms
 - Parties have fixed ideological positions
 - Parties propose trade policies **instrumentally**: to maximize votes
 - Voters are heterogeneous in ideological views, vote for preferred party based on ideology and trade platform
- If the distributions of ideological preferences are common in different groups, the instrumental policies converge to those that maximize aggregate welfare (otherwise, weighted sum of welfare levels)
 - 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

Social Identity Regimes

- Three **potential** identity groups: *Working Class*, *Elite*, *Americans*
- Who identifies as **Working Class**?
 - Less-skilled are homogeneous, so no cost to doing so; **all unskilled identify as working class** (not necessarily so with ethnic divisions)
 - Dissonance costs for skilled are too high for them to identify as working class; **no skilled identify as working class**
- Who identifies as **Elite**?
 - Skilled are homogeneous, so no cost to doing so; **all skilled identify as elite**
 - Dissonance costs for unskilled are too high for them to identify as elite
- Who identifies as **Nationals**?
 - Here it means to identify with **broad group of nationals**, not only certain “real” nationals
 - Compare status benefit with dissonance cost ($\mathbb{I}_h^b = 1$ or 0 ; $\mathbb{I}_\ell^b = 1$ or 0)

The Maximand: Socioeconomic Classes

- World price and domestic price of X equal one; world price of Z equals q and the domestic price is $p = q(1 + t)$
- Material well-being: $w_i(p) + T(p, q) + \Gamma(p)$
 - $w_h(p)$ a declining function, $w_\ell(p)$ an increasing function
- Utility of h from identification:

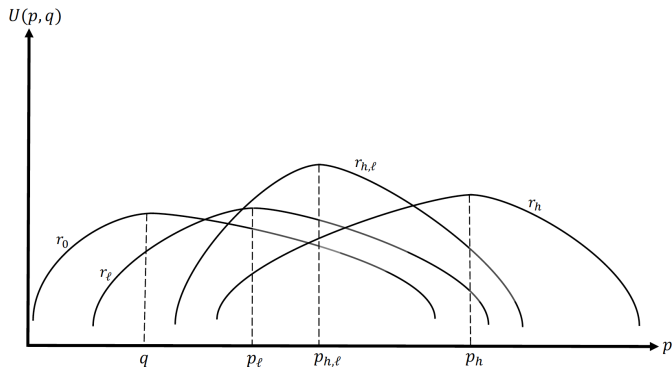
$$A_h^\varepsilon + \alpha v_h(p, q) + \mathbb{I}_h^b \left\{ A_h^b + \alpha^b \bar{v}^b(p, q) - \beta_h^b [v_h(p, q) - \bar{v}^b(p, q)]^2 \right\}$$

- Similar for ℓ
- Aggregate utility $U(p, q)$ equals:

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

Equilibrium Policy

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



Characterizing Equilibrium Trade Policy

- In the absence of social identification, policy maximizes aggregate **material** well-being, which calls for **free trade** (our benchmark)
- If no one identifies broadly with the nation ... aggregate welfare includes status benefits from identifying (only) with own social class
 - Concerns for own social class **offset**
 - Free trade!
- When individual identifies with broad nation, wage inequality is costly
 - Altruism, but for selfish reasons
 - Protection reduces dissonance costs
 - As usual, material welfare cost of small tariff is second order
 - In aggregate, protection addresses social aversion to inequality

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.

- The FOC is $U_p(p, q) = 0$, where:

$$U_p(p, q) = \left(1 + \alpha + \alpha^b \sum_{i=h,\ell} \lambda_i \mathbb{I}_i^b \right) (p - q) \Omega'(p) - 2 \sum_{i=h,\ell} \beta_i^b \mathbb{I}_i^b \lambda_i (1 - \lambda_i)^2 \delta(p) \delta'(p)$$

- Within an identification regime this implies:

$$\text{sign} \frac{dp^\circ}{d\zeta} = \text{sign} \frac{dU_p(p^\circ, q)}{\zeta}$$

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 an increase 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.

- 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 status from identification
- Despite apparent ambiguity, **Hicks-neutral technological progress induces higher tariff rate**
- Skill-biased technological progress?
 - Tariff rises if technologies are Leontief in both sectors
 - Tariff rises if technologies are Cobb-Douglas in both sectors
 - We also provide more general sufficient conditions

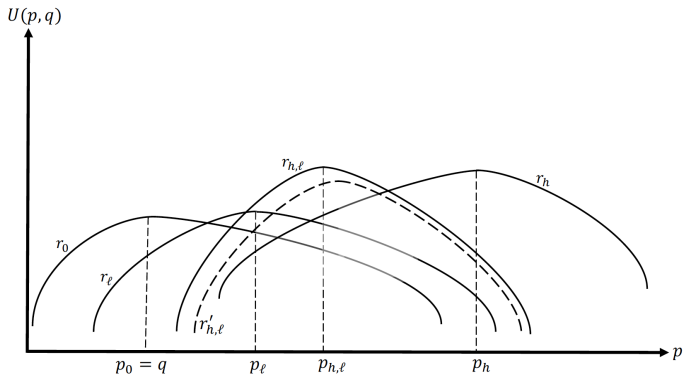
- When TOT improve ($q \downarrow$)
 - Domestic price $p \downarrow$; i.e., at least some pass-through
 - But potentially offsetting forces on tariff rate
 - Change in marginal efficiency cost of tariff depends on how elasticity of import demand changes with p
 - Change in marginal benefit of tariff depends on how the response of wage gap to 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 rate will increase
 - We provide necessary and sufficient conditions

Populist Revolution

- Turn now to change in identification regime. Focus on a “populist revolution.”
- **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”
 - Populism seeks to justify policy in the name of **the people** (i.e., “us”)
- Consider a shift in the economic or political 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

- Initially, 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: $r^\circ \rightarrow r_h$
- p rises discretely iff $p_h > p_{h,\ell}$



Condition for Rise in Protection

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

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

- There exists λ_h^* such that the inequality is satisfied for $\lambda_h < \lambda_h^*$ and violated for $\lambda_h > \lambda_h^*$
- More likely when β_h^b is high relative to β_ℓ^b
- 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
- **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 more cleavages: wider menu of identity choices
- One of these sociocultural distinctions has become increasingly salient in recent elections in the United States and Europe: that perceived along ethnic and racial lines
 - Perhaps due to political opportunism?
- 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
- There are now three goods: X, Z, S , with S being a nontraded service produced by k -type workers
- Material well-being is $c_X + v(c_Z, c_S)$ or $w_i(p) + T(p, q, p_S) + \Gamma(p, p_S)$
- The price p determines wages and the price of services, $p_S(p)$, with $w_k(p) = p_S(p)$
- $p_S(p)$ is a declining function if and only if Z and S are complements in consumption

Identification Patterns

- Individuals with ethnicity j and skill level i may identify with others of the same ethnicity ($\mathbb{I}_i^{j,j} = 1$) or not ($\mathbb{I}_i^{j,j} = 0$), they may identify with others in their own social class ($\mathbb{I}_{i,i}^j = 1$) or not ($\mathbb{I}_{i,i}^j = 0$), and they may identify with the nation ($\mathbb{I}_i^{j,b} = 1$) or not ($\mathbb{I}_i^{j,b} = 0$)
- The benefit from identifying with ethnic group j is $\alpha^e \left(\sum_i \lambda_i^j v_i \right) / \lambda^j$, the benefit from identifying with social class i is αv_i , the benefit from identifying with the nation is $\alpha^b \sum_i \lambda_i v_i$
- Dissonance costs now have two components: the first component is proportional to the squared distance in the space of material well-being, as before, given by $\beta (v_i - \bar{v}^g)^2$; the second component of psychological cost for individuals with ethnicity j who identify with some group g is $\beta^e (E^j - \bar{E}^g)^2$ (distance in “ethnic space”; distance in conceptual space)
- Without loss of generality, we assign individuals in the majority an ethnic value of one ($E^M = 1$) and individuals in the minority an ethnic value of zero ($E^m = 0$)

Imagine that politicians increase salience of ethnic distance, β^e rises, perhaps due to opportunistic behaviors by politicians

- This affects cost of identification with social class and with broad nation
- But no interaction with trade policy
- Marginal costs and benefits of protection unchanged, and therefore

Proposition

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

- An increase in β^e may lead to 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.

- These are sufficient conditions, not necessary

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: immigrations policy? growth-friendly policies?
 - Large question: What determines salient divisions in society (potential identity groups) and characteristics of prototypical member?
 - Large question: What mechanisms can politicians use to shift costs or benefits of various identification patterns?