

NBER WORKING PAPER SERIES

A THEORY OF TRADE POLICY TRANSITIONS

Renee Bowen
J. Lawrence Broz
B. Peter Rosendorff

Working Paper 31662
<http://www.nber.org/papers/w31662>

NATIONAL BUREAU OF ECONOMIC RESEARCH
1050 Massachusetts Avenue
Cambridge, MA 02138
September 2023

The authors would like to thank Giampaolo Bonomi, Xiameng Hua and Yue Wang and for excellent research assistance, and workshop participants at UCSD and Princeton. For excellent comments, we thank Jeffrey Kucik, Malte Lammert, Joel Sobel, and seminar participants at Princeton University, UC San Diego, and the 2022 Political Economy of International Organizations (PEIO) conference at Oxford University. This research benefited from support from the Center for Commerce and Diplomacy at UC San Diego's School of Global Policy and Strategy. The views expressed herein are those of the authors and do not necessarily reflect the views of the National Bureau of Economic Research.

NBER working papers are circulated for discussion and comment purposes. They have not been peer-reviewed or been subject to the review by the NBER Board of Directors that accompanies official NBER publications.

© 2023 by Renee Bowen, J. Lawrence Broz, and B. Peter Rosendorff. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

A Theory of Trade Policy Transitions
Renee Bowen, J. Lawrence Broz, and B. Peter Rosendorff
NBER Working Paper No. 31662
September 2023
JEL No. B27,F13,P0,P11

ABSTRACT

Trade policy is set by domestic political bargaining between globalists and protectionists, representing owners of factors specific to export and import-competing sectors respectively. Consistent with the post-Civil War Era of Restriction, protectionists implement high tariffs when status quo tariffs are low. When status quo tariffs are high, reciprocal free trade combined with domestic transfers to protectionists are implemented, explaining the 1930s Era of Reciprocity with Re- distribution. Consensus emerges for Retreat from free trade when imports are high and domestic transfers are low, suggesting that US protectionist turn in the late 2010s was in part due to low levels of social transfers.

Renee Bowen
Department of Economics and
School of Global Policy and Strategy
University of California, San Diego
9500 Gilman Dr. #0519
La Jolla, CA 92093-0519
and NBER
trbowen@ucsd.edu

B. Peter Rosendorff
Wilf Family Department of Politics
New York University
19 West 4th Street, Second Floor
New York, NY 10012
peter.rosendorff@nyu.edu

J. Lawrence Broz
Department of Political Science
University of California, San Diego
9500 Gilman Dr. #0521
La Jolla, CA 92093-0521
jlbroz@ucsd.edu

1 Introduction

In 2018, the United States (US) unilaterally imposed tariffs between 10% and 50% on imports from several countries and across a variety of goods. This marked a significant departure from the previous 75 years of trade policy making, which had relied on a rules-based, multilateral system of reciprocity to obtain persistently low tariffs. The retreat from global cooperation beginning in the late 2010s was furthered by the withdrawal of the US from the Trans-Pacific Partnership (TPP), renegotiation of the existing North American Free Trade Agreement (NAFTA/USMCA) and failure to renew judges to the World Trade Organization’s Appellate Body. The negative economic effects were immediate. Handley and Kamal (2020) showed lower US export growth as a result of the new US tariffs, Kong and Weinstein (2020) estimated that investment growth would decline by 1.9 percentage points by 2020, and Fajgelbaum et al. (2019) estimated real income loss to the US of \$7.2 billion (to name a few studies). The direct economic effects of the tariffs could be expected, but the political economy forces leading up to them are not well understood in the extant literature.

We develop a theoretical framework that helps explain the current retreat from reciprocal trade liberalization, as well as other major transitions in US trade policy. We introduce a role for parties, bargaining within legislatures, and agenda-setting in simultaneously determining tariff and domestic transfer policies in equilibrium. Shifts in trade and transfer policies emerge when there are changes in either economic conditions (such as trade flows) or political conditions (such as elections). We emphasize that bargaining across parties takes place in the shadow of the status quo trade and transfer policies, and policy changes (even if efficient) may not occur in the political equilibrium.

The model is motivated by the transitions between three distinct eras of US trade policy—1860-1931, 1932-2015, and 2016 to the present. Irwin (2017) refers to the first two eras as *Restriction* and *Reciprocity* respectively. Throughout this paper we refer to the second era as *Reciprocity with Redistribution* to highlight the rise of the welfare state and the implied domestic transfers. The transition between each era is marked by major political shifts, and significant changes in transfers. Figure 1 plots the evolution of average tariffs on dutiable imports in the United States from 1859 to 2021 in green.¹ The persistently high average tariffs (sometimes over 50%) in the *Restriction*

¹US average tariff data are from the Department of Commerce, Bureau of the Census, Historical Statistics of the the United States 1798-1970, and the US International Trade Commission <https://www.usitc.gov>

era is clear. The dramatic decline in tariffs in the *Reciprocity with Redistribution* era combined with the introduction and steady increase in domestic social transfers is also evident. The increase in average tariffs on dutiable imports as a result of US trade policy since 2016 marks a possible shift into a new regime, which we call the *Era of Retreat*. This era of retreat is precipitated by slower growth in domestic transfers and eventual decline when the era begins. We seek a political economy theory consistent with these stylized facts.

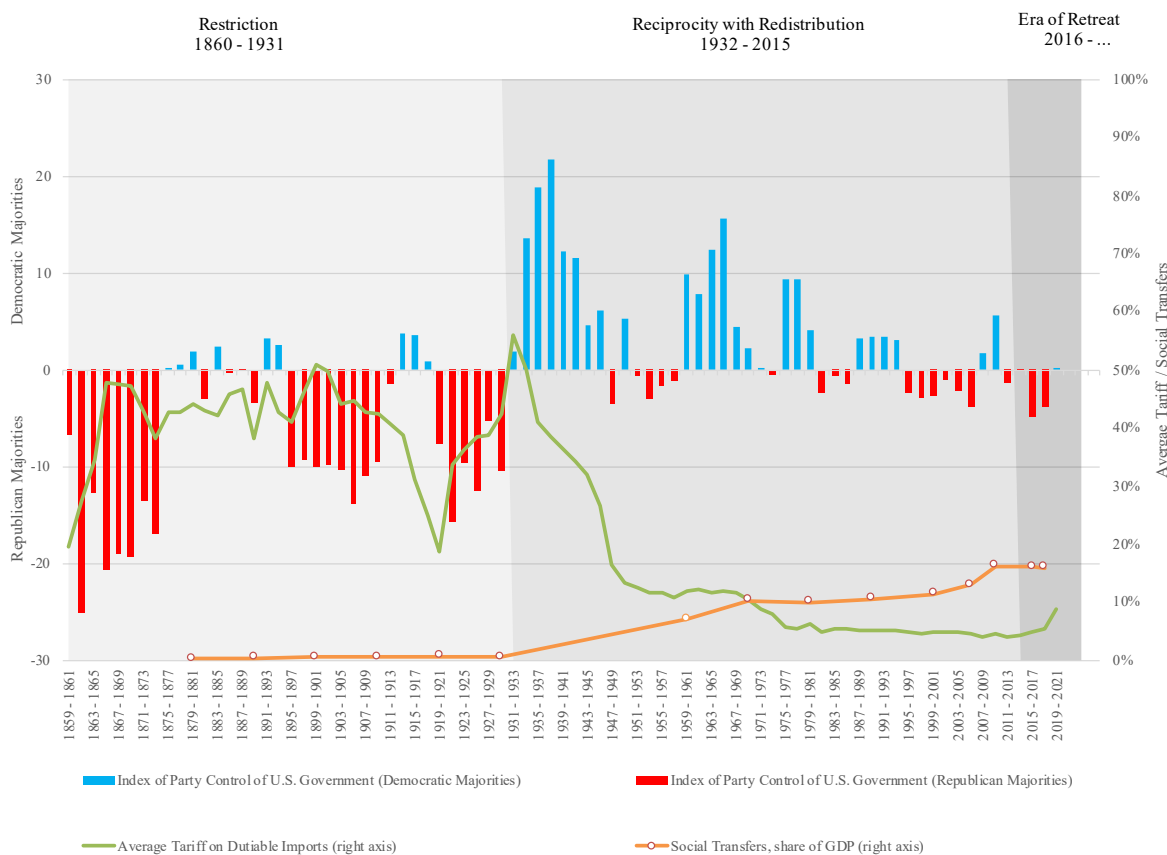


Figure 1: US Party Majorities, Average Tariffs, and Social Transfers, 1859-2021

[//www.usitc.gov/documents/dataweb/ave_table_1891_2016.pdf](http://www.usitc.gov/documents/dataweb/ave_table_1891_2016.pdf) The Index of Party Control is based on Lee (2016). It is the average of the Democratic Party’s share of the total national popular vote for president (Congressional Quarterly Press 2021, Table 3-1), and House and Senate seats (Brookings Institution 2021, Table 1-20). We subtract 50 from the average to differentiate Republican Party majorities (red bars below the zero line) from Democratic Party majorities (blue bars above the zero line). Capital stock data for China and the US are from the Penn World Table version 10.0 using the variable “rma,” capital stock at constant 2017 national prices based on investment in structures and equipment. The data on social transfers is from Peter H. Lindert, *Growing Public: Social Spending and Economic Growth Since the Eighteenth Century, Volume x: The Story*. New York: Cambridge University Press 2004. Chapter 2, table 1.2. P12-P13. OECD Social Expenditure Database (SOCX) 1980-2018.

Figure 1 also plots an index of political party control of the US government for the period 1859-2019. The blue bars represent Democratic majorities and red bars, Republican. The transitions between trade policy eras are marked by significant changes in US politics. We refer to *Party Position*, *Political Process* and *Power Shifts* to characterize the political features of the three eras in US trade policy. As well-documented in Irwin (2017), the history of US trade policy has featured two major political parties taking opposite stands on trade, one party representing the *globalists* and the other, the *protectionists*. Thus, our theory features these two parties setting policy. “Process” refers to the institutional features that govern trade-policy setting. Congress is charged with setting US trade policy; consequently tariffs are the outcome of negotiations between the globalist and protectionist parties.² This bargaining is done in the shadow of an existing status quo, and given the checks and balances in the US political system, movements from the status quo are rare. “Power shifts” refer to the pivotal moments in history where agenda-setting power changed hands. As can be seen in Figure 1, from 1861 to 1932, the Republican Party dominated American politics. This rise to power was precipitated by the Civil War, but after World War II the Democratic Party emerged as the leader.

Motivated by the facts presented in Figure 1, trade policy transitions are explained by the interaction of global economic conditions, politics, and the status quo trade policy. We study a stylized economic model of two countries—Home and Foreign. Foreign trade policy is taken as exogenous to focus on the domestic trade-policy setting process at Home. Details of the model are further explained below.

Economy In each country, there are two sectors each producing a good using a sector-specific factor. Each factor is owned by a single individual, hence there are two factor owners in each economy. We make assumptions on endowments such that one sector is the exporter and one is import-competing for Home, with the reverse for Foreign. For tractability we adopt a partial equilibrium economic structure as in Grossman and Helpman (1994, 1995) and quadratic preferences of factor owners as in Maggi and Rodríguez-Clare (2007). We assume that tariff revenue is rebated lump-sum to each factor owner, so each benefit to some extent from improvements in terms-of-trade. The sum of utilities of factor owners are, thus, equivalent to the preferences of a benevolent social planner fully internalizing their welfare. Each factor owner’s

²See Bowen and Broz (2020) for a summary of the importance of Congressional leadership in setting US trade policy.

preferred economic policy is distorted away from a benevolent social planner's, but is on the Pareto Frontier.

Party positions Each factor owner is represented by a political party—the *globalists* represent the owner of the factor specific to exports, and the *protectionists* represent the owner of the factor specific to the import-competing sector. The simple economic model allows us to derive single-peaked preferences over a single-dimensional unilateral tariff. We first show that with a unilateral trade policy, the globalist party has a lower (positive) ideal tariff than the protectionist party. Moreover, the globalists prefer reciprocal free trade to unilateral trade policy while the protectionists have opposite preferences.

Political Process An agenda-setter is assumed to arrive by an exogenous election that determines the dominant party. Following the agenda-setting model of Romer and Rosenthal (1978), the agenda-setting party proposes a trade policy, and the responding party votes yes or no. The status quo prevails if there is no agreement. There are two trade policy regimes that parties can propose and vote for—unilateral trade policy (an endogenous tariff on imports), or reciprocal free trade (where tariffs at Home and Foreign go to zero). Since Foreign is not considered a strategic player, it is assumed that reciprocal free trade would be accepted by the Foreign country.³ Either regime may be the status quo trade policy.

Transfers If globalists are the agenda-setter, and choose to enact reciprocal free trade, based on model primitives, they must make transfers to the protectionists for them to agree. We allow for this possibility, but only in the case of reciprocal free trade. As Grossman and Helpman (1994) point out, most international economists blame “politics” as the reason free trade is preached but not practiced. Conventional economic models suggest that any shift to free trade should be accompanied by sufficient transfers to compensate the losers of liberalization. This compensation is through

³While tariffs going to zero for reciprocal free trade may appear a strong assumption, it has been observed in practice. The more than 75 year old General Agreement on Tariffs and Trade (GATT) (later World Trade Organization (WTO)) adheres to the principle of reciprocity in tariff liberalizations, and allows Preferential Trade Agreements (PTAs) to form only if tariffs go substantially to zero in all countries in the PTA. The authors are unaware of an offer by the US to negotiate a free trade agreement being rejected by a foreign country. To the authors' knowledge, foreign countries routinely seek PTAs with the United States, so the assumption that the FTA is accepted by Foreign is reasonable.

the standard modes of social transfers—unemployment and retraining benefits, health insurance, social security, and trade-related active labor market programs, such as Trade Adjustment Assistance (TAA). Such transfers are the consequence of a complex interplay between political actors, institutions (formal and informal), and economic fundamentals, and are typically un-modeled as a result.⁴ Our model parsimoniously captures *politically* feasible transfers to accompany reciprocal free trade.

Given the structure of the model with two countries, two goods, two factors and two parties, we refer to this as a $2 \times 2 \times 2 \times 2$ model in the spirit of extending the classic Heckscher-Ohlin-Vanek model to include a richer model of politics. Our model is very stylized, and we ignore other important factors affecting trade such as trade in intermediate inputs, differentiated products, skill-biased technological change.⁵ We also focus on inter-party bargaining to the exclusion of international and intra-party bargaining, and on transfers across industries rather than within them.⁶ We made these choices in order to highlight important features of US trade policy-making that have not been included in existing models: two political parties bargaining over tariffs and transfers in the shadow of global economic conditions, with political institutions imparting a strong status quo bias.⁷ We expect the primary insights to hold if these other elements are incorporated. We summarize the main results next.

If the status quo is a unilateral domestic tariff, either party, as agenda setter, will set its ideal trade policy as long as the status quo tariff is very high or very low, and Foreign tariffs are not too high. The ideal tariff of each party is intermediate, because of inefficiencies introduced by tariffs that are too high, and because of positive terms-of-trade effects for low tariffs. Once an intermediate status quo tariff is in place,

⁴Some features of the political process have been captured in previous work (Stigler 1971, Hillman and Ursprung 1988, Magee, Brock, and Young 1989, Grossman and Helpman 1994). We enrich this literature by adding political bargaining with a status quo.

⁵See Kim et al. (2019) for how global value chain embeddedness matters for firm level trade preferences.

⁶We make the somewhat strong assumption that the parties are homogenous and aligned entirely either with exporting or importing competing interests. Of course US political parties are amalgams of (at times) competing economic interests with varying degrees of discipline within the legislature (Milner and Judkins 2004, McGillivray 1997). Dean (2016) explores the case where the economy is not at full employment and capital is not required by market forces to share profits with labor within an industry. Labor market institutions that centralize wage bargaining induce transfers within an industry from capital to labor.

⁷Other aspects of the domestic politics of trade policy are omitted here too: lobbying by firms and interest groups, rural bias of US electoral rules, veto players and divided government and more (Aklin et al. 2015). We focus on the simplest political institution: a bargaining game between parties where one may have agenda setting power, and we explore the predictive consequences of this structure.

i.e., between both parties' ideals, it remains in place. This generates stable unilateral tariffs as observed in the Restriction Era. Reciprocal free trade is selected if and only if the *foreign* tariff is sufficiently high. If there is enough surplus to be gained by reciprocal free trade, the globalists benefit enough to compensate the losses to the protectionists via transfers. This is consistent with the observed multilateralism and system of transfers emergent in the Reciprocity and Redistribution Era.

When the status quo is free trade, both parties prefer to revert to unilateral policy if domestic transfers are relatively low and the foreign export sector endowment expands. Protectionists are not receiving sufficient transfers to incentivize openness, and would prefer a tariff. When the foreign export sector endowment expands, implying higher volume of imports) the constraint on transfers gets slacker; by switching to a tariff the globalists benefit from paying less in transfers and benefit from improved terms-of-trade. Both prefer a return to unilateralism. To keep the exporters at the current level of well-being, and as a rising export power abroad emerges, tariffs are the result of the domestic policy bargain. Notably, the model predicts bi-partisan consensus for a return to protectionism, consistent with what has emerged in US politics since the mid-2010s.

Crucially, the expansion of the foreign trade sector *alone* is not sufficient to explain a reversion to protectionism; insufficient transfers are equally important. The inability to forge a political coalition to maintain free trade leads us to denote the current era as the *Era of Retreat*. The model suggests that unilateralism is not an inevitable result of a large increase in foreign imports. If the status quo transfers were sufficiently flexible to respond to an increase in the foreign capital stock, it may have been possible to avoid the retreat. This conclusion is not surprising given that state-contingent mandatory policies have been shown to ensure efficiency in a dynamic setting (Bowen et al. 2017).

In essence, bargaining in the shadow of a status quo ensures that any agreement must be a Pareto improvement. This Pareto improvement takes into account domestic economic conditions, but also the foreign economic and policy environment. Under some conditions, reciprocal liberalization results—when domestic transfers to facilitate free trade are available. However when foreign tariffs are sufficiently low, there may not be enough surplus to be gained by the agenda-setter from a move to free trade, and hence there is no feasible value of transfers that can induce it.

Literature Review Our work joins a rich theoretical literature studying the political economy of trade policy. The seminal work of Grossman and Helpman (1994, 1995) models policy determined by a unitary government that maximizes a political support function, giving weight to aggregate income, trade tax revenues, total consumer surplus and lobbying contributions, moving beyond pure social welfare optimization.⁸ “Politics” in these models is encapsulated by the lobby: firms offer the policymaker a contribution in return for policy, effectively increasing the influence of import-competing firms’ interests on government support.⁹ There are no legislatures, no parties and there is no voting in these canonical models; the actors, their interests, and the institutional environment in which they interact is ignored, hiding the “politics” from view.

We adopt a richer political environment that accounts for the role of parties, agenda-setting and the status quo using the model of Romer and Rosenthal (1978). By introducing political bargaining with a status quo, we provide a micro-foundation for weights assigned to the trade policy preferences of different sectors in a social welfare function. Bargaining in legislatures is also rarely over a single policy dimension; side-payments and other forms of compensation are often part of the deliberative process. Traditional trade models assume that transfers to the losers from trade occur costlessly and efficiently to ensure that Pareto optimality is maintained. In fact, social transfers are actively debated, negotiated and bargained over, as much as are trade or tariff policy measures. We include transfers as an element of the policy vector over which bargaining takes place, and hence endogenize what is politically feasible.

Status quo effects have a long tradition in the broader political economy literature. Existing work suggests the status quo can generate “gridlock” (Dziuda and Loeper 2016), but can also increase the provision of public goods through increasing the bargaining power of the responding party (Bowen, Chen, and Eraslan 2014). This also happens in our model, where “lower tariffs” can be thought of as a public good. Cole, Lake, and Zissimos (2021) model a contest function with pro- and anti-trade interests where a status quo plays a role in the bargaining over the ratification over a free trade agreement. Like Milner and Rosendorff (1996, 1997) and Cole, Lake, and Zissimos (2021) (who investigate trade agreement ratification), we emphasize the interaction between status quo social transfers, current trade policy and endowments (at home and abroad) in determining trade policy. The status quo, therefore, is constituted by

⁸Johnson (1954), Bagwell and Staiger (1990), Baldwin (1987), Hillman (1982).

⁹The added weight can be viewed as the outcome of bargaining between the firms and the policy-maker (Maggi and Rodriguez-Clare 1998).

both trade and transfer policies.

Empirical researchers have long studied how constituent interests and political parties affect US trade policy (Fetter 1933, Schattschneider 1935, Eichengreen 1986, Irwin 1996, Bailey and Brady 1998, Weller 2009, Milner and Tingley 2015). Scholars have also shown that the trade policymaking *process* affects outcomes (Haggard 1988, O’Halloran 1994, Lohmann and O’Halloran 1994, Bailey, Goldstein, and Weingast 1997, Gilligan 1997, Hiscox 1999, Irwin and Kroszner 1999, Goldstein and Gulotty 2014). Our model incorporates interests, parties, and process, as well as global economic conditions.

The rest of the paper is organized as follows. Section 2 provides a brief historical account of the political economy of tariff setting during the three phases. In Section 3 we analyze our stylized $2 \times 2 \times 2 \times 2$ model of a global economy and the bargaining game between the globalists and protectionist parties. In Section 4 we interpret the three phases in the context of the model and Section 5 concludes.

2 Party Positions, Political Process, and Power Shifts

To contextualize our model, we highlight three historical features of the American political economy landscape that have created remarkable stability in US trade policy, and, hence, few transitions: (1) two major political parties that typically take opposing views on trade policy reflecting industry interests, (2) checks and balances in the political system that impart a status quo bias to policy, and (3) political realignments, shifting power of the trade policy agenda. These are part of the three features of American politics, *Party Positions*, *Political Process*, and *Power Shifts*. We draw heavily from the magisterial history of US trade policy by Irwin (2017) throughout this section.

2.1 Party Positions

According to Irwin (2017, 21), “For most of US history, American politics has been dominated by two political parties, each taking a different stand on trade policy.” For over a century after the formation of the modern party system in the 1830s, Democrats ran on a platform of low tariffs, reflecting the economic interests of the agrarian South, which produced cotton and tobacco for export. Republicans, representing the interests of the industrial North, advocated high tariffs to protect US manufacturing from low-cost imports. These positions—Democrats reliably advocating low tariffs, Republicans consistently advocating high protective tariffs—were persistent.

In the 1960s, social upheaval associated with the civil rights movement caused the South to flip from being a Democratic Party stronghold to being dominated by Republicans (Kuziemko and Washington 2018). Democrats, in turn, shifted to representing a multi-ethnic urban coalition centered in the North. Subsequently, the parties reversed their traditional trade policy positions and, from the early 1990s to 2016, Democrats consistently advocated for protectionism while Republicans reliably supported reciprocal free trade agreements (Karol 2000). As Irwin (2020, 32) notes, “the regions of the country did not change their trade policy views, but the parties changed which regions of the country they represented.” The election of a protectionist Republican president in 2016 marked a shift of the Republican Party back to protectionism. Coupled with continued trade skepticism within the Democratic Party, this initiated a bi-partisan retreat from trade openness.

Notably, the label of the party representing a particular industry may change, but the trade orientation of the party follows the trade orientation of the industry (or factor) that it represents. The Democratic Party may be the “globalist” party and the Republicans the “protectionist” party, or vice versa, depending on the economic geography of party representation. In the model we present, party preferences for trade are driven by these factor-based motivations.

2.2 Political Process

The framers of the US Constitution designed the lawmaking process to make it very difficult to enact significant policy changes or reversals. Lawmaking power is dispersed across three bodies—the House of Representatives, the Senate, and the Executive—each represented by a different constituency and each required to approve any new legislation before it becomes law.¹⁰ By creating three “veto points” in the lawmaking process, the framers built a strong status-quo bias into the political system.¹¹

The US Constitution grants Congress the authority to set tariffs and regulate foreign commerce, so analysis of trade policy must begin with the legislative branch (O’Halloran 1994). At various points in time, Congress has delegated significant aspects of this constitutional authority to the executive branch (Lohmann and O’Halloran 1994). One prominent form of this delegation was the landmark Reciprocal Trade

¹⁰See Persson, Roland, and Tabellini (1997) for a formalization of separation of powers with checks and balances.

¹¹See Tsebelis (2002), Henisz and Mansfield (2006) for a formalization of veto point theory and the measurement of veto points across different political systems.

Agreements Act of 1934 (RTAA), which authorized the president to negotiate agreements to reduce tariffs with other countries (Irwin and Kroszner 1999, Bailey, Goldstein, and Weingast 1997). Since 1934, Congress has delegated broad powers to the president, but it has not abdicated its prerogative over trade policy. In fact, Congress has more vigorously asserted its authority in recent trade legislation by imposing substantial limitations on the president’s authority (Linarelli 1995). Because of the importance of agreement between parties in Congress, trade policy-setting is modeled as political bargaining game between two parties representing the globalist and protectionist interests. Partisan differences make significant policy change rare resulting in a bias towards the status quo.

2.3 Power Shifts

“Power Shifts” are large, durable changes in the balance of electoral power between the two major political parties. Political scientists call them “realignments” (Key 1959). Power shifts are usually associated with cataclysmic national events, like the Civil War (1861-1865) and the Great Depression (1929-1933), which discredited the policies of the previously dominant party and ushered in significant policy changes under the new dominant party (Mayhew 2000). According to (Irwin 2020, 32), “the Civil War redistributed political power away from the South and toward the North and led to a political realignment in favor of the Republican Party and against the Democratic Party. Because Republicans from the North favored protective tariffs, the primary goal of trade policy shifted from revenue to restriction, and the average tariff rose accordingly.” The Great Depression, in turn, acted as the catalyst that moved the Democrats from minority to majority status, where they remained for the next five decades. In this era, Democrats enacting an ambitious set of policies that expanded state intervention in the economy, laid the foundations of the modern welfare state, and embraced international economic cooperation. In short, power shifts—which can be interpreted as changes in agenda-setting power—allow for major changes in trade policies away from the status quo.

3 Specific-Factor Political Economy of Trade

We build a simple political economy of trade model consistent with features discussed in the previous sections. First, representation of industries by parties is induced by the

geographic concentration of factors used predominantly in each industry—agriculture in the South and manufacturing in the North. Consistent with this, we include a role for the level of factor endowments in each industry and in each country. Second, policymaking is driven by domestic bargaining between a dominant exporting industry and a dominant import-competing industry. The focus on dominant industries is consistent with Kim and Osgood (2019) who highlight that a minority of large and highly productive firms account for almost all global engagement. Bargaining occurs in the shadow of a status quo, which results in persistent policies. The third feature is power shifts or party turnover. This results in either party having agenda-setting power.

The two-country, two-good, two-factor model of the global economy we present is reminiscent of the Heckscher-Ohlin-Vaneck $2 \times 2 \times 2$ model (Vaneck 1968). To simplify incorporation of political economy factors, we begin with a partial equilibrium framework closest to Maggi and Rodríguez-Clare (2007). We depart from these authors by introducing bargaining over trade policy between two political parties representing the interests of the two dominant factor owners. In this sense the model we outline can be thought of as a $2 \times 2 \times 2 \times 2$ model.

3.1 Economy

The stylized global economy consists of two countries $I \in \{A, B\}$, where A can be thought of as “Home” and B can be thought of as “Foreign”. Each country produces two goods $x \in \{a, b\}$ and a numeraire good denoted by zero. Good zero is freely traded, and supply in each country is such that the world price is 1. Country A is endowed with γ_a units of good a and $1 - \gamma_a$ units of good b . Similarly, Country B is endowed with γ_b units of good b and $1 - \gamma_b$ units of good a . The endowment γ_x is greater than a half so that good a is Country A ’s export good and good b is Country A ’s import good. There are two agents in each country $i \in \{\alpha, \beta\}$. Agent α owns all endowment of good a in each country and agent β owns all endowment of good b . Agent α thus represents the export sector in Country A , and agent β represents the import-competing sector. Below we solve for county A ’s equilibrium.

Domestic demand. We assume that agents maximize utility taking prices as given, and all goods are consumed by all agents. Denote the consumption of good x by agent

i as q_{xi} . The utility of agent $i \in \{\alpha, \beta\}$ is thus

$$u_i = \sum_{x \in \{a, b\}} u(q_{xi}) + q_{0i} \quad (1)$$

with $u(q_{xi}) = cq_{xi} - (1/2)(q_{xi})^2$ and c is an exogenous constant.

Denote by $\tau_b \geq 0$ the specific tariff on imports of good b . We do not consider export taxes or import subsidies since these are less common in practice. Agent i derives income from his endowment, and an equal share of tax revenue from imports.¹² Agent α thus maximizes (1) subject to the budget constraint

$$\sum_{x \in \{a, b\}} p_x^A q_{x\alpha} + q_{0\alpha} \leq p_a^A \gamma_a + \frac{\tau_b [q_b - (1 - \gamma_a)]}{2}, \quad (2)$$

where p_x^A is the domestic price of good x in Country A , $q_b = \sum_{i \in \{\alpha, \beta\}} q_{bi}$ is Country A 's aggregate demand for its import good b , and $\tau_b [q_b - (1 - \gamma_a)]$ is tariff revenue. An analogous budget constraint holds for agent β .

The relevance of tariff revenue in sector-level trade-policy preferences has been pointed out by Feenstra and Bhagwati (1982), Mayer (1984), Hansen (1990), Irwin (2017) and others. By incorporating tariff revenue in the budget constraint, each agent (and consequently each party) internalizes a portion of the terms-of-trade motive for trade policy. This gives both parties an incentive to desire low positive tariffs, but to varying degrees. This is consistent with the *Revenue* era of trade policy described by Irwin (2017). Moreover, in the *Revenue* era, tariffs were the main source of government revenue and battles over tariff policy were battles over taxes (Hansen 1990). This is a key part of the trade policy negotiation we seek to model. The maximizations for agents α and β give the following aggregate demands in Country A :¹³

$$q_a = 2c - 2p_a^A \quad (3)$$

$$q_b = 2c - 2p_b^A + \tau_b. \quad (4)$$

¹²In Section 3.4 we relax the assumption that tariff revenue is equally divided and results are qualitatively unaffected for divisions that are not too extreme.

¹³Agents internalize tariff revenue when making consumption choices, and hence tariffs increase the demand for good b as reflected in (4). All results hold qualitatively if agents do not internalize tariff revenue in consumption choices, but results will vary quantitatively.

World Prices. Denote the world price of good b as p_b . Since Country A will be a net importer of good b , the domestic price of good b in Country A is $p_b^A = p_b + \tau_b$. World trade balance determines world prices of goods a and b :

$$p_a = c - \frac{\gamma_a + 1 - \gamma_b + \tau_a}{4} \quad (5)$$

$$p_b = c - \frac{\gamma_b + 1 - \gamma_a + \tau_b}{4}. \quad (6)$$

As is standard, there exists a tariff τ^{aut} such that for all $\tau_x \geq \tau^{aut}$ trade in Country I 's import good is zero. We call this the autarky tariff and we can show that $\tau^{aut} = \gamma_a + \gamma_b - 1$. We henceforth assume $\tau_x \leq \tau^{aut}$ for all $I \in \{A, B\}$.

Tariff preferences. World prices give rise to indirect utilities over tariffs $v_i(\tau_b; \tau_a)$ for agents $i \in \{\alpha, \beta\}$. These indirect utilities are the sum of each agent's share of total welfare (producer surplus, consumer surplus and tariff revenue). Indirect utilities are strictly concave, and hence single-peaked. Single-peakedness implies $v_i(\tau_b; \tau_a)$ attains a unique maximum in τ_b . Denote the ideal tariff for sector i by τ_{bi} . We illustrate the indirect utility functions below in Figure 2 with ideal tariffs for the import-competing and export sectors.

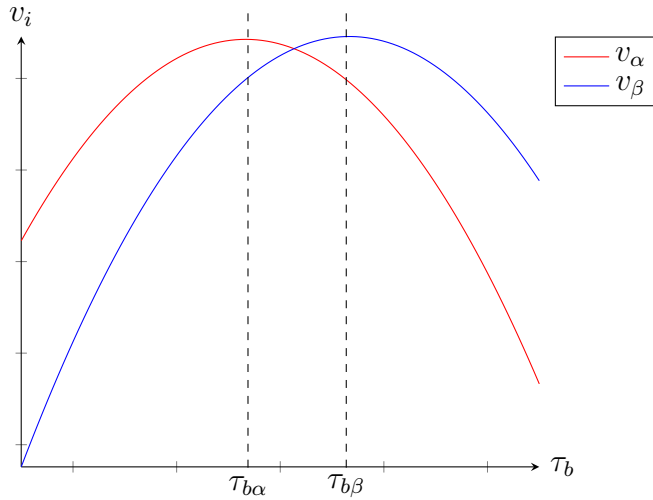


Figure 2: Indirect utilities as a function of τ_b for each industry i in Country A

With a slight abuse of terminology, we will henceforth refer to agents α and β as the export and import-competing sectors, respectively. The following results are immediate.

Proposition 1

$$\begin{aligned}\tau_{b\alpha} &= \min \left\{ \max \left\{ \frac{\gamma_b - 7(1 - \gamma_a)}{3}, 0 \right\}, \tau^{aut} \right\} \\ \tau_{b\beta} &= \min \left\{ \max \left\{ \frac{\gamma_b + 5(1 - \gamma_a)}{3}, 0 \right\}, \tau^{aut} \right\}.\end{aligned}\tag{7}$$

- (i) *The export sector has a lower ideal tariff than the import-competing sector.*
- (ii) *The ideal tariff for the export and import-competing sectors are increasing in the Foreign country's export sector endowment, γ_b .*
- (iii) *The ideal tariff for the export sector is decreasing in Home's import-competing sector endowment, $(1 - \gamma_a)$.*
- (iv) *The ideal tariff for the import-competing sector is increasing in Home's import-competing sector endowment, $(1 - \gamma_a)$.*

These properties are intuitive. The ordering of $\tau_{b\alpha}$ and $\tau_{b\beta}$ follows because the import-competing sector benefits from terms of trade effects (through tariff revenue) as well as the increase in producer surplus (through increase in domestic prices), while the export sector only benefits from terms of trade effects. Both sectors terms of trade benefit increases when export supply increases, hence the ideal tariff increases with γ_b . Part (iii) follows because an increase in the import-competing sector endowment decreases the price of good b and hence lowers the potential terms of trade gain, reducing the incentive for a high tariff. Part (iv) follows because an increase in the import-competing sector endowment increases potential producer surplus gains from the tariff.

3.2 Domestic Trade Policymaking

We consider a representative democracy in Country A (which can be thought of as the United States to match our historical narrative) in which two parties $i \in \{\alpha, \beta\}$ negotiate trade policy according to the interests of each sector in the economy. The party representing the export sector (party α) is called the *globalists* and the party of the import-competing sector (party β) the *protectionists*. Many narratives of trade policy focus on lobbying by the import-competing sector, however Kim and Osgood

(2019) point out that pro-trade firms account for a significant portion of legislative activity related to trade policy, and, thus, are an important part of our theory.¹⁴

Domestic trade policy can take the form of a unilateral tariff $\tau_b \in [0, \tau^{aut}]$ or free trade $\tau^{FT} = (0, 0)$. In the context of the model, “free trade” denotes a coordinated reduction of foreign and domestic tariffs relative to the status quo. Historical accounts suggest that concessions to domestic interests were a necessary part of the compromise that secured free trade (Brown 2003, Hornbeck 2013), thus we assume free trade policy can be accompanied by a domestic transfer to the import-competing sector $T \in \mathbb{R}^+$. Denote $\mathcal{I}_{FT} \in \{0, 1\}$ as the indicator variable that is 0 if trade policy is unilateral, and 1 if it is free trade with transfers. Trade policy is thus summarized by the triple $\tau = (\tau_b, T, \mathcal{I}_{FT})$.

We assume Country B ’s policy is fixed unless free trade is negotiated. This assumption simplifies the analysis, maintains the focus on domestic bargaining, and is consistent with evidence.¹⁵ Given domestic trade policy τ and Country B tariff τ_a party payoffs are

$$\hat{v}_\alpha(\tau; \tau_a) = (1 - \mathcal{I}_{FT})v_\alpha(\tau_b; \tau_a) + \mathcal{I}_{FT}[v_\alpha(0, 0) - T] \quad (8)$$

$$\hat{v}_\beta(\tau; \tau_a) = (1 - \mathcal{I}_{FT})v_\beta(\tau_b; \tau_a) + \mathcal{I}_{FT}[v_\beta(0, 0) + T]. \quad (9)$$

The policy-setting game between parties follows the legislative bargaining literature. Decisions are made via unanimity rule and the agenda can be set by either party. The agenda setter requires the agreement of the responding party for trade policy to be

¹⁴Kim and Osgood (2019) also point out that pro- and anti-trade coalitions often cross industry lines. In the model, for a given set of exogenous parameters, either one or both industries may be in favor of free trade or not. In this sense we add nuance to the traditional pro- and anti-trade cleavage along exporter and import-competing lines. This may help explain firms with pro- and anti-trade stance within a single industry—with heterogeneous returns to trade, preferences for trade will also vary. See also Milner (1988).

¹⁵Bilateral trade bargaining in the United States was authorized by the Reciprocal Trade Agreements Act (RTAA) in 1934 (Bailey, Goldstein, and Weingast 1997). Until that point, trade policy in the United States was set largely independent of foreign trade policy (Irwin 2017, Brown 2003). Up to then it was motivated by revenue maximization or protecting domestic interests against adverse economic conditions. Brown (2003) states that “The US Congress did not, for the most part, see tariffs as an issue that was negotiable between nations; the determination of their level was a matter of domestic policy.” One could explicitly model the negotiation between Country A and B to achieve a trade agreement. If this includes a transfer from one country to another (as in Grossman and Helpman 1995), the equilibrium tariff will maximize the joint utility of both countries and hence be zero as we assume. Even without inter-country transfers bargaining between countries implies that both parties in Country A can only improve their outcomes relative to the status quo, and so similar forces to what we find will be at work.

implemented. Otherwise, trade policy reverts to the status quo $\tau^0 = (\tau_b^0, \mathcal{I}_{FT}^0, T^0)$.

Strategies Denote a strategy for party i as $\sigma_i = (\pi_i, \rho_i)$ where π_i is the proposal strategy and ρ_i is the response strategy. A proposal strategy for party i maps the status quo trade policy τ^0 into a complete trade policy proposal $\pi_i = (\tau_b^i, T^i, \mathcal{I}_{FT}^i)$. A response strategy for party i maps the status quo and proposal into a choice to accept or reject the proposal. Rejection is indicated by $\rho_i = 0$ and acceptance by $\rho_i = 1$. Denote a strategy profile as $\sigma = (\sigma_\alpha, \sigma_\beta)$. Given a strategy profile σ , status quo τ^0 and proposer i the implied trade policy is

$$\tau_b(\sigma; \tau^0, i) = \begin{cases} \pi_i & \text{if } \rho_{-i} = 1 \\ \tau^0 & \text{otherwise .} \end{cases}$$

The timing of the game is illustrated in Figure 3.

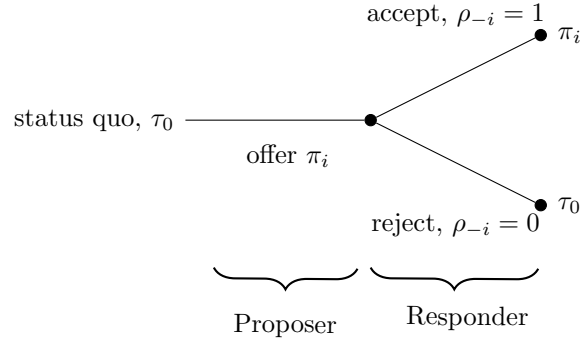


Figure 3: The trade policy-making game

We seek a subgame perfect Nash equilibrium of the trade policy setting game between the globalist and protectionist parties and solve by backward induction. Acceptance strategies are straightforward. Party i accepts party $-i$'s proposal if and only if it makes party i at least as well off as under the status quo. Denoting equilibrium strategies with an asterisk, this implies for $i \in \{\alpha, \beta\}$,

$$\rho_i^* = \begin{cases} 1 & \text{if } \hat{v}_i(\pi_{-i}; \tau_a) \geq \hat{v}_i(\tau^0; \tau_a) \\ 0 & \text{otherwise.} \end{cases}$$

3.3 Proposal Strategies

We restrict attention to proposal strategies in which the responder accepts the proposal. This is without loss since the proposer is able to propose the status quo which is equivalent to a proposal being rejected. The proposer's equilibrium proposal strategy must solve

$$\begin{aligned} \pi_i^* &= \arg \max_{\hat{\tau}} \quad \hat{v}_i(\hat{\tau}; \tau_a) \\ \text{s.t.} \quad & \hat{v}_{-i}(\hat{\tau}; \tau_a) \geq \hat{v}_{-i}(\tau^0; \tau_a). \end{aligned}$$

The constraint ensures the responding party will accept the proposal. To further analyze proposal strategies we first consider when the status quo is a unilateral policy and then when the status quo is free trade with transfers.

3.3.1 Unilateral status quo policy

Suppose the status quo is a unilateral tariff τ^0 , and a unilateral tariff τ_b is proposed by party i . In this case $\mathcal{I}_{FT}^0 = 0$ and $\mathcal{I}_{FT}^i = 0$, which implies $\hat{v}_i(\tau^0; \tau_a) = v_i(\tau_b^0, \tau_a)$ and $\hat{v}_i(\tau; \tau_a) = v_i(\tau_b; \tau_a)$. Since $v_i(\tau_b; \tau_a)$ is single-peaked in τ_b , the solution takes a standard form (for example Bowen et al. 2017).

Proposition 2 *Suppose the status quo is a unilateral policy, i.e., $\mathcal{I}_{FT}^0 = 0$, and a unilateral policy is proposed, i.e., $\mathcal{I}_{FT}^i = 0$. Each party will propose their ideal tariff if the status quo is sufficiently low or high, will propose the status quo if it is between the ideal points of each party, and will propose τ'_{Ai} otherwise. Specifically,*

$$\tau_b^{\alpha*} = \begin{cases} \tau_{b\alpha} & \text{if } \tau_b^0 \in [0, \tau_{b\alpha}] \\ \tau_b^0 & \text{if } \tau_b^0 \in (\tau_{b\alpha}, \tau_{b\beta}] \\ \tau'_{A\alpha} & \text{if } \tau_b^0 \in (\tau_{b\beta}, 2\tau_{b\beta} - \tau_{b\alpha}] \\ \tau_{b\alpha} & \text{if } \tau_b^0 \in (2\tau_{b\beta} - \tau_{b\alpha}, \tau^{aut}] \end{cases}, \quad \tau_b^{\beta*} = \begin{cases} \tau_{b\beta} & \text{if } \tau_b^0 \in [0, 2\tau_{b\alpha} - \tau_{b\beta}] \\ \tau'_{A\beta} & \text{if } \tau_b^0 \in (2\tau_{b\alpha} - \tau_{b\beta}, \tau_{b\alpha}] \\ \tau_b^0 & \text{if } \tau_b^0 \in (\tau_{b\alpha}, \tau_{b\beta}] \\ \tau_{b\beta} & \text{if } \tau_b^0 \in (\tau_{b\beta}, \tau^{aut}], \end{cases}$$

where

$$\tau'_{bi} = 2\tau_{b-i} - \tau_b^0.$$

The proof for Proposition 2 and all omitted proofs are in the Appendix. The proposal strategies for unilateral policy are illustrated in Figure 4 and discussed below.

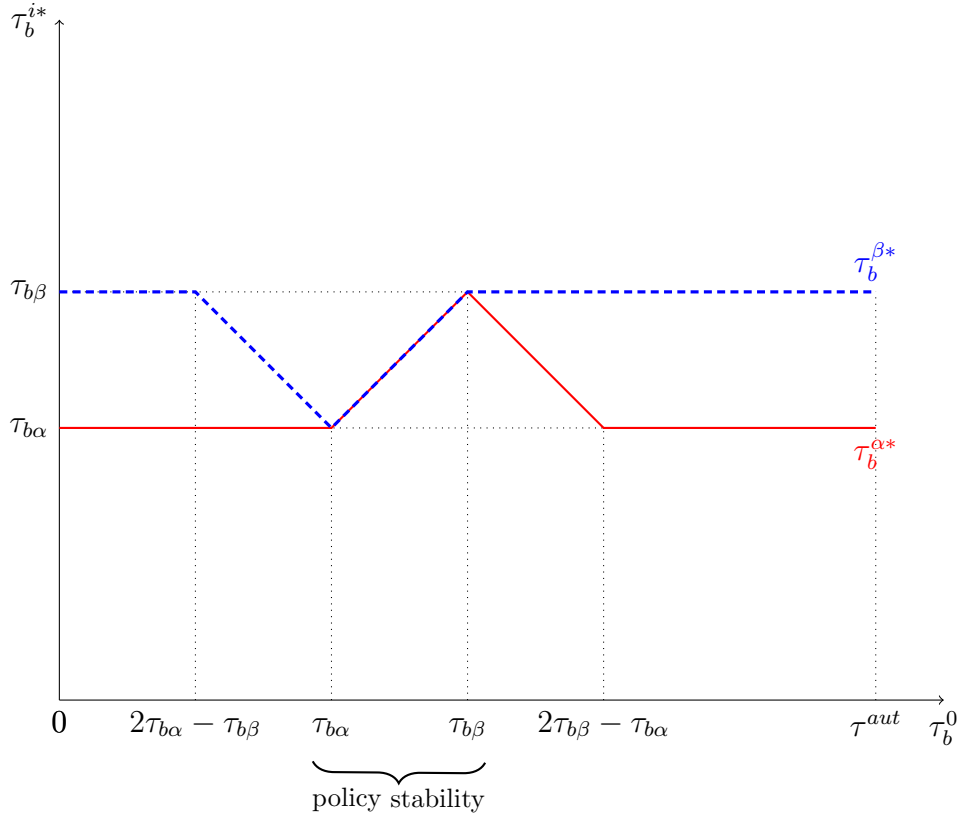


Figure 4: Unilateral proposal strategies when the status quo is unilateral

When the status quo tariff is very low, it is in the interest of both parties to increase the tariff for revenue reasons. If the agenda-setter is the globalist, the resulting tariff is its ideal—positive, but low. The protectionists accept this, because it is better than the status quo. Similarly, if the agenda-setter is the protectionist, the resulting tariff is its ideal—positive and high. The globalists accept this because it is better than a tariff that does not provide sufficient revenue. The same intuition holds when the status quo tariff is too high. Each party will have their ideal proposal accepted because these imply a Pareto improvement over the status quo.

If the status quo is between the ideal of both parties, this induces policy stability as indicated in Figure 4. There is no unilateral policy that can make at least one party better off without harming the other party, and so the status quo policy remains in place. If there is a significant shock to the domestic or global economy (positive or negative) this can disrupt the stability.

For any other status quo, the responder’s acceptance constraint binds, and so the agenda-setter is not able to attain its ideal, but is able to bring policy closer to its ideal

(lower for globalists, higher for protectionists). This new equilibrium policy will fall inside the policy stability interval and will remain unless there is an economic shock.

We next characterize the equilibrium free trade proposal when the status quo is a unilateral policy. In this case $\mathcal{I}_{FT}^i = 1$. The free trade proposal for each party is simply the choice of a transfer that satisfies

$$\begin{aligned} T^{\alpha*} &= \arg \max_{\hat{T} \in \mathbb{R}^+} v_{\alpha}(0, 0) - \hat{T} \\ \text{s.t.} \quad & v_{\beta}(0, 0) + \hat{T} \geq v_{\beta}(\tau_b^0, \tau_a). \end{aligned}$$

and

$$\begin{aligned} T^{\beta*} &= \arg \max_{\hat{T} \in \mathbb{R}^+} v_{\beta}(0, 0) + \hat{T} \\ \text{s.t.} \quad & v_{\alpha}(0, 0) - \hat{T} \geq v_{\alpha}(\tau_b^0, \tau_a). \end{aligned}$$

The solution to the parties' maximization problems are straightforward. Party α pays transfers to party β to equate free trade with transfers to the status quo, as long as these transfers are positive. Party β extracts as much in transfers as possible without violating party α 's acceptance constraint.

Proposition 3 *Suppose the status quo is a unilateral policy, i.e. $\mathcal{I}_{FT}^0 = 0$, then the equilibrium transfers under free trade, $\mathcal{I}_{FT}^i = 1$, satisfy*

$$\begin{aligned} T^{\alpha*} &= \max\{0, v_{\beta}(\tau_b^0, \tau_a) - v_{\beta}(0, 0)\} \\ T^{\beta*} &= \max\{0, v_{\alpha}(0, 0) - v_{\alpha}(\tau_b^0, \tau_a)\}. \end{aligned}$$

We now compare the payoffs under a free trade proposal and a unilateral tariff proposal to determine the equilibrium choice of free trade or unilateral policy. That is each party solves

$$\begin{aligned} \mathcal{I}_{FT}^{\alpha*} &= \arg \max_{\hat{\mathcal{I}}_{FT} \in \{0,1\}} (1 - \hat{\mathcal{I}}_{FT})v_{\alpha}(\tau_b^{\alpha*}, \tau_a) + \hat{\mathcal{I}}_{FT}[v_{\alpha}(0, 0) - T^{\alpha*}] \\ \mathcal{I}_{FT}^{\beta*} &= \arg \max_{\hat{\mathcal{I}}_{FT} \in \{0,1\}} (1 - \hat{\mathcal{I}}_{FT})v_{\beta}(\tau_b^{\beta*}, \tau_a) + \hat{\mathcal{I}}_{FT}[v_{\beta}(0, 0) + T^{\beta*}]. \end{aligned}$$

The next proposition states that under a unilateral status quo, each party proposes free trade when the status quo tariff of Country B is sufficiently high and proposes

unilateral trade policy otherwise. This is true for any value of the Country A 's status quo tariff.

Proposition 4 *When the status quo is a unilateral policy, i.e. $\mathcal{I}_{FT}^0 = 0$, for all $i \in \{\alpha, \beta\}$, for all $\tau_b^0 \in [0, \tau^{aut}]$ and for all $(\gamma_a, \gamma_b) \in (1/2, 1)^2$, there exists a $\bar{\tau}_a^i \in [0, \tau^{aut}]$ such that $\mathcal{I}_{FT}^{i*} = 1$ if and only if $\tau_a \geq \bar{\tau}_a^i$.*

This implies that Country A prefers unilateral policy when Country B is sufficiently open. Conversely, Country A prefers free trade when Country B is closed. This is true regardless of which party is the agenda setter. The intuition is in line with the logic of two countries engaged in a policy-setting game—the more closed Country B is, the more Country A gains from reciprocal openness. If Country B is already quite open, there is little to gain from reciprocal opening for Country A . This holds even though domestic bargaining determines trade policy, because the benefits that accrue to the country, also accrue to the parties, albeit unevenly.

3.3.2 Free trade status quo

As before, we consider a unilateral proposal first with $\mathcal{I}_{FT}^i = 0$.¹⁶ Proposal strategies solve

$$\begin{aligned} \tau_b^{\alpha*} &= \arg \max_{\hat{\tau}_b \in [0, \tau^{aut}]} v_\alpha(\hat{\tau}_b, 0) \\ &\text{s.t.} \quad v_\beta(\hat{\tau}_b, 0) \geq v_\beta(0, 0) + T^0, \end{aligned}$$

$$\begin{aligned} \tau_b^{\beta*} &= \arg \max_{\hat{\tau}_b \in [0, \tau^{aut}]} v_\beta(\hat{\tau}_b, 0) \\ &\text{s.t.} \quad v_\alpha(\hat{\tau}_b, 0) \geq v_\alpha(0, 0) - T^0. \end{aligned}$$

Define

$$\begin{aligned} \bar{\tau}_{b\alpha}(T^0) &= \min\{\tau_b \in [0, \tau^{aut}] : v_\beta(\tau_b, 0) = v_\beta(0, 0) + T^0\} \\ \bar{\tau}_{b\beta}(T^0) &= \max\{\tau_b \in [0, \tau^{aut}] : v_\alpha(\tau_b, 0) \geq v_\alpha(0, 0) - T^0\}. \end{aligned}$$

¹⁶In the instance that a party proposes a deviation from free trade and a return to unilateral policy, we treat the foreign country's tariff as fixed at the free trade level, zero. Retaliatory tariff hikes are rare in practice, and usually emerge only after a negotiations have failed, and all other remedies have been exhausted.

Provided that $T^0 \leq v_\alpha(0,0) - v_\alpha(\tau^{aut}, 0)$, these values are the best unilateral tariff for the agenda-setter that makes the responding party indifferent between a unilateral policy and free trade with status quo transfer T^0 . Note that $\bar{\tau}_{Ai}$ must be greater than $\tau_{b\alpha}$ and less than $\tau_{b\beta}$ for any $i \in \{\alpha, \beta\}$. This follows from the single-peakedness of the indirect utility functions.

Consider party α 's problem, first. If there exists a $\hat{\tau}_b > \tau_{b\beta}$ that satisfies $v_\beta(\hat{\tau}_b, 0) = v_\beta(0,0) + T^0$, by single-peakedness of v_β there must also exist a $\hat{\tau}'_b < \tau_{b\beta}$ such that party α is better off and keeps party β at least indifferent. Similarly, party β will never choose a tariff less than party α 's ideal since a higher tariff will make both parties better off.

Proposition 5 *If the status quo is free trade with transfers, i.e., $\mathcal{I}_{FT}^0 = 1$, then, when an equilibrium unilateral tariff proposal exists, party α 's (β 's) proposal is α 's (β 's) ideal for T^0 sufficiently low (high) and is between $\tau_{b\alpha}$ and $\tau_{b\beta}$ otherwise. Specifically*

$$tau_b^{\alpha*} = \begin{cases} \tau_{b\alpha}, & \text{if } T^0 \leq v_\beta(\tau_{b\alpha}, 0) - v_\beta(0, 0) \\ \bar{\tau}_{b\alpha}(T^0), & \text{if } v_\beta(\tau_{b\alpha}, 0) - v_\beta(0, 0) < T^0 \leq v_\beta(\tau_{b\beta}, 0) - v_\beta(0, 0) \\ \text{no solution,} & \text{if } T^0 > v_\beta(\tau_{b\beta}, 0) - v_\beta(0, 0) \end{cases}$$

and

$$tau_b^{\beta*} = \begin{cases} \bar{\tau}_{b\beta}(T^0), & \text{if } T^0 < v_\alpha(0, 0) - v_\alpha(\tau_{b\beta}, 0) \\ \tau_{b\beta}, & \text{if } T^0 \geq v_\alpha(0, 0) - v_\alpha(\tau_{b\beta}, 0) \end{cases}$$

First observe that if the free trade payoff with transfers exceeds the protectionists' unilateral ideal payoff as responder, there is no unilateral tariff this party will accept. Hence when the globalist proposes, there is no solution for sufficiently high status quo transfers to the protectionists. Protectionists have no incentive to return to unilateralism. For sufficiently low transfers to the protectionists, if the globalists chooses a unilateral policy, they can obtain their desired tariff. For an intermediate range of transfers, there is a tariff between the two parties' ideals that can make the protectionists indifferent. The reverse is true when the protectionists propose, but in this case a solution always exists because transfers are always positive.

Choice of free trade or unilateral policy when status quo is free trade The only possible transfer under a free trade proposal is the status quo transfer T^0 (anything

else would be rejected by one of the parties). Thus, each party solves the following problem to determine the equilibrium proposal

$$\begin{aligned}\mathcal{I}_{FT}^{\alpha*} &= \arg \max_{\hat{\mathcal{I}}_{FT} \in \{0,1\}} (1 - \hat{\mathcal{I}}_{FT})v_{\alpha}(\tau_b^{\alpha*}, 0) + \hat{\mathcal{I}}_{FT}[v_{\alpha}(0, 0) - T^0] \\ \mathcal{I}_{FT}^{\beta*} &= \arg \max_{\hat{\mathcal{I}}_{FT} \in \{0,1\}} (1 - \hat{\mathcal{I}}_{FT})v_{\beta}(\tau_b^{\beta*}, 0) + \hat{\mathcal{I}}_{FT}[v_{\beta}(0, 0) + T^0].\end{aligned}$$

If there is no solution for a unilateral policy, then the equilibrium proposal must be to maintain free trade.

Proposition 6 *If the status quo is free trade with transfers, i.e., $\mathcal{I}_{FT}^0 = 1$, then for all γ_a, γ_b , there exists a finite \bar{T}^0 such that for all $T^0 \leq \bar{T}^0$ party $i \in \{\alpha, \beta\}$ chooses a unilateral policy in equilibrium and otherwise maintains free trade with transfers.*

Counterintuitively, unilateralism results when transfers are too low, regardless of which party is the agenda-setter. When the globalists are the agenda setters, low transfers imply that the protectionists are easy to buy-off because their free trade payoff is already low. Globalists prefer their ideal tariff to free trade (conditional on the foreign country maintaining low tariffs), so if their ideal tariff (or something close) can be implemented, they prefer this to making concessions to the protectionists under free trade. The same logic applies if the protectionists set the agenda. Low transfers cannot compensate for the harm from free trade so they prefer to revert to unilateralism as long as the globalists are willing to agree.

By Proposition 6 the threshold transfer is finite for any feasible γ_a, γ_b . This implies that even when Country A experiences a very high level of imports from Country B , unilateralism results *if and only if* transfers are too low.

Comparative Statics We explore how the threshold level of transfers changes with the size of the foreign export sector. As might be expected, a larger foreign export sector admits a greater range of transfers that lead to unilateralism.

Proposition 7 *The threshold \bar{T}^0 is increasing in γ_b . Thus, when the status quo is free trade, as the foreign export sector increases, there is a greater range of transfers over which the agenda setter selects unilateral policy in equilibrium.*

Proposition 7 has a natural empirical implication. It suggests that an increase in the endowment used in Country B 's exports would be associated with a reduction in

support for free trade across parties in Country A . As the endowment in the foreign export sector expands, foreign exports and domestic imports expand. Consistent with standard intuition, under free trade, with little redistribution, protectionists become more disadvantaged and have a strong preference to revert to unilateralism. Our analysis adds nuance to this narrative—protectionists will accept unilateralism under almost any condition, *including* accepting the globalists’ low ideal tariff.

Perhaps more surprising, the export oriented winners from free trade realize that some protection offers several benefits relative to the status quo under some conditions. First, instead of paying the higher redistributive costs to keep the protectionists whole as imports expand (the rise in the threshold \bar{T}^0), a tariff would offer the domestic losers from trade some protection. Second, the export sector benefits from some (potentially small) share of any tariff revenues that accrue. This motivates the export-oriented sector to desire a small positive tariff, which improves outcomes for the protectionists (relative to the free trade status quo). As a rising export power abroad emerges, low tariffs emerge as the bargained domestic policy.

Notably, the model predicts bi-partisan consensus for a return to protectionism, consistent with what has emerged in US politics since the mid-2010s. While the growth in the foreign export sector contributes to the motive for protectionism, our results show that in isolation it is not sufficient. Low status quo transfers, and no incentive to raise them, are crucial in driving the break-down in the political consensus for free trade. The combination of changes in external economic conditions and domestic political constraints lead to a shift towards protectionism. This is the main contribution to the extant literature on the political economy of trade policy and is why we refer to the current era as the *Era of Retreat*.

3.4 Alternate Distributions of Tariff Revenue

For completeness, we consider alternate distributions of tariff revenue. Consider the economy as modeled in Section 3.1, but, rather than sharing tariff revenue equally, a share $0 < z < 1$ is allocated to the import-competing sector and $1 - z$ to the export sector. The budget constraints for the export and import-competing sectors are thus

respectively

$$\begin{aligned} \sum_{i \in \{\alpha, \beta\}} p_i^A q_{\alpha i} + q_{\alpha 0} &\leq p_\alpha^A \gamma_\alpha + (1 - z) \tau_b [q_\beta - (1 - \gamma_\alpha)], \text{ and} \\ \sum_{i \in \{\alpha, \beta\}} p_i^A q_{\beta i} + q_{\beta 0} &\leq p_\beta^A (1 - \gamma_\alpha) + z \tau_b [q_\beta - (1 - \gamma_\alpha)]. \end{aligned}$$

We restrict attention values of z such that the second order condition for each sector is satisfied.

Assumption 1 $1/2 - \sqrt{13}/4 < z < 3/2 - \sqrt{13}/4$.

Proposition 8 *The ideal tariff on imports for the export sector and import-competing sector when a share of tariff revenue z goes to the import-competing sector are respectively*

$$\begin{aligned} \tau_{b\alpha} &= \min \left\{ \max \left\{ -\frac{8\gamma_\alpha q + 8\gamma_b q - 11\gamma_\alpha - 5\gamma_b - 8q + 11}{16z^2 - 48q + 23}, 0 \right\}, \tau^{aut} \right\} \\ \tau_{b\beta} &= \min \left\{ \max \left\{ \frac{8\gamma_\alpha z + 8\gamma_b z - 9\gamma_\alpha - 3\gamma_b - 8z + 9}{16z^2 + 16z - 9}, 0 \right\}, \tau^{aut} \right\}. \end{aligned}$$

Moreover $\tau_{b\alpha} < \tau_{b\beta}$ so the export sector has a lower ideal tariff than the import-competing sector.

The proof of Proposition 8 follows from straightforward maximization to obtain the ideal tariffs. The ordering of $\tau_{b\alpha}$ and $\tau_{b\beta}$ follows from $\gamma_\alpha, \gamma_b > 1/2$. The incentive for positive tariffs is tariff revenue. The incentive is greater for the import-competing sector as tariff revenue accounts for a larger proportion of income.

When can show that the main results hold qualitatively for any value of z satisfying Assumption 1. The steps of the proofs follow the existing proofs closely.

4 Model Interpretation

We now consider the three phases of US trade policy over the last 160 years in the light of the model presented above. Changes in the exogenous parameters may induce shifts across trade regimes—from unilateral trade restrictions to free trade and vice versa. First, the identity of the trade policy agenda setter matters. We interpret large shifts in political power across the parties as changes in the agenda setter, with

attendant shifts in the agenda setter’s ideal policy. Second, the status quo trade policy affects the political feasibility of trade policy realignments, and this includes the size of domestic social transfers (if any). Third, international economic conditions—which consists of the level of foreign tariffs and the size of the export sector of the foreign trading partner—determine the feasibility of a negotiated trade policy.

4.1 The Restriction Era, 1860-1931

The Civil War (1861-1865) marked a major shift in political power, from agricultural, export interests in the South, represented by the Democratic Party, towards the industrial and import-competing North, largely represented by the Republicans. While revenue generation was the primary motivation for trade policy prior to the war (Irwin 2017), trade policy shifts postbellum towards trade restriction, and the average tariff rises above 50% towards the end of the 19th century (see Figure 1).

Propositions 2 and 4 offer the key insights to understanding US trade policy under these conditions. When the Republicans ascend to power in 1859-1861, the status quo tariff is low and the protectionists have proposal power. Figure 4 illustrates the equilibrium proposals as a function of the status quo tariff and the identity of the agenda setter. At low status quo tariffs protectionists Republicans propose their high ideal, or a tariff higher than the status quo. This tariff is accepted by the weaker globalist Democrats, motivated by their share of the tariff revenue. As we can see in Figure 1 this period is marked by high and sustained tariffs (the green line), restricting foreign trade well into the 20th century, and ending with the Smoot-Hawley Tariff of 1930 that raised tariffs to 47% which as Irwin (2020) notes, when combined with price deflation made the ad valorem rate effectively closer to 60%.¹⁷

Our model also speaks to the difficulty of shifting to a free trade regime during this period. Foreign tariffs are effectively low for most of this period and they only start to rise after World War I (see Figure 5).¹⁸ Proposition 4 states that when foreign tariffs are low, and as was the case over this period, the status quo policy is restriction,

¹⁷Similarly, the decline in the average tariff during the First World War (1914-1918) follows from the jumps in prices which reduces the ad valorem equivalent of specific tariffs, not due to changes in applied tariff rates Irwin (2020).

¹⁸We thank Michael Clemens for graciously sharing the regional tariff data in Figure 5 (Clemens and Williamson 2004). “European Core Average Tariff” is the unweighted average of France, Germany, and the United Kingdom. “Asia Average Tariff” is the unweighted average of Burma, Ceylon, China, Egypt, India, Indonesia, Japan, Philippines, Thailand, and Turkey. For ease of comparison, we include the US average tariff on all imports (dark green).

any move to free trade can only be supported in equilibrium with transfers. Transfers were near zero at this point (see Figure 1). Intuitively, US exporters had little to gain from liberalization abroad (foreign tariffs are already low), and in order to make the protectionists whole, transfers would have needed to be very large, given the high level of trade protection. Moreover the globalists would lose access to the tariff revenue. Protectionism, therefore, was self-sustaining, which is consistent with the persistently high tariffs observed in the era of Restriction.

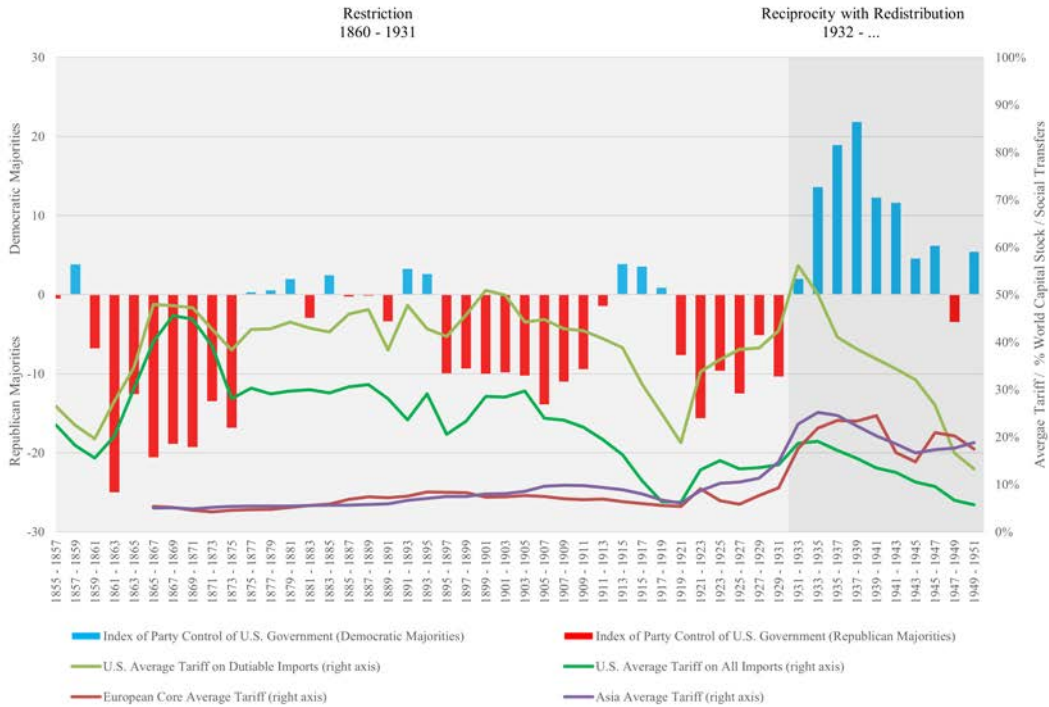


Figure 5: Party Majorities, US Tariffs, and Foreign Tariffs, 1859-1951

4.2 The Reciprocity with Redistribution Era, 1932-2015

After the stock market crash of 1929 and the onset of the Great Depression, the Democratic Party swept the 1932 election and became the dominant party. The Democrats continue to represent export-oriented agriculture while the Republican Party still represents import-competing industries.

This alignment lasts until World War II, which destroys much of the capital stock of Europe and Asia. US manufacturing becomes a dominant exporting industry and Republicans adopt a more free trade posture, consistent with Proposition 1(ii). This

brief consensus lasts only until the 1960s and 1970s, when Japan and Europe have fully restored their capital stocks and become exporting powerhouses in mature industries like steel, autos and electronics. At this time there is a shift in alignment between parties and industries. Democrats now represented the industrial working class and minorities and became protectionists. Republicans became globalists, in line with the interests of a new coalition of export-oriented high-skilled industries located in coastal areas aerospace, advanced industrial and scientific equipment, telecommunications, chemicals, financial services and export agricultural. Importantly, while party alignments shifted, the preferences of the industries remained constant, with agriculture consistently export-oriented and Rust Belt manufacturing consistently protectionist.

Proposition 4 again offers key insights as to how this political shift in the agenda setter from the protectionists to the globalists in an environment of high domestic and foreign tariffs determined the subsequent reduction in tariffs at home. This change was driven by the political benefits of reciprocity, combined with a transfer program designed to compensate the protectionists for going along with liberalization. The proposition states that if the status quo is protectionism (unilateral trade policy), a shift to reciprocal free trade with transfers to compensate the protectionists is feasible, and occurs in equilibrium, when foreign tariffs are high enough. The party of free trade sees its export interests gain sufficiently from reciprocal liberalization abroad that it is willing to incur the costs of funding a transfer program to insure the protectionists against the adverse distributional effects. This is feasible only because of the reductions in tariffs abroad.

A striking feature of the political economy of the US in the 20th century is the emergence of a transformative social safety net, and government investment in public assistance. Unemployment insurance, social security, a health insurance system, a public education system, and trade related programs such as Trade Adjustment Assistance all become part of the Reciprocity with Redistribution Era. At a time when social spending is at an all time high (the orange line in Figure 1) tariffs remain low (and continue to decline) after 1948 (the green line). Figure 1 shows transfers and spending as a share of GDP in the US, rising from effectively zero to almost 20% over this period.

Proposition 6 speaks to the long term stability of the free trade with transfers regime. While Democratic Party dominance in government declines towards the end of the 20th century, and the Democrats themselves become less committed to the

liberalization enterprise, conditions for a switch back to protectionism did not emerge. This proposition says that if the status quo is free trade with transfers, and as long as the transfers reach a minimum threshold, neither party would propose a shift back to protectionism. Even though Democratic commitment to free trade wanes towards the end of this period (and Republican protectionism has yet to take full effect) there is no political bargain available to either party to reverse the reciprocal liberalization of the era. Export interests prefer to fund social transfers to the degree that keeps the import-competers relatively indifferent to a return to protectionism.

The rise of the welfare state in the 1930s, and its expansion in the 1960s and 1970s, are thus crucial to the persistence of reciprocal free trade in this era. This is consistent with the literature emphasizing that trade openness must be combined with a generous social safety net to be politically sustainable. Political scientist John Ruggie coined the phrase “embedded liberalism” to describe the post-war combination of social transfers and globalization (Ruggie 1982), and confirmed empirically by Cameron (1978). In economics, Dani Rodrik has been a leading voice calling attention to the political importance of social transfers in sustaining free trade (Rodrik 1997, 2011).

The Reciprocity with Redistribution Era lasts for over 80 years, until the next major shift, this time not in any major political realignment as in the previous cases, but rather in relative factor endowments.

4.3 The Era of Retreat? 2016—

The narrative thus far has stressed the interests of the agenda setter, and interacted that with the status quo trade policy, comprised of the domestic tariff and any transfers, in the context of the broader world economy summarized by the foreign tariff. The model also stresses role of transformative reversals in relative factor endowments across trading partners, most relevant in the current era.

Since China’s accession to the WTO in 2001 and its emergence as a major trading partner of the US, its economy has grown at an annualized rate of more than 6% per year, raising its GDP to one of the largest in the world. Even more profound is the growth of the Chinese capital stock, both as a share of the world capital stock and relative to the United States. The China/US capital stock ratio has risen from 0.08 in 1952 to 1.21 in 2019, and this massive accumulation of productive capital has led to China’s rise as a major exporter of manufactured goods.¹⁹ Over a similar period, the

¹⁹Capital stock data for China and the US are from the Penn World Table version 10.0 using the

US share of the world’s captial stock, plotted in Figure 1 (the purple line), has declined precipitously from above 80% at the end of World War II to less than 15% currently, while China’s share (the red line) has risen to exceed that of the United States. As China has become relatively capital abundant, its exports of capital intensive goods have caused major dislocations for US manufacturers and contributed to a backlash against trade (Autor, Dorn, and Hanson 2013, Autor et al. 2020, Broz, Frieden, and Weymouth 2021).

The 2016 presidential election solidified the Republican Party’s return to protectionism. The new Trump administration quickly withdrew from the Trans-Pacific Partnership, a broad free trade agreement, applied tariffs to steel and aluminum from several countries, and engaged in an escalating trade war with China. The US refused to appoint judges to the WTO’s Appellate Body, bringing the effective adjudication of trade disputes to a halt. The US renegotiated the NAFTA, strengthening some of the rules of origin for tariff free trade across the member states. Most recently, the new Biden administration appears unwilling, as yet, to reverse many of these Trump administration restrictions on trade. The Reciprocity with Redistribution Era appears to have reached its end, and the pendulum may be swinging back towards protectionism and isolationism.

At the end of the Reciprocity with Redistribution Era, both domestic and foreign tariffs had declined to historical lows, making the status quo one of free trade with transfers. Proposition 6 establishes that, irrespective of the identity of the agenda setter, the free trade regime can be sustained as long as the status quo transfers T^0 are large enough—above the crucial threshold \bar{T}^0 .

This crucial threshold \bar{T}^0 is the transfer that leaves the parties indifferent between free trade and feasible bargains over the tariff. This indifference condition depends on equilibrium world prices, and the available gains from trade. As the foreign export sector expands, local import-competers see their welfare shrink (as observed in US manufacturing after 1980). The levels of social transfers required to keep the import-competing interests inside the free trade coalition must rise. Proposition 7 states that as the foreign export sector expands, the crucial cutoff threshold for social transfers *rises*.

Transfer spending as a share of GDP has been flat since the mid-2000s, and did not rise to compensate the domestic US losers from the growth in Chinese exports (see

variable “*r_{na}*,” capital stock at constant 2017 national prices based on investment in structures and equipment.

Figure 1). At some point in the 2000s, transfers are no longer large enough, and the free trade coalition cannot be sustained.

This holds irrespective of the agenda setter: both parties agree to switch to a more protectionist stance when transfers are too low. The apparent return to protectionism in the current era emerges from the lack of an available policy bargain among the major US parties to adequately invest in social transfers and protection for those harmed by trade. The return to protectionism is a consequence of the failure of redistribution consequent to globalization.

5 Conclusion

Our model of political bargaining between two parties supplements a standard two good, two factor, two country trade model, and offers a foundation for understanding 160 years of US trade policy. We endogenize trade policy as the outcome of bargaining between political parties, we examine switches from periods of protectionism to free trade and vice versa, and we offer an explanation for the long periods of trade policy stability.

The model has as its primitives the status quo domestic tariff and transfer levels, the interests of the agenda setting party, and economic conditions abroad (the foreign tariff and the size of the foreign export sector). Political conditions determine the identity and interests of the agenda setter, and any offer the agenda setter makes to the rival political party must be no worse (for either party) than that available under the status quo tariffs and transfers. While this status quo bias leads to long periods of policy stability, significant political and economic shifts can be large enough to fundamentally change trade policy outcomes.

When the agenda setter represents protectionist interests, and status quo tariffs are low, the protectionist party can get the globalist party to agree to moderately higher tariffs in return for a share of the tariff revenue. Immediately following the Civil War, Republicans, representing import-competing manufacturers, proposed and received their preferred higher tariffs, ushering in the period of Restriction. When instead both domestic and foreign tariffs are high, a globalist agenda setter will propose (reciprocal) tariff reductions, together with social transfers to the protectionist interests—the gains from trade exceed the cost of any transfers—and a consensus emerges in favor of free trade (with transfers). The Great Depression and the Smoot-

Hawley Tariff of 1930 set the stage for a political upheaval—the Democratic Party, the party of export interests, initiated a period of reciprocal tariff reduction and an emergent welfare state, ushering in the era of Reciprocity with Redistribution.

When a major shift in the size of the foreign export sector occurs, especially when the status quo is free trade, and current social transfers are low, the free trade consensus comes under pressure. Added imports negatively affect the well-being of protectionist interests; the social transfers needed to keep the protectionists supportive of free trade must rise. The globalists fearing the added costs of these transfers chooses instead to offer modest protection. The protectionists benefit; and the globalists see their social transfers bill decline while taking a share of any tariff revenue. The rise of China as a large exporter of manufactured goods at the end of the 20th century put US import-competing interests under pressure, raising the minimum levels of social transfers necessary for continued support of free trade; the Democratic Party’s commitment to free trade waned over this period, and the Republican Party took on a protectionist position around 2016. A consensus emerged in the face of large shocks to foreign exports and low domestic transfers, shifting policy away from free trade, evident in the current Era of Retreat.

The model also offers insights into long periods of policy stability. During the Restriction period, foreign tariffs remain low—there was little to be gained from liberalization for exporters, and transfers would have to be paid to importers, adding to the burdens of the export sector. No consensus was available during this period for a shift to free trade. While World War II shifted relative capital abundance towards the US, this only reinforced the free trade consensus in place since 1932, where social transfers were high by historical standards. The emergence of Europe and Japan as large trading partners in the 1960s and 1970s did little to dislodge the free trade consensus, held in place by the post-war social compact of embedded liberalism.

Our historical narrative complements that of Irwin (2020) and Irwin (2017) by emphasizing two additional and related elements: political bargaining over trade policy and the attendant societal transfers necessary to achieve or sustain free trade. On the first, Irwin stresses the role of the majority party in US history and equates observed policy with the preferences of the party in power, especially when there is unified government. Here, we emphasize the need for *bargained* outcomes and a degree of consensus among the parties, given the difficulty of shifting the status quo in the US system of multiple veto players and checks and balances. Majority parties get to set

the agenda but they do not get to set policy unilaterally.

On the second, we integrate the social transfer into the trade policy bargain, and recognize that Irwin’s Era of Reciprocity would not have been possible politically without high enough social transfers, where the globalists compensate the protectionists for their losses associated with liberalization. We take the liberty of renaming this period the Era of Reciprocity with Redistribution.

The combined effects of a richer politics and the importance of transfers permits explanations for periods of trade policy stability even when exogenous economic conditions change, and even when the party in power shifts yet trade policy does not, as in the latter part of the twentieth century.

Our model also highlights the importance of political institutions in understanding trade policy. While a social planner may implement free trade with transfers in almost any conditions, political bargaining across parties with divergent interests, given low foreign tariffs and protectionism at home, is unlikely to result in liberalization. Similarly, a long period of free trade with transfers is not immune to reversal—when the foreign export sector expands, there may not be a domestic willingness, even among exporters, to raise social transfers sufficiently to compensate trade’s losers. Instead, consensus emerges to replace free trade with transfers with unilateral tariffs, a condition that appears to manifesting in the current Era of Retreat.

The persistence of free trade depends on both global economic conditions and the available political bargains. It emerges and persists when the adversely affected can be compensated; but there is no guarantee that sufficient transfers are available in a political equilibrium, especially in a globalized world. The social compact is contingent.

References

- Aklin, Michaël, Eric Arias, Emine Deniz, and B. Peter Rosendorff. 2015. *Domestic Politics of Trade Policy*. John Wiley & Sons, Ltd, 1–14. URL <https://onlinelibrary.wiley.com/doi/abs/10.1002/9781118900772.etrds0089>.
- Autor, David, David Dorn, Gordon Hanson, and Kaveh Majlesi. 2020. “Importing Political Polarization? The Electoral Consequences of Rising Trade Exposure.” *American Economic Review* 110 (10):3139–83. URL <https://www.aeaweb.org/articles?id=10.1257/aer.20170011>.

- Autor, David H., David Dorn, and Gordon H. Hanson. 2013. “The China Syndrome: Local Labor Market Effects of Import Competition in the United States.” *American Economic Review* 103 (6):2121–68. URL <https://www.aeaweb.org/articles?id=10.1257/aer.103.6.2121>.
- Bagwell, Kyle and Robert W. Staiger. 1990. *A Theory of Managed Trade*, vol. 80.
- Bailey, Michael and David W. Brady. 1998. “Heterogeneity and Representation: The Senate and Free Trade.” *American Journal of Political Science* 42 (2):524–544. URL <http://www.jstor.org/stable/2991769>.
- Bailey, Michael A., Judith Goldstein, and Barry R. Weingast. 1997. “The Institutional Roots of American Trade Policy: Politics, Coalitions, and International Trade.” *World Politics* 49 (3):309–338. URL <http://www.jstor.org/stable/25054005>.
- Baldwin, Richard. 1987. “Politically Realistic Objective Functions and Trade Policy.” *Economics Letters* 24 (3):287–90.
- Bowen, T. Renee and J. Lawrence Broz. 2020. “Designing an International Economic Order: A Research Agenda.” *NBER Working Paper* .
- Bowen, T. Renee, Ying Chen, and Hülya Eraslan. 2014. “Mandatory Versus Discretionary Spending: The Status Quo Effect.” *American Economic Review* 104 (10):2941–2974.
- Bowen, T. Renee, Ying Chen, Hülya Eraslan, and Jan Zapal. 2017. “Efficiency of Flexible Budgetary Institutions.” *Journal of Economic Theory* 167:148–176.
- Brookings Institution. 2021. “Vital Statistics of Congress.” URL <https://www.brookings.edu/multi-chapter-report/vital-statistics-on-congress/>.
- Brown, Andrew G. 2003. *The Failed Attempts of the Interwar Years*, chap. 4. Studies In International Economics. University of Michigan Press, 66–81.
- Broz, J. Lawrence, Jeffry Frieden, and Stephen Weymouth. 2021. “Populism in Place: The Economic Geography of the Globalization Backlash.” *International Organization* 75 (2):464–494.
- Cameron, David R. 1978. “The Expansion of the Public Economy: A Comparative Analysis.” *American Political Science Review* 72 (4):1243–1261.

- Clemens, Michael A. and Jeffrey G. Williamson. 2004. "Why Did the Tariff-Growth Correlation Change after 1950?" *Journal of Economic Growth* 9 (1):5–46. URL <http://www.jstor.org/stable/40215892>.
- Cole, Matthew T., James Lake, and Ben Zissimos. 2021. "Contesting an International Trade Agreement." *Journal of International Economics* 128:1–22.
- Congressional Quarterly Press. 2021. *Vital Statistics of the Presidency*. Congressional Quarterly Press. URL <http://sk.sagepub.com/cqpress/vital-statistics-on-the-presidency-4e/n4.xml>.
- Dean, Adam. 2016. *From Conflict to Coalition: Profit-Sharing Institutions and the Political Economy of Trade*. Political Economy of Institutions and Decisions. Cambridge University Press.
- Dziuda, Wioletta and Antoine Loeper. 2016. "Dynamic Collective Choice with Endogenous Status Quo." *Journal of Political Economy* 124 (4).
- Eichengreen, Barry. 1986. "The Political Economy of the Smoot-Hawley Tariff." Working Paper 2001, National Bureau of Economic Research. URL <http://www.nber.org/papers/w2001>.
- Fajgelbaum, Pablo D., Pinelopi K. Goldberg, Patrick J Kennedy, and Amit K Khandelwal. 2019. "The Return to Protectionism." *The Quarterly Journal of Economics* 135 (1):1–55.
- Feenstra, Robert C. and Jagdish N. Bhagwati. 1982. *Tariff Seeking and the Efficient Tariff*, book 9. University of Chicago Press, 245–262. URL <http://www.nber.org/chapters/c6007>.
- Fetter, Frank Whitson. 1933. "Congressional Tariff Theory." *The American Economic Review* 23 (3):413–427. URL <http://www.jstor.org/stable/1806431>.
- Gilligan, Michael. 1997. *Empowering Exporters: Delegation, Reciprocity and Collective Action in Twentieth Century American Trade Policy*. University of Michigan Press.
- Goldstein, Judith and Robert Gulotty. 2014. "America and Trade Liberalization: The Limits of Institutional Reform." *International Organization* 68 (2):263–295.

- Grossman, Gene M. and Elhanan Helpman. 1994. "Protection for Sale." *The American Economic Review* 84 (4):833–850.
- . 1995. "Trade Wars and Trade Talks." *The Journal of Political Economy* 103 (4):675–708.
- Haggard, Stephan. 1988. "The Institutional Foundations of Hegemony: Explaining the Reciprocal Trade Agreements Act of 1934." *International Organization* 42 (1):91–119. URL <http://www.jstor.org/stable/2706771>.
- Handley, Kyle and Fariha Kamal. 2020. "Rising Import Tariffs, Falimg Export Growth: When Modern Supply Chains Meet Old-STyLe Protectionism." *Working Paper* .
- Hansen, John Mark. 1990. "Taxation and the Political Economy of the Tariff." *International Organization* 44 (4):527–551.
- Henisz, Witold J. and Edward D. Mansfield. 2006. "Votes and Vetoes: The Political Determinants of Commercial Openness." *International Studies Quarterly* 50 (1):189–211. URL [+http://dx.doi.org/10.1111/j.1468-2478.2006.00398.x](http://dx.doi.org/10.1111/j.1468-2478.2006.00398.x).
- Hillman, Arye L. 1982. "Declining Industries and Political-Support Protectionist Motives." *American Economic Review* 72 (5):1180–1190.
- Hillman, Arye L. and Heinrich W. Urspring. 1988. "Domestic Politics, Foreign Interests, and International Trade Policy." *American Economic Review* 78 (4):729–745.
- Hiscox, Michael J. 1999. "The Magic Bullet? The RTAA, Institutional Reform, and Trade Liberalization." *International Organization* 53 (4):669–698.
- Hornbeck, J.F. 2013. "Trade Adjustment Assistance (TAA) and Its Role in U.S. Trade Policy." *CRS Report for Congress* .
- Irwin, D.A. 2017. *Clashing Over Commerce: A History of US Trade Policy*. Long-term factors in economic development. University of Chicago Press. URL <https://books.google.com/books?id=IzxCDwAAQBAJ>.
- Irwin, Douglas A. 1996. "Industry or Class Cleavages over Trade Policy? Evidence from the British General Election of 1923." In *The Political Economy of Trade Policy: Papers in Honor of Jagdish Bhagwati*. MIT Press.

- Irwin, Douglas A. 2020. "Trade Policy in American Economic History." *Annual Review of Economics* 12:23–44.
- Irwin, Douglas A. and Randall S. Kroszner. 1999. "Interests, Institutions, and Ideology in Securing Policy Change: The Republican Conversion to Trade Liberalization After SmootHawley." *The Journal of Law & Economics* 42 (2):643–674. URL <http://www.jstor.org/stable/10.1086/467437>.
- Johnson, Harry G. 1954. "Optimal Tariffs and Retaliation." *The Review of Economic Studies* 21 (2):142–153.
- Karol, David. 2000. "Divided Government and U.S. Trade Policy: Much Ado About Nothing?" *International Organization* 54 (4):825–844. URL <http://www.jstor.org/stable/2601383>.
- Key, V. O. 1959. "Secular Realignment and the Party System." *The Journal of Politics* 21 (2):198–210. URL <http://www.jstor.org/stable/2127162>.
- Kim, In Song, Helen V Milner, Thomas Bernauer, Iain Osgood, Gabriele Spilker, and Dustin Tingley. 2019. "Firms and Global Value Chains: Identifying Firms' Multidimensional Trade Preferences." *International Studies Quarterly* 63 (1):153–167. URL <https://doi.org/10.1093/isq/sqy055>.
- Kim, In Song and Iain Osgood. 2019. "Firms in Trade and Trade Politics." *Annual Review of Political Science* 22:399–417.
- Kong, Mary Amity Sang Hoon and David Weinstein. 2020. "The Effect of the US-China Trade War on U.S. Investment." *Working Paper* .
- Kuziemko, Ilyana and Ebonya Washington. 2018. "Why Did the Democrats Lose the South? Bringing New Data to an Old Debate." *American Economic Review* 108 (10):2830–67. URL <https://www.aeaweb.org/articles?id=10.1257/aer.20161413>.
- Lee, Frances E. 2016. *Insecure Majorities: Congress and the Perpetual Campaign*. University of Chicago Press.
- Linarelli, John. 1995. "International Trade Relations and the Separation of Powers under the United States Constitution." *Dickinson Journal of International Law* 13 (2):203–240.

- Lohmann, Susanne and Sharyn O'Halloran. 1994. "Divided Government and U.S. Trade Policy: Theory and Evidence." *International Organization* 48 (4):595–632. URL <http://www.jstor.org/stable/2706897>.
- Magee, Stephen P., William A. Brock, and Leslie Young. 1989. *Black Hole Tariffs and Endogenous Policy Theory: Political Economy in General Equilibrium*. Cambridge University Press.
- Maggi, Giovanni and Andres Rodriguez-Clare. 1998. "The Value of Trade Agreements in the Presence of Political Pressures." *Journal of Political Economy* 106:574–601.
- Maggi, Giovanni and Andrés Rodríguez-Clare. 2007. "A Political-Economy Theory of Trade Agreements." *The American Economic Review* 97 (4):1374–1406.
- Mayer, Wolfgang. 1984. "Endogenous Tariff Formation." *American Economic Review* 74 (5):970–985.
- Mayhew, David R. 2000. "Electoral Realignment." *Annual Review of Political Science* 3 (1):449–474. URL <https://doi.org/10.1146/annurev.polisci.3.1.449>.
- McGillivray, Fiona. 1997. "Party Discipline as a Determinant of the Endogenous Formation of Tariffs." *American Journal of Political Science* 41 (2):584–607. URL <http://www.jstor.org/stable/2111778>.
- Milner, Helen V. 1988. *Resisting Protectionism: Global Industries and Politics of International Trade*. Princeton, NJ: Princeton University Press.
- Milner, Helen V. and Benjamin Judkins. 2004. "Partisanship, Trade Policy, and Globalization: Is There a Left–Right Divide on Trade Policy?" *International Studies Quarterly* 48 (1):95–120. URL <http://dx.doi.org/10.1111/j.0020-8833.2004.00293.x>.
- Milner, Helen V. and B. Peter Rosendorff. 1996. "Trade Negotiations, Information and Domestic Politics: The Role of Domestic Groups." *Economics and Politics* 8 (2):145–189.
- . 1997. "Democratic Politics and International Trade Negotiations: Elections and Divided Government as Constraints on Trade Liberalization." *Journal of Conflict Resolution* 41 (1):117–147.

- Milner, Helen V. and Dustin Tingley. 2015. *Sailing the Water's Edge: The Domestic Politics of American Foreign Policy*. Princeton University Press. URL <http://press.princeton.edu/titles/10627.html>.
- O'Halloran, Sharyn. 1994. *Politics, process, and American trade policy*. University of Michigan Press.
- Persson, Torsten, Gerard Roland, and Guido Tabellini. 1997. "Separation of Powers and Political Accountability." *The Quarterly Journal of Economics* 112 (4):1163–1202. URL <http://www.jstor.org/stable/2951269>.
- Rodrik, Dani. 1997. *Has Globalization Gone Too Far?* Washington, DC: Institute for International Economics. URL <http://bookstore.piie.com/book-store/57.html>.
- . 2011. *The Globalization Paradox: Democracy and the Future of the World Economy*. New York and London: W.W. Norton. URL <http://books.wwnorton.com/books/The-Globalization-Paradox/>.
- Romer, Thomas and Howard Rosenthal. 1978. "Political Resource Allocation, Controlled Agendas, and the Status Quo." *Public Choice* 33 (4):27–43.
- Ruggie, John Gerard. 1982. "International Regimes, Transactions and Change: Embedded Liberalism in the Postwar Economic Order." *International Organization* 36 (2):379–415.
- Schattschneider, E. E. 1935. *Politics, Pressures and the Tariff*. Prentice Hall.
- Stigler, George T. 1971. "The Theory of Economic Regulation." *The Bell Journal of Economics and Management Science* 2 (1):3–21.
- Tsebelis, George. 2002. *VETO PLAYERS THEORY*. Princeton University Press. URL <http://www.jstor.org/stable/j.ctt7rvv7.7>.
- Vanek, Jarsolav. 1968. "The Factor Proportions Theory: The N-Factor Case." *Kyklos* 21 (4):749–756.
- Weller, Nicholas. 2009. "Trading Policy: Constituents and Party in U.S. Trade Policy." *Public Choice* 141 (1/2):87–101. URL <http://www.jstor.org/stable/40270947>.

Appendix For Online Publication

6 Proof of Proposition 2

We start by showing that for any $i \in \{\alpha, \beta\}$, $(\gamma_a, \gamma_b) \in (\frac{1}{2}, 1)^2$, $\tau_a \in [0, \tau^{aut}]$ and $\tau_b, \tau'_b \in [0, \tau^{aut}]$ it holds

$$v_i(\tau'_b, \tau_a) \gtrsim v_i(\tau_b, \tau_a) \iff |\tau'_b - \tau_{bi}| \lesssim |\tau_b - \tau_{bi}|. \quad (10)$$

Fix $i \in \{\alpha, \beta\}$, $(\gamma_a, \gamma_b) \in (\frac{1}{2}, 1)^2$, $\tau_a \in [0, \tau^{aut}]$. Define $\tilde{v}_i(\cdot | \tau_a) : \mathbb{R} \rightarrow \mathbb{R}$ to have the exact same functional form as $v_i(\cdot | \tau_a)$ but unrestricted domain. Since $\tilde{v}_i(\cdot | \tau_a)$ is a concave quadratic, it is single peaked and symmetric. Hence, for any $\tau_b, \tau'_b \in \mathbb{R}$, $\tilde{v}_i(\tau'_b, \tau_a) \gtrsim \tilde{v}_i(\tau_b, \tau_a)$ if and only if $|\tau'_b - \tau^*| \lesssim |\tau_b - \tau^*|$, where τ^* is the point of global maximum of $\tilde{v}_i(\cdot | \tau_a)$. We have two cases. If $\tau^* \in [0, \tau^{aut}]$ then $\tau_{bi} = \tau^*$, by definition of τ_{bi} , implying (10). If $\tau^* \notin [0, \tau^{aut}]$, then $\tau_{bi} = \arg \min_{\tau \in [0, \tau^{aut}]} |\tau^* - \tau|$. Hence either (x) $\hat{\tau} \leq \tau_{bi} < \tau^*$ or (ii) $\hat{\tau} \geq \tau_{bi} > \tau^*$ for each $\hat{\tau} \in [0, \tau^{aut}]$. Let $\tau_b, \tau'_b \in [0, \tau^{aut}]$. Since either (x) or (ii) must hold for both $\hat{\tau} = \tau_b$ and $\hat{\tau} = \tau'_b$, $|\tau'_b - \tau^*| \lesssim |\tau_b - \tau^*|$ if and only if $|\tau'_b - \tau_{bi}| \lesssim |\tau_b - \tau_{bi}|$. Hence $\tilde{v}_i(\tau'_b, \tau_a) \gtrsim \tilde{v}_i(\tau_b, \tau_a)$ if and only if $|\tau'_b - \tau_{bi}| \lesssim |\tau_b - \tau_{bi}|$, which implies (10).

Note that (10) means that i 's preference ranking over domestic tariffs in $[0, \tau^{aut}]$ only depends on the distance of each tariff from her bliss point τ_{bi} . But for $\tau_b, \tau_b^0 \in [0, \tau^{aut}]$, we have that $|\tau_b - \tau_{bi}| \leq |\tau_b^0 - \tau_{bi}|$ if and only if $\tau_b \in [\min\{2\tau_{bi} - \tau_b^0, \tau_b^0\}, \max\{2\tau_{bi} - \tau_b^0, \tau_b^0\}]$. Hence for any responding party $i \in \{\alpha, \beta\}$, $\tau_b^0, \tau_{bi}, \tau_a \in [0, \tau^{aut}]$, and unilateral tariff proposal $\tau_b^{-i} \in [0, \tau^{aut}]$, it has

$$\rho_i = 1 \iff \tau_b^{-i} \in A_i,$$

where $A_i \equiv [\min\{2\tau_{bi} - \tau_b^0, \tau_b^0\}, \max\{2\tau_{bi} - \tau_b^0, \tau_b^0\}]$ and we assumed acceptance when i is indifferent.

To see why proposition 2 holds, consider the agenda setter $i \in \{\alpha, \beta\}$ and fix $\tau_b^0, \tau_{b-i}, \tau_a \in [0, \tau^{aut}]$. By (10), τ_b^{i*} is the tariff in $A_{-i} \cap [0, \tau^{aut}]$ that is closest to τ_{bi} . Formally $\tau_b^{i*} = \arg \min_{\tau \in A_{-i} \cap [0, \tau^{aut}]} |\tau - \tau_{bi}|$. If $\tau_{bi} \in A_{-i}$ then $\tau_b^{i*} = \tau_{bi}$. If $\tau_{bi} \notin A_{-i}$ then, given that $\tau_{b-i} \in A_{-i}$ by construction, and $\tau_{b\alpha} < \tau_{b\beta}$, it must be either $i = \alpha$ and $\tau_{b\alpha} < \min\{2\tau_{b\beta} - \tau_b^0, \tau_b^0\}$, or $i = \beta$ and $\tau_{b\beta} > \max\{2\tau_{b\alpha} - \tau_b^0, \tau_b^0\}$. Hence, if $\tau_{bi} \notin A_{-i}$, we have $\tau_b^{i*} = \min\{2\tau_{b-i} - \tau_b^0, \tau_b^0\}$ if $i = \alpha$ and $\tau_b^{i*} = \max\{2\tau_{b-i} - \tau_b^0, \tau_b^0\}$ otherwise.

In conclusion,

$$\tau_b^{\alpha*} = \begin{cases} \tau_{b\alpha} & \text{if } \tau_{b\alpha} \geq \min\{2\tau_{b\beta} - \tau_b^0, \tau_b^0\} \\ \min\{2\tau_{b\beta} - \tau_b^0, \tau_b^0\} & \text{if } \tau_{b\alpha} < \min\{2\tau_{b\beta} - \tau_b^0, \tau_b^0\} \end{cases}$$

$$\tau_b^{\beta*} = \begin{cases} \tau_{b\beta} & \text{if } \tau_{b\beta} \leq \max\{2\tau_{b\alpha} - \tau_b^0, \tau_b^0\} \\ \max\{2\tau_{b\alpha} - \tau_b^0, \tau_b^0\} & \text{if } \tau_{b\beta} > \max\{2\tau_{b\alpha} - \tau_b^0, \tau_b^0\} \end{cases}$$

where we used the fact that $\tau_{b\alpha} < \tau_{b\beta} \leq \max\{2\tau_{b\beta} - \tau_b^0, \tau_b^0\}$ and $\tau_{b\beta} > \tau_{b\alpha} \geq \min\{2\tau_{b\alpha} - \tau_b^0, \tau_b^0\}$. Since $\tau_{b\alpha} < \tau_{b\beta}$, the above definitions of $\tau_b^{\alpha*}$ and $\tau_b^{\beta*}$ are a compact form of the ones in Proposition 2.

7 Proof of Proposition 3

$T^{\alpha*}$ solves α 's problem

$$\begin{aligned} & \max_{\hat{T} \geq 0} v_\alpha(0, 0) - \hat{T} \\ & \text{subject to } v_\beta(0, 0) + \hat{T} \geq v_\beta(\tau_b^0, \tau_a). \end{aligned}$$

Given that $v_\alpha(0, 0)$ does not depend on T , the problem can be rewritten as

$$\begin{aligned} & \min_{\hat{T} \geq 0} \hat{T} \\ & \text{subject to } \hat{T} \geq v_\beta(\tau_b^0, \tau_a) - v_\beta(0, 0). \end{aligned}$$

We have two cases. If $v_\beta(\tau_b^0, \tau_a) - v_\beta(0, 0) \leq 0$ then $T^0 \geq 0$ implies $\hat{T} \geq v_\beta(\tau_b^0, \tau_a) - v_\beta(0, 0)$; hence, we can ignore the latter constraint and the solution is $\hat{T} = 0$. If $v_\beta(\tau_b^0, \tau_a) - v_\beta(0, 0) > 0$ then $\hat{T} \geq v_\beta(\tau_b^0, \tau_a) - v_\beta(0, 0)$ implies $T^0 > 0$; hence we can ignore the non-negativity constraint and the solution becomes $\hat{T} = v_\beta(\tau_b^0, \tau_a) - v_\beta(0, 0)$.

To sum up,

$$T^{\alpha*} = \begin{cases} 0, & \text{if } v_\beta(\tau_b^0, \tau_a) - v_\beta(0, 0) \leq 0 \\ v_\beta(\tau_b^0, \tau_a) - v_\beta(0, 0), & \text{if } v_\beta(\tau_b^0, \tau_a) - v_\beta(0, 0) > 0, \end{cases}$$

This proves the first part of Proposition 3. The proof of the second part follows

analogously.

8 Proof of Proposition 4

Fix $(\gamma_a, \gamma_b) \in (\frac{1}{2}, 1)^2$. Let $\Delta^{FT}(\tau_b, \tau_a) = v_\alpha(0, 0) + v_\beta(0, 0) - (v_\alpha(\tau_b, \tau_a) + v_\beta(\tau_b, \tau_a))$ be country A aggregate welfare gain from free trade when unilateral tariffs are (τ_b, τ_a) .

First, note that $\Delta^{FT}(\tau_b, \tau_a)$ takes the following form:

$$\begin{aligned} \Delta^{FT}(\tau_b; \tau_a) = & \frac{(1 - \gamma_a + \gamma_b)\tau_b - (1 + \gamma_a - \gamma_b)\tau_a}{8} - \frac{\tau_a^2 + \tau_b^2}{16} + \\ & - \tau_b \left(\frac{1 - \gamma_a + \gamma_b - \tau_b}{4} - 1 + \gamma_a \right) + \frac{\gamma_a}{4}\tau_a - \frac{3(1 - \gamma_a)}{4}\tau_b; \end{aligned}$$

it can be easily verified that $\Delta^{FT}(\tau_b; \tau_a)$ has the following properties, which will be useful in proving proposition 4:

1. $\Delta^{FT}(\tau_b; \tau_a)$ is continuous in τ_b and τ_a .
2. $\Delta^{FT}(\tau_b; \tau_a)$ is strictly increasing in τ_a on $[0, \tau^{aut}]$.
3. $\Delta^{FT}(\tau_b; \tau_a)$ is a strictly convex quadratic equation in τ_b , with minimum at $\tau_b = \frac{\tau^{aut}}{3}$ and maximum at $\tau_b = \tau^{aut}$.
4. $\Delta^{FT}(\frac{\tau^{aut}}{3}, \tau^{aut}) > 0$, $\Delta^{FT}(\frac{\tau^{aut}}{3}, 0) < 0$.

Second, note that for all $(\tau_b; \tau_a) \in [0, \tau^{aut}]^2$ it holds $\frac{\partial v_\beta(\tau_b; \tau_a)}{\partial \tau_a} = \frac{1 + \tau_a + \gamma_a - \gamma_b}{16} > 0$ and $\tau_{b\beta} \geq \tau_b^{\beta*}(\tau_b^0) > 0$, implying $v_\beta(0, 0) - v_\beta(\tau_b^{\beta*}(\tau_b^0), \tau^B) < 0$. Assuming that agenda setter β chooses $\mathcal{I}_{FT}^\beta = 1$ if indifferent between $\mathcal{I}_{FT}^\beta = 1$ and $\mathcal{I}_{FT}^\beta = 0$, for all $(\tau_b^0, \tau_a) \in [0, \tau^{aut}]^2$ it holds

$$\begin{aligned} \mathcal{I}_{FT}^{\beta*} = 1 & \iff v_\beta(0, 0) + T^{\beta*} \geq v_\beta(\tau_b^{\beta*}(\tau_b^0), \tau^B) \\ & \iff v_\beta(0, 0) - v_\beta(\tau_b^{\beta*}(\tau_b^0), \tau^B) \\ & \quad + \max \left\{ 0, v_\alpha(0, 0) - v_\alpha(\tau_b^{\beta*}(\tau_b^0), \tau^B) + v_\alpha(\tau_b^{\beta*}(\tau_b^0), \tau^B) - v_\alpha(\tau_b^0, \tau^B) \right\} \geq 0 \\ & \iff \Delta^{FT}(\tau_b^{\beta*}(\tau_b^0), \tau_a) + v_\alpha(\tau_b^{\beta*}(\tau_b^0), \tau_a) - v_\alpha(\tau_b^0, \tau_a) \geq 0, \end{aligned}$$

where the last implication follows from $v_\beta(0, 0) - v_\beta(\tau_b^{\beta*}(\tau_b^0), \tau^B) < 0$. Similarly, assuming that agenda setter α chooses $\mathcal{I}_{FT}^\alpha = 1$ if indifferent between $\mathcal{I}_{FT}^\alpha = 1$ and $\mathcal{I}_{FT}^\alpha = 0$,

for all $(\tau_b^0, \tau_a) \in [0, \tau^{aut}]^2$ it holds

$$\begin{aligned}
\mathcal{I}_{FT}^{\alpha*} = 1 &\iff v_\alpha(0, 0) - T^{\alpha*} \geq v_\alpha(\tau_b^{\alpha*}(\tau_b^0), \tau^B) \\
&\iff v_\alpha(0, 0) - v_\alpha(\tau_b^{\alpha*}(\tau_b^0)) + \min \left\{ 0, v_\beta(0, 0) - v_\beta(\tau_b^0, \tau_a) \right\} \geq 0 \\
&\iff \Delta^{FT}(\tau_b^{\alpha*}(\tau_b^0), \tau_a) \\
&\quad + \min \left\{ v_\beta(\tau_b^{\alpha*}(\tau_b^0), \tau_a) - v_\beta(0, 0), v_\beta(\tau_b^{\alpha*}(\tau_b^0), \tau_a) - v_\beta(\tau_b^0, \tau_a) \right\} \geq 0.
\end{aligned}$$

This second set of results allows us reformulate proposition 4 as follows. For all $\tau_b; \tau_a \in [0, \tau^{aut}]$, let

$$\begin{aligned}
d_\alpha(\tau_b; \tau_a) &= \min \{ v_\beta(\tau_b^{\alpha*}(\tau_b), \tau_a) - v_\beta(0, 0), v_\beta(\tau_b^{\alpha*}(\tau_b), \tau_a) - v_\beta(\tau_b, \tau_a) \}, \\
d_\beta(\tau_b; \tau_a) &= v_\alpha(\tau_b^{\beta*}(\tau_b), \tau_a) - v_\alpha(\tau_b, \tau_a), \\
\Delta_i(\tau_b; \tau_a) &= \Delta^{FT}(\tau_b^{i*}(\tau_b), \tau_a) + d_i(\tau_b; \tau_a), \text{ for } i \in \{\alpha, \beta\};
\end{aligned}$$

proving Proposition 4 is equivalent to showing that, for all $i \in \{\alpha, \beta\}$ and all $\tau_b^0 \in [0, \tau^{aut}]$, there exist $\bar{\tau}_B^i(\tau_b^0) \in [0, \tau^{aut}]$ such that:

$$\Delta_i(\tau_b^0, \tau_a) \geq 0 \iff \tau_a \geq \bar{\tau}_B^i(\tau_b^0). \quad (11)$$

We start by showing that for all $i \in \{\alpha, \beta\}$ and $\tau_b^0 \in [0, \tau^{aut}]$, $\Delta_i(\tau_b^0, \tau_a)$ is strictly increasing in τ_a . To see this, note that (i) $\frac{\partial^2 v_{-i}}{\partial \tau_b \partial \tau_a} = 0$ and therefore $v_{-i}(\tau_b^{i*}(\tau_b), \tau_a) - v_{-i}(\tau_b, \tau_a)$ is constant in τ_a ; and (ii) $v_\beta(\tau_b^{\alpha*}(\tau_b), \tau_a) - v_\beta(0, 0)$ is strictly increasing in τ_a because $\frac{\partial v_\beta}{\partial \tau_a} > 0$. Hence, for each $i \in \{\alpha, \beta\}$, d_i is weakly increasing in τ_a . This, together with property 2 of Δ^{FT} implies that Δ_i is strictly increasing in τ_a on $[0, \tau^{aut}]$. The strict monotonicity result has three immediate consequences: for any given $\tau_b^0 \in [0, \tau^{aut}]$ and $i \in \{\alpha, \beta\}$, (i) there exist at most one value $\hat{\tau}_B^i(\tau_b^0) \in [0, \tau^{aut})$ such that $\Delta_i(\tau_b^0, \hat{\tau}_B^i(\tau_b^0)) = 0$; (ii) if $\hat{\tau}_B^i(\tau_b^0)$ exists, then 11 holds by setting $\bar{\tau}_B^i(\tau_b^0) = \hat{\tau}_B^i(\tau_b^0)$; (iii) if $\Delta_i(\tau_b^0, 0) \geq 0$ then 11 holds by setting $\bar{\tau}_B^i(\tau_b^0) = 0$. It remains to show is that if $\Delta_i(\tau_b^0, 0) < 0$ then $\hat{\tau}_B^i(\tau_b^0)$ exists in $(0, \tau^{aut})$. This can be shown using the intermediate value theorem. Fix $i \in \{\alpha, \beta\}$ and τ_b^0 such that $\Delta_i(\tau_b^0, 0) < 0$. By definition of τ_b^{i*} , $d_i(\tau_b^0, \tau_a) \geq 0$ for each $\tau_a \in [0, \tau^{aut}]$. Moreover, properties 3 and 4 of Δ^{FT} imply that $\Delta^{FT}(\tau_b^{i*}(\tau_b^0), \tau^{aut}) > 0$. It follows that $\Delta_i(\tau_b^0, \tau^{aut}) = \Delta^{FT}(\tau_b^{i*}(\tau_b^0), \tau^{aut}) + d_i(\tau_b^0, \tau^{aut}) > 0$. Finally, note that Δ_i is continuous in its arguments, due to the continuity of Δ^{FT} , τ_b^{i*} and d_i . Hence

by the intermediate value theorem, there exist $\hat{\tau}_B^i \in (0, \tau^{aut})$ such that $\Delta_i(\tau_b^0, \hat{\tau}_B^i) = 0$. This completes the proof of proposition 4.

9 Proof of Proposition 5

First consider α 's problem

$$\begin{aligned} \tau_b^{\alpha*} &= \arg \max_{\hat{\tau} \geq 0} v_\alpha(\hat{\tau}, 0) \\ &\text{subject to } v_\beta(\hat{\tau}, 0) \geq v_\beta(0, 0) + T^0 \\ &\hat{\tau} \leq \tau^{aut}. \end{aligned}$$

We know $v_i(\cdot; \tau_a)$ is single-peaked, so the KKT sufficient condition is satisfied. The Lagrangian of the problem is

$$\mathcal{L}(\hat{\tau}, \lambda_1, \lambda_2) = v_\alpha(\hat{\tau}, 0) + \lambda_1(v_\beta(\hat{\tau}, 0) - v_\beta(0, 0) - T^0) + \lambda_2(\tau^{aut} - \hat{\tau}).$$

The KKT conditions are

$$\begin{aligned} \frac{\partial \mathcal{L}}{\partial \hat{\tau}} &= \frac{\partial v_\alpha}{\partial \hat{\tau}} + \lambda_1 \frac{\partial v_\beta}{\partial \hat{\tau}} - \lambda_2 \leq 0, & \hat{\tau} \geq 0, \hat{\tau} \frac{\partial \mathcal{L}}{\partial \hat{\tau}} &= 0, \\ v_\beta(\hat{\tau}, 0) - v_\beta(\tau_b^0, 0) - T^0 &\geq 0, & \lambda_1 \geq 0, \lambda_1(v_\beta(\hat{\tau}, 0) - v_\beta(0, 0) - T^0) &= 0, \\ \tau^{aut} - \hat{\tau} &\geq 0, & \lambda_2 \geq 0, \lambda_2(\tau^{aut} - \hat{\tau}) &= 0. \end{aligned}$$

First, notice that $\frac{\partial \mathcal{L}}{\partial \hat{\tau}}(\hat{\tau}, 0, 0) = \frac{\partial v_\alpha}{\partial \hat{\tau}} = 0$ solves party α 's unconstrained utility maximization problem and implies $\hat{\tau} = \tau_{b\alpha} \in [0, \tau^{aut}]$. Second, $\bar{\tau}_{b\alpha}(T^0)$, if exists, is defined as the smallest $\hat{\tau}$ such that β 's incentive constraint binds, so $\frac{\partial v_\beta}{\partial \hat{\tau}}$ is increasing at $\bar{\tau}_{b\alpha}(T^0)$, that is, $\bar{\tau}_{b\alpha}(T^0) \leq \tau_{b\beta}$. Further recall that by definition, $\tau_{b\alpha} < \tau_{b\beta}$.

There are two cases based on the existence and location of $\bar{\tau}_{b\alpha}(T^0)$:

1. The problem is infeasible when the constraints lead to an empty set. When $\bar{\tau}_{b\alpha}(T^0)$ doesn't exist on $[0, \tau^{aut}]$, that is when $T^0 > v_\beta(\tau_{b\beta}, 0) - v_\beta(0, 0)$, the β 's incentive constraint is violated in α 's problem, therefore, α 's problem has no solution. The set of parameters making the problem infeasible is

$$T^0 > v_\beta(\tau_{b\beta}, 0) - v_\beta(0, 0).$$

2. When the problem is feasible, that is when $T^0 \leq v_\beta(\tau_{b\beta}, 0) - v_\beta(0, 0)$:

- (a) When $\bar{\tau}_{b\alpha}(T^0) \leq \tau_{b\alpha}$. In this case $\tau_{b\alpha} < \tau_{b\beta}$ and the monotonicity of v_β on $[0, \tau_{b\beta}]$ imply $v_\beta(\bar{\tau}_{b\alpha}(T^0), 0) \leq v_\beta(\tau_{b\alpha}, 0) < v_\beta(\tau_{b\beta}, 0)$. Therefore it holds

$$T^0 \leq v_\beta(\tau_{b\alpha}, 0) - v_\beta(0, 0) < v_\beta(\tau_{b\beta}, 0) - v_\beta(0, 0).$$

If $\bar{\tau}_{b\alpha}(T^0) < \tau_{b\alpha}$, the above condition translates into the KKT condition being interior solution with constraints unbinding: $\tau_b^{\alpha*} \in (0, \tau^{aut})$ (that is $\lambda_2 = 0$ and $\frac{\partial \mathcal{L}}{\partial \hat{\tau}} = 0$), and β 's constraint is slack $\lambda_1 = 0$. In this case, the optimal solution is pinned down by the first order condition of unconstrained problem $\frac{\partial \mathcal{L}}{\partial \hat{\tau}}(\hat{\tau}, 0, 0) = 0$ and thus $\hat{\tau} = \tau_{b\alpha}$ if $\tau_{b\alpha} \in (0, \tau^{aut})$. If instead $\bar{\tau}_{b\alpha}(T^0) = \tau_{b\alpha}$, the problem is solved by $\hat{\tau} = \tau_{b\alpha}$.

- (b) When $\tau_{b\alpha} < \bar{\tau}_{b\alpha}(T^0) \leq \tau_{b\beta}$, that is when

$$v_\beta(\tau_{b\alpha}, 0) - v_\beta(0, 0) < T^0 \leq v_\beta(\tau_{b\beta}, 0) - v_\beta(0, 0).$$

This condition translates into the KKT condition being interior solution with β 's incentive constraint binding: $\tau_b^{\alpha*} \in (0, \tau^{aut})$ (that is $\lambda_2 = 0$ and $\frac{\partial \mathcal{L}}{\partial \hat{\tau}} = 0$), and β 's constraint binds $\lambda_1 \geq 0$ and $v_\beta(\hat{\tau}, 0) - v_\beta(0, 0) = T^0$. To check $\frac{\partial \mathcal{L}}{\partial \hat{\tau}} = 0$, we need $\frac{\partial v_\alpha}{\partial \hat{\tau}} + \lambda_1 \frac{\partial v_\beta}{\partial \hat{\tau}} = 0$ for $\lambda_1 \geq 0$, which requires $\frac{\partial v_\alpha}{\partial \hat{\tau}}$ and $\frac{\partial v_\beta}{\partial \hat{\tau}}$ to have opposite signs at $\bar{\tau}_{b\alpha}(T^0)$. Because $\tau_{b\alpha} < \tau_{b\beta}$, this requires $\bar{\tau}_{b\alpha}(T^0) \in [\tau_{b\alpha}, \tau_{b\beta}]$, which is satisfied in this case. Hence $\hat{\tau} = \bar{\tau}_{b\alpha}(T^0)$.

Next, β 's problem is solved similarly. With $\bar{\tau}_{b\beta}(T_0)$ being defined as the maximum $\hat{\tau}$ satisfying α 's constraint in β 's problem, then $\frac{\partial v_\alpha}{\partial \hat{\tau}}$ is decreasing at $\bar{\tau}_{b\beta}(T_0)$, that is, $\bar{\tau}_{b\beta}(T_0) \geq \tau_{b\alpha}$. Further recall that by definition, $\tau_{b\alpha} < \tau_{b\beta}$. There are two cases based on the location of $\bar{\tau}_{b\beta}(T_0)$:

1. When $\bar{\tau}_{b\beta}(T_0) \geq \tau_{b\beta}$, that is, when

$$T_0 \geq v_\alpha(0, 0) - v_\alpha(\tau_{b\beta}, 0),$$

α 's constraint is satisfied at $\tau_{b\beta}$ so $\hat{\tau} = \tau_{b\beta}$.

2. When $\tau_{b\beta} > \bar{\tau}_{b\beta}(T^0) \geq \tau_{b\alpha}$, that is,

$$v_\alpha(0, 0) - v_\alpha(\tau_{b\beta}, 0) > T^0$$

α 's constraint in β 's problem binds, so $\hat{\tau} = \bar{\tau}_{b\beta}(T^0)$, with $v_\alpha(\bar{\tau}_{b\beta}, 0) = v_\alpha(0, 0) - T^0$.

In conclusion,

$$\tau_b^{\alpha*} = \begin{cases} \tau_{b\alpha}, & \text{if } T^0 \leq v_\beta(\tau_{b\alpha}, 0) - v_\beta(0, 0) \\ \bar{\tau}_{b\alpha}(T^0), & \text{if } v_\beta(\tau_{b\alpha}, 0) - v_\beta(0, 0) < T^0 \leq v_\beta(\tau_{b\beta}, 0) - v_\beta(0, 0) \\ \text{no solution,} & \text{if } T^0 > v_\beta(\tau_{b\beta}, 0) - v_\beta(0, 0) \end{cases}$$

and

$$\tau_b^{\beta*} = \begin{cases} \bar{\tau}_{b\beta}(T^0), & \text{if } T^0 < v_\alpha(0, 0) - v_\alpha(\tau_{b\beta}, 0), \\ \tau_{b\beta}, & \text{if } T^0 \geq v_\alpha(0, 0) - v_\alpha(\tau_{b\beta}, 0) \end{cases}$$

10 Proof of Proposition 6

Fix $(\gamma_a, \gamma_b) \in (\frac{1}{2}, 1)^2$. If $T^0 = 0$ and $\tau_{b\alpha} = 0$ then $\mathcal{I}_{FT}^{i*} = 1$ for each $i \in \{\alpha, \beta\}$. In what follows we rule out this specific case, assuming $\max\{T^0, \tau_{b\alpha}\} > 0$.

First, note that the following holds. Let $i \in \{\alpha, \beta\}$ be the agenda setter and $T^0 \in \mathbb{R}^+$ be the free trade status quo transfer. A switch away from free trade, $\mathcal{I}_{FT}^{i*} = 0$, occurs if and only if each of the following two conditions holds:

1. $\bar{\tau}_{bi}(T^0)$ exists in $[0, \tau^{aut}]$
2. $v_i(\tau_b^{i*}, 0) \geq v_i(0, 0) - \mathbb{1}_{\{i=\alpha\}}T^0 + \mathbb{1}_{\{i=\beta\}}T^0$

Condition 1 is equivalent to $T^0 \leq v_\beta(\tau_{b\beta}, 0) - v_\beta(0, 0)$ when the agenda setter is $i = \alpha$, and ensures that there exist a unilateral tariff such that β is willing to accept the switch away from free trade. Condition 2 means that the agenda setter $i \in \{\alpha, \beta\}$ is willing to switch from free trade to the unilateral tariff τ_b^{i*} defined in Proposition 5.

Now, consider the problem when the agenda setter is $i = \alpha$.

- If $T^0 \leq v_\beta(\tau_{b\alpha}, 0) - v_\beta(0, 0)$ then condition 1 is always satisfied by definition of $\tau_{b\beta}$. By proposition 5, in this case $\tau_b^{\alpha*} = \tau_{b\alpha}$. Since $v_\alpha(\tau_{b\alpha}, 0) \geq v_\alpha(0, 0)$ by definition of $\tau_{b\alpha}$, condition 2 also holds, and hence $\mathcal{I}_{FT}^{\alpha*} = 0$.

- If $v_\beta(\tau_{b\alpha}, 0) - v_\beta(0, 0) < T^0 \leq v_\beta(\tau_{b\beta}, 0) - v_\beta(0, 0)$, then condition 1 is satisfied, hence it suffices to check when condition 2 holds for $i = \alpha$. By proposition 5 it has $\tau_b^{\alpha*} = \bar{\tau}_{b\alpha}(T^0) > \tau_{b\alpha}$, and therefore $v_\beta(\tau_b^{\alpha*}, 0) = v_\beta(0, 0) + T^0$. Since $T^0 = v_\beta(\tau_b^{\alpha*}, 0) - v_\beta(0, 0)$, we can rewrite condition 2 as

$$\Delta^{UT}(\bar{\tau}_{b\alpha}(T^0), 0) \geq 0,$$

where $\Delta^{UT}(\bar{\tau}_{b\alpha}(T^0), 0) = -\Delta^{FT}(\bar{\tau}_{b\alpha}(T^0), 0)$ is the welfare gain in country A when the policy switches from free trade to the unilateral tariff $\bar{\tau}_{b\alpha}(T^0)$. Using the expression of Δ^{FT} reported at the beginning of the proof of proposition 4, it is easily verified that

$$\Delta^{UT}(\bar{\tau}_{b\alpha}(T^0), 0) \geq 0 \iff \bar{\tau}_{b\alpha}(T^0) \leq \frac{2}{3}\tau^{aut}.$$

We have two cases.

1. If $\tau_{b\beta} \leq \frac{2}{3}\tau^{aut}$ then $\bar{\tau}_{b\alpha}(T^0) \leq \frac{2}{3}\tau^{aut}$ follows from the assumption that $T^0 \leq v_\beta(\tau_{b\beta}, 0) - v_\beta(0, 0)$, which guarantees that $\bar{\tau}_{b\alpha}(T^0) \leq \tau_{b\beta}$ exists. Hence condition 2 also holds and $\mathcal{I}_{FT}^{\alpha*} = 0$.
 2. If instead $\tau_{b\beta} > \frac{2}{3}\tau^{aut}$, condition 2 is satisfied if and only if $\bar{\tau}_{b\alpha}(T^0) \leq \frac{2}{3}\tau^{aut}$, which is equivalent to $T^0 \leq v_\beta(\frac{2}{3}\tau^{aut}, 0) - v_\beta(0, 0)$ since $\bar{\tau}_{b\alpha}(T^0)$ is strictly increasing in T^0 . Hence, in this case $\mathcal{I}_{FT}^{\alpha*} = 0$ if and only if $T^0 \leq v_\beta(\frac{2}{3}\tau^{aut}, 0) - v_\beta(0, 0)$.
- Finally, if $T^0 > v_\beta(\tau_{b\beta}, 0) - v_\beta(0, 0)$ then condition 1 does not hold and therefore $\mathcal{I}_{FT}^{\alpha*} = 1$.

Given that $\tau_{b\alpha} < \min\{\frac{2}{3}\tau^{aut}, \tau_{b\beta}\}$ the previous results imply that

$$\mathcal{I}_{FT}^{\alpha*} = 0 \iff T^0 \leq v_\beta(\min\{\frac{2}{3}\tau^{aut}, \tau_{b\beta}\}, 0) - v_\beta(0, 0).$$

Consider now the problem when the agenda setter is $i = \beta$. Note that $\bar{\tau}_{b\beta}$ always exists, so $\mathcal{I}_{FT}^{\beta*} = 0$ if and only if condition 2 holds.

- If $T^0 < v_\alpha(0, 0) - v_\alpha(\tau_{b\beta}, 0)$ by proposition 5 we have that $\tau_b^{\beta*} = \bar{\tau}_{b\beta}(T^0) < \tau_{b\beta}$ and therefore $v_\alpha(0, 0) - T^0 = v_\alpha(\tau_b^{\beta*}, 0)$. Since $T^0 = v_\alpha(0, 0) - v_\alpha(\tau_b^{\beta*}, 0)$, we can rewrite condition 2 as

$$\Delta^{UT}(\bar{\tau}_{b\beta}(T^0), 0) \geq 0,$$

and, by the same argument followed above, it has

$$\Delta^{UT}(\bar{\tau}_{b\beta}(T^0), 0) \geq 0 \iff \bar{\tau}_{b\beta}(T^0) \leq \frac{2}{3}\tau^{aut}.$$

We have two cases.

1. If $\tau_{b\beta} \leq \frac{2}{3}\tau^{aut}$ then $\bar{\tau}_{b\beta}(T^0) < \frac{2}{3}\tau^{aut}$, $\Delta^{UT}(\bar{\tau}_{b\beta}(T^0), 0) > 0$ and $\mathcal{I}_{FT}^{\beta*} = 0$.
 2. If instead $\tau_{b\beta} > \frac{2}{3}\tau^{aut}$ then condition 2 is satisfied if and only if $\bar{\tau}_{b\beta}(T^0) \leq \frac{2}{3}\tau^{aut}$. Since $\bar{\tau}_{b\beta}(T^0)$ is strictly increasing in T^0 when T^0 is in the considered range, in this case $\bar{\tau}_{b\beta}(T^0) \leq \frac{2}{3}\tau^{aut}$ if and only if $T^0 \leq v_\alpha(0, 0) - v_\alpha(\frac{2}{3}\tau^{aut}, 0)$. Hence, when $\tau_{b\beta} > \frac{2}{3}\tau^{aut}$, $\mathcal{I}_{FT}^{\beta*} = 0$ if and only if $T^0 \leq v_\alpha(0, 0) - v_\alpha(\frac{2}{3}\tau^{aut}, 0)$.
- If $T^0 \geq v_\alpha(0, 0) - v_\alpha(\tau_{b\beta}, 0)$ then $\tau_b^{\beta*} = \tau_{b\beta}$, and condition 2 becomes $T^0 \leq v_\beta(\tau_{b\beta}, 0) - v_\beta(0, 0)$. Hence in this case $\mathcal{I}_{FT}^{\beta*} = 0$ if and only if $T^0 \leq v_\beta(\tau_{b\beta}, 0) - v_\beta(0, 0)$. Note that this condition is never satisfied for $\tau_{b\beta} > \frac{2}{3}\tau^{aut}$. In fact, $\tau_{b\beta} > \frac{2}{3}\tau^{aut}$ implies $\Delta^{UT}(\tau_{b\beta}, 0) < 0$, which means that $v_\beta(\tau_{b\beta}, 0) - v_\beta(0, 0) < v_\alpha(0, 0) - v_\alpha(\tau_{b\beta}, 0)$, and consequently $v_\beta(\tau_{b\beta}, 0) - v_\beta(0, 0) < v_\alpha(0, 0) - v_\alpha(\tau_{b\beta}, 0) \leq T^0$.

We conclude that if $\tau_{b\beta} \leq \frac{2}{3}\tau^{aut}$

$$\mathcal{I}_{FT}^{\beta*} = 0 \iff T^0 \leq v_\beta(\tau_{b\beta}, 0) - v_\beta(0, 0),$$

while if $\tau_{b\beta} > \frac{2}{3}\tau^{aut}$

$$\mathcal{I}_{FT}^{\beta*} = 0 \iff T^0 \leq v_\alpha(0, 0) - v_\alpha(\frac{2}{3}\tau^{aut}, 0).$$

Finally note that $\Delta^{UT}(\frac{2}{3}\tau^{aut}, 0) = 0$, which implies $v_\alpha(0, 0) - v_\alpha(\frac{2}{3}\tau^{aut}, 0) = v_\beta(\frac{2}{3}\tau^{aut}, 0) - v_\beta(0, 0)$.

It follows that Proposition 6 holds setting

$$\bar{T}^0 = v_\beta(\min\{\frac{2}{3}\tau^{aut}, \tau_{b\beta}\}, 0) - v_\beta(0, 0)$$

for $i \in \{\alpha, \beta\}$.

11 Proof of Proposition 7

Let $\gamma_a \in (\frac{1}{2}, 1)$ and $i \in \{\alpha, \beta\}$. By solving the algebra, one obtains that (x) $v_\beta(\tau_{b\beta}, 0) - v_\beta(0, 0) = \frac{[5(1-\gamma_a)+\gamma_b]^2}{96}$; (ii) $v_\beta(\frac{2}{3}\tau^{aut}, 0) - v_\beta(0, 0) = \frac{[\gamma_b-(1-\gamma_a)](1-\gamma_a)}{4}$; and (iii) $\frac{2}{3}\tau^{aut} \geq \tau_{b\beta}$ if and only if $\gamma_b \geq 7(1-\gamma_a)$. Hence, we can rewrite the expression of \bar{T}^0 derived in the proof of proposition 6 as follows:

$$\bar{T}^0 = \begin{cases} \frac{[5(1-\gamma_a)+\gamma_b]^2}{96} & \text{if } \gamma_b \geq 7(1-\gamma_a) \\ \frac{[\gamma_b-(1-\gamma_a)](1-\gamma_a)}{4} & \text{if } \gamma_b < 7(1-\gamma_a). \end{cases}$$

Note that $\frac{[5(1-\gamma_a)+\gamma_b]^2}{96}$ and $\frac{[\gamma_b-(1-\gamma_a)](1-\gamma_a)}{4}$ are both strictly increasing in γ_b since $\gamma_a \in (0, 1)$. Moreover, \bar{T}^0 is continuous in γ_b at $\gamma_b = 7(1-\gamma_a)$, since in that case $\frac{[5(1-\gamma_a)+\gamma_b]^2}{96} = \frac{[\gamma_b-(1-\gamma_a)](1-\gamma_a)}{4} = \frac{3}{2}(1-\gamma_a)^2$. Hence \bar{T}^0 is strictly increasing in γ_b .