Ninth Edition, Global Edition

Chapter 9

Formulation of National Trade Policies

Learning Objectives

At the end of this chapter you should be able to:

9.1 Present the major arguments in favor of and against governmental intervention in international trade

9.2 Describe the major tools countries use to restrict trade.

9.3 Specify the techniques countries use to promote international trade.

9.4 Explain how countries protect themselves against unfair trade practices.

Rationale for Trade Intervention (1 of 2)

- Politicians, economists, and businesspeople - arguing for centuries over government policies regarding international trade

- **Two principal issues**
  - Protect domestic firms
    - Taxing foreign imports or put import barriers
  - Help domestic firms increase foreign sales
    - Export Subsidies, Government-to-Government Negotiations, and Guaranteed Loan Programs

Rationale for Trade Intervention (2 of 2)

- North America - debate whether govt should promote either :-
  - **Free Trade**
    - Minimal Influence on exports/imports decision of private forms/individuals
  - **Fair Trade**
    - Active Intervention - govt ensure equitable share of foreign markets - control imports to minimize domestic jobs and market share in specific industry - level playing field - compete on equal terms

Rationale for Trade Intervention: Industry-Level Arguments

- Primary arguments against free trade and for government intervention

- Trade policies that focus on the needs of individual industries

- National Defense
- Infant Industry
- Maintenance of Existing Jobs
- Strategic Trade Theory

1. The National Defense Argument

- Used as a reason to support governmental protection of specific industries

- World events turn hostile to a country's interest,
- Self-sufficient in critical
  - Raw materials
  - Machinery
  - Technology

- Many special interest groups have used this argument to protect their industries from foreign competition

2. The Infant Industry Argument

- Government Protection- impose tariffs on numerous imported goods

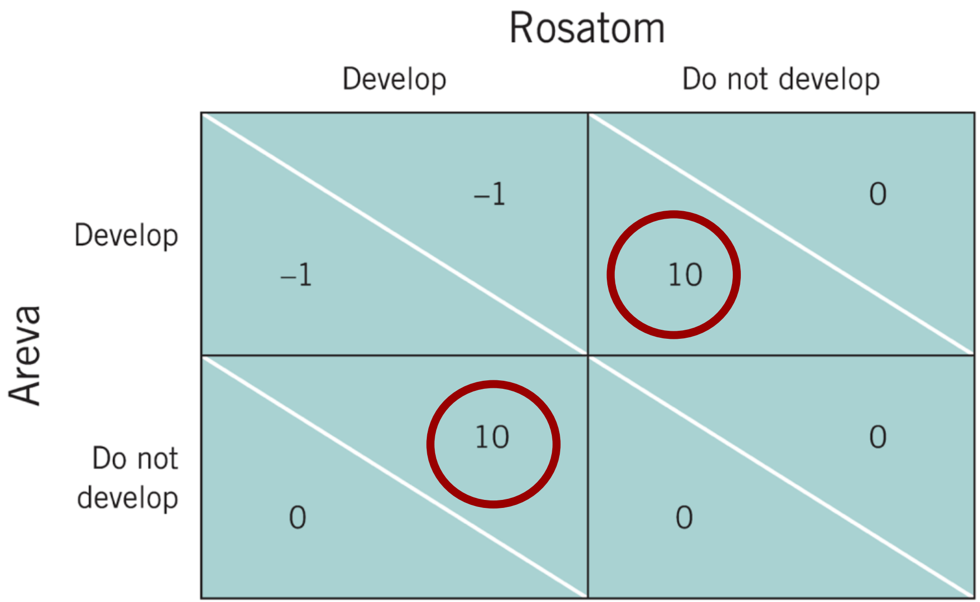
- Governmental nurturing of domestic industries that will ultimately have a comparative advantage can be a powerful economic development strategy

3. Maintenance of Existing Jobs

- High-wage countries, in well established industries, threatened by imports from low-wage countries
- To maintain existing levels of employment - petition for relief from foreign competition
- Government assistance in the form of tariffs, quotas, or other barriers

4. Strategic Trade Theory (1 of 2)

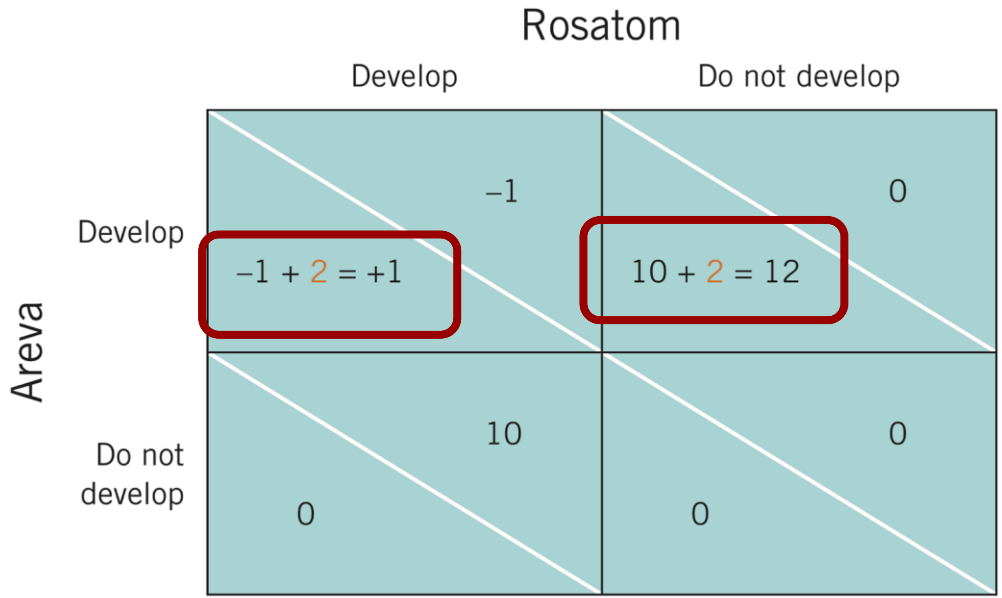
Figure 9.1 Payoff Matrix: Profits from Developing a Nuclear Power Plant Design (in billions of dollars)



- Assume economies of scale, market will be extremely profitable if one firm decides to enter it.
- Assume only two firms, France's Areva and Russia's Rosatom, have the engineering talent and financial resources to develop the new plant

4. Strategic Trade Theory (2 of 2)

Figure 9.2 Payoff Matrix: Profits Resulting from a $2 Billion Subsidy to Areva (in billions of dollars)



France offer Areva subsidy of $2 billion to develop the new nuclear technology, Areva's payoff increased by $2 billion if and only if it develops the technology.

What has the French government accomplished with its $2 billion subsidy?

1. **Induced Areva to develop the new nuclear power plant technology.**
2. **Induced the Russian firm to stay out of the market.**
3. **Succeeded in allowing a French firm to make a $12 b**

Rationale for Trade Intervention: National Trade Policies

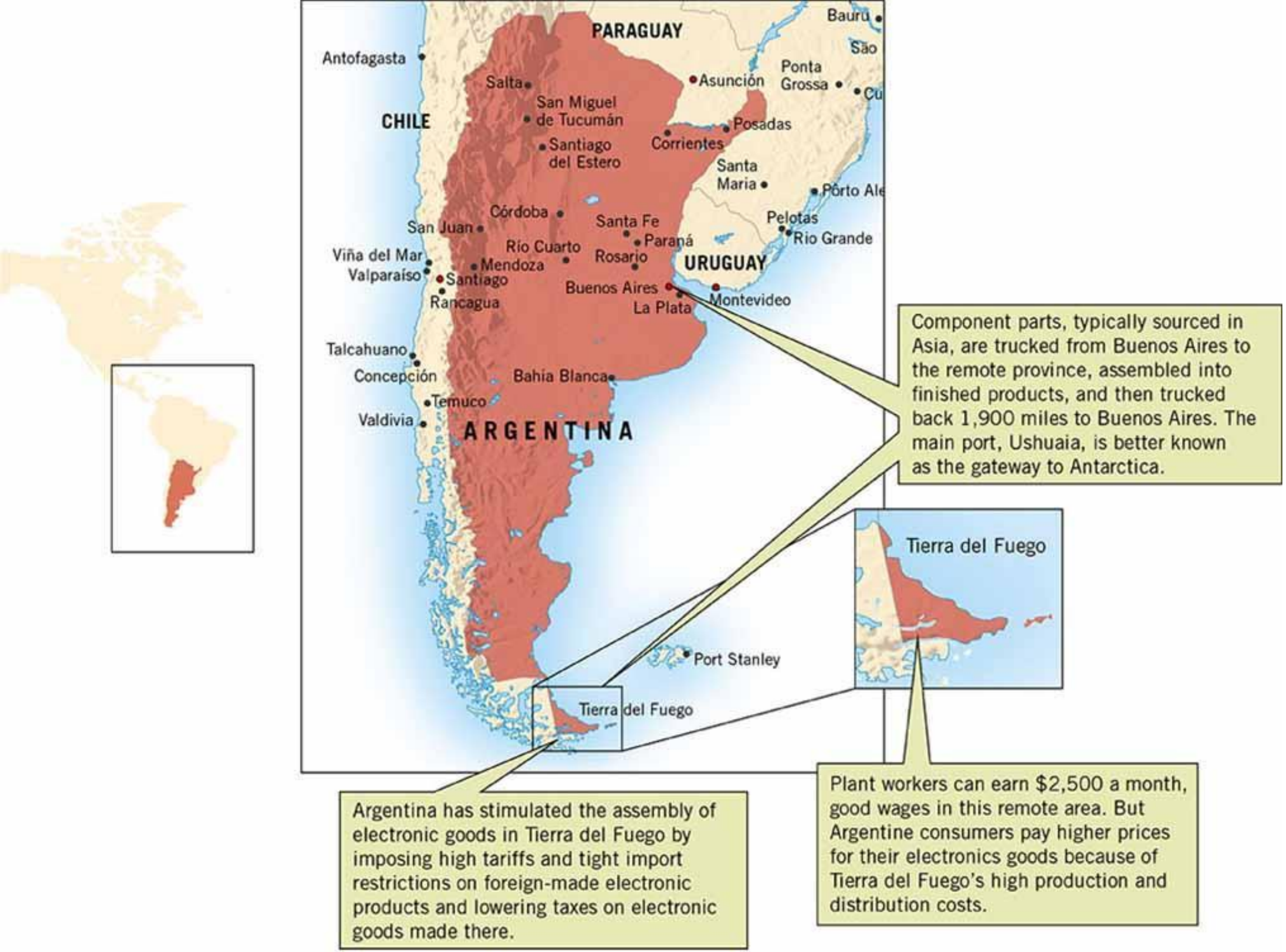
- National government may also develop trade policies that begin by looking at economy-wide perspective

- First, assess needs of national economy
- Then, develop Industry-by-Industry Policies to promote overall economic agenda

Industrial Policy

- Identifying key domestic industries critical to the country's future economic growth
- Industrial Policy - To formulate programs that improve competitiveness, assists firms capture global markets

- Industrial Policy Debate
  - Bureaucrats cannot perfectly identify the right industries
  - Choice of industries - domestic political clout rather than potential international competitiveness
  - The question of what is proper role of government in a market economy



- MITI Industrial Policy - Japan
- France = postwar industrial policy target auto, military, etc. resulted in govt subsidizing.
- Argentina - consumer pay double than in Chile - see Map Tierra del Feugo

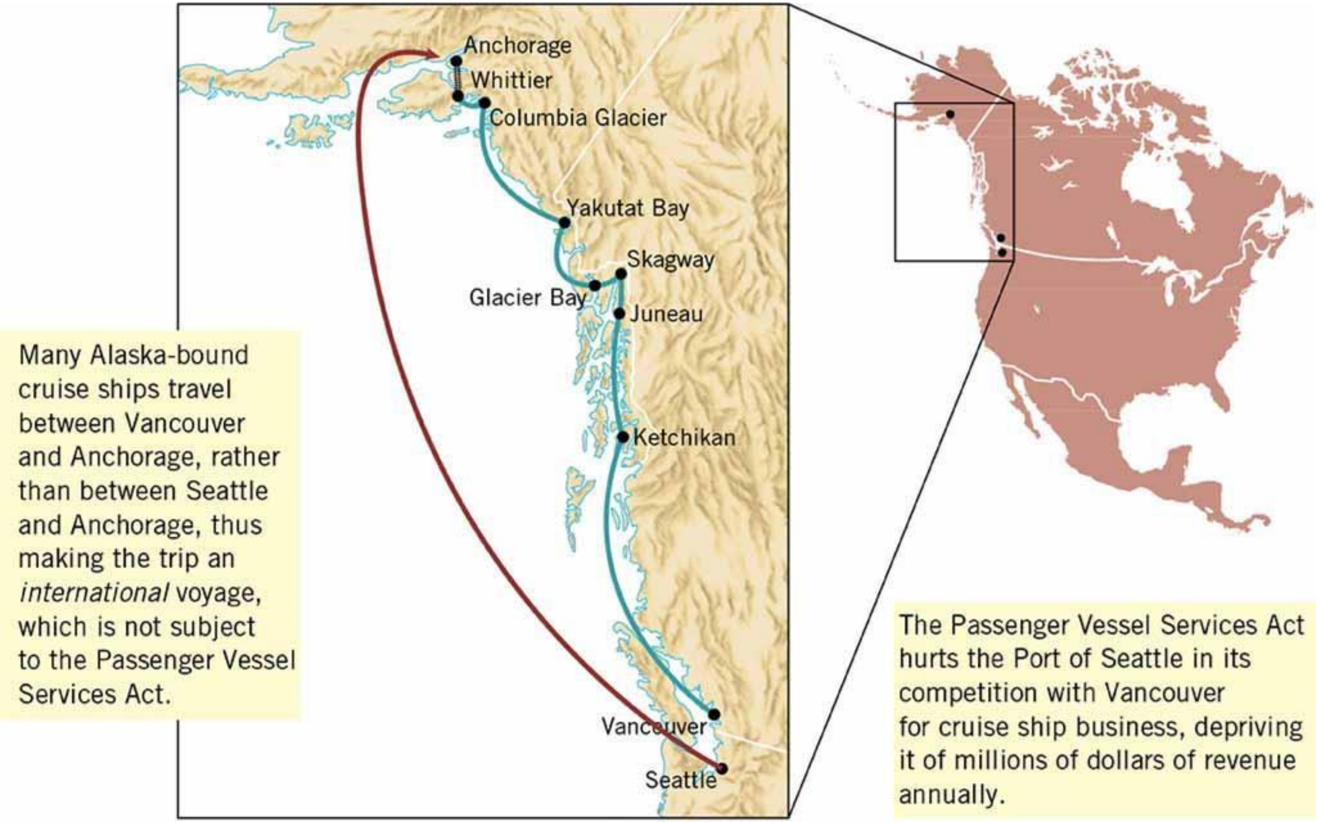
Public Choice Analysis

Scenario:
George Bush impose tariffs on imported steel helped US Steel producers but jeopardized the more numerous steel-using domestic industry . Reduced work at ports to unload steel in Baltimore, New York, . Raised prices for automotive, refrdergagors, and products using steel. President Trump impose steel tariff in 2018 also created similar collateral damages

Public Choice Analysis

Why national governments adopt public policies that hinder international business and hurt their own citizenry overall, even though the policies may benefit small groups within their societies?

- According to Public Choice analysis (branch of economics that analyse public decision making) : Special-interest groups - work hard to promote their interests than the general public is willing to work to defeat policies unfavorable to its interests



Jones Act 1920 - US restricts foreign ships from providing cargo services between US ports. Supported by owners of US oceangoing vessels, gain increased profits of $630mil / yr. - But, it increased transportation costs consumers pay by $10.5 bil per yr or $35/person.

Public Choice Analysis

- Domestic trade policies that affect international business stem not from some grandiose vision of a country's international responsibilities but rather from the mundane interaction of politicians trying to get elected

Barriers to International Trade

Government intervention = 2 categories

- Tariffs
- Non Tariff Barriers

Barriers to International Trade: Tariff Barriers

Tariffs

- Export Tariffs
- Transit Tariffs
- Import Tariffs

- **A tariff** is a tax placed on a good that is traded internationally

Levied on goods as they leave the country

Transit - taxed as they pass through one country bound for another

- Import - collected on imported goods - highest

Barriers to International Trade: Tariff Barriers

Import Tariffs

- Ad Valorem Tariff
- Specific Tariff
- Compound Tariff

1. **An ad valorem tariff** is assessed as a percentage of the market value of the imported good.
2. **A specific tariff** is assessed as a specific dollar amount per unit of weight or other standard measure.
3. **A compound tariff** has both an ad valorem component and a specific component.

A section of Harmonized Tariff Schedule (HTS) of the USA

Heading/ Subheading	Statistical Suffix	Article Description	Units of Quantity	Rates of Duty
2006.00		Fruit, nuts, fruit peel, and other parts of plants, preserved by sugar (drained, glacé, or crystallized):		
2006.00.20	00	Cherries	kg	9.9¢/kg + 6.4%
2006.00.30	00	Ginger root	kg	2.4%
2006.00.40	00	Pineapples	kg	2.1%
		Other, including mixtures:		
2006.00.50	00	Mixtures	kg	16%
2006.00.60	00	Citrus fruit; peel of citrus or other fruit	kg	6¢/kg
2006.00.70	00	Other fruit and nuts	kg	8%
2006.00.90	00	Other	kg	16%

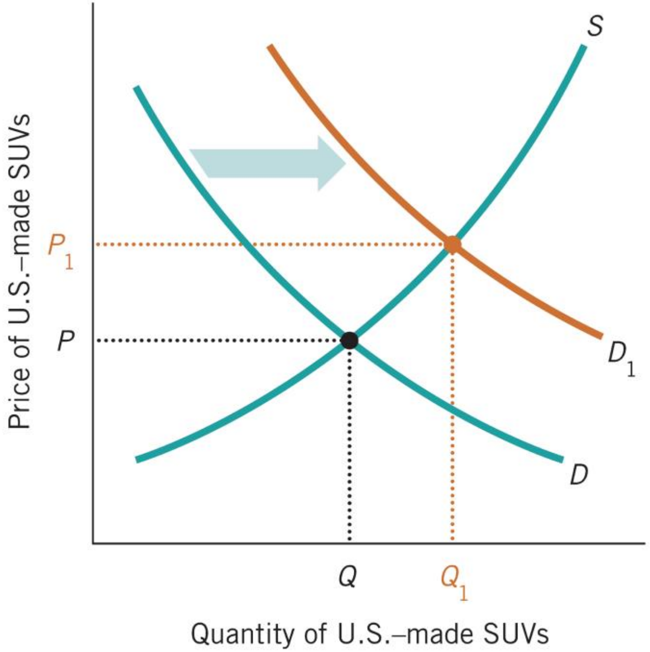
Source: U.S. International Trade Commission, *Harmonized Tariff Schedule of the United States* (Washington, DC: ITC Trade Database as of April 26, 2018).

Barriers to International Trade: Tariff Barriers

- Tariffs have been imposed for two reasons:
    - Raise revenue for the national government
    - Act as trade barriers

Barriers to International Trade: Tariff Barriers
(3 of 3)

Figure 9.3 Impact of an Import Tariff on Demand for U.S.-Made SUVs



Say, U.S. government imposes a $2,000 specific tariff on imported SUV

Shift in demand U.S.-made SUVs from D to D_1, ⇒ more domestic vehicles being sold at higher prices. Creates *gainers* and *losers*.

Gainers- GM, Ford, and Chrysler dealerships selling domestic SUVs; suppliers to domestic SUVs; workers at GM, Ford, Chrysler plants, communities located at domestic SUV factories

Losers -domestic consumers pay higher prices for both domestic and foreign SUVs.

Foreign producers lose - people and firms that depend on them, Toyota and Mazda dealerships in the United States, workers and suppliers in Japan, and communities in Japan manufacturing the SUVs

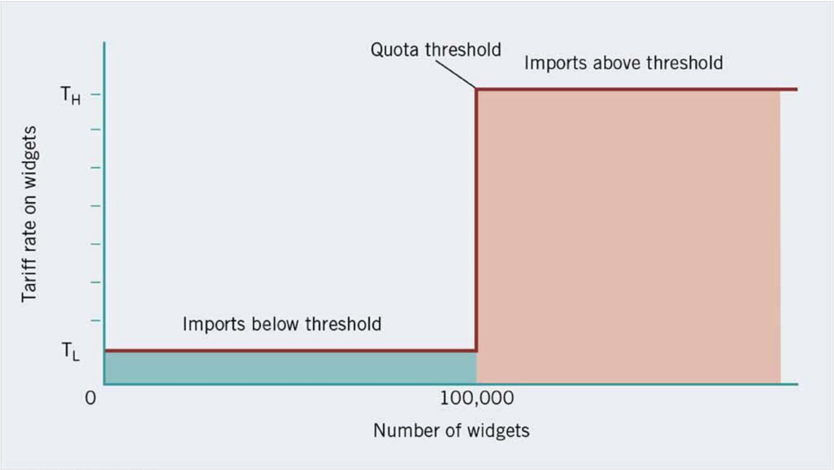
Barriers to International Trade: Nontariff Barriers (NTBs)

- any government regulation, policy, or procedure (other than a tariff) that impedes international trade
- 3 kinds of NTBs

- Quotas
- Numerical Export Controls
- Other NTBs

Quotas

- **Quota**: a numerical limit on the quantity of a good that may be imported into a country during some time period
- **Tariff Rate Quotas** (TRQ):
  - Low tariff rate under quota's threshold
  - Prohibitive tariff rate above the threshold



Numerical Export Controls

- Quantitative Trade Barriers
  - Voluntary Export Restraint - promise by a country to limit its exports of a good to another country to a pre-specified amount or percentage of the affected market
  - Embargo - absolute ban on the exporting (and/or importing) of goods to a particular destination

Other Nontariff Barriers

- **Product and Testing Standards**
- **Restricted Access to Distribution Network**
- **Public-Sector Procurement Policies**
- **Local-Purchase Requirements**
- Regulatory Controls
- Currency Controls
- Investment Controls

Foreign goods must meet country's product / testing standards before it can be offered for sale in that country.

Restricting foreign suppliers' access to the normal channels of distribution

Preferential treatment to domestic firms

Requiring the firms to purchase goods or services from local suppliers

Other Nontariff Barriers

Regulatory Controls

Conducting health and safety inspections, enforcing environmental regulations, requiring firms to obtain licenses before beginning operations or constructing new plants

Currency Controls

Exporters of goods allowed to exchange foreign currency at favorable rates to make foreign markets attractive sales outlets for domestic producers.

Importers forced to purchase foreign exchange from the central bank at unfavorable exchange rates, thus raising the domestic prices of foreign goods

Investment Controls

Controls on foreign investment and ownership are common, particularly in key industries such as broadcasting, utilities, air transportation, defense contracting, and financial services

Barriers to International Trade: A Summary

Figure 9.5 Types of Barriers to International Trade: A Summary

Promotion of International Trade

- Subsidies
  - Economic Development Incentives
- Foreign Trade Zones (FTZ)
  - Maquiladora System
- Export Financing Programs
  - Government-Owned Agencies
    - The Export-Import Bank of the United States (EXIM Bank)
    - The Overseas Private Investment Corporation (OPIC)

- stimulate exports by offering subsidies designed to reduce firms’ costs of doing business

- geographic area where imported or exported goods receive preferential tariff treatment

Mauritius, which was once a French naval base, is a tropical island, roughly $10\frac{1}{2}$ times the area of Washington, D.C. For much of its history Mauritius' 1.3 million residents depended on sugarcane, and even today 90 percent of its cultivated land is devoted to this crop.

Mauritius has created a foreign trade zone (FTZ) to diversify its economy and encourage manufacturing. Today the country exports over $1 billion worth of textiles, apparel, and other goods to Europe and the United States. Because of the FTZ's success, the country's economy has enjoyed 5 percent annual growth during the last decade.

Controlling Unfair Trade Practices (1 of 2)

- U.S. International Trade Administration (ITA)
- U.S. International Trade Commission (ITC)

Any allege unfair trade practices

First investigated by ITA
Confirmed cases of unfair trading transferred to ITC
If majority of six commissioners decide unfair trade suffered 'material injury'
⇒ then ITC impose duties on offending imports to counteract the unfair trade practice
Same as Canadian Int. Trade Tribunal -- focus on 1) Govt subsidies, 2) unfair pricing practices

Controlling Unfair Trade Practices (2 of 2)

- **Countervailing Duties (CVD)**
  - Ad Valorem Tariff
- **Antidumping Regulations**
  - International Price Discrimination
  - Predatory Pricing

- A **countervailing duty (CVD)** is an ad valorem tariff on an imported good. It is imposed by the importing country to counter the impact of foreign subsidies. The CVD is calculated to just offset the advantage the exporter obtains from the subsidy

- sells its goods in a foreign market at a price below what it charges in its home market

- selling its goods below cost in the foreign market

Controlling Unfair Trade Practices: Enforce or Abolish?

- **Abolition Advocates Assertions:**
  - These laws do more harm than good
  - These laws serve as a protectionist trade barrier
  - These laws make no sense

Controlling Unfair Trade Practices: Safeguards

- "Safeguard Clauses" or "Escape Clauses"
- U.S. Trade Act of 1974

permits the enactment of temporary trade barriers, if the International Trade Commission finds that American firms have been seriously harmed by a sudden increase in imported goods

allows countries to protect themselves from sudden surges in imported goods, even if the goods were traded fairly, in order to allow them time to adjust to the changed economic environment

- Choose one country
- Analyze the Trade Policies of the selected country with one trading country / partner. Report and analyze in terms of losers and gainers (can be from any perspective – industry level or country level)

Review Questions (1 of 2)

- How does free trade benefit consumers?
- What is the national defense argument?
- Why would a country agree to voluntary export restraint?
- Why is it useful for an importer to seek out an advance tariff classification from the U.S. Customs Service?
- What is the likely trade approach for a country that has low labor costs?

Review Questions (2 of 2)

- What are the major forms of NTBs?
- What are subsidies?
- What is the role of OPIC?
- What is the purpose of a CVD?
- What are the two definitions of dumping?