Learning Objectives

1. Present the major arguments in favor of and against government intervention in international trade.
2. Identify the advantages and disadvantages of adopting an industrial policy.
3. Analyze the role of domestic politics in formulating a country’s international trade policies.
4. Describe the major tools countries use to restrict trade.
5. Specify the techniques countries use to promote international trade.
6. Explain how countries protect themselves against unfair trade practices.
Opening Case: Jumbo Battle over Jumbo Jets

- US’s Boeing vs. EU’s Airbus
- Boeing’s 747: the world’s largest commercial aircraft
  - Monopoly in the jumbo jet market
  - 495-seat
- Airbus introduces its 650 seat aircraft in 2000
  - R&D costs aided by “launch aid” from German, French and British governments
- US vs. EU
  - US: previous European loans to Airbus have been written off provided the airframe manufacturer with illegal subsidies
  - EU: Boeing’s commercial aircraft division has benefited from hidden subsidies from the US government
    - US Defense Department contracts that are limited to US firms
Opening Case: Jumbo Battle over Jumbo Jets

- **US vs. EU**
  - 1992 agreement
    - Limited the amount of indirect subsidies the US could grant Boeing through military contracts
    - European governments were allowed to provide limited loans to Airbus for development of new aircraft
    - Predates the WTO & the new obligations imposed on members of WTO
  - In 2004, US officials withdrew from the 1992 accord & filed a complaint with the WTO

- **WTO’s rule**
  - 2010: the WTO ruled that the EU’s launch aid for the Airbus aircraft violated its rules
  - 2011: the WTO ruled that Boeing received $5.3 billion in subsidies through contracts awarded by the US Department of Defense and the National Aeronautics and Space Administration
Formulation of National Trade Policies

- Globalization
  - May benefit many firms around the world
  - But at times, firms believe that their foreign competitors have gained an unfair advantage as a result of policies adopted by their governments
  - A firm may ask its national government for protection against foreigners
    - The development of national trade policies that protect domestic firms from foreign competition & help promote the country’s exports

1. Rationales for Trade Intervention
2. Barriers to International Trade
3. Promotion of International Trade
4. Controlling Unfair Trade Practices
1) Rationales for Trade Intervention

- Two principal issues over appropriate trade policies

  - Should governments *intervene* to protect the country’s domestic firms by *taxing foreign goods or constructing other barriers against imports*?

  - Should governments *directly help* the country’s domestic firms increase their foreign sale through *export subsidies, government-to-government negotiations and guaranteed loan programs*?
1) Rationales for Trade Intervention

- **Free Trade or Fair Trade?**
  - **Free trade:**
    - The national government exerts *minimal influence* on the exporting and importing decision of private firms and individuals
  - **Fair trade:**
    - The national government should *intervene* to ensure that domestic firms’ exports receive an *equitable share* of foreign markets
      - imports are controlled to minimize losses of domestic jobs and market share in specific industries
    - Government should ensure a “*level playing field*” on which foreign and domestic firms can compete on equal terms
Rationales for Trade Intervention

- Industry-Level Arguments
  - The National Defense Argument
  - The Infant Industry Argument
  - Maintenance of Existing Jobs
  - Strategic Trade Theory

- National Trade Policies
  - Economic Development Programs
  - Industrial Policy
  - Public Choice Analysis
a) Industry-Level Arguments

- Adam Smith’s view (free trade)
  - The welfare of a country and its citizens is best promoted by allowing self-interest individuals, regardless of where they reside

- Arguments against free trade
  - Under certain circumstances, deviations from free trade are appropriate
i. The National Defense Argument

- A country must be self-sufficient in critical raw materials, machinery, and technology or else be vulnerable to foreign threats
  - E.g. Japan banned the importation of rice since WWII
    - As a means of promoting domestic self-sufficiency in the country’s dietary staple
  - US developed numerous programs to support its domestic shipbuilding industry
    - To retain shipbuilding skills and expertise within the country in case of war
    - All US naval vessels must be built in US shipyards
ii. The Infant Industry Argument

- Governmental nurturing of domestic industries that will ultimately have a comparative advantage
  - Articulated by Alexander Hamilton, the first US secretary of the treasury in 1791
  - The newly independent country’s infant manufacturing sector possessed a comparative advantage that would ultimately allow it to thrive in international markets
    - But their potential may be blocked by fierce competition from more mature firms
    - Should impose tariffs on imported manufactured goods to give domestic firms temporary protection from foreign competition until they could fully establish themselves

- How can we determine which industries deserve infant industry protection?
  - Often done on a political rather than an economic basis
iii. Maintenance of Existing Jobs

- To maintain existing employment levels
- Firms in high-wage countries are often threatened by imports from low-wage countries
iv. Strategic Trade Theory

- Assumptions underlying traditional trade theories
  - Firms operate in perfectly competitive markets
  - Each country’s consumers are able to buy goods and services at the lowest possible prices from world’s most efficient producers
  - Any governmental intervention that denies consumers these buying opportunities will make the country as a whole worse off

- Strategic Trade Theory
  - Applies to those industries capable of supporting only a few firms world wide
    - Oligopoly
  - Suggests that a national government can make its country better off if it adopts trade policies that improve the competitiveness of its domestic firms in such oligopolistic industries
Strategic Trade Theory - Example

- Market for a new nuclear power plant design
  - The market will be extremely profitable if one (only one) firm decides to enter it
    - Due to economies of scale
  - Player: France’s Areva & Japan’s Toshiba
    - Capable – have engineering talent and financial resources to develop the new plant design
Strategic Trade Theory - Example

- 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 Japanese firm to stay out of the market
  3. Succeeded in allowing a French firm to make a $12 billion profit at a cost to French taxpayers of only $2 billion

- Strategic Trade Theory
  - Applies only to markets that are incapable of supporting more than a handful of firms on a worldwide basis
b) National Trade Policies

- Economic Development Programs
- Industrial Policy
- Public Choice Analysis
i. Economic Development Programs

- Countries that depend on a single export often choose to diversify their economies to reduce the impact of falling prices for the dominant export
  - E.g. Ghana-cocoa: began an industrialization program to protect itself from fluctuations in cocoa prices
  - Dubai – oil sales: making the emirate a business center and aviation hub

- Export Promotion Strategy
  - A country encourages firms to compete in foreign markets by harnessing some advantage the country possesses
    - E.g. South Korea, Singapore, and Taiwan  heavy reliance on exports

- Import Substitution Strategy
  - Encourages the growth of domestic manufacturing industries by erecting high barriers to imported goods
    - E.g. Argentina, India, and Brazil
ii. Industrial Policy

- **Industrial Policy**
  - The national government identifies key domestic industries critical to the country’s future economic growth & formulates programs that promote their competitiveness
  - Assists a country’s firms in capturing large shares of important, growing global market
    - E.g. Japan’s MITI (Ministry of International Trade and Industry), and South Korea

- **Arguments against industrial policy**
  - Government bureaucrats cannot perfectly identify the right industries to favor under such a policy
    - E.g. France with industrial policy targeting automobiles, computers, and aircrafts
    - Japan’s analog-based HDTV in the early 1980s
  - The choice of industries to receive governmental largess will depend on the domestic political clout of those industries rather than on their potential international competitiveness
iii. Public Choice Analysis

- Government intervention typically results in benefiting some special-interest groups but hurts other domestic interests and the general public

*Why do national governments adopt public policies that hinder IB and hurt general public and benefit small groups within the society?*

- Public Choice Analysis
  - The special interest will often dominate the general interest on any given issue for a simple reason
    - Special-interest groups are willing to work harder for the passage of laws favorable to their interests than the general public do
      - E.g. 1920 Jones Act:
iii. Public Choice Analysis - Example

- **1920 Jones Act**
  - The US restricts foreign ships from providing transportation services between US ports
    - Benefits the owners of oceangoing vessels in US ($630 million p.a.)
    - Increase the transportation costs of consumers ($10 billion p.a.)
  - Unintended consequence of the Act – page 262
  - Few consumers will be motivated to learn how the Jones Act impacts them
  - The special interest groups are motivated to know all the ins and outs of the Jones Act & protect the Act from repeal

- PCA suggests that domestic trade policies that affect international business stem from the mundane interaction of politicians trying to get elected
  - Rather than from grandiose vision of a country’s international responsibilities
2) Barriers to International Trade

- Two categories of government intervention
  - Tariffs
  - Nontariff Barriers
    - Quotas
    - Numerical Export Controls
  Other Non-tariff Barriers
    - Product and Testing Standards
    - Restricted Access to Distribution Networks
    - Public-sector Procurement Policies
    - Local-purchase Requirements
    - Regulatory Controls
    - Currency Controls
    - Investment Controls
Tariffs

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

- **Export Tariff**
  - A tax that are levied on goods as they leave the country

- **Transit Tariff**
  - A tax that are levied on goods as they pass through one country bound for another

- **Import Tariff**
  - A tax collected on imported goods
Import Tariffs

- Three forms of import tariffs
  - Ad valorem tariff
    - Assessed as a percentage (%) of the market value of the imported good
    - In practice, most tariffs imposed by developed countries are ad valorem
  - Specific tariff
    - Assessed as a specific dollar amount per unit of weight or other standard measure
  - Compound tariff
    - Has both an ad valorem component and a specific component
Import tariffs

- Harmonized tariff schedule (HTS)
  - A detailed classification scheme for imported goods
  - Complex
    - Sometimes difficult to use
    - E.g. Imported leather ski gloves assessed at a 5.5% ad valorem tariff
    - If the gloves are specifically designed for cross-country skiing assessed at a 3.5% ad valorem tariff

- Why do governments impose tariffs?
  - Tariffs raise revenues for the national government
  - A tariff acts as a trade barrier
Import tariffs - example

- E.g. The US government imposes a $2,000 specific tariff on imported SUVs
  - Foreign producers: forced to raise their US prices, reducing their US sales
  - increase the demand for US-made SUVs
Nontariff Barriers

- **Nontariff Barriers**
  - Any government regulations, policy, or procedure other than a tariff that has the effect of impeding international trade

- **Types of non-tariff barriers**
  - Quotas
  - Numerical Export Controls
  - Other non-tariff barriers
Quota

- A numerical limit on the quantity of a good that may be imported into a country during some time period (e.g. a year)
  - Traditionally been used to protect politically powerful industries
    - E.g. agriculture, automobiles, and textiles
    - Use of quotas to limit imports of rice by Japan, Korea, Taiwan and the Philippines
  - But after the Uruguay Round of WTO meeting, many countries have replaced quotas with tariff rate quotas

Tariff rate quota (TRQ)

- Imposes a low tariff rate on a limited amount of imports of a specific good
- Above that threshold, a TRQ imposes a prohibitively high tariff rate on the good
Numerical Export Controls

- Quantitative barriers to trade in the form of **numerical limits** on the amount of a good it will **export**
- **A Voluntary Export Restraint (VER)**
  - A promise by a country to limit its exports of a good to another country to a prespecified amount of percentage of the affected market
  - Used to resolve or avoid trade conflicts with an otherwise friendly trade partner
- **Embargo**
  - An absolute ban on the exporting (and/or importing) of goods to a particular destination
  - Export controls to punish a country’s political enemies
- **Export controls to promote a country’s industrial policy or to promote the competitiveness of other of its industries**
  - E.g. Russia: limits the export of logs and round wood to stimulate its wood-processing industry
  - Lowers the price paid by Russian wood processors; increases the input costs of their foreign competitors
Other Non-tariff Barriers

- **Other Non-tariff Barriers**
  - More difficult to eliminate than tariffs and quotas
  - Often embedded in bureaucratic procedures & are not quickly changeable
    - Product and Testing Standards
    - Restricted Access to Distribution Networks
    - Public-sector Procurement Policies
    - Local-purchase Requirements
    - Regulatory Controls
    - Currency Controls
    - Investment Controls
Other Non-tariff Barriers

- **Product and Testing Standards**
  - A requirement that foreign goods meet a country’s product standards or testing standards before the goods can be offered for sale in that country
    - E.g. US’s FDA; Brazil: new pharmaceutical products must undergo clinical testing in Brazil

- **Restricted Access to Distribution Networks**
  - E.g. China: requires that imported sugar and petroleum be distributed only by state-owned trading enterprises
  - Thailand: foreign banks are limited to a single branch and are forbidden from utilizing off-site ATM machines

- **Public-sector Procurement Policies**
  - Give preferential treatment to domestic firms
    - E.g. US: the federal government in US generally requires international air travel purchased with US government funds occur on US airlines
    - Egypt: gives state-owned enterprises (SOEs) a 15% bidding preference on public contracts
Other Non-tariff Barriers

- **Local-purchase Requirements**
  - Requiring foreign firms to purchase goods or services from local suppliers
    - E.g. Indonesia: encourages pharmaceutical companies to manufacture locally if they wish their drugs to be approved for sale
    - China: requires that all travel agents use China’s state-owned reservation service when booking flights for Chinese tourists

- **Regulatory Controls**
  - Conducting health and safety inspections, enforcing environmental regulations, requiring firms to obtain licenses before beginning operations or constructing new plants, and changing taxes and fees for public services
    - E.g. Taiwan’s National Health Insurance Bureau’s reimbursement schedule for pharmaceuticals and medical devices *favors domestically made products* over foreign-produced ones
    - Brazil: health & fitness equipment, processed food, and cosmetics must register their products with the Ministry of Health (approvals routinely take 3~6 months)
Other Non-tariff Barriers

- **Currency Controls**
  - Exporters of goods: allowed to exchange foreign currency at favorable rates
  - Importers of goods: forced to purchase foreign exchange from the central bank at unfavourable exchange rates
  - Tourists: offered a separate exchange rate
    - to extract as much foreign exchange as possible from free-spending foreigners
    - E.g. Venezuela imposed currency controls in 2003 (dual exchange rate system)

- **Investment Controls**
  - Controls on foreign investments and ownership
    - E.g. broadcasting, utilities, air transportation, defense contracting and financial services
  - Such controls often make it difficult for foreign firms to develop an effective presence in such markets
    - E.g. the Philippines restricts foreign ownership in advertising to 30% and telecommunication to 40%
3) Promotion of International Trade

- Subsidies
- Foreign Trade Zones (FTZs)
- Export Financing Programs
Subsidies

- Nations seek to stimulate exports by offering subsidies designed to reduce firms’ cost of doing business
  - E.g. Brazil & Kenya: taxes and tariffs exempt for imported inputs that are used to produce goods for export
- Govts *provide economic development incentives* to entice firms to locate or expand facilities in their communities to provide jobs & increase local tax bases
  - Property tax abatements, free land, training of workforces, reduced utility rates etc.
  - E.g. Georgia (US) agreed to provide Kia Motors with $400 million incentives to capture that firm’s first US plant & the 2,500 jobs
Foreign Trade Zones (FTZs)

- A geographic area where imported or exported goods receive preferential tariff treatment
  - Can be small (a warehouse - e.g., Caterpillar's diesel engine facility in Illinois) or large (the entire city of Shenzhen, China)

- To spur regional economic development
  - E.g., Mauritius – FTZ: firms can reduce, delay, or totally eliminate customs duties
  - Mexico’s Maquiladora system
    - Factory located in an FTZ in Mexico
    - Imports unfinished goods (or components), further process the goods, and re-export them
    - Mexico levies no customs duties on unfinished goods imported by a maquiladora, provided that they are re-exported
    - Second largest sector of the Mexican economy
Export Financing Programs

- Nations create government-owned agencies to assist their domestic firms in arranging financing of export sales
  - Industries like aircraft, offshore drilling rigs, and large constructions projects
  - which the success or failure in exporting depends on a firm’s producing a high-quality product, reliable repair after the sale
    - E.g. Boeing vs. Airbus
- Export-Import Bank of the US (Eximbank)
  - A government-owned agencies in US to assist their domestic firms in arranging financing of export sales
  - Provides financing for US exports through direct loans and loan guarantees
    - In 2010, it supplied financing for more than 3,500 export transactions worth $24.5 billion
      - E.g. Boeing major client
- Korea Eximbank
  - Official export credit agency providing comprehensive export credit and guarantee programs to support Korean enterprises in conducting overseas business
  - Established in 1976
4) Controlling Unfair Trade Practices

- Countervailing Duties (CVD)
- Antidumping Regulations
- Safeguards
Countervailing Duties (CVDs)

- An ad valorem tariff on an imported good that is imposed by the importing country to counter the impact of foreign subsidies
  - Calculated to just offset the advantage the exporter obtains from the subsidy
    - E.g. the EU and the US each imposed countervailing duties on high-end glossy paper imported from China
    - Believed that Chinese producers had benefited from cheap governmental financing and land sales
- Most countries impose CVDs only when foreign subsidy leads to a distortion of international trade
  - Determine whether the particular subsidy is generally available to all industries in a country or restricted to a specific industry
Antidumping Regulations

- **Dumping**
  - Domestic firms being victimized by discriminatory or predatory pricing practices of foreign firms

- **Two Types of Dumping**
  1. **International price discrimination**
     - When a firm sells its goods in a foreign market at a price below what it charges in its home market
  2. **Predatory pricing**
     - When a firm sells its goods below cost in the foreign market
     - A foreign company may lower its prices in the host country to drive host country firms out of the market and charge monopoly prices to host country consumers once competitors have been eliminated
Safeguards

- International trade law 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
    - E.g. US permits the imposition of temporary trade restrictions to protect American firms from serious harm
    - In 2009, President Obama imposed temporary tariffs for 3 years on tiers imported from China
    - Believed that American tire producers were harmed by rapid increases in imports
      - 2004-2008: US market share of Chinese tires: 4.7%  16.7%
      - Year 1: 35% tariffs; Year 2: 30%; Year 3: 25% tariffs on Chinese tires
      - American Steelworkers  happy
      - American tire wholesalers  not happy
Homework #15 – due Friday

- Read the case “Green Energy and Free Trade”
- Answer the **four** case discussion questions
- Do not spend more than 2 pages answering the questions
- You may use bullet points
- Keep your answers brief but think!
- Type your answers

- Due date: Friday, 15\textsuperscript{th} of May by 11 a.m.
Group discussion Report #7 (due Friday)

- With your group members discuss;
  - About Chapter 9
  - About Chapter 9 case study
  - And discuss based on case discussion questions

- Discuss following statement
  “What are the advantages and disadvantages of an industrial policy?”

- Report due date: Friday, 15th of May by 11 a.m.
- Group report / Individual Report (sheets are downloadable from the website http://ecampus.cbnu.ac.kr)
Case Study
Green Energy and Free Trade

Week 11 Day 2

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Discussion Question
Discussion Question

“What are the advantages and disadvantages of an industrial policy?”
Case Study Discussion

Green Energy and Free Trade
The promotion of Green Energy,
- By several countries as a focal point in recovering from the negative effects of the Global Recession of 2008-2009
- Many of these national programs run contrary to the free trade objectives of the World Trade Organization (WTO)
- The case provides examples of these trade barriers, and looks at the impact of them on all parties.

Green energy involves power generated by sustainable renewable resources.
- In 2008, President Obama promoted a Green Energy initiative designed to reduce dependency on foreign oil, lower green house gas emission, and create jobs.
- Similar programs were announced by various governments around the world.

The goals of these programs were to spur economic growth and protect the environment.
- Most of these countries are members of the WTO whose primary mission is to reduce barriers to trade.
- Many of these programs run contrary to their obligations to the charter of the WTO.
- Many of these programs include “feed-in tariffs,” local content rules, and subsidies, all of which hinder trade and raise prices to consumers.
Green Energy and Free Trade

- National programs promoting green energy
  - Provide subsidies for suppliers or customers
    - E.g. India: subsidizes homeowners 30% of the cost of installing rooftop solar panels
    - US: tax breaks for Americans who made their homes more energy efficient
    - China: subsidized local companies who entered the solar panel supply business

- Concerns for free trade advocates & WTO
  - Direct subsidies to the manufacturers of goods embodying green technologies give recipients a competitive advantage in export markets
    - Makes it more difficult for manufacturers in countries who offer no subsidies to compete both domestically and internationally
      - E.g. China has become the world’s largest producer of solar panels due, in part, to government subsidies
  - Proposed border tax adjustments (BTAs) on imported goods that have benefited from the regulatory “face to the bottom”
    - E.g. Country A requires its domestic manufacturers to adopt expensive technologies to reduce their greenhouse gas emission; Country B does not
  - The US and the EU propose to impose BTAs on goods imported from countries whose environmental standards are lower than theirs
Green Energy and Free Trade

- Why have so many governments chosen to subsidize green energy initiatives? Can all of these programs be successful?
Green Energy and Free Trade

- China has passed the United States as the largest emitter of greenhouse gases, which displeases environmentalists concerned about global climate change. China has subsidized its green energy manufacturers, allowing them to dominate key industries, such as solar panels, which displeases advocates of free trade.

- What would you recommend China do? Should it accommodate its critics? Should it ignore them?
What is the rationale for BTAs? Under what conditions, if any, should countries be allowed to impose BTAs?
Green Energy and Free Trade

- What is the appropriate trade-off between promoting free trade and promoting green energy? Should the WTO rules be suspended when dealing with green energy?
Homework #16 – due next Wednesday

- Read Chapter 10 – International Cooperation Among Nations
- Answer the following questions
  1. What does *most favored nation* (MFN) mean?
  2. Under what conditions can WTO members not use MFN when dealing with one another?
  3. How does the WTO differ from the GATT?
  4. How do the various forms of economic integration differ?
  5. Why do free trade areas develop rules of origin?
  6. What was the goal of Treaty of Rome?
  7. Describe the five major organizations governing the EU

- Do not spend more than 2 pages *(Type your answers)*
- Try and keep your answers brief
- Due date: Wednesday, 20th of May by 10 a.m.
Homework #17 – due next Friday

- Read the case “The New Conquistador”
- Answer the first four case discussion questions
- Do not spend more than 2 pages answering the questions
- You may use bullet points
- Keep your answers brief but think!
- Type your answers

- Due date: Friday, 22nd of May by 11 a.m.
Group discussion Report #8 (due next Friday)

- With your group members discuss;
  - About Chapter 10
  - About Chapter 10 case study
  - And discuss based on case discussion questions

- Discuss following statement
  “Should international business promote or fight the creation of regional trading blocks?”

- Report due date: Friday, 22\textsuperscript{nd} of May by 11 a.m.
- Group report / Individual Report (sheets are downloadable from the website \url{http://ecampus.cbnu.ac.kr})