Global Economy
Lecture 6

Dr Wioletta Nowak

Instruments of trade policy

Tariffs

Non-tariff barriers (NTBs)

Arguments for trade liberalization and arguments for trade protection

Tariffs

- A tariff is a tax imposed on goods when they are moved across a political boundary.

- Tariff rates vary across goods and services as well over time.

- **Import tariff** – levied on imports.

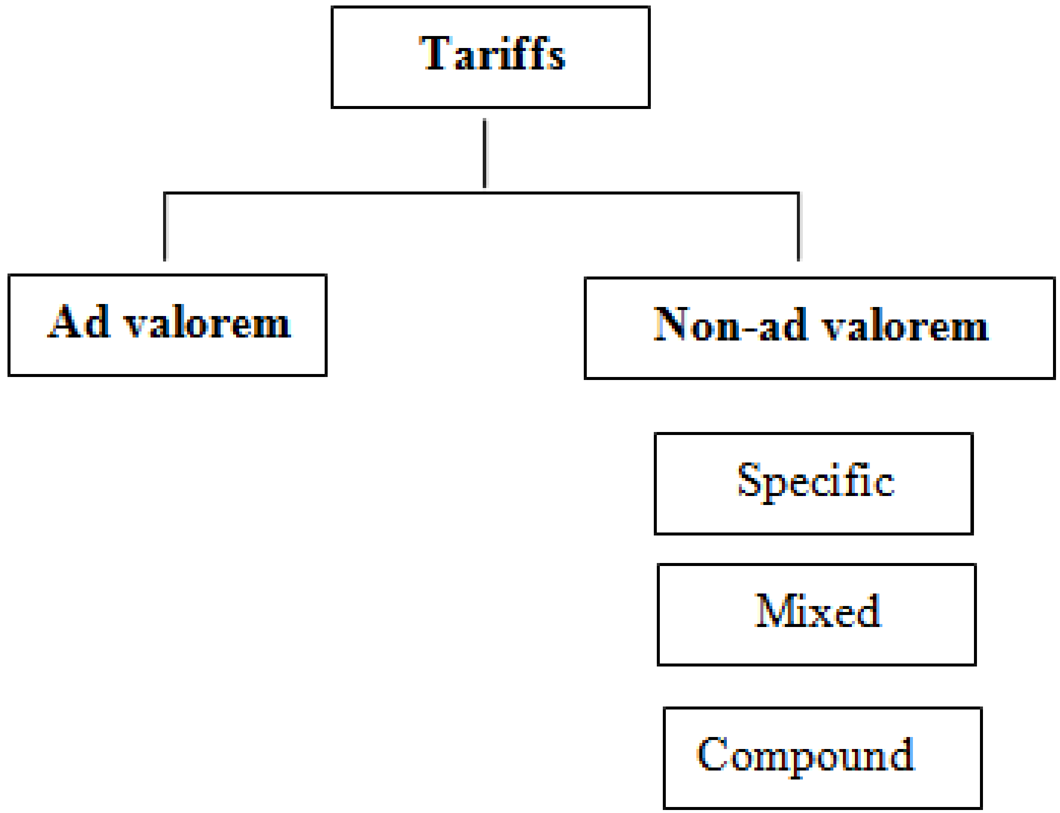
- **Export tariff** – levied on exported goods as they leave the country.

Why impose tariff?

- to raise revenue (a **revenue tariff** – a tariff imposed to generate public revenue),

- to protect domestic industries (a **protective tariff** is intended to artificially inflate prices of imports and "protect" domestic industries from foreign competition),

- to discourage consumption and imports (special case a **prohibitive tariff** – so high that no one imports any of the item) – prohibitive tariffs on used vehicles


Tariffs
Ad valorem
Non-ad valorem
Specific
Mixed
Compound

Different technical methods of assessing customs duties

- **ad valorem** – percentage of the value of the imported goods, e.g. 10 per cent of the value,
- **specific** – based on weight or volume of goods, e.g. 2 dollars per kilogram,
- **mixed** – ad valorem or specific – whichever is higher/lower,
- **compound** – ad valorem and specific, e.g. 10 per cent plus 2 dollars per kilogram or on another basis (technical tariff) e.g. according to percentage content of a product component (e.g. sugar or alcohol).

What is a non-tariff barrier?

- NTBs appeared in the mid-1970s. By the mid-1980s the rapid growth of NTBs threatened the liberalization created by decades of tariff reductions.

- There is no agreement on the best definition of a ‘protectionist measure’ or in particular, a non-tariff barrier to trade.

- To a large degree, NTBs are defined by what they are not - <u>that is, all barriers to trade that are not tariffs</u>.

Import quotas

- Import quotas are limitations on the quantity of goods that can be imported into the country during a specified period of time.

- There are two basic types of quotas: **absolute** quotas and **tariff-rate** quotas (TRQs).

Tariff-rate quotas (TRQs)

- **Tariff quotas** (tariff-rate quotas) - lower tariff rates for specified quantities, higher (sometimes much higher) rates for quantities that exceed the quota.

- In March 2002, the United States imposed tariff-rate quotas of about 30 percent on most imported steel above set quotas. This measure is expected to reduce steel exports from East Asian countries, particularly from Japan and Korea.

Tariff-rate quotas (TRQs)

- 1993 – the EU’s regulatory regime for imported bananas
- ACP (Africa, the Caribbean, the Pacific) bananas – duty-free entry up to a celling of 857,000 tons, imports in excess of this amount paid 750 ECUs per ton.
- Non-ACP bananas – duty of 100 ECUs per ton on imports up to 2 million tons and 850 ECUs on imports above that amount.

Tariff-rate quotas (TRQs)

- 5 Latin-American banana producing countries (Colombia, Costa Rica, Guatemala, Nicaragua, Venezuela) – GATT dispute settlement proceedings in June 1993.
- Framework Agreement – the non-ACP quota 2.1 million tons in 1994, 2.2 million tons in 1995, 75 ECUs per ton (except Guatemala); above quota duty at 765 ECUs per ton

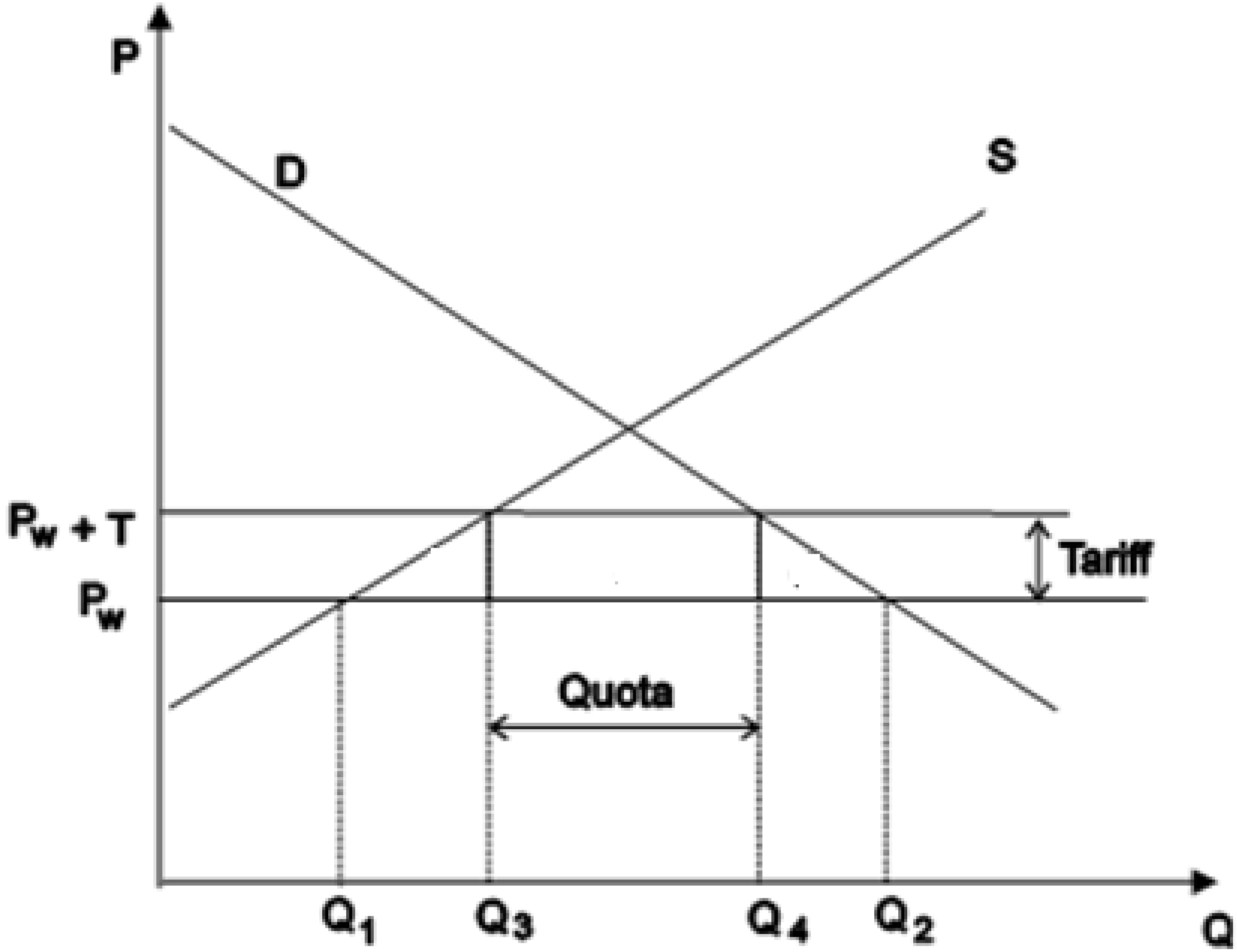
There are three basic methods used to administer import quotas

- **First-Come, First-Served** – The government can allow imports to enter freely from the start of the year until the quota is filled. Once filled, customs officials would prohibit entry of the product for the remainder of the year.

- **Auction Quota Rights** – The government can auction quota rights.

- **Give Away Quota Rights** – The government can give away the quota rights by allocating quota tickets to appropriate individuals.

Tariffs vs import quotas



The choice between a tariff and a quota depends on several different concerns

- The revenue effects
- Administrative costs of tariffs and quotas
- The protective effect the policy has on the import-competing industries

The revenue effects

- A tariff has an immediate advantage for governments in that it will automatically generate tariff revenue.

- Quotas may or may not generate revenue depending on how the quota is administered. If a quota is administered by selling quota tickets (i.e., import rights) then a quota will generate government revenue, however, if the quota is administered on a first-come, first-served basis, or if quota tickets are given away, then no revenue is collected.

Administrative costs of tariffs and quotas

- Tariff involves product identification and processing of fees.

- Quota administration involves product identification and some method of keeping track, or counting, the product as it enters the country in multiple ports of entry. It may also involve some method of auctioning or disbursing quota tickets.

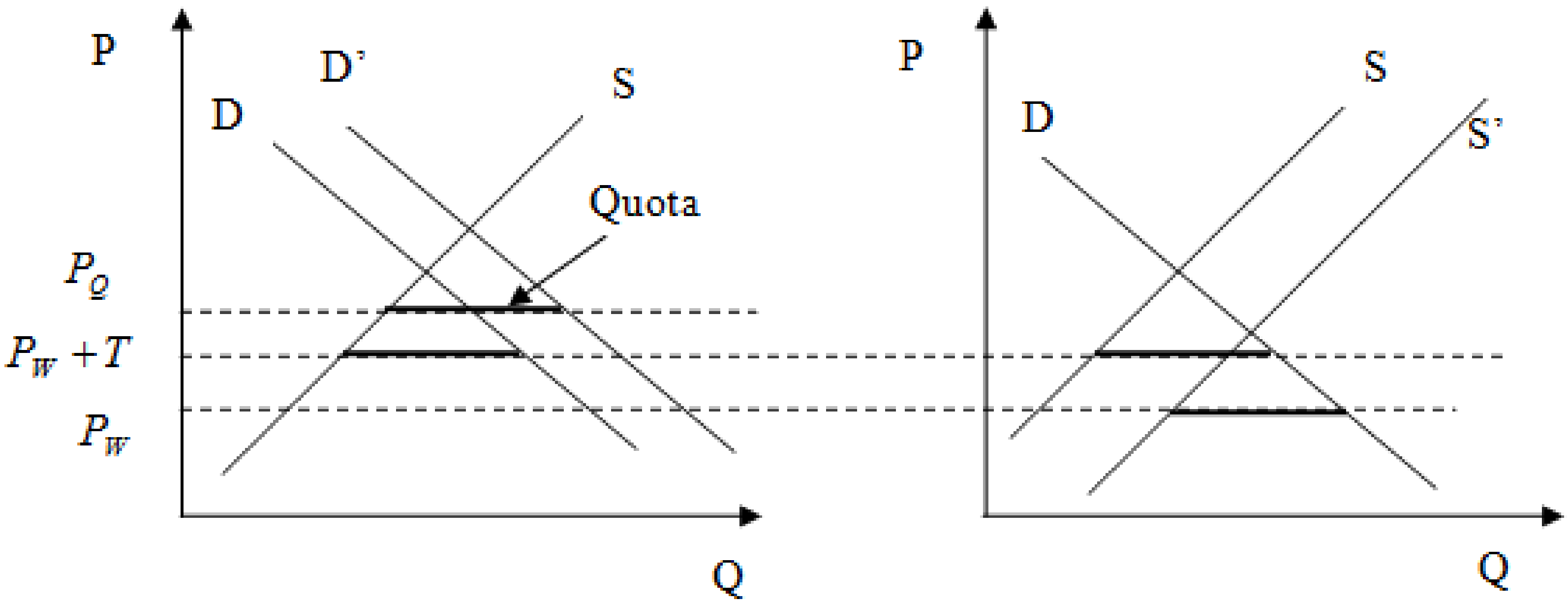
The protective effect the policy has on the import-competing industries

- Quotas are more protective for the domestic industry because they limit the extent of import competition to a fixed maximum quantity. The quota provides an upper bound to the foreign competition the domestic industries will face.

- In contrast, tariffs simply raise the price, but do not limit the degree of competition or trade volume to any particular level.

- Although tariffs and quotas are generally equivalent to each other in terms of their static price and welfare effects, this equivalence does not remain true in the face of market changes.

The Protective Effects of Tariffs vs. Quotas with Market Changes (a Small Country Case)



An increase in domestic demand

- A tariff – the increase in domestic demand will leave the domestic price unaffected and increase the level of imports.

- A quota – the increase in domestic demand causes the domestic price to rise up in order to maintain the import level unchanged.

- The quota is more protective for domestic producers than a tariff.

An increase in domestic supply

- A tariff – the increase in domestic supply will leave the domestic price unaffected and reduce the level of imports.

- A quota – the increase in domestic supply causes the domestic price to fall back to the free trade level in order to maintain the import level unchanged.

- The tariff is more protective for domestic producers than a quota in the face of an increase in domestic supply.

- In situations where market changes cause a decrease in imports, **a tariff** is more protective than a quota. This occurs if domestic demand falls, domestic supply rises, the world price rises, or some combination of these changes occurs.

- Since import-competing firms are generally more concerned about situations where imports may increase, industry preferences usually favour **quotas** over tariffs since quotas will be more protective in these situations.

Non-tariff measures notified by GATT/WTO members for non-agricultural products

Government participation in trade and restrictive practices tolerated by governments
Government aids
Countervailing duties
Government procurement
Restrictive practices tolerated by governments
State trading, government monopoly practices, etc.

Non-tariff measures notified by GATT/WTO members for non-agricultural products

Customs and administrative entry procedures
Anti-dumping duties
Valuation
Customs classification
Consular formalities and documentations
Samples
Rules of origins
Customs formalities

Non-tariff measures notified by GATT/WTO members for non-agricultural products

Technical barriers to trade
General
Technical regiulations and standards
Testing and certification arrangements

Non-tariff measures notified by GATT/WTO members for non-agricultural products

Specific limitations	
Quantitative restrictions and import licensing	Export restraints
Embargoes and other restrictions of similar effect	Measures to regulate domestic prices
Screen-time quotas and other mixing regulations	Tariff quotas
Exchange control	Export taxes
Discrimination resulting from bilateral agreements	Requirements concerning marking, labelling and packaging
Discriminatory sourcing	Other specific limitations

Non-tariff measures notified by GATT/WTO members for non-agricultural products

Charges on import
Prior import deposits
Port taxes, statistical taxes, etc.
Discriminatory film taxes, use taxes, etc.
Discriminatory credit restrictions
Border tax adjustments

Voluntary Export Restraints (VERs)

- A VER is an agreement, explicit or tacit, between exporting and importing countries, where the former „voluntarily” limit the quantity or the growth of their exports.

- VERs are known by other names, including „orderly marketing arrangements”.

Voluntary Export Restraints (VERs)

- In case of **perfect competition** VERs are similar to a quota, except that the quota rents are captured by the foreign exporters in the form of higher profits.

- Welfare of foreign country can improve because of the transfer of quota rents to the foreign country, or equivalently an improvement in its terms of trade.

Voluntary Export Restraints (VERs)

- For exporting countries, the VER is often more attractive alternative compared to other import-restricting measures at the disposal of the importing country.

- Firms accept the VERs because the alternative is the threat of retaliation with more permanent form of protection such as tariff or quotas.

Voluntary Export Restraints (VERs)

- VERs began to emerge as elements of some industrial countries’ trade policies in the mid-1950s. They were the most frequently used in the decades of the 1970s and 1980s.

- VERs became prominent restrictions in the industries where Japan, the East Asian tigers and other developing countries built-up competitiveness - textiles and clothing, footwear, iron, steel, and motor vehicles.

Voluntary Export Restraints (VERs)

- The Agreement on Safeguards (the Uruguay Round, 1986-94) phased out existing VERs.

- They are contrary to some GATT provision, especially Articles XI and XIII on export and import quotas.

Voluntary Export Restraints (VERs)

Economic factors that contribute to the demise of VERs:

- restraints were ineffective (the principal exporters maintained their market share during the height of the restriction);
- the expected employment effect failed to materialize;
- the industries were able to adjust,
- a high cost for consumers, part of benefits transferred to the exporters (as quota rents) and part to the import competing domestic industry.

Examples of VERs: US-Japan automobile VERs in the early 1980s

- Japanese cars - cheap and fuel efficient.
- 1981 voluntary export restraint agreement limited Japan to exporting 1.68 million cars to the US annually.

- Since the quantity of car trade between Japan and the US was limited but the value of trade was not, Japanese producers began upgrading the quality of their exports to raise their profitability.

Examples of VERs: US-Japan automobile VERs in the early 1980s

- The profits of Japanese firms have risen in the face of the imposition of the VERs. By the late 1980s, new higher-quality car lines such as Acura, Infiniti, and Lexus made their debut.

- Japanese cars assembled in the US were not counted as part of the export restriction - only complete cars exported from Japan were restricted. Thus, after the VERs were implemented, Honda, Mazda, Toyota, Mitsubishi, and Nissan all opened assembly plants in the US.

Examples of VERs: US-Japan textile VERs in the 1950s and 60s

- In the mid-1950s, US **cotton textile** producers faced increases in Japanese exports of cotton textiles which negatively affected their profitability.
- The US government subsequently negotiated a VER on cotton textiles with Japan.
- By the early 1960s, other textile producers in the US, who were producing **clothing using the new synthetic fibres** like polyester, began to experience the same problem with Japanese exports that cotton producers faced earlier.
- VERs were negotiated on exports of synthetic fibres from Japan to the US.

Export Subsidies

- Export subsidies are payments made by the government to encourage the export of specified products.
- The most common product groups where export subsidies are applied are agricultural and dairy products.

- Country's subsidies can hurt: a domestic industry in an importing country, rival exporters from another country when the two compete in third markets, exporters trying to compete in the subsidizing country's domestic market.

- If domestic producers are hurt by imports of subsidized products, **countervailing duty** can be imposed.

Subsidies and Countervailing Measures

- **Agreement on Subsidies and Countervailing Measures** allows the use of countervailing measures on subsidized imported goods.

- A country can use the WTO's dispute settlement procedure to seek the withdrawal of the subsidy or the removal of its adverse effects.

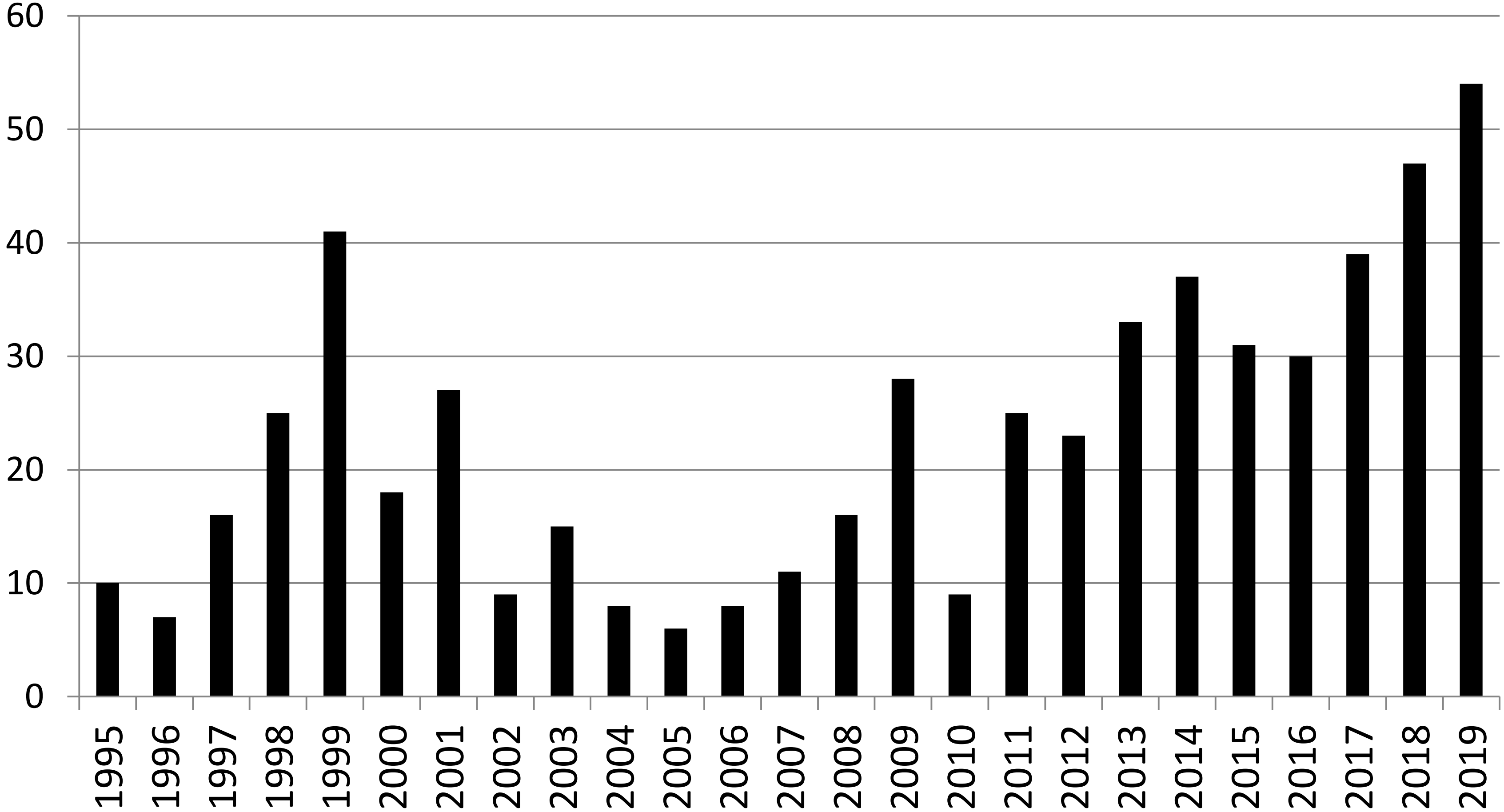
- Country can launch its own investigation and ultimately charge extra duty (known as "countervailing duty") on subsidized imports that are found to be hurting domestic producers.

Subsidies and Countervailing Measures

- Countervailing investigations will be terminated immediately in cases where the amount of a subsidy is *de minimis* (**the subsidy is less than 1 per cent *ad valorem*)** or where the volume of subsidized imports, actual or potential, or the injury is negligible.

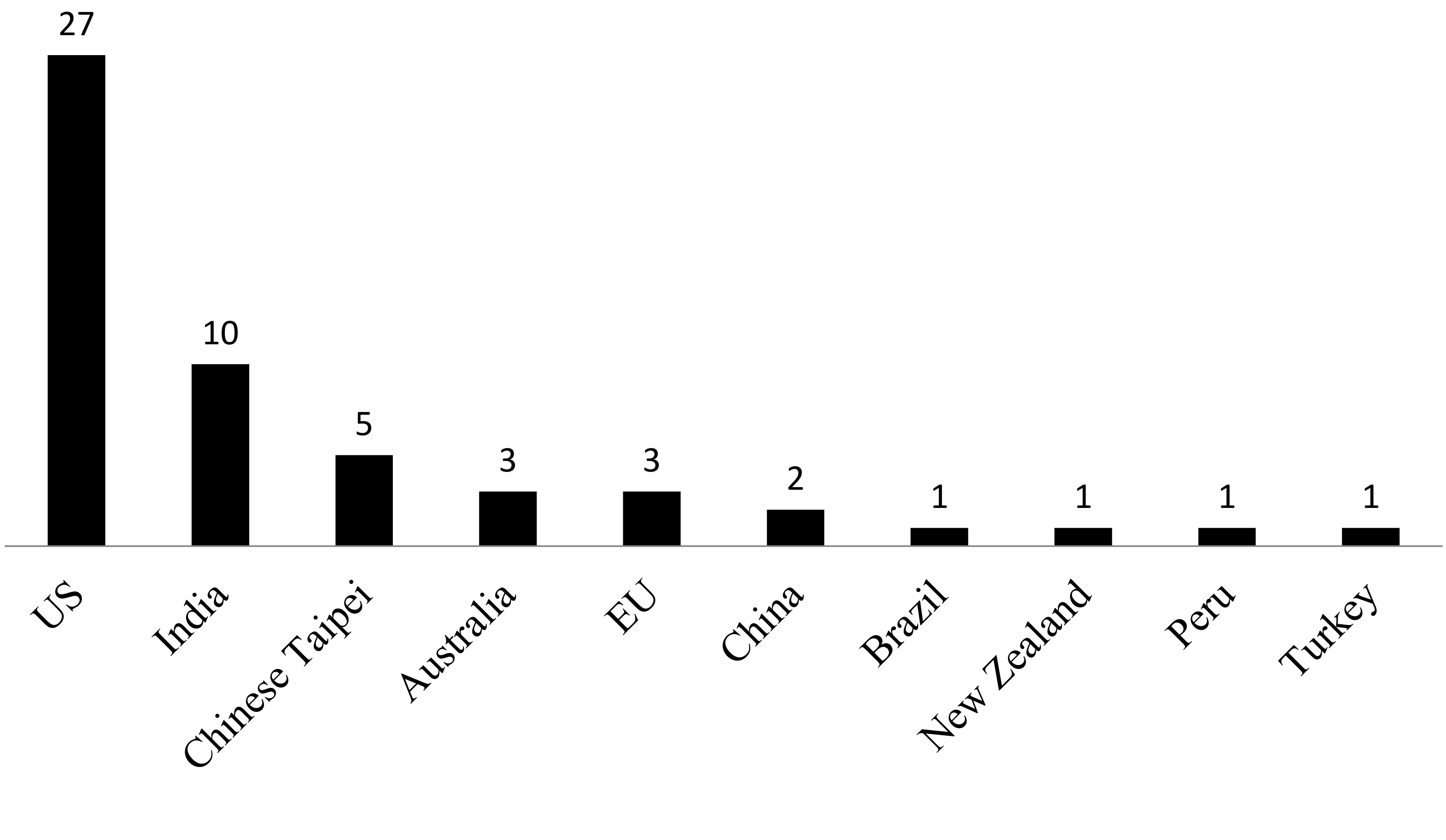
Countervailing initiations by all countries

Source: www.wto.org



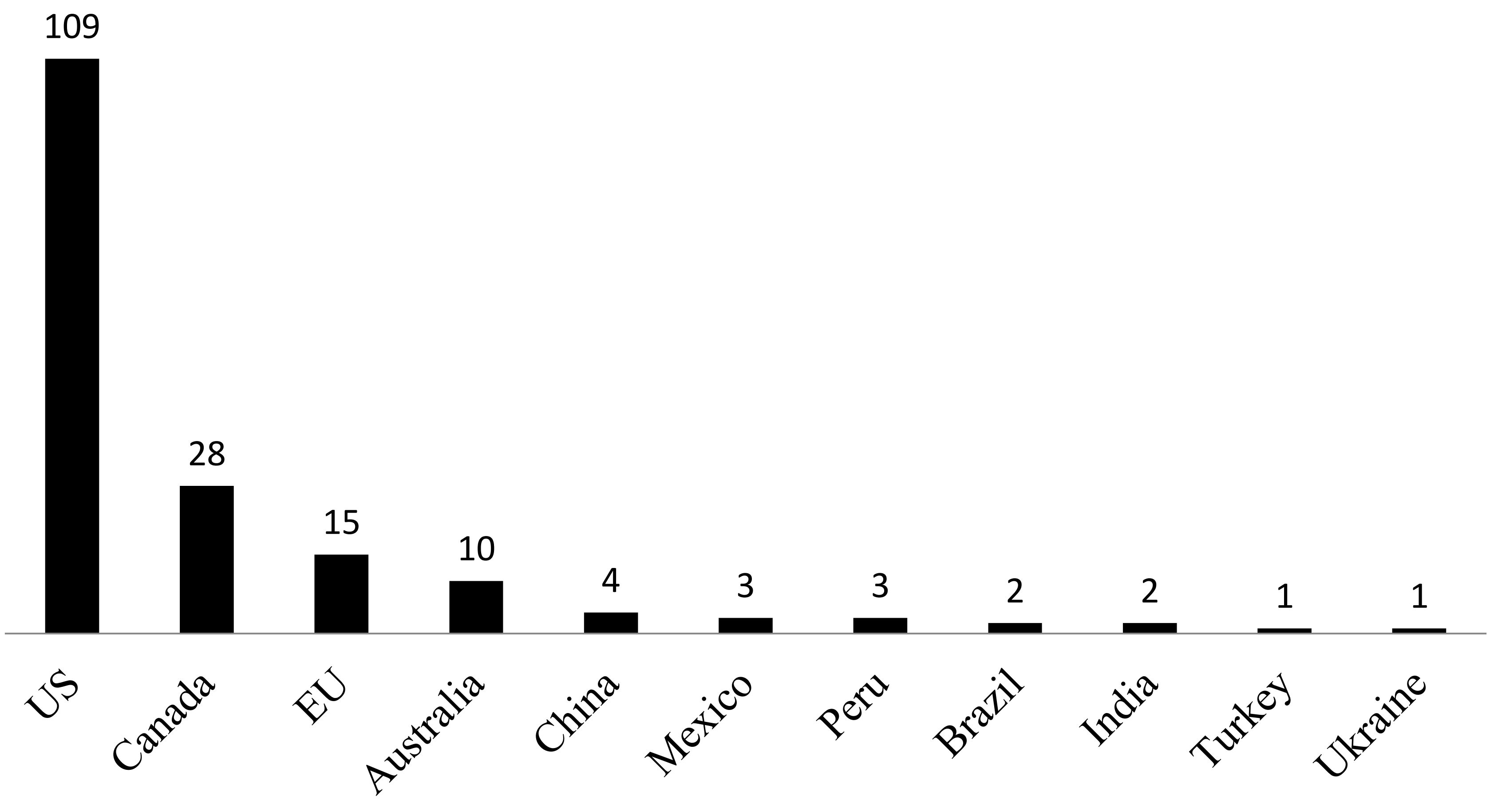
Countervailing initiations, 30/06/2019

Source: www.wto.org



Countervailing duties in force, 30/06/2019

Source: www.wto.org



Technical Barriers to Trade (TBT)

- If technical measures differ across countries they can represent significant barriers to trade. It is costly for exporters to obtain accurate and up-to-date information on technical measures abroad and on related conformity assessment procedures.

- Adjusting to foreign technical measures often causes significant costs.

- The OECD (1999) found that the cost of meeting standards and technical regulations in its member nations, along with the cost of testing and certification, could amount to between 2 and 10 per cent of overall product costs.

Technical Barriers to Trade (TBT)

The Uruguay TBT Agreement recognizes that governments employ technical regulations to attain legitimate objectives such as:

- national security requirements,
- the prevention of deceptive practices,
- protection of human health or safety,
- protection of animal or plant life or health,
- protection of environment.

Technical Barriers to Trade (TBT)

- However, technical regulation must not be prepared, adopted or applied with a view to, or have the effect of, creating unnecessary obstacles to international trade.
- Technical regulations should not to be more trade-restrictive than necessary to fulfil a government's objectives.

- The TBT Agreement covers: technical regulations, labelling requirements, nutrition claims and concerns, and quality and packaging regulations.

The *Cassis de Dijon* case (1979)

- The case concerned the sale by an importer of the liquor - **Crème de Cassis de Dijon** (20% alcohol content), a blackcurrant flavoured liqueur, produced in France.

- The German government had a law restricting the minimum amount of alcohol which should exist in certain products being sold as a liqueur, being a minimum of 25%.
- Therefore the importer was told that the product could not be sold as they wished to sell it.

The *Cassis de Dijon* case (1979)

- The European Court of Justice – held that there are no valid reasons why a product that is lawfully marketed in one member state should not be introduced in another member state.

- **The Cassis de Dijon principle -** goods lawfully produced in a Member State of the European Union (EU) can also be sold in any other EU state.

Examples of Technical Barriers to Trade

- Italy’s pasta purity laws required that pasta be made of durum wheat, a high-quality type produced in the south of the country.

Sanitary and Phytosanitary (SPS) Measures

- SPS Agreement covers all measures which purpose is

- to protect human or animal health from food-borne risks;
- to protect human health from animal- or plant-carried diseases;
- to protect animals and plants from pests or diseases;
- to prevent or limit other damage to a country from the entry, establishment or spread of pests.

- The number of notifications on technical, sanitary and phytosanitary barriers to trade increased significantly after the Uruguay Round.

Protection of health or environment: cases

The „mad cows" case

- On March 27th 1996 the European Union imposed a world-wide ban on beef exports from the United Kingdom because cases of BSE (Bovine Spongiform Encephalopathy) had been detected in British cattle.

- Scientific evidence published at the time suggested that there was a real possibility that mad cow disease could affect people (the human equivalent is Creutzfeldt-Jakob Disease).

Protection of health or environment: cases

The „mad cows" case

- In the UK, beef cattle sales fell by nearly 90% the week after the ban was declared.
- Two weeks later, beef prices had fallen by 20 to 50% throughout the countries of the EU.
- Sales volumes had dropped even further, with consumption falling 50% in Belgium, 30% in France, 50% in Portugal and 60% in Italy.

- In 1995, exports of British beef and related products had reached US $1 billion.

Protection of health or environment: cases

The Kenya fish exports case

- In January 1998 the EU banned the imports of fresh fish and fish products from Kenya, Mozambique, Tanzania, and Uganda, to safeguard EU consumers from the risk of cholera.

- The ban was motivated by the lack of credible system in Kenya to safeguard the products from possible contamination.

Protection of health or environment: cases

The poisoned grapes case

- On March 13th 1989, the US Food and Drug Administration (FDA) announced it had detected in the port of Philadelphia <u>two grapes </u>from Chile contaminated with cyanide.

- Without consulting the Chilean Government, the FDA promptly banned Chilean fruit, triggering the „poisoned grapes crisis” as it became known, which hit one of Chile’s main exports hard.

Protection of health or environment: cases

The poisoned grapes case

- FDA decided to quarantine all fruit from Chile headed for the US market, calling on stores to take it off their shelves and consumers to avoid consuming the fruit. The decision to ban the fruit and to publicize this created real panic.

- Four days later, following though bargaining between government representatives from Chile and the US, and the signing of agreements on strict sanitary controls, the US formally ended the embargo. In the meantime, Chile had lost over US $400 million.

Protection of health or environment: cases
Hormone-fed beef case

- The WTO ruled against the EU ban on beef raised with growth hormones because EU failed to produce a science-based risk assessment showing that it might be dangerous.

- The EU did not cancelled the ban. Their strategy - „precautionary principle" that says to prohibit new technologies that have not yet been proven safe, even if there is no evidence that they are dangerous.

Protection of health or environment: cases

Shrimp-turtle case

Shrimp imports and the protection of sea turtles

- US Endangered Species Act

- International trade in shrimp was harming sea turtles by ensnaring them in nets. US had banned shrimp imports from countries that did not have in place for all production a specific turtle-protection regime - Turtle Excluder Devices.

Protection of health or environment: cases

Shrimp-turtle case

- 1998 - the WTO panel and the Appellate Body - the ban in imports from countries without adequate regulatory regimes was **arbitrarily and unjustifiably discriminatory** against the four Asian shrimp suppliers (India, Malaysia, Pakistan, Thailand).

- The Asian suppliers had been given only four months' notice, thus discriminating against them and in favour of Caribbean suppliers (three years).
- (The majority of suppliers in India raise shrimp by aquaculture, where no sea turtles are endangered)

Protection of health or environment: cases
Tuna-dolphin case

Tuna imports and the protection of dolphins

- US (under the Marine Mammal Protection Act) had banned imports of tuna from countries that allowed the fishermen to use nets that also caught dolphins.

- Mexico brought a case before the GATT, and the GATT panel ruled against the US law (because the ban did not discriminate according to which type of net was used).

- A system for labelling tuna in the US market as either „dolphin safe" or not was later found consistent with the GATT. Since 1990, the major companies have sold only the dolphin-safe kind tuna.

„Blue tariffs”- labour standards

- Labour standards differ between countries and tend to be lower and/or enforced less in developing countries.

- Some countries use trade policy to induce other countries to adopt something closer to their social policy standards.

- Labour standards contributes to differences in countries’ comparative advantages in trade.

„Blue tariffs”- labour standards

- Shorter working weeks, higher overtime pay, longer annual leave, safer and healthier working conditions raise worker welfare but also raise the cost of employing labour.

- Labour standards tends to raise the cost of production in labour-intensive industries most in high-standard countries thereby reducing the capacity of those industries to compete with producers in low-standard countries.

Red-Tape Barriers

- Red-tape barriers refers to costly administrative procedures required for the importation of foreign goods. Red-tape barriers can take many forms.

- In 1982 France required that all Japanese videocassette recorders enter the country through one small port in the south of France. Because the port capacity was limited, it effectively restricted the number of videocassette recorders that could enter the country.

- A red-tape barrier may arise if multiple licences must be obtained from a variety of government sources before importation of a product is allowed.

Rules of Origin (RoO)

- Rules of origin are the criteria used to define where a product was made.
- ***Non-preferential rules of origin*** are used to distinguish foreign products from domestic products when a country does not want to provide the former with the same treatment granted to the latter. In some countries, for example, public procurement either excludes foreign products or reserves certain transactions to domestic products, or grants a margin of preference to them.
- ***Preferential rules of origin*** are used to determine which goods may enter a country under a preferential treatment (Free Trade Area (FTA) or Customs Union (CU)).

Note: FTA - members maintain their own external tariffs, CU members have a common external tariff.

Requirements that the product has been „substantially transformed”

- RoO can be defined in a variety of different ways.

- <u>The “value-added” criterion (ad valorem percentage test)</u> it defines the degree of transformation required to confirm origin to the good in terms of minimum percentage of value that must come from the originating country or of maximum amount of value that can come from the use of imported parts and materials.

- This criterion is applied by Australia, Canada, New Zealand and the United States and also by Bulgaria, the Czech Republic, Hungary, Poland, the Russian Federation and Slovakia.

Requirements that the product has been „substantially transformed”

- <u>The “process” criterion</u> it confers origin to the product based on the results of tests it must undergo. This criterion is applied by Japan, Norway and Switzerland.

- <u>The “change in tariff classification” criterion</u> determines the origin of a good by specifying the change in tariff classification of the Harmonised System of Tariff Nomenclature (HS) required to conferring origin on a good.
- As a general rule, imported materials, parts or components are considered to have undergone substantial transformation when the product obtained is classified in a heading of the HS at the four-digit level which is different from those in which the non-originating inputs used in the process are classified. Requires the product to change its tariff heading under the HS in the originating country.

Requirements in terms of specified processes that must be performed within the Free Trade Area (FTA) or Customs Union (CU).

- Only if each step of transformation from raw material to finished garment has been undertaken within the FTA will preferential treatment be given.

Rules of Origin (RoO)

- The EU applies very detailed rules of origin to several products categories: textiles, clothes, meat, grape juice, wine, vermouth, leather clothes, shoes, tape-records, magnetic discs, television sets, integrated circuits, copier machines, and ceramic articles.

Antidumping (AD)

- The first recorded antidumping law was in Canada (1904).

- The Canadian legislation was followed by similar legislation in most of the major trading nations in the industrialised world prior to and after World War I (Australia in 1906; US in 1916 and 1921).

- Nowadays, virtually all of the industrialised and developing countries have adopted antidumping legislation.

Antidumping (AD)

- **Dumping** occurs when export price is below normal value. Normal value is usually based on domestic prices, unless domestic sales are made in relatively low volumes or are made at prices below cost.

- Export prices should be compared against the higher of: domestics prices or cost of production plus reasonable amount for selling costs and profit.

Antidumping (AD)

- Antidumping has become the trade policy of choice to provide administered protection to domestic firms to offset the injury that results from the dumping practices of foreign exporters.
- An easy way for import-competing firms to gain protection.

Antidumping (AD)

- AD is GATT/WTO consistent and requires no concessions. Article VI of GATT 1994 allows Members to apply antidumping measures on imports of a product with an export price below its „normal value" if such imports causes or threaten to cause material injury to a domestic industry.
- The WTO agreement on anti-dumping defines **de minimis dumping as below 2%**. That is, export prices can be up to 2% below normal value before they will be considered 'dumped'.
- WTO rules define negligible injury as less than 3% of imports into the country concerned.

Example: Polish golf carts case

- In the 1970s, Poland began exporting electric golf carts to the United States in significant numbers.

- In 1975, US golf cart producers complained that these Polish golf carts were unfairly priced and filed an antidumping complaint.

- Problem of pricing Polish golf carts. Poland did not have convertible currency and had no usable cost data on inputs, since most were simply provided by the government. There was no domestic Polish market or third market for the golf carts, because the carts were exported only to the US. At the time, golf carts were made by only the US and Poland.

Example: Polish golf carts case

- Poland was asked to provide actual data on the amount of labour, electricity, and other inputs. Surrogate market was chosen to set appropriate monetary values for the inputs.

- The constructed values, based on Spanish prices, led to a determination that the golf carts were not being sold below fair value.

Antidumping (AD)

- Until the last two decades of the 20th century most antidumping actions were confined to a small group of GATT Contracting Parties - the US, Canada, Australia and the European Community (EC).

- In the mid-1980s, antidumping actions began to spread beyond the traditional users to involve many developing countries.

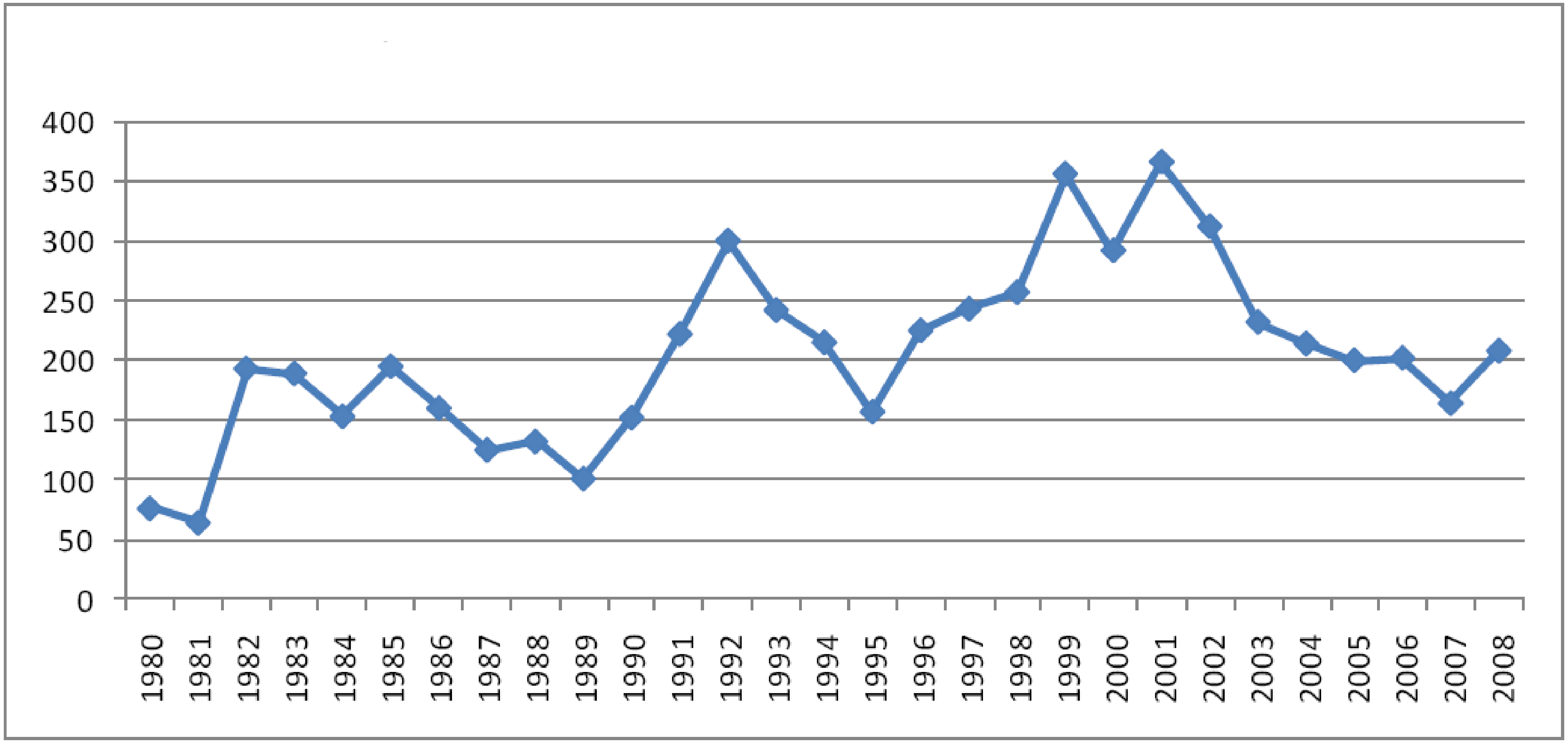
- Total antidumping initiations have continued to rise since 1980. Antidumping initiations by the US, Canada, Australia, EC has tailed off in the last decade.

Antidumping (AD)

- Developing countries like Argentina, Brazil, India and Mexico have become quite active users and have been responsible for much of the growth of antidumping activity since the mid-90s.
- The new users initiate antidumping cases more intensively (15 to 20 times more frequently per dollar of imports) than US or EC.

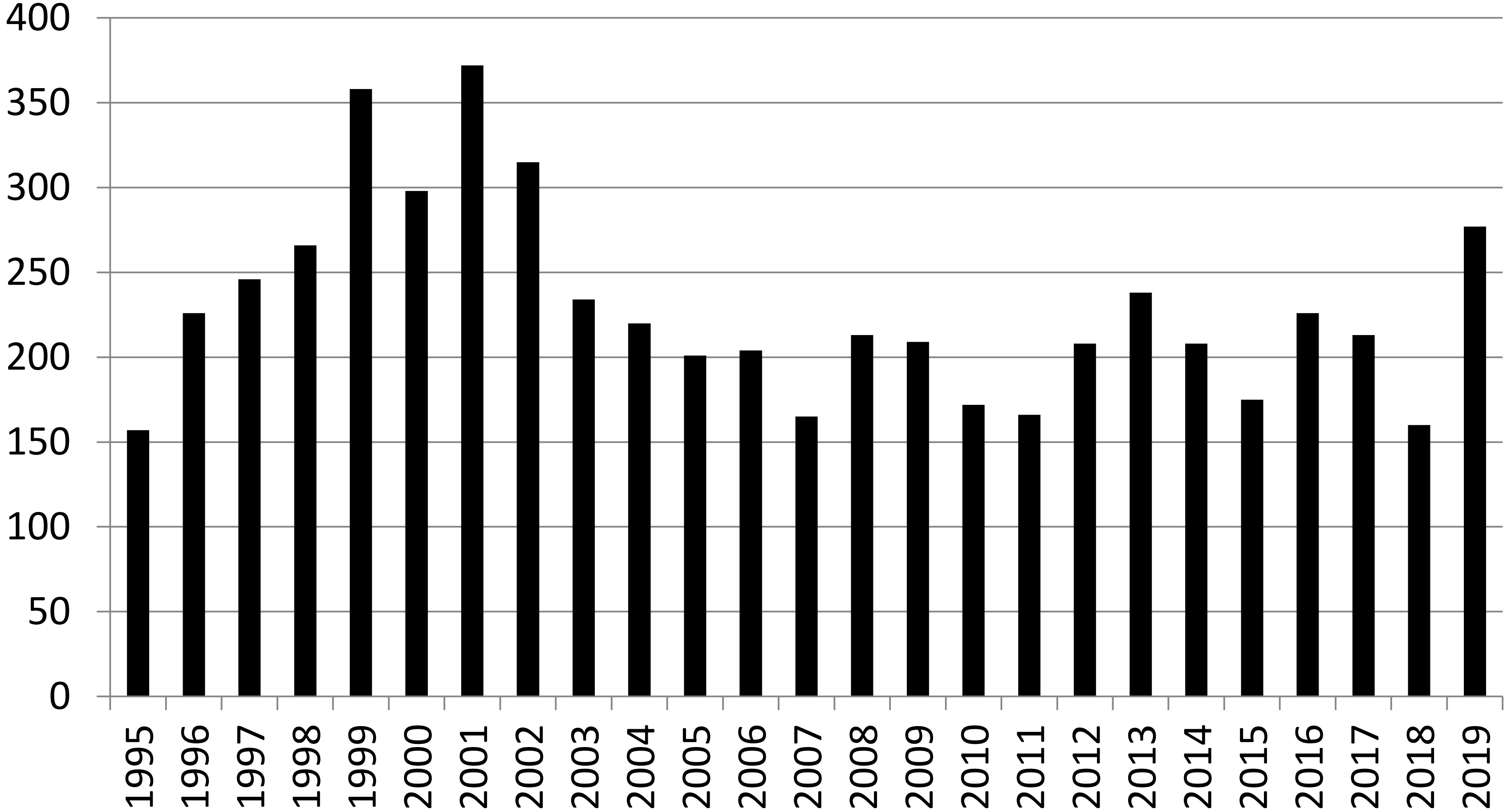
Anti-dumping investigations initiated 1980-2008

Source: Global Trade Protection Report 2009 (15 June 2009)



AD initiations by all countries

Source: www.wto.org, https://www.wto.org/english/news_e/news19_e/g20_wto_report_june19_e.pdf



Average number of AD investigations

Source: www.wto.org

1980-1989	139
1990-1999	237
2000-2009	242
1995-2018	**227**

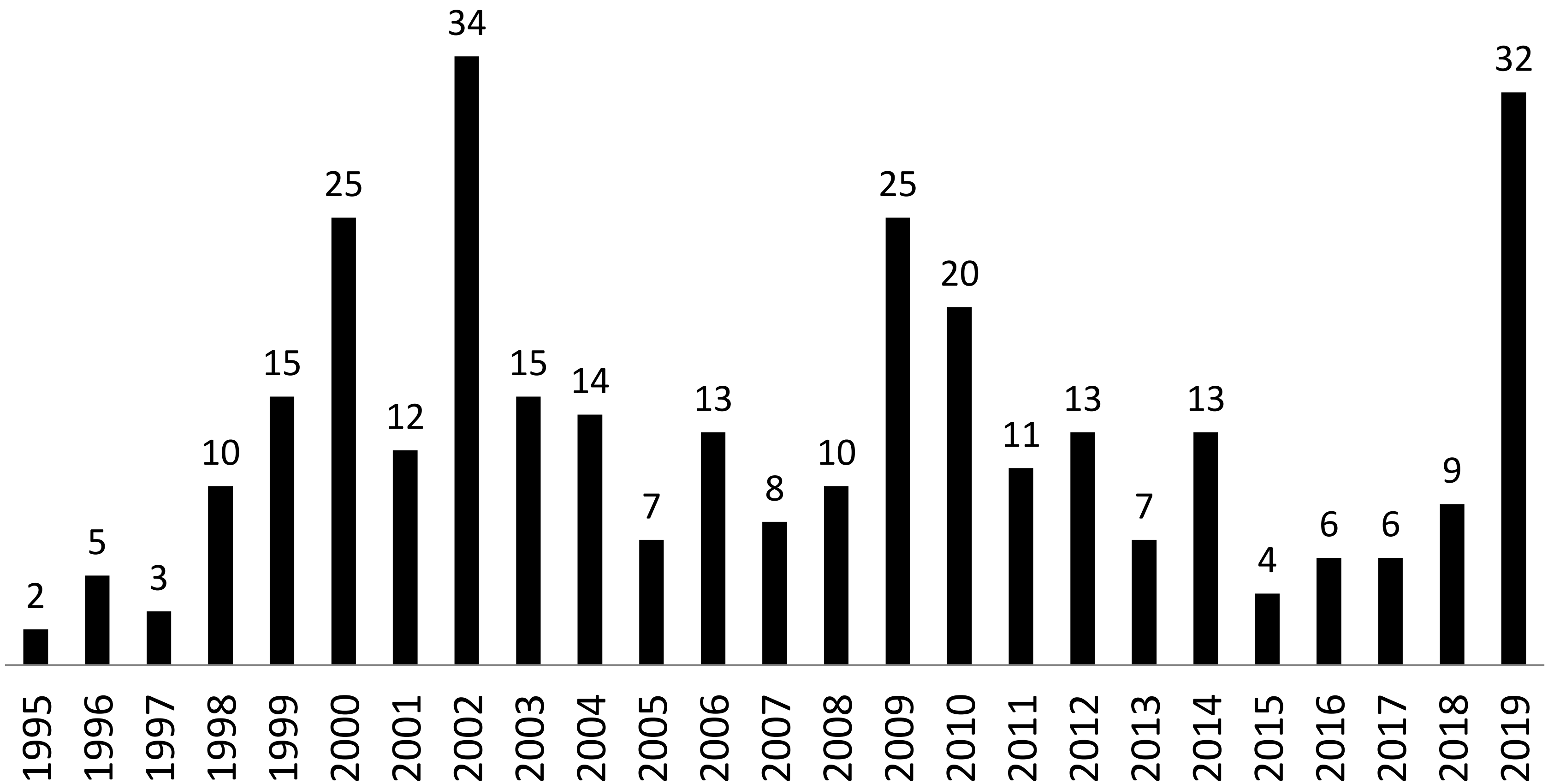
Safeguards

- A **safeguard** is a tool used by a state to restrain international trade to protect a certain home industry from foreign competition.

- A WTO member may take a “safeguard” action (i.e., restrict importation of a product temporarily) to protect a specific domestic industry from an increase in imports of any product which is causing, or which is threatening to cause, serious injury to the domestic industry that produces like or directly-competitive products (Article XIX of the General Agreement).

Safeguard initiations

Source: www.wto.org



Measures initiated and in force as of 30/06/2019

Source: www.wto.org

Measure	Initiated	In force
Sanitary and Phytosanitary	15 143	3 494
Technical Barriers to Trade	24 070	2 870
Antidumping	277	1861
Countervailing	54	178
Safeguards	32	48

Arguments for Trade Liberalization
Arguments for Trade Protection

Arguments for trade liberalization

- Trade promotes competition that leading to innovative investments and improvements in productivity.

- Trade improves resources allocation and fosters specialization in sectors where countries have comparative advantage.

- Trade enlarges a country’s access to scarce resources and its consumption capacities.

Arguments for trade liberalization

- Trade attracts foreign capital and technology into developing countries.

- Trade accelerates overall economic growth, which raises profits and promotes greater savings and investment and thus further growth.
- It causes long run improvements in living standards.

Arguments for trade liberalization

- Trade provides access to worldwide markets for poor countries.
- Trade generates very needed foreign exchange to pay for debt or imports.
- Trade increases world output.

Arguments against trade liberalization

- The „race to bottom" hypothesis - international trade will put downward pressure on countries' environmental standards and thus damage the environment.
- Domestic regulation raises the costs of production - domestic producers may lose their competitiveness against firms in other countries.

Arguments against trade liberalization

- The pollution haven hypothesis - comparative advantage could be deliberately created by differences in environmental regulation itself.
- A migration of dirty industries to the LDCs (lower pollution costs).
- The poor countries produce and sell the products that require pollution (the rich countries specialize in products that can be produced cleanly).

Arguments against trade liberalization

- Large scale exit of domestic firms.

- Large scale unemployment.

- Increased poverty.

Arguments for protection – optimum tariff argument

- Traditional trade theory suggests a large country can increase its welfare by using an import tariff or export tax to improve its terms of trade.

- Increasing national welfare by improving the terms of trade becomes one possible motive for tariff protection.

Arguments for protection – optimum tariff argument

- An increase in the rate of tariff raises the production and consumption costs as it improves the terms of trade.
- The rate that squeezes out as much gains as possible is known as the **optimum tariff**.
- An optimum tariff exists, which maximizes an economy's welfare.

Arguments for protection – optimum tariff argument

- The essence of the optimum tariff is the exploitation of monopsonistic power.
- If a country can influence world prices, the citizens of that country collectively possess monopsonistic power – by restricting import demand they can force the price down.
- The tariff is the instrument by which the country manipulates the market.

Further traditional arguments for protection

Trade policy as a part of broader social policy objectives for a nation

- Tariff as a source of government revenue (revenue argument).
- Tariff to improve the balance of trade.
- Tariff to reduce aggregate unemployment.
- Tariff to increase employment in a particular industry.

Further traditional arguments for protection
Trade policy as a part of broader social policy objectives for a nation

- Tariff to benefit a scarce factor of production.
- National defense argument for a tariff.
- To “encourage better policy” abroad.

Further traditional arguments for protection
Trade policy as a part of broader social policy objectives for a nation

- **To “encourage better policy” abroad.** On March 27, 2006 Russia stopped wine imports from Moldova and Georgia (reason – low quality and harmful). The Russian sanctions - a response to Chisinau's new border regime with Transnistria.

- The Russian sanctions came only a few weeks after Moldova and Ukraine imposed a new customs regime at the Transnistrian border. The breakaway republic could only export its goods to or through Ukraine with Moldovan customs approval.

Further traditional arguments for protection

Trade policy as a part of broader social policy objectives for a nation

- Chisinau lost about 21 million U.S. dollars in the first five months of 2006. Moldova delivered about 80 percent of its wines (at a value of about 250 million dollars in 2005) to Russia before the embargo. Up to the date of the embargo, about 130 companies delivered alcoholic drinks to Russia (36 companies in 2008).
- 2007 Russian inspectors came to Moldova – five companies, all of whom had Russian capital, received the right to export to Russia.

Further traditional arguments for protection

Trade policy as a part of broader social policy objectives for a nation

- According to various estimates, Moldovan producers in 2009 had a 10-15-percent market share on the Russian market compared to 60-70 percent they had before 2006.

- 2011 - 40 percent of Moldova's wine production was exported to Russia

Protection as a response to international policy distortions

- Tariff to offset foreign dumping.

- Tariff to offset a foreign subsidy.

Protection to offset market imperfections

- Tariff to extract foreign monopoly profit.

- The use of an export tax to redistribute profit from a domestic monopolist.

Infant industry argument

- Argument that a tariff is needed to protect an industry in its early stage of development.

- Nascent industries often do not have the economies of scale that their older competitors from other countries may have, and thus need to be protected until they can attain similar economies of scale.

Infant industry argument

- Firms may face initial losses in an industry. Tariffs allows those domestic industries to grow and become self sufficient within the international economy once they reach a reasonable size.
- Protectionism allows an industry to develop until it is able to compete in international trade.

- Infant industries are by definition those that are not strong enough to survive open competition - they are dependent on government protectionism in order to survive.

Infant industry argument

- It was first used by Alexander Hamilton in 1790 and later by Friedrich List, in 1841, to support protection for German manufacturing against British industry.

- History provides numerous examples of the benefits of protecting infant industries.
- In the 1830's the average tariff in the US was 40%, the highest in the world, allowing the development of manufacturing industries until World War II when the manufacturing supremacy of the States was absolute.

- In 1939 Japan kicked out General Motors to protect Toyota which at the time was uncompetitive in the global market.

Strategic trade policy

- Consideration of strategic trade policy is a relatively recent addition to the trade policy debate, having started in the early 1980s.

- **Spencer, B. and Brander, J.** (1983), *International R&D rivalry and industrial strategy*, Review of Economic Studies 50, 707–22.
- **Brander, J. and Spencer, B**. (1985), *Export subsidies and international market share rivalry*, Journal of International Economics 18, 83-100.

Strategic trade policy

- Strategic trade policy refers to trade policy that affects the outcome of strategic interactions between firms in an actual or potential international oligopoly.

- The term “strategic” arises from consideration of the strategic interaction between firms.

Strategic trade policy

- Strategic interaction requires that firms recognize that their payoffs in terms of profit or other objectives are directly affected by the decisions of rivals or potential rivals.

- As a result, firms recognize that their own choices concerning such variables as output, price and investment depend on the decisions of other firms.

Strategic trade policy

- The requirement that the oligopoly be "international" implies that production is actually or potentially carried out in two or more countries. Trade policy instruments set by one country then tend to affect the strategic choices of firms located in that country differently from firms located abroad.

- A well-known application is the strategic use of export subsidies, but import tariffs as well as subsidies to R&D or investment for firms facing global competition can also have strategic effects.

- **A main idea is that trade policies can raise domestic welfare by shifting profits from foreign to domestic firms.**

Numerical example

Krugman, P. (1987), *Is Free Trade Passé?* Journal of Economic Perspectives, 1(2), 131–44.

- Two firms, Boeing, an American firm, and Airbus, a European firm, are capable of producing a certain type of passenger aircraft. The aircraft are all exported to a third country.

- The profit earned by each country's firm minus the cost of any subsidy is then the appropriate measure of each country's national benefit.

- The third-country market is profitable if there is only one producer, but both firms would make losses if they both enter and must share the market.

The European government is considering whether to subsidize the entry of Airbus.

Table 1. Intervention by Europe

Non-intervention				**Subsidize entry by 25**			
		Airbus				Airbus	
		Enter	Not enter			Enter	Not enter
Boeing	Enter	(-5;-5)	(100;0)	Boeing	Enter	(-5;20)	(100;0)
	Not enter	(0;100)	(0;0)		Not enter	(0;125)	(0;0)

Alternative case – subsidy as a wrong idea

Table 2. Intervention by Europe

Non-intervention

		Airbus	
		Enter	Not enter
Boeing	Enter	(5;-20)	(125;0)
	Not enter	(0;100)	(0;0)

Subsidize entry by 25

		Airbus	
		Enter	Not enter
Boeing	Enter	(5;5)	(125;0)
	Not enter	(0;125)	(0;0)