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2025 RELEASE

INTERNATIONAL BUSINESS

Competing in the Global Marketplace



Chapter 07

Government Policy and International Trade

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Competing in the Global Marketplace

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Learning Objectives

- 7-1** Identify the policy instruments used by governments to influence international trade flows.
- 7-2** Understand why governments sometimes intervene in international trade.
- 7-3** Summarize and explain the arguments against strategic trade policy.
- 7-4** Describe the development of the world trading system and the current trade issue.
- 7-5** Explain the implications for managers of developments in the world trading system.

Introduction

Free Trade

- Occurs when governments do not attempt to restrict what citizens can buy from another country or what they can sell to another country.
- Nations nominally committed to free trade but intervene to protect interests of politically important groups.
- Modern international trading system is based on General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO).

Instruments of Trade Policy¹

Import Tariffs

- Taxes levied on imports.
- Specific tariffs are levied as a fixed charge for each unit of imported good.
- Ad valorem tariffs are levied as a proportion of the value of an imported good.
- Are paid by the importer.

Instruments of Trade Policy₂

Import Tariffs

Governments get an increase in revenue.

Domestic producers gain protection from foreign competitors.

Consumers pay more for certain imports.

Economic impact:

- Are pro-producer and anti-consumer.
- Reduce overall efficiency of the world economy.

Instruments of Trade Policy₃

Export Tariffs and Bans

Export tariff is a tax placed on the export of a good.

- Goal is to discriminate against exporting in order to ensure that there is sufficient supply of a good within a country.

Export ban is a policy that partially or entirely restricts the export of a good.

- Example: 1975 ban on U.S. crude oil exports.

Instruments of Trade Policy⁴

Subsidies

Government payment to a domestic producer.

1. Cash grants.
2. Low-interest loans.
3. Tax breaks.
4. Government equity participation.

Help domestic producers compete against foreign imports and gain export markets.

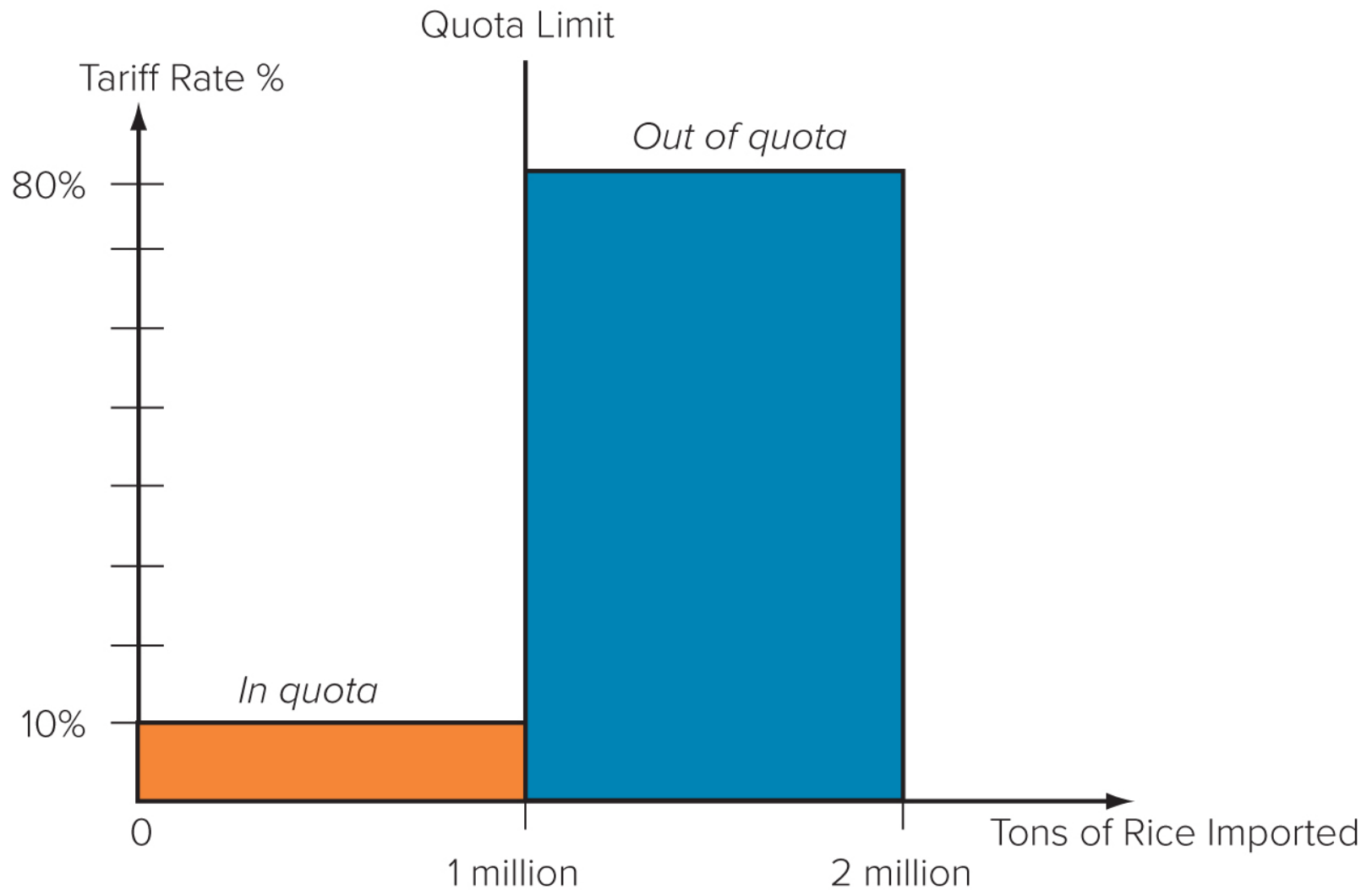
Domestic producers gain while consumers typically absorb the costs.

Instruments of Trade Policy⁵

Import Quotas and Voluntary Export Restraints

- Import quotas are direct restrictions on quantity of some good that may be imported.
- Tariff rate quotas provide a lower tariff rate to imports within the quota than those over the quota.
- Voluntary export restraint (VER) is a quota on trade imposed by the exporting country.
- Quota rent refers to the extra profit producers make when supply is artificially limited by an import quota.

Figure 7.1 Hypothetical Tariff Rate Quota



Instruments of Trade Policy⁶

Local Content Requirements (LCR)

- Some fraction of a good must be produced locally.
- Expressed in either physical or value terms.
- Protects domestic producers.
- Consumers face higher prices.

Administrative Policies

- Bureaucratic rules designed to make it difficult for imports to enter a country.
- Hurt consumers by limiting choice.

Instruments of Trade Policy⁷

Antidumping Policies

Dumping occurs when companies sell goods in a foreign market at below their costs of production or below their “fair” market value.

- A way to unload excess production.

Antidumping policies punish foreign firms that engage in dumping, protecting domestic producers from unfair foreign competition.

- Also known as countervailing duties.

The Case for Government Intervention¹

Political Arguments for Intervention

Protecting jobs and industries:

- Most common political argument for government intervention.
- Critics say claims of unfair competition are overstated for political reasons.

Protecting national security:

- Certain industries, like defense-related ones, must be protected.
- In 2017, the United States was importing about 30 percent of steel used in the country, with the largest sources of imports being Canada and Mexico.

The Case for Government Intervention₂

Political Arguments for Intervention

Retaliating:

- Government should use threat of intervention as bargaining tool to open foreign markets.
- May liberalize trade and result in economic gains.
- Risky strategy.

Protecting consumers:

- Protect from unsafe products.
- Indirect effect is to limit or ban imports.

The Case for Government Intervention₃

Political Arguments for Intervention

Furthering foreign policy objectives:

- Government may grant preferential trade terms to a country where it wants to build strong relations.
- Trade policy can be used to punish “rogue states.”

Protecting human rights:

- Government trade policy used to improve human rights policies of trading partners.
 - Example: apartheid in South Africa.

The Case for Government Intervention⁴

Economic Arguments for Intervention

The infant industry argument:

- Governments should temporarily support new industries until they have grown strong enough to meet international competition.
- Support comes through tariffs, import quotas, and subsidies.
- Two criticisms:
 1. Protection of manufacturing from foreign competition does no good unless it helps make the industry efficient.
 2. Assumes firms are unable to make efficient long-term investments by borrowing money from the domestic or international capital market.

The Case for Government Intervention₅

Economic Arguments for Intervention

Strategic trade policy:

- Government can help raise national income when a domestic firm gains first-mover advantages.
- Might pay for a government to intervene in an industry by helping domestic firms overcome the barriers to entry created by foreign firms that have already reaped first-mover advantages.
- Both arguments support government intervention in international trade.

The Revised Case for Free Trade ¹

Retaliation and Trade War

Krugman argues that strategic trade policies aimed at establishing domestic firms in a dominant position in a global industry boost national income at the expense of other countries.

- Will probably provoke retaliation.
- Help establish antidumping policies and rules that minimize trade-distorting subsidies.

The Revised Case for Free Trade₂

Domestic Policies

- Governments don't always act in the national interest.
- Political interest groups may influence policy.
- Krugman concludes that strategic trade policy is almost certain to be captured by special-interest groups, which will distort it to their own ends.

Development of the World Trading System¹

Strong economic arguments for unrestricted free trade.

- Governments unwilling to unilaterally lower trade barriers for fear others might not follow suit.
- General Agreement on Tariffs and Trade (GATT).
- World Trade Organization (WTO).

Development of the World Trading System₂

From Smith to the Great Depression

Case for free trade dates to late eighteenth-century work of Adam Smith and David Ricardo.

First embraced by Great Britain in 1846.

- Corn Laws.
- Major trading partners did not reciprocate in free trade.

Smoot–Hawley Act created a wall of tariff barriers against imports into the United States.

Development of the World Trading System³

1947–1979: GATT, Trade Liberalization, and Economic Growth

Following the Great Depression, United States embraced free trade.

GATT was a multilateral agreement designed to liberalize trade by eliminating tariffs, subsidies, import quotas, and so on.

- Tariff reduction was spread over eight rounds with great success.

Development of the World Trading System ⁴

1980–1993: Protectionist Trends

Three reasons for increased protectionism:

- Japan's perceived protectionist (neo-mercantilist) policies created intense political pressures in other countries.
- Persistent trade deficits in the United State and resulting unemployment.
- Use of nontariff barriers increased (VERs).

Development of the World Trading System ⁵

The Uruguay Round and the World Trade Organization

Uruguay Round sought to:

- Extend GATT rules to cover trade in services.
- Develop rules on intellectual property.
- Reduce agricultural subsidies.
- Strengthen the GATT's monitoring and enforcement mechanism.

Development of the World Trading System⁶

The Uruguay Round and the World Trade Organization

The World Trade Organization:

- Encompasses GATT and two other groups:
 - General Agreement on Trade in Services (GATS).
 - Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

Development of the World Trading System ⁷

WTO: Experience to Date

- By 2024, 164 members accounting for 98 percent of world trade.
- Strong early start, but since late 1990s unable to get agreements to further reduce barriers.
- Limited protectionism returned following global financial crisis of 2008–2009.
- The Brexit vote and election of Donald Trump also suggest a move toward greater protectionism.

Development of the World Trading System⁸

WTO: Experience to Date

WTO as global police:

- Enforcement mechanisms appear to be having a positive effect.
- Countries involved have mostly adopted WTO's recommendations.

Expanded trade agreements:

- Global telecommunication and financial services industries.
- Foreign direct investment.

Development of the World Trading System 9

WTO: Unresolved Issues

- The current agenda of the WTO focuses on:
 1. The rise of anti-dumping policies.
 2. The high level of protectionism in agriculture.
 3. The lack of strong protection for intellectual property rights in many nations.
 4. Continued high tariffs on nonagricultural goods and services in many nations.

Development of the World Trading System ¹⁰

WTO: Unresolved Issues

Antidumping actions:

- Vague definition of what constitutes “dumping”; many countries exploiting loophole.
- Concentrated in certain sectors: metal industries, chemicals, plastics, and machinery and electrical equipment.
- WTO pushing members to strengthen regulations governing antidumping duties.

Development of the World Trading System ¹¹

WTO: Unresolved Issues

Protectionism in agriculture:

- High level of tariff rates and subsidies in the agricultural sector.
- Reflects desire to protect domestic agriculture and traditional farming communities.
- Net effect is to raise consumer prices.



Bonfanti Diego/Getty Images

Production operations at J.M. Larson Dairy.

Development of the World Trading System ¹²

WTO: Unresolved Issues

Protection of intellectual property:

- TRIPS agreement obliges WTO members to grant and enforce patents lasting at least 20 years and copyrights lasting 50 years.
- Inadequate protections would reduce the incentive for innovation, resulting in less economic growth.

Development of the World Trading System ¹³

WTO: Unresolved Issues

Market access for nonagricultural goods:

- Most developed nations have average tariff rates of under 4 percent of value.
- Certain imports still have high tariffs, which limits market access and economic growth.
- Tariffs are higher on services than industrial goods.
- WTO's goal is to reduce tariff rates to zero.

Development of the World Trading System ¹⁴

WTO: Unresolved Issues

The Doha Round

- Have been ongoing since 2001, currently stalled.
- Agenda includes:
 - Cut tariffs on industrial goods and services.
 - Phase out subsidies to agricultural producers.
 - Reduce barriers to cross-border investment.
 - Limit use of antidumping laws.

As of 2023, the goal was to reduce tariffs for manufactured and agricultural goods by 60–70 percent and to cut subsidies to half of their current level—but getting nations to agree to these goals was proving exceedingly difficult.

Development of the World Trading System ¹⁵

Bilateral and Multilateral Trade Agreements

- Reciprocal trade agreements between two or more partners.
- Created in response to failed Doha Round progress.
- Designed to capture gain from trade beyond WTO treaties.

Development of the World Trading System ¹⁶

The World Trading System Under Threat

Two events challenged belief of global consensus to embrace free trade and lower barriers to cross-border flow of goods and services.

1. British withdrawal from the European Union.
2. Election of Donald Trump to U.S. president.

Britain is still committed to free trade; U.S. position is unclear.

360° View: Managerial Implications¹

Trade Barriers, Firm Strategy, and Policy Implications

Trade Barriers and Firm Strategy:

- Trade barriers raise the cost of exports, creating a competitive disadvantage.
- Quotas may limit a firm's ability to serve a country from locations outside the country.
- Local content requirements might raise costs.
- Firms might locate production activities in another country to reduce threat of future trade barriers.
- Threat of antidumping action limits firm's ability to use aggressive pricing to gain market share.

360° View: Managerial Implications₂

Trade Barriers, Firm Strategy, and Policy Implications

Policy implications:

- Three drawbacks to government intervention:
 - Tends to protect the inefficient rather than help firms become efficient global competitors.
 - Might invite retaliation and trigger a trade war.
 - Unlikely to be well executed, given the opportunity for it to be captured by special-interest groups.