The political economy of international trade

[Economics](), [Trade]()

The Political Economy of International Trade Chapter Outline OPENING CASE: Why Are GlobalFoodPrices Soaring? INTRODUCTION INSTRUMENTS OF TRADE POLICY Tariffs Subsides Country Focus: Subsidized Wheat Production in Japan Import Quotas and Voluntary Export Restraints Local Content Requirements Administrative Polices Antidumping Policies Management Focus: U. S. Magnesium Seeks Protection THE CASE FOR GOVERNMENT INTERVENTION Political Arguments for Intervention Country Focus: Trade in Hormone-Treated Beef Economic Arguments for Intervention THE REVISED CASE FOR FREE TRADE

Retaliation and Trade War Domestic Politics DEVELOPMENT OF THE WORLD TRADING SYSTEM From Smith to theGreat Depression1947-1979: GATT, Trade Liberalization, and Economic Growth 1980-1993: Protectionist Trends The Uruguay Round and the World Trade Organization WTO: Experience to Date The Future of the WTO: Unresolved Issues and the Doha Round Country Focus: Estimating the Gains from Trade for America FOCUS ON MANAGERIAL IMPLICATIONS Trade Barriers and Firm Strategy Policy Implications SUMMARYCRITICAL THINKINGAND DISCUSSION QUESTIONS CLOSING CASE: Agricultural Subsidies

Learning Objectives 1. Describe the policy instruments used by governments to influence international trade flows. 2. Understand why governments sometimes intervene in international trade. 3. Articulate the arguments against strategic trade policy. 4. Describe the development of the world trading system and the current trade issues. 5. Explain the implications for managers of developments in the world trading system. Chapter Summary This chapter begins with a discussion of the six main instruments of trade policy, including tariffs, subsidies, import quotas, voluntary export estraints, local content requirements, and administrative policies. This section is followed by a discussion of the merits of government intervention into international trade. The author provides a balanced view of this difficult issue. The second half of the chapter focuses on the development of the global trading system. A historical context is provided, along with a view of the global trading system as it exists today. The author acquaints the reader with the General Agreement on Trade and Tariffs (GATT) and the World Trade Organization. Opening Case: Why Are Global Food Prices Soaring?

Summary The opening case examines why global food prices are rising significantly. For more than two decades, improvements in agricultural productivity and output have contributed to lower food prices, but in 2007, the price of wheat was double its price of just a few months earlier, and the price of corn had risen some 60 percent. Two explanations for the phenomenon are increased demand, and the effects of tariffs and subsidies for bio-fuels. Discussion of the case can revolve around the following questions: QUESTION 1: Food prices have risen dramatically since 2007.

Reflect on the reasons for the price increase, and discuss the implications of higher prices for consumers in developed and developing countries. ANSWER 1: For decades, consumers have enjoyed the benefits of increased productivity and output in the global food industry. In 2007, however, everything changed. The price of wheat reached its highest point ever, and the price of corn rose 60 percent over its 2006 price. Two factors contributed to this situation. The first was the increased demand for food from China and India. The second factor involved tariffs and subsidies for bio-fuels.

Farmers in the European Union and in the United States are currently the recipients of subsidies for the production of crops used in bio-fuels. As a result, land that might be used for growing food is being converted to bio-fuel crops, pushing up prices on food. While some experts believe that sugar cane may be a better product for bio-fuel production than corn, tariffs on imported sugar cane effectively are keeping the crop out of the market. While all consumers are feeling the pain of higher food prices, the situation is especially dire for consumers in poor countries where calorie intake could be reduced by as much as -8 percent by 2020.

QUESTION 2: How has demand for bio-fuels affected the price of food? What are the implications of this trend? Reflect on the role of government in pushing prices up. What role do tariffs and subsidies play in the situation? In your opinion, should the governments of the United States and the European Union bear anyresponsibilityfor bringing food prices back down? ANSWER 2: In an effort to slowglobal warming, both the European Union and the United States have adopted policies designed to increase the production of ethanol and bio-diesel.

The policies involve providing subsidies to farmers. The net effect of the subsidies is to encourage farmers to produce less food, and more crops that can be used in bio-fuel production. The situation is exacerbated by high tariffs on alternative products that can be used for bio-fuel production – particularly sugar cane. Most students will recognize that the combined effect of the subsidies and tariffs are creating a difficult situation for consumers, while at the same time protecting producers. Some students may note the irony of the situation.

Consumers, hit by higher prices at the pump are putting more pressure on companies to develop cheaper and more environmentally friendly sources of energy, but in doing so are actually contributing to higher prices at the grocery store. Some students may wonder whether it makes more sense to consider non-food related sources of energy. Honda Motors is currently developing a car that runs on Teaching Tip: To expand this discussion, consider {http://www. businessweek. com/bwdaily/dnflash/content/may2008/db20080513_317940. htm? chan= search}, {http://www. usinessweek. com/globalbiz/content/may2008/gb20080520_439607. htm? chan= search}, and {http://www. businessweek. com/magazine/content/08_19/b4083026413508. htm? chan= search}. Video Note: There are two iGlobes directly related to this case. The first is Supply, Price of Food Increase Hardship for World’s Poor, and the second is Agricultural Problems Lead to Farmer Suicides in India. Chapter Outline with Lecture Notes, Video Notes, and Teaching Tips INTRODUCTION A) This chapter explores the political reality of international trade.

Free trade refers to a situation where a government does not attempt to restrict what its citizens can buy from another country or what they can sell to another country. While many nations are nominally committed to free trade, they tend to intervene in international trade to protect the interests of politically important groups. B) The major objective of this chapter is to describe how political realities have shaped, and continue to shape, the international trading system. INSTRUMENTS OF TRADE POLICY A) In this section, the text reviews seven main instruments of trade policy.

These are: tariffs, subsidies, import quotas, voluntary export restraints, local content requirements, antidumping policies and administrative policies. Tariffs B) A tariff is a tax levied on imports (or exports) that effectively raises the cost of imported (or exported) products relative to domestic products. Specific tariffs are levied as a fixed charge for each unit of a good imported, while ad valorem tariffs are levied as a proportion of the value of the imported good. The important thing to understand about a tariff is who suffers and who gains. The government gains, because the tariff ncreases government revenues. Domestic producers gain, because the tariff affords them some protection against foreign competitors by increasing the cost of imported foreign goods. Consumers lose since they must pay more for certain imports. C) Thus, tariffs are unambiguously pro-producer and anti-consumer, and tariffs reduce the overall efficiency of the world economy. Subsidies D) A subsidy is a government payment to a domestic producer. By lowering costs, subsidies help domestic producers in two ways: they help producers compete against low-cost foreign imports and they help producers gain export markets.

However, many subsidies are not that successful at increasing the international competitiveness of domestic producers. Moreover, consumers typically absorb the costs of subsidies. Country Focus: Subsidized Wheat

Production in Japan Summary This feature explores the subsidies Japan continues to pay its wheat farmers. Tens of thousands of Japanese farmers continue to grow wheat despite the fact that the wheat grown in North America, Argentina, and Australia is far cheaper and of superior quality. The Japanese farmers stay in business thanks to the hefty subsidies paid by the Japanese government.

As a result, wheat prices in Japan are substantially higher than they would be if a free market were allowed to operate. Suggested Discussion Questions 1. Who are the winners and who are the losers from Japanese wheat subsidies? Discussion Points: Students will probably recognize that, as is usually the case with protectionist measures, the subsidies Japan pays its wheat farmers benefit the farmers, but cost the average consumer in the form of higher wheat prices. In fact, in 2004, Japanese consumers covered $700 million in subsidies!

The subsidies also limit imports of wheat, which negatively affects foreign wheat farmers. 2. Why does Japan continue to subsidize its wheat farmers when cheaper wheat is readily available in international markets? Discussion Points: Thanks to subsidies, wheat prices in Japan are between 80 and 120 percent higher than they are in world markets. In fact, if the subsidies were eliminated, Japanese wheat production would cease entirely. However, at least for now, because politicians count on the votes of the wheat farmers, there appears to be no plan to end the subsidies.

Teaching Tip: To extend this discussion, consider discussing Japan’s role in the production of rice. For more on this, go to {http://www. businessweek.

com/globalbiz/content/may2008/gb20080522_132137. htm? chan= search}, and {http://www. businessweek. com/globalbiz/content/may2008/gb20080522_132137_page_2. htm}. Import Quotas and Voluntary Export Restraints E) An import quota is a direct restriction on the quantity of some good that may be imported into a country. A tariff rate quota is a hybrid of a quota and a tariff where a lower tariff is applied to imports within the quota than to those over the quota.

A voluntary export restraint is a quota on trade imposed by the exporting country, typically at the request of the importing country's government. F) While import quotas and voluntary export restraints benefit domestic producers by limiting import competition, they raise the prices of imported goods. The extra profit that producers make when supply is artificially limited by an import quota is referred to as a quota rent. Local Content Requirements G) A local content requirement demands that some specific fraction of a good be produced domestically.

As with import quotas, local content requirements benefit domestic producers, but consumer face higher prices. Administrative Policies H) Administrative trade polices are bureaucratic rules that are designed to make it difficult for imports to enter a country. The effect of these polices is to hurt consumers by denying access to possibly superior foreign products. Antidumping Policies I) Dumping is variously defined as selling goods in a foreign market below their costs of production, or as selling goods in a foreign market at below their " fair" market value.

Dumping is viewed as a method by which firms unload excess production in foreign markets. Alternatively, some dumping may be the result of predatory behavior, with producers using substantial profits from their home markets to subsidize prices in a foreign market with a view to driving indigenous competitors out of that market. Once this has been achieved the predatory firm can raise prices and earn substantial profits. J) Antidumping polices (also known as countervailing duties) are policies designed to punish foreign firms that engage in dumping. The ultimate objective is to protect domestic producers from “ unfair” foreign competition.

Management Focus: U. S. Magnesium Seeks Protection Summary This feature explores the dumping charged levied by U. S. Magnesium against Chinese and Russian producers. According to U. S. Magnesium, the sole American producer of magnesium, Russian and Chinese producers were selling magnesium significantly below market value in an effort to drive U. S. Magnesium out of business. The company failed a complaint with the International Trade Commission (ITC) which ultimately ruled in favor of U. S. Magnesium. Suggested Discussion Questions 1. What is dumping? Were Chinese and Russian producers guilty of dumping? How did U.

S. Magnesium justify its claims against Russian and Chinese producers? Discussion Points: Dumping is defined as selling goods in a foreign market below the cost of production, or below fair market value. In 2004, U. S. Magnesium claimed that China and Russia had been dumping magnesium in the United States. The company noted that in 2002 and 2003, magnesium imports rose, and prices fell. While the ITC ruled in favor of the American company, some students might question whether the fact that the Chinese could sell their product at low prices might simply reflect the country's significantly lower wage rates. . What does the ITC's ruling mean for American consumers of magnesium? In your opinion, was the ruling fair? Discussion Points: The ITC ruled in favor of U. S. Magnesium finding that indeed China and Russia had been dumping their product in the United States. Fines ranging from 50 to 140 percent on imports were imposed against China, and 19 to 22 percent on Russian companies. Most students will note that while the ITC's decision is a good one for U. S. Magnesium and its employees. for consumers, the ruling means magnesium prices that are significantly higher than those in world markets.

Students will probably argue that this result is unfair, and should be revisited. Teaching Tip: U. S. Magnesium's web site is available at {http://www. usmagnesium. com/}. THE CASE FOR GOVERNMENT INTERVENTION A) In general, there are two types of arguments for government intervention, political and economic. Political arguments for intervention are concerned with protecting the interests of certain groups within a nation (normally producers), often at the expense of other groups (normally consumers).

Economic arguments for intervention are typically concerned with boosting the overall wealth of a nation (to the benefit of all, both producers and consumers). Political Arguments for Intervention B) Political arguments for government intervention cover a range of issues including protecting jobs, protecting industries deemed important for national security, retaliating against unfair foreign competition, protecting consumers from “ dangerous” products, furthering thegoalsof foreign policy, and protecting thehuman rightsof individuals in exporting countries.

Protecting Jobs and Industries C) The most common political reason for trade restrictions is " protecting jobs and industries. " Usually this results from political pressures by unions or industries that are threatened by more efficient foreign producers, and have more political clout than the consumers who will eventually pay the costs. National Security D) Protecting industries because they are important for national security is another argument for trade restrictions. The U. S. overnment protects industries like steel, aerospace, and electronics, on the basis of this argument, and has made special arrangements to protect the semiconductor industry. Lecture Note: In the United States, the Bureau of Export Administration enhances the nation's security and its economic prosperity by controlling exports for national security, foreign security, foreign policy, and short supply reasons. To learn more, go to {http://www. bis. doc. gov/about/index. htm}, click on Policies and Regulations and then on Export Administration Regulations. .

Retaliation E) Government intervention in trade can be used as part of a " get tough" policy to open foreign markets. By taking, or threatening to take, specific actions, other countries may remove trade barriers. But when threatened governments do not back down, tensions can escalate and new trade barriers may be enacted. Lecture Note: The trading relationship between China and the United States is an ongoing topic of discussion for many. To expand the discussion on the role of government and retaliatory trade measures, consider {http://www. businessweek. om/globalbiz/content/may2008/gb20080528_845850. htm? chan= search} Protecting Consumers F) Consumer protection can also be an argument for restricting imports. The Country Focus below suggests that the European Union’s concern over beef was, in part, due to an interest in protecting consumers. Since different countries do have differenthealthand safety standards, what may be acceptable in one country may be unacceptable in others. Furthering Foreign Policy Objectives G) On occasion, governments will use trade policy to support their foreign policy objectives.

One aspect of this is to grant preferential trade terms to countries that a government wants to build strong relations with. Trade policy has also been used several times as an instrument for pressuring punishing “ rogue states” that do not abide by international laws or norms. In recent years the United States has imposed trade restrictions against Libya, Iran, Iraq, North Korea, Cuba, and other countries where governments were pursuing policies that were not viewed favorably by the U. S. government.

A serious problem with using trade as an instrument of foreign policy is that other countries can undermine any unilateral trade sanctions. The U. S. Congress has passed two acts, the Helms-Burton Act and the D’Amato Act, in an effort to protect American companies from such actions. Protecting Human Rights H) Concern over human rights in other countries plays an important role in foreign policy. Governments sometimes use trade policy to improve the human rights policies of trading partners. Governments also use trade policies to put pressure on governments to make other changes.

Unless a large number of countries choose to take such action, however, it is unlikely to prove successful. Some critics have argued that the best way to change the internal human rights of a country is to engage it in international trade. The decision to grant China most favored nation status was based on thisphilosophy. Country Focus: Trade in Hormone-Treated Beef Summary This feature describes the trade battle between the United States and the European Union over beef from cattle that have been given growth hormones.

It outlines the basic issues that led to the dispute, and shows how the World Trade Organization has treated the case. Suggested Discussion Questions 1. Why is the European Union so concerned about beef from cattle that have been given growth hormones? Discussion Points: Some students may argue that the European Union’s ban on growth hormones in cattle was little more than a thinly veiled form of protectionism. Australia, New Zealand, and Canada, which also use the hormones in their cattle industry, were also affected by the ban.

The European Union claimed that it was merely protecting the health of its citizens, however studies showed that the hormones posed no health issues for people. 2. Why did the WTO rule against the European Union? Discussion Points: The World Trade Organization ruled against the European Union stating that the European Union’s ban on imported hormone treated beef had no scientific justification. Even so, the European Union refused to lift the ban, which had strong public support, and in the end, the European Union was assessed punitive tariffs.

The European Union held on to its principles though, and as of 2008, continued to maintain its restrictions on hormone treated beef despite the resulting punitive tariffs. Teaching Tip: The WTO maintains a site for students. Go to {www. wto. org} and click on the students icon to search the site, research countries, and even see a list of internships that are available at the WTO. Economic Arguments for Intervention I) Economic arguments for intervention include the infant industry argument and strategic trade policy. The Infant Industry Argument

J) The infant industry argument suggests that an industry should be protected until it can develop and be viable and competitive internationally. Unless an industry is allowed to develop and achieve minimal economies of scale, foreign competitors may undercut prices and prevent a domestic industry from developing. The infant industry argument has been accepted as a justification for temporary trade restrictions under the WTO. K) A problem with the infant industry argument is determining when an industry " grows up. " Some industries that are just plain inefficient and uncompetitive have argued they are still infants after 50 years.

The other problem is that given the existence of global capital markets, if the country has the potential to develop a viable competitive position its firms should be capable of raising the necessary funds without additional support from the government. Strategic Trade Policy L) Strategic trade policy suggests that in cases where there may be important first mover advantages, governments can help firms from their countries attain these advantages. Strategic trade policy also suggests that governments can help firms overcome barriers to entry into industries where foreign firms have an initial advantage.

THE REVISED CASE FOR FREE TRADE A) While strategic trade policy identifies conditions where restrictions on trade may provide economic benefits, there are two problems that may make restrictions inappropriate: retaliation and politics. Retaliation and Trade War B) Krugman argues that strategic trade policies aimed at establishing domestic firms in a dominant position in a global industry are beggar-thy-neighbor policies that boost national income at the expense of other countries. A country that attempts to use such policies will probably provoke retaliation. Domestic Politics

C) Governments do not always act in the national interest when they intervene in the economy. Instead special interest groups may influence governments. Thus, a further reason for not embracing strategic trade policy, according to Krugman, is that such a policy is almost certain to be captured by special interest groups within an economy, who will distort it to their own ends. DEVELOPMENT OF THE GLOBAL TRADING SYSTEM A) Many governments recognize the value of unrestricted free trade, but are hesitant to unilaterally lower their trade barriers in case other countries do not follow suit.

Since World War II, and international trading framework has evolved that enables governments to negotiate a set of rules to govern cross-border trade and lower trade barriers. For the first 50 years, the framework was known as the General Agreement on Tariffs and Trade (GATT). More recently, it has been known as the World Trade Organization (WTO). From Smith to the

GreatDepressionB) Up until the Great Depression of the 1930s, most countries had some degree of protectionism. Great Britain, as a major trading nation, was one of the strongest supporters of free trade.

C) Although the world was already in a depression, in 1930 the United States enacted the Smoot-Hawley Act, which created significant import tariffs on foreign goods. As other nations took similar steps and the depression deepened, world trade fell further. 1947-1979: GATT, Trade Liberalization, and Economic Growth D) After WWII, the U. S. and other nations realized the value of freer trade, and established the General Agreement on Tariffs and Trade (GATT). E) The approach of GATT (a multilateral agreement to liberalize trade) was to gradually eliminate barriers to trade.

Over 100 countries became members of GATT, and worked together to further liberalize trade. Teaching Tip: A full review of GATT, containing an actual copy of the agreement, is available at {http://www. ciesin. org/TG/PI/TRADE/gatt. html}. 1980-1993: Protectionist Trends F) During the 1980s and early 1990s the world trading system as " managed" by GATT came under strain. First, Japan's economic strength and huge trade surplus stressed what had been more equal trading patterns, and Japan's perceived protectionist (neo-mercantilist) policies created intense political pressures in other countries.

Second, persistent trade deficits by the United States, the world's largest economy, caused significant economic problems for some industries and political problems for the government. Third, many countries found that although limited by GATT from utilizing tariffs, there were many other more subtle forms of intervention that had the same effects and did not technically violate GATT (e. g. VERs). The Uruguay Round and the World Trade Organization G) Against the background of rising protectionist pressures, in 1986 GATT members embarked on their eighth round of negotiations to reduce tariffs (called the Uruguay Round).

This was the most ambitious round to date. Services and Intellectual Property H) One goal was to expand beyond the regulation of manufactured goods and address trade issues related to services and intellectual property, and agriculture. The World Trade Organization Lecture Note: To see current issues at the WTO, go to {http://www. wto. org/} and click on " News. " I) When the WTO was established, its creators hoped the WTO's enforcement mechanisms would make it a more effective policeman of the global trade rules than the GATT had been.

The WTO encompassed GATT along with two sister organizations, the General Agreement on Trade in Services (GATS) and the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS). WTO: Experience to Date J) At the time of its establishment, the great hope was that the WTO might emerge as an effective advocate and facilitator of future trade deals, particularly in such areas as services. In general, the experience so far has been encouraging. WTO as Global Police K) So far, the WTO's policing and enforcement mechanisms are having a positive effect.

In general, countries have adopted WTO recommendations for trade disputes. Expanding Trade Agreements L) In 1997, 68 countries that account for more than 90 percent of world telecommunications revenues pledged to open their markets to foreign competition and to abide by common rules for fair competition in telecommunications. Similarly, 102 countries pledged to open to varying degrees their banking, securities, and insurance sectors to foreign competition. Like the telecommunications deal, the agreement covers not just cross-border trade, but also foreign direct investment.

The WTO in Seattle: A Watershed? M) The 1999 meeting of the WTO in Seattle was important not only for what happened between the member countries, but also for what occurred outside the building. Inside, members failed to agree on how to work toward the reduction of barriers to cross-border trade in agricultural products and cross-border trade and investment in services. Outside, the WTO became a magnet for various groups protesting free trade. The Future: Unresolved Issues and the Doha Round N) Substantial work still remains to be done on the international trade front.

Four issues on the current agenda of the WTO are the rise of anti-dumping policies, the high level of protectionism in agriculture, the lack of strong protection for intellectual property rights in many nations, and continued high tariffs on nonagricultural goods and services in many nations. Lecture Note: The European Union’s trade commissioner is urging nations to complete Doha round negotiations prior to the beginning of a new administration in the United States. Further details can be found at {http://www. businessweek. com/globalbiz/content/jan2008/gb20080128_519854. htm? chan= search}.

Anti-Dumping Actions O) There has been a proliferation of antidumping actions in recent years, perhaps because of the rather vague definition of what constitutes dumping. The WTO is encouraging members to strengthen the regulations governing the imposition of antidumping duties. Protectionism in Agriculture P) The WTO is concerned with the high level of tariffs and subsidies in the agricultural sector of many economies. However, the advanced countries of the world defend the current system because they want to protect their producers from lower-cost producers from developing nations.

Protecting Intellectual Property Q) The agreement to protect intellectual property (TRIPS) obliges WTO members to grant and enforce patents lasting at least 20 years and copyrights lasting 50 years. The basis for this agreement was a strong belief among signatory nations that the protection of intellectual property rights is an essential element of the international trading system. Market Access for Nonagricultural Goods and Services R) The WTO would like to bring down tariff rates on nonagricultural goods and services, and reduce the scope for the selective use of high tariff rates.

The hope is that at some point, rates would move to zero. Country Focus: Estimating the Gains from Trade for America Summary This feature explores the results of a study by the Institute for International Economics. The study, which estimated the gains to the U. S. economy from free trade, found that the United States' GDP was more than 7 percent higher as a result of reductions in trade barriers than it would have been if the barriers remained. The study also estimated that if tariffs were reduced to zero, significant gains would still result. Suggested Discussion Questions 1.

What does the Institute for International Economics suggest about the benefits of free trade? Discussion Points: The Institute for International Economics found that thanks to reductions in trade restrictions, the United States' GDP was up. The Institute also estimated that even greater gains in the country's GDP would occur if protectionism was eliminated all together. Students should recognize that these findings follow the principles of Adam Smith and David Ricardo and suggest that free trade is beneficial. 2. According to the Institute for International Economics study, a move oward free trade would cause disruption in employment. Is it still worth pursuing free trade if it means that some people lose their jobs? Discussion Points: This question should prompt a strong debate among students. Some students will probably suggest that the costs in terms of lost wages and benefits associated with free trade outweigh the benefits that would be gained. Other students however, will probably argue that since protectionism typically benefits only a few at the expense of others, while free trade generates greater economic growth and higher wages, a free trade policy should be followed.

Teaching Tip: The Web site for Institute for International Economics is available at {http://www. iie. com/}. A New Round of Talks: Doha R) In late 2001, the WTO launched a new round of talks at Doha, Qatar. The agenda includes cutting tariffs on industrial goods and services, phasing out subsidies to agricultural producers, reducing barriers to cross-border investment, and limiting the use of anti-dumping laws. FOCUS ON MANAGERIAL IMPLICATIONS A) What does all of this mean for business?

Managers need to consider how trade barriers impact firm strategy, and what role they can play in promoting free trade or trade barriers. Trade Barriers and Firm Strategy B) Trade barriers are a constraint upon a firm's ability to disperse its productive activities. First, trade barriers raise the cost of exporting products to a country. Second, voluntary export restraints (VERs) may limit a firm's ability to serve a country from locations outside that country. Third, to conform to local content requirements, a firm may have to locate more production activities in a given market than it would otherwise. All f the above effects are likely to raise the firm's costs above the level that could be achieved in a world without trade barriers. In addition, the threat of antidumping action could limit the ability of a firm to use aggressive pricing as a way to gain market share. Policy Implications C) In general, international firms have an incentive to lobby for free trade, and keep protectionist pressures from causing them to have to change strategies. While there may be short-term benefits to having governmental protection in some situations, in the long run these can backfire and other governments can retaliate.

Critical Thinking and Discussion Questions 1. Do you think the U. S. government should consider human rights when granting preferential trading rights to countries? What are the arguments for and against taking such a position? Answer: China is frequently cited as a violator of human rights, and can form the basis for a discussion of this question. While the answer to the first question clearly is a matter of personal opinion, in stating their opinions, students should consider the following points.

Trade with the U. S. is very important to China, as China views the U. S. as an important market. The U. S. is also an important source of certain products. Thus, the U. S. has some leverage with trade when trying to influence China's human rights policies. For this policy to have much effect, however, other nations important to China must adopt similar policies. Otherwise China will simply choose to work with other countries, and U. S. consumers and producers may be more negatively impact than the Chinese.

Another concern with tying MFN status to human rights is that denying MFN may make the human rights situation worse rather than better. By engaging in trade, the income levels in China will increase, and with greater wealth the people will be able to demand and receive better treatment. 2. Whose interests should be the paramount concern of government trade policy - the interests of producers (businesses and their employees) or those of consumers? Answer: The long run interests of consumers should be the primary concern of governments.

Unfortunately consumers, each of whom may be negatively impacted by only a few dollars, are less motivated and effective lobbyists than a few producers that have a great deal at stake. While in some instances it could be argued that domestic consumers will be better off if world-class domestic producers are nurtured and allowed to gain first mover advantages in international markets, it is doubtful that the government will be better than international capital markets at " picking winners", and will more likely pick the firms with the greatest political clout.

While employees may well lose jobs if there are more efficient foreign competitors, some would argue that this is just the nature of competition, and that the role of government should be to help these employees get jobs where they can be efficiently employed rather than to protect them from reality in inefficient firms. 3. Given the arguments relating to the new trade theory and strategic trade policy, what kind of trade policy should business be pressuring government to adopt?

Answer: According to the textbook, businesses should urge governments to target technologies that may be important in the future and use subsidies to support development work aimed at commercializing those technologies. Government should provide export subsidies until the domestic firms have established first mover advantages in the world market. Government support may also be justified if it can help domestic firms overcome the first-mover advantages enjoyed by foreign competitors and emerge as viable competitors in the world market. In this case, a combination of home market protection and export-promoting subsidies may be called for. . You are an employee of an U. S. firm that produces personal computers in Thailand and then exports them to the U. S. and other countries for sale. The personal computers were originally produced in Thailand to take advantage of relatively low labor costs and a skilled workforce. Other possible locations considered at that time were Malaysia and Hong Kong. The U. S. government decides to impose punitive 100 percent ad valorem tariffs on imports of computers from Thailand to punish the country for administrative trade barriers that restrict U. S. exports to Thailand. How should your firm respond?

What does this tell you about the use of targeted trade barriers? Answer: As long as the manufacturing requirements haven't changed significantly, looking at Malaysia or Hong Kong again for production would appear obvious. By the U. S. government introducing a specific ad valorem tariff on Thai computer imports, it would be easy to get around these by looking at other locations. Hence such targeted trade barriers can often be easily circumvented without having to locate production facilities in an expensive country like the U. S. 5. Reread the Management Focus feature on U.

S. Magnesium Seeks Protection. Who gains most from the anti-dumping duties levied by the United States on imports of magnesium from China and Russia? Who are the losers? Are these duties in the best national interests of the United States? Answer: Most students will probably recognize that U. S. producers and their employees are the primary beneficiaries of the anti-dumping duties levied by the United States on Chinese and Russian magnesium imports. As a result of the duties, consumers in the United States will pay higher prices for magnesium-based products.

Some students may suggest that by imposing the duties, the United States runs the risk of retaliatory measures from both China and Russia. Closing Case: Agricultural Subsidies Summary The closing case examines the effects of subsidies paid to U. S. cotton farmers. The United States currently pays about $5 billion to cotton farmers for a crop that is worth just $4 billion. The lower prices resulting from the subsides and the excess production they encourage, have had particularly devastating effects on cotton farmers in poor countries.

Some estimates show, for example, that the subsidies and excess production in the United States has cost the African country of Benin more economically than it receives in aid from the United States. Discussion of this case can revolve around the following questions: QUESTION 1: Why do you think that the U. S. government pays subsidies to farmers? ANSWER 1: The United States initially began paying subsidies to farmers in the middle of the Great Depression. Many students will probably suggest that the subsidies are still being paid simply because they have been in place for so long.

Other students however, may note the power of agricultural lobbyists and the fact that without the subsidies, U. S. farmers could not compete in world markets. This suggests that the government has some incentive to continue with its current policies. QUESTION 2: What is the impact of farm subsidies on the price of agricultural products in the United States, and on prices elsewhere? ANSWER 2: The subsidies paid to U. S. farmers currently run around $29 billion annually. They encourage farmers to produce more products than are needed, and in doing so depress global prices. Cotton subsidies for example, pushed the price of cotton to just $0. 5 in 2006, about half the 1995 price. For farmers in poor countries, the drop in prices has pushed income levels down over 20 percent. QUESTION 3: Who benefits from U. S. farm subsidies, who are the losers? ANSWER 3: Most students will recognize that the primary beneficiaries of the subsidies are farmers. As a result of the subsidies, consumers must pay more, and producers in other countries are faced with falling prices, and ultimately lower incomes. QUESTION 4: What would happen if the United States (and other countries) stopped paying subsidies to farmers to grow certain crops? Who would benefit, who would lose?

ANSWER 4: If the United States stopped paying subsidies to farmers, consumers would initially see prices fall. Later however, as some farmers, without the support of the subsidies, went out of business, consumers would probably see prices rise to some degree as supply and demand moved together. Producers in other countries like Benin would benefit from increased demand and higher prices. Video Note: The iGlobe Agricultural Problems Lead to Farmer Suicides in India explores the effects of cotton subsidies on farmers in India. The iGlobe is a good complement to the Closing Case. Continuous Case Concept

As automakers establish production operations in multiple countries around the world, and rely on suppliers from numerous countries, the question of tariffs and quotas becomes more important. In this chapter's Continuous Case Concept, explore what happens if a country places a tariff or other trade barrier on imported cars. • Ask students to consider, for example, how consumers would react if the U. S. charged a tariff on every car that is imported from Japan. What would be the likely reaction of Japanese automakers? What would American producers do? • Next, ask students to consider whether such as tariff is " fair. Who really pays the tariff? Who benefits from the tariff? Who would benefit from free trade in automobiles and car parts? • Finally, explore how efforts by both the United States and the European Union to increase the production of ethanol and bio-diesel (see Opening Case) could impact the auto industry. Honda is currently a market leader in the hybrid vehicle market, but is hampered by the lack of infrastructure to fully support the industry. In 2008, Toyota established a goal to sell 500, 000 hybrid vehicles. This exercise works well after the notion of trade barriers has been introduced.

It can also be used in a summary discussion of the chapter's material or in conjunction with the Opening Case. globalEDGE Exercises Use the globalEDGE Resource Desk {http://globalEDGE. msu. edu/ResourceDesk/} to complete the following exercises. Exercise 1 Your company is considering exporting its pharmaceutical products to Japan, but management's current knowledge of the country's trade policies and barriers for this sector is limited. Conduct the appropriate level of research in a trade barriers database to identify any information on Japan's current standards and technical requirements for pharmaceutical products.

Prepare an executive summary of your findings. Answer: The quickest way to reach this information would be to search globalEDGE using the phrase " trade barriers database" at http://globaledge. msu. edu/ResourceDesk/. Once at the Market Access Database website, select " Trade Barriers Database. " On the search option " Select Country," choose " Japan," and on the search option " Select Sector," choose " Pharmaceuticals. " A series of reports are listed from which those with more general titles will provide adequate insight for the exercise.

Search Phrase: " Trade Barriers Database" Resource Name: Market Access Database Website: http://mkaccdb. eu. int/ globalEDGE Category: " Research: Multi-Country" Exercise 2 You work for a national chain of clothing stores that is considering importing textiles from India into the U. S. You want to determine whether the goods are subject to import quotas. Using information provided by the U. S. Customs and Border Protections, prepare a report highlighting the elements that determine whether a shipment is subject to this type of trade restriction.

Answer: The U. S. Customs and Border Protections website hosted by the U. S. government offers considerable information on the details of importing or exporting into or out of the U. S. The information for the exercise can be reached by searching for the phrase " U. S. Customs and Border Protections" at http://globaledge. msu. edu/ResourceDesk/. This resource can also be found under the globalEDGE category " Research: Government Resources. " Once on the website, click on " Trade" and select " Textiles and Quotas" under " Trade Program Areas. The report, " Are my Goods Subject to Quotas? ," is readily available. Search Phrase: " U. S. Customs and Border Protections" Resource Name: United States: U. S. Customs and Border Protections Website: http://www. cbp. gov/ globalEDGE Category: " Research: Government Resources" Additional Readings and Sources of Information Economists Rethink Free Trade http://www. businessweek. com/magazine/content/08_06/b4070032762393. htm? chan= search Brazil Urges EU to Scrap Biofuel Tariffs http://www. businessweek. com/globalbiz/content/jul2007/gb2007076_483689. htm? chan= search