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NEW ECONOMIC POWERS

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Dumping

- may be used to introduce a new product,
- may cause higher prices or subsidies in the exporting country,
- is hard to prove.

the imported product disrupts domestic production; otherwise host-country consumers get the benefit of lower prices and don't complain. While exporting countries may encourage dumping to improve employment, companies may dump products to introduce them and build a market abroad. Essentially, a low entry price encourages consumers to sample the foreign brand—after which they can charge a high enough price to make a profit.

Companies can afford to dump products if they are subsidized or if they can charge high prices in their home market. Ironically, exporting-country consumers or taxpayers seldom realize that they are paying for foreign consumers' lower prices. An industry that believes it's competing against dumped products may appeal to its government to restrict the imports. However, determining a foreign company's cost or even its domestic price to middlemen is difficult because of limited access to its accounting records, fluctuations in exchange rates, and the passage of products through layers of distribution before reaching the end consumer. Nevertheless, industries do manage to succeed, (e.g., U.S. steelmakers' curtailment of Korean steel pipes).[12] However, critics claim that governments allegedly limit imports arbitrarily through antidumping restrictions and are slow to dispose of the restrictions if pricing situations change. Companies caught by antidumping restrictions often lose the export market they labored to build.

An optimum tariff's success

- shifts revenue to an importing country,
- is difficult to predict,
- may cause lower worker income in developing countries.

Invoking the Optimum-Tariff An **optimum-tariff theory** is one by which a foreign producer lowers its export prices when an importing country places a tax on its products. If this occurs, benefits shift to the importing country because the producer lowers its profits on the export sales.

Let's examine a hypothetical situation. Assume an exporter has costs of $500 per unit and is selling abroad for $700 per unit. With the imposition of a 10 percent tax on the imported price, the exporter may choose to lower its price to $636.36 per unit, which, with a 10 percent tax of $63.64, would keep the price at $700 in the foreign market. The exporter may feel that a foreign market price higher than $700 would result in lost sales and that a profit of $136.36 per unit instead of the previous $200 is better than no profit at all. Consequently, an amount of $63.64 per unit has shifted to the importing country.

As long as the foreign producer lowers its price by any amount, some shift in revenue goes to the importing country and the tariff is deemed an optimum one. There are many examples of products whose prices did not rise as much as the amount of the imposed tariff. For instance, purveyors of luxury producers have narrowed profit margins in Brazil to help offset import levies and sales taxes.[13] However, predicting when, where, and which exporters will voluntarily reduce their profit margins is imprecise. Further, a criticism of the optimum tariff is that developing country exporters reduce payment to their workers rather than absorbing the full impact through a lower profit margin, thus sometimes causing severe hardships.[14]

GOVERNMENTS' NONECONOMIC RATIONALES AND OUTCOME FOR TRADE INTERVENTION

Although noneconomic arguments are used to influence trade, many of these also have economic undertones and consequences. However, let's look at the major noneconomic rationales:

- Maintaining essential industries (especially defense)
- Promoting acceptable practices abroad
- Maintaining or extending spheres of influence
- Preserving national culture

In protecting essential industries, countries must

- determine which ones are essential,
- consider costs and alternatives,
- consider political and economic consequences.

MAINTAINING ESSENTIAL INDUSTRIES

Under the **essential-industry argument** nations apply trade restrictions to protect crucial domestic industries so that they are not dependent on foreign supplies during hostile political periods. For example, the United States subsidizes domestic silicon production so that its computer-chip makers need not depend on foreign suppliers. (In some cases, countries also prevent foreign companies from acquiring domestic companies needed for national security; the United States does this through the Committee on Foreign Investment in the United States [CFIUS].) Because of nationalism, defense needs have much appeal in rallying support for import barriers. However, in times of real (or perceived) crisis or military emergency, almost any product could be deemed essential.

The essential-industry argument should not be (but frequently is) accepted without a careful evaluation of costs, real needs, and alternatives. Once given, protection is hard to remove, even when the rationale for protection no longer exists. For instance, the United States subsidized mohair producers for more than 20 years after mohair was no longer essential for military uniforms.[15]

In addition, governments buy and stockpile supplies of essential raw materials that might be in future short supply. For example, the United States stockpiles rare-earth elements because China controls most output and because the military needs them for weapons, jet engines, high-powered magnets, and other gear.[16]

PROMOTING ACCEPTABLE PRACTICES ABROAD

Trade limitations may be used to compel a foreign country to amend an objectionable practice.

Governments limit exports, even to friendly countries, of strategic goods that might fall into the hands of potential enemies. They also limit exports and imports to compel a foreign country to change some objectionable policy or capability. The rationale is to weaken the foreign country's economy by decreasing its foreign sales and by limiting its access to needed products, thus coercing it to amend its practices on some issue such as human rights, environmental protection, military activities, and production of harmful products. Trade limitations are often combined with other economic pressures and incentives such as restricting access to bank accounts and cutting off or increasing foreign aid.

The effectiveness of trade sanctions depends on the sanctioned country's inability to retaliate effectively, secure alternative markets and supplies, and develop a production capability of its own. Our Point-Counterpoint section discusses the pros and cons of sanctions.

Point

Should Governments Impose Trade Sanctions?

Point **Yes** Let's face it: We're now living in a global society where actions in one country can spill over and affect people all over the world. For instance, the development of a nuclear arsenal in one nation can escalate the damage that terrorists can do elsewhere. The failure of a country to protect endangered species can have long-term effects on the whole world's environment. We simply can't sit back and let things happen elsewhere that will come back to haunt us.

At the same time, some pretty dastardly things occur in some countries that most of the world community would like to see stopped: human trafficking for forced prostitution, child slaves to harvest crops, political prisoners given near-starvation diets, to name a few. Even if we can't stop such occurrences, we have a moral responsibility not to participate even if it costs us. I may get some economic benefits by buying from criminals, and I may not stop their activity by withholding my business; however, I refuse to deal with them because, in effect, that makes me a criminal's associate.

Although not all trade sanctions have been successful, many have at least been influential in achieving their objectives. These included UN sanctions against Rhodesia (now Zimbabwe), U.K. and U.S. sanctions against the Amin government of Uganda, and Indian sanctions against Nepal.[17] Sanctions against Myanmar helped bring the country to such economic disaster that its military leaders decided democracy was a better route to take.[18] Sanctions against Iran helped terminate Iran's nuclear program, and pressure on Brazil led to greatly reduced cutting of Amazon forests.[19] Further, even if sanctions do not completely change behavior, they may force countries not to escalate their unacceptable practices.[20]

Finally, when a nation breaks international agreements or acts in unpopular ways, what courses of action can other nations take? Between 1827 and World War I, nations mounted 21 blockades, but these are now considered too dangerous. Military force has also been used, for example, during the overthrow of the Saddam regime in Iraq, but such measures have little global support. Thus, nations may take such punitive actions as withholding diplomatic recognition, boycotting athletic and cultural events, seizing the other country's foreign property, and eliminating foreign aid and loans. These may be ineffective in and of themselves without the addition of trade sanctions.

Should Governments Impose Trade Sanctions?

Counterpoint

No Every time I turn around, I see governments imposing a new sanction. Some of these cause law-abiding companies to lose revenue that took years to develop. For one, there is a chance of retaliation. Trade sanctions on Russia after its annexation of Crimea were costly to Norwegian fish exporters because Russia turned to Chile.[21] Thus, the trade sanctions aimed at hurting the Russian government ended up hurting non-Russian companies even though they'd never engaged in any objectionable behavior.

Besides, I really question whether these sanctions even work. When the United States was maintaining its 20-year trade embargo on Vietnam, Vietnamese consumers could still buy U.S. products such as Coca-Cola, Kodak film, and Apple computers through other countries that did not enforce the sanctions.[22] The more than 50-year trade embargo with Cuba weakened over time and became ineffective as countries ceased their trade suppression. Oil embargoes against South Africa, because of its racial policies, merely spurred South African companies to become leaders in converting coal to oil.[23]

Even if trade sanctions succeed at weakening the targeted countries' economies, who really suffers? You can bet that the political leaders will still get whatever they need, so innocent people bear the costs of sanctions. This occurred in Iran, where there were widespread reports of deaths because of sanction-induced shortages

Counterpoint

of medicine.[24] Moreover, the people adversely affected usually blame their suffering not on their internal regime but on the countries carrying on the sanctions. Despots are very good at manipulating public opinion.[25]

In addition, critics of sanctioning point to import restrictions that are not fully effective because they aim too much at curtailing supply rather than demand (e.g., U.S. actions aiming to curtail the production of opiates abroad rather than efforts to restrain U.S. demand). In another example, many countries restrict ivory imports so that countries (mainly African) will limit ivory supplies by protecting elephants.[26] However, although restrictions may have slowed elephant slaughter, poaching still continues (in the five years between 2010 and 2015, Tanzania and Mozambique lost 60 and 48 percent of their elephants respectively) because of high demand for ivory.[27] The below photo shows part of 1.5 tons of imported ivory products seized and destroyed by the Belgian government.

Finally, governments sometimes seem to impose trade sanctions based on one issue rather than on a country's overall record. For instance, some critics have suggested using trade policies to press Brazil to restrict the cutting of Amazon forests, even though its overall environmental record—particularly its limitation of adverse exhaust emissions by converting automobile engines to use methanol instead of gasoline—is quite good.

Photo shows seized ivories and ivory products prior to their destruction in Belgium.

Source: Gong Bing/Xinhua/Alamy Stock Photo

MAINTAINING OR EXTENDING SPHERES OF INFLUENCE

Governments use trade to support their spheres of influence—giving aid and credits to, and encouraging imports from, countries that join a political alliance or vote a preferred way within international bodies. For example, the EU and 78 states from Africa, the Caribbean, and the Pacific participate in the Cotonou Agreement that formalizes an array of economic and political ties and economic issues.

PRESERVING NATIONAL CULTURE

CONCEPT CHECK

We observe in Chapter 2 (pages 73–74) that a primary function of culture is that it supports a nation's sense of its uniqueness and integrity.

To help sustain a collective identity that sets their citizens apart from other nationalities, governments prohibit exports of art and historical items deemed to be part of their national heritage. In addition, they limit imports that may either conflict with or replace their dominant values. The relevance of culture has been confirmed through several UNESCO conventions aimed at preserving cultural diversity, and the concern has been largely focused, but not entirely, on media (print, visual, and audio).[28] For instance, many countries, such as Canada and Australia, require levels of national content in media.[29] In addition to media, Japan, South Korea, and China maintained for many years an almost total ban on rice imports, largely because rice farming has been a historically cohesive force in each nation.[30]

MAJOR INSTRUMENTS OF TRADE CONTROL

In seeking to influence exports or imports, governments' choice of trade-control instrument is crucial because each may incite different responses from domestic and foreign groups. One way to understand these instruments is by distinguishing between those that directly influence export or import *prices* and those that directly limit the *amount* of a good that can be traded. Let's review these instruments.

TARIFFS: DIRECT PRICE INFLUENCES

Tariffs may be levied

- on goods entering, leaving, or passing through a country;
- for protection or revenue;
- on a per-unit basis, a value basis, or both.

Tariff barriers directly affect prices, and *nontariff barriers* may directly affect either price or quantity. A **tariff** (also called a **duty**) is a tax levied on a good shipped internationally. That is, governments charge a tariff on a good when it crosses an official boundary—whether it be that of a nation or a group of nations that have agreed to impose a common tariff on goods crossing the boundary of their bloc. A tariff assessed on a per-unit basis is a **specific duty**, on a percentage of the item's value an **ad valorem duty**, and on both a **compound duty**.

Tariffs collected by the exporting country are called **export tariffs**; if they're collected by a country through which the goods pass, they're **transit tariffs**; if they're collected by importing countries, they're **import tariffs**. Because import tariffs are by far the most common, we discuss them in some detail.

Import Tariffs Unless they're *optimum tariffs* (discussed earlier in the chapter), import tariffs raise the price of imported goods by taxing them, thereby giving domestically produced goods a relative price advantage. Although consumers are often unaware of the cost increase from tariffs on imports, they learn very quickly when encountering duty-free shops in international airports and at cruise ship stopovers. (See the following photo.)

Tariffs as Sources of Revenue Tariffs also generate governmental revenue, but revenue is of little importance to developed countries because collection costs usually exceed the yield.[31] In many developing countries, though, they are a major source of revenue because they are often more easily collected than income taxes. Although revenue tariffs are most commonly

Tourists shopping for duty-free items in St. John's, Antigua and Barbuda.
Source: M.Sobreira/Alamy Stock Photo

collected on imports, some countries charge export tariffs on raw materials. Transit tariffs were once a major source of countries' revenue, but governmental agreements have nearly abolished them.

Developing countries argue that their processed portion of commodities have higher tariffs than the published rates.

The Effective Tariff Controversy Raw materials (say, coffee beans) from developing countries frequently enter developed countries free of duty; however, if they are processed (say, instant coffee), developed countries then assign an import tariff. Because an ad valorem tariff is based on the total value of the product (say, 10 percent on a $5 jar of instant coffee), the raw materials and the processing combined (say, $2.50 for the coffee beans and $2.50 for the processing) pays $.50. Developing countries have argued that the **effective tariff** on the manufactured portion turns out to be higher than the published tariff rate because the manufactured portion is effectively charged 20 percent. This anomaly further challenges developing countries to find export markets for products that use their raw materials.

NONTARIFF BARRIERS: DIRECT PRICE INFLUENCES

Now that we've shown how tariffs raise prices, let's discuss other ways that governments alter product prices to affect their trade.

Governmental subsidies may help companies be competitive,

- but there is little agreement on what a subsidy is,
- but agricultural subsidies are difficult to dismantle,
- especially to overcome market imperfections because they are least controversial.

Subsidies **Subsidies** offer direct assistance to companies to boost their competitiveness. Although this definition is straightforward, disagreement on what constitutes a subsidy causes trade frictions. In essence, not everyone agrees that companies are being subsidized just because they lose money, nor that all types of government loans or grants are subsidies. One long-running controversy involves commercial aircraft. Airbus Industrie and the EU claim that the U.S. national and state governments subsidize Boeing through R&D contracts for military aircraft that also have commercial applications and through the granting of incentives to influence their location decisions. Further, because the U.S. Ex-Im Bank offers loan guarantees to foreign buyers, Delta Air Lines has argued that this gives non-U.S. airlines an advantage not available to U.S. airlines.[32] Meanwhile, Boeing and the U.S. government claim that the EU subsidizes Airbus Industrie through low-interest government loans.[33]

An area that may well raise future questions about subsidies is governmental support to shore up floundering companies and industries, especially during global recessions. For instance, governments have bailed out banks, granted generous consumer loans to support their auto companies, eliminated taxes on their companies' export earnings, and invested in an ownership share of key companies. In turn, these actions alter international competitiveness.[34]

Agricultural Subsidies The one area in which everyone agrees that subsidies exist is agriculture, especially in developed countries. The official reason is that food supplies are too critical to be left to chance. Although subsidies lead to surplus production, they are argued to be preferable to the risk of food shortages. Further, to counter overproduction, the United States pays additional subsidies to farmers so that they do not produce as much.[35] However, this official reason does not explain agricultural subsidies for nonfood products, such as U.S. cotton subsidies that Brazil claims to disadvantage its competitiveness.[36]

The strength of agricultural interests is also important. Within Japan, the United States, and the EU, rural areas have a disproportionately high representation in government decision-making. For instance, Japanese rural interests have been able to force a 778 percent tariff on rice.[37] In the United States, there is one senator per 300,000 people in Vermont (a state with a 68 percent rural population) and one senator per 19 million in California (which is 93 percent urban). Agriculture accounts for 38 percent of the EU budget even though it composes only 7 percent of GDP.[38] The result is that internal politics effectively prevent the dismantling of such instruments as price supports for farmers, government agencies to improve agricultural productivity, and low-interest loans to farmers.

What is the effect? Although some developing countries, such as India, are also major agricultural subsidizers, many are deprived from fully serving the developed markets with competitive agricultural products. Further, much surplus production from developed countries is exported at very low prices, thus distorting trade and further disadvantaging developing countries' production.[39]

Overcoming Market Imperfections Most countries offer potential exporters many business development services, such as market information, trade expositions, and foreign contacts. This type of subsidization is less contentious than tariffs because the actions seek to overcome, rather than create, market imperfections. Further, collecting and disseminating information widely is less costly than if each potential exporter were to work individually.

Aid and Loans When governments require foreign aid and loan recipients to spend the funds in the donor country, a situation known as *tied aid* or *tied loans,* some otherwise noncompetitive output can compete abroad. For instance, tied aid helps win large contracts for infrastructure, such as telecommunications, railways, and electric power projects.

However, tied aid and loans sometimes require the recipient to use output and suppliers that may not be the best. They may also slow the advancement of local suppliers in developing countries. These concerns led OECD members to untie financial aid to developing countries.[40] However, China is using tied aid for nearly all its foreign infrastructure projects.[41]

Because it is difficult for customs officials to determine the honesty of import invoices,
- valuation procedures have been developed,
- they may restate the value,
- they may question the origin of and product-classification of imports.

Customs Valuation Import tariff assessments depend on the product, price, and origin—which tempts exporters and importers to declare these wrongly to pay a lower duty and tempts governments to declare wrongly as a protectionist measure.

What Is the Import Worth? Most countries have agreed to use import invoice information unless customs doubt its authenticity. Agents must then appraise on the basis of the value of identical or similar goods arriving at about the same time.[42] Customs must appraise similarly when goods enter for lease rather than purchase because there is no invoice. Critics,