International Trade Part II

I've never believed protectionism will lead us anywhere. There is not a shred of doubt in my mind that when you open an economy you should do it in totality. Foreign investment adds a sense of competition; we should see this as a wake-up call to modernize and upgrade. Companies that do not will undoubtedly die.

-Ratan Tata

Microeconomic Pressures

Affected industries will try to restrict imports in order to preserve their own jobs and incomes.

Import-Competing Industries

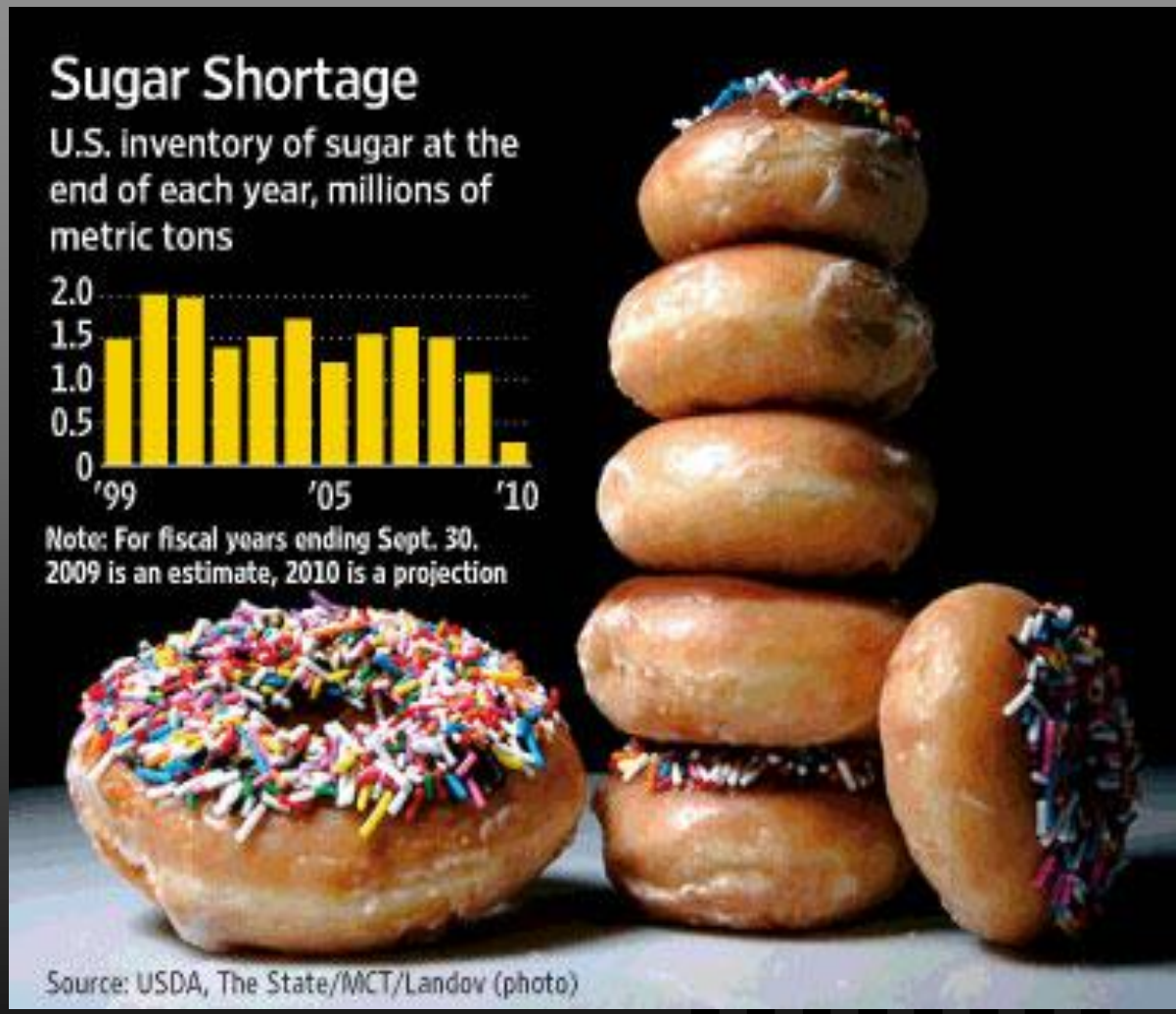
Workers and producers who compete with imported products – who work in import-competing industries – have an economic interest in restricting trade.

Food Companies vs Farmers

- Kraft Foods, General Mills, Hershey and Mars have threatened to raise consumer prices and lay off workers if the Agriculture Department doesn't allow them to import more tariff-free sugar.
- This is a long-simmering dispute between US food companies and the US sugar industry over federal policy that artificially inflates the domestic price of US-produced sugar in order to support the incomes of politically savvy sugar-beet and cane-sugar farmers.
- Current import quotas limit the amount of tariff-free sugar the food companies can import in a given year. The increased cost is passed on to consumers, of course.

Food Companies vs Farmers cont.

- Most years, the price US food companies pay for US sugar is twice the world level.
- Farmers are absolutely opposed to expanding the sugar-import quota in part because it would cause the prices received by US growers to sink.



Export Industries

Trade not only alters the mix of output but also redistributes income from import-competing industries to export industries.

Additional Pressures

- Trade restrictions designed to protect specific microeconomic interests reduce the total gains from trade.
- Micro interests are not the only source of trade restrictions.
- Other arguments are used to restrict trade.

Additional Pressures: National Security Concerns

- Essential defense-related goods are vital during times of war.
- A war could disrupt this flow leaving us vulnerable.
- Exporting vital technology to a potential enemy is not wise.

Additional Pressures: Dumping

- Import competing industries are placed at risk when goods are consistently dumped in a nation.
- ***Dumping*** is the sale of goods in export markets at prices below domestic prices.

Additional Pressures: Infant Industries

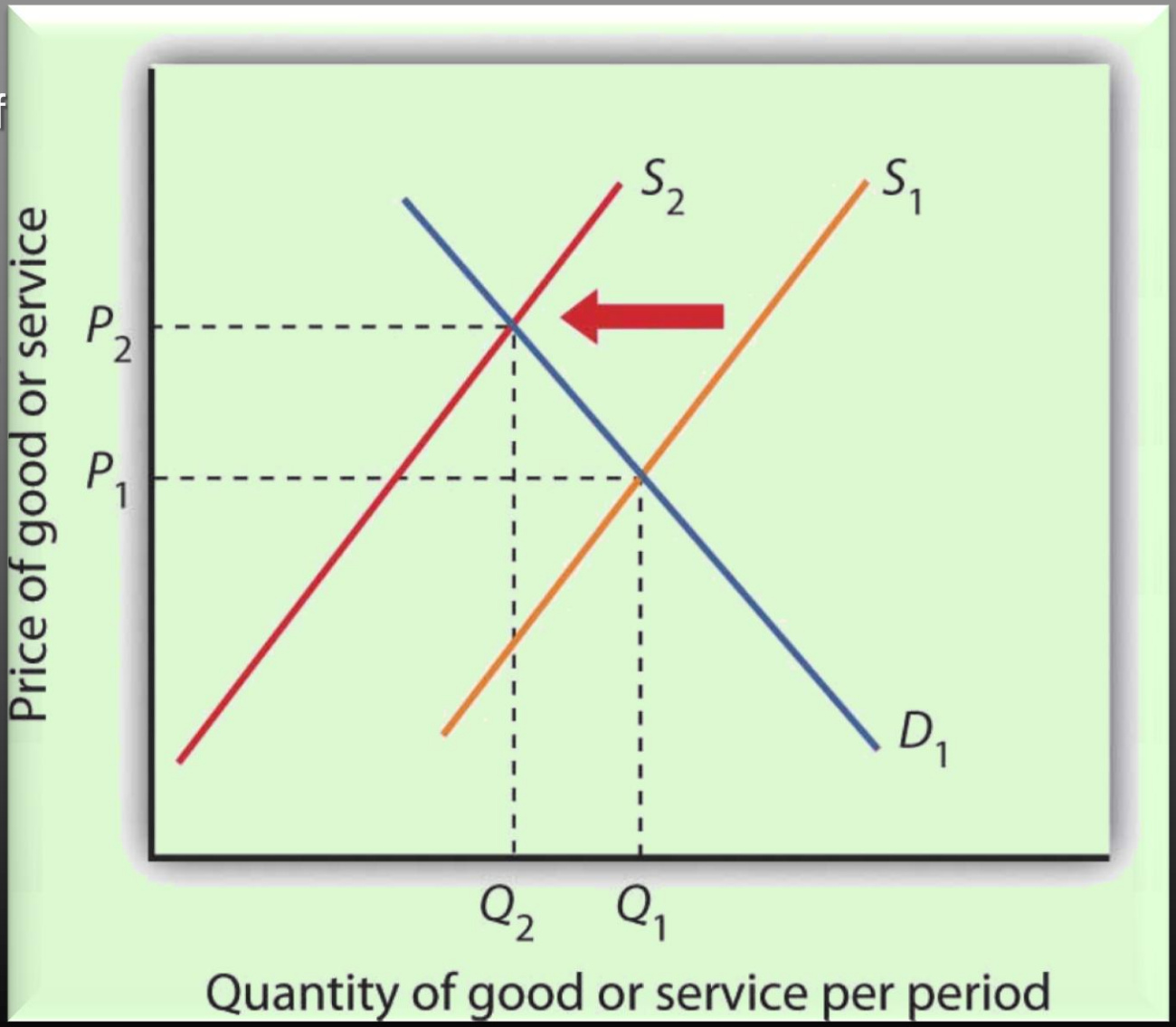
- Even normal export prices might make it difficult or impossible for a new domestic industry to develop.
- These industries may need temporary protection from imports.
- But trade restrictions are justified only if there is tangible evidence that the industry can develop a comparative advantage reasonably quickly.

Additional Pressures: Improving the Terms of Trade

- The distribution of the gains from trade depends on the terms of trade.
- Putting restrictions on imports can move the terms of trade in our favor
- We would end up with a larger share of the gains from trade.

Chart: The Impact of Protectionist Policies

Protectionist policies reduce the quantities of foreign goods and services supplied to the country that imposes the restriction. Such policies shift the supply curve to the left for the good or service whose imports are restricted. In the case shown, the supply curve shifts to S_2, the equilibrium price rises to P_2 and the equilibrium quantity falls to Q_2.



Barriers to Trade

The microeconomic losses associated with trade give rise to a constant clamor for trade restrictions.

Barriers to Trade: Embargoes

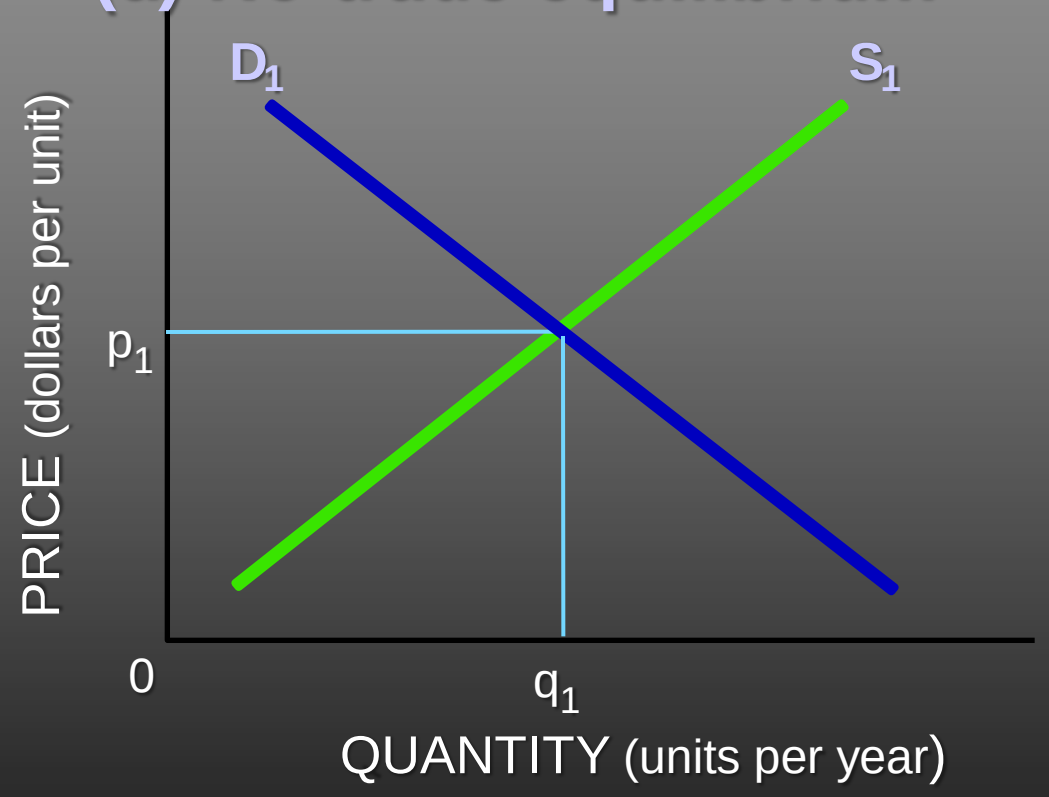
- The sure-fire way to restrict trade is simply to eliminate it.
- An ***embargo*** is a prohibition against trading particular goods.

No-Trade Equilibrium

- The equilibrium price is completely determined by domestic demand and supply curves.
- **Equilibrium price** – the price at which the quantity of a good demanded in a given time period equals the quantity supplied

Impact of Trade Restrictions

(a) No-trade equilibrium



Barriers to Trade: Tariffs

- A more frequent trade restriction is a tariff.
- A ***tariff*** is a tax (duty) imposed on imported goods.
- A tariff on imported goods makes them more expensive to domestic consumers and less competitive with domestically priced goods.

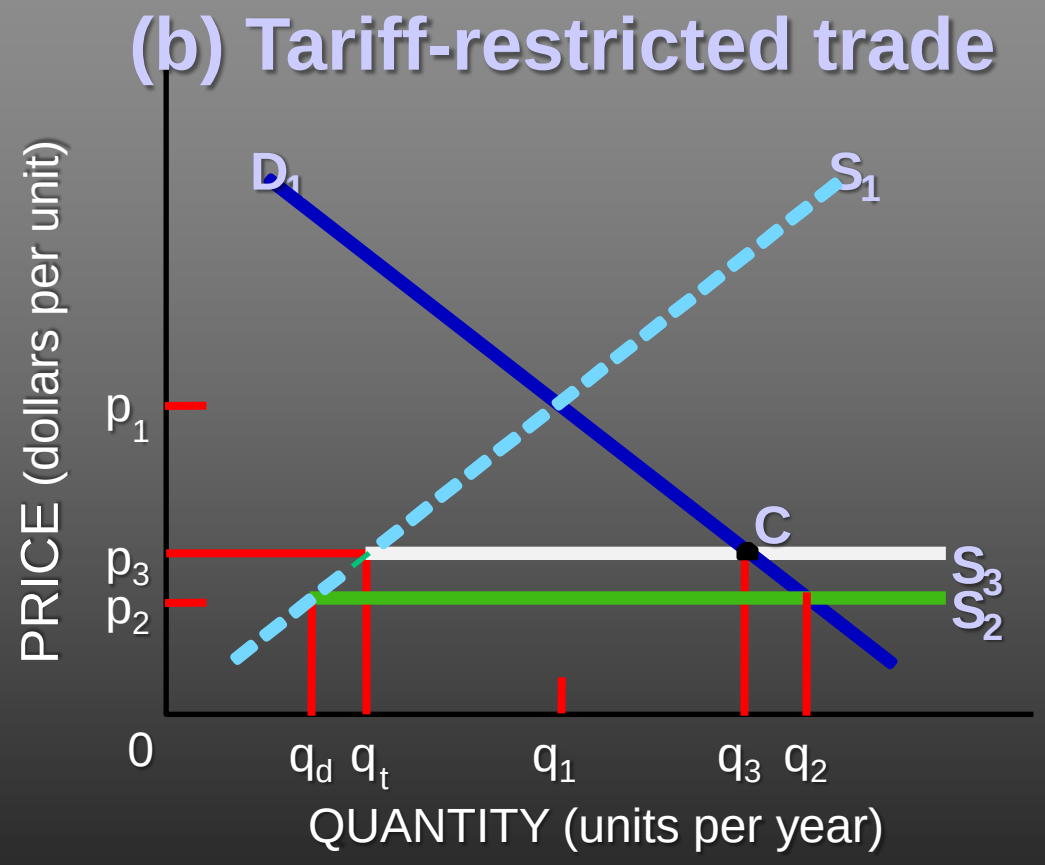
“Beggar-Thy-Neighbor”

- The curtailment of imports looks like an easy solution to the problem of domestic unemployment.
- Tariffs inflict harm on foreign producers.
- When foreign countries retaliate with tariffs of their own, world trade shrinks and unemployment increases in all countries.

Tariff-Restricted Trade

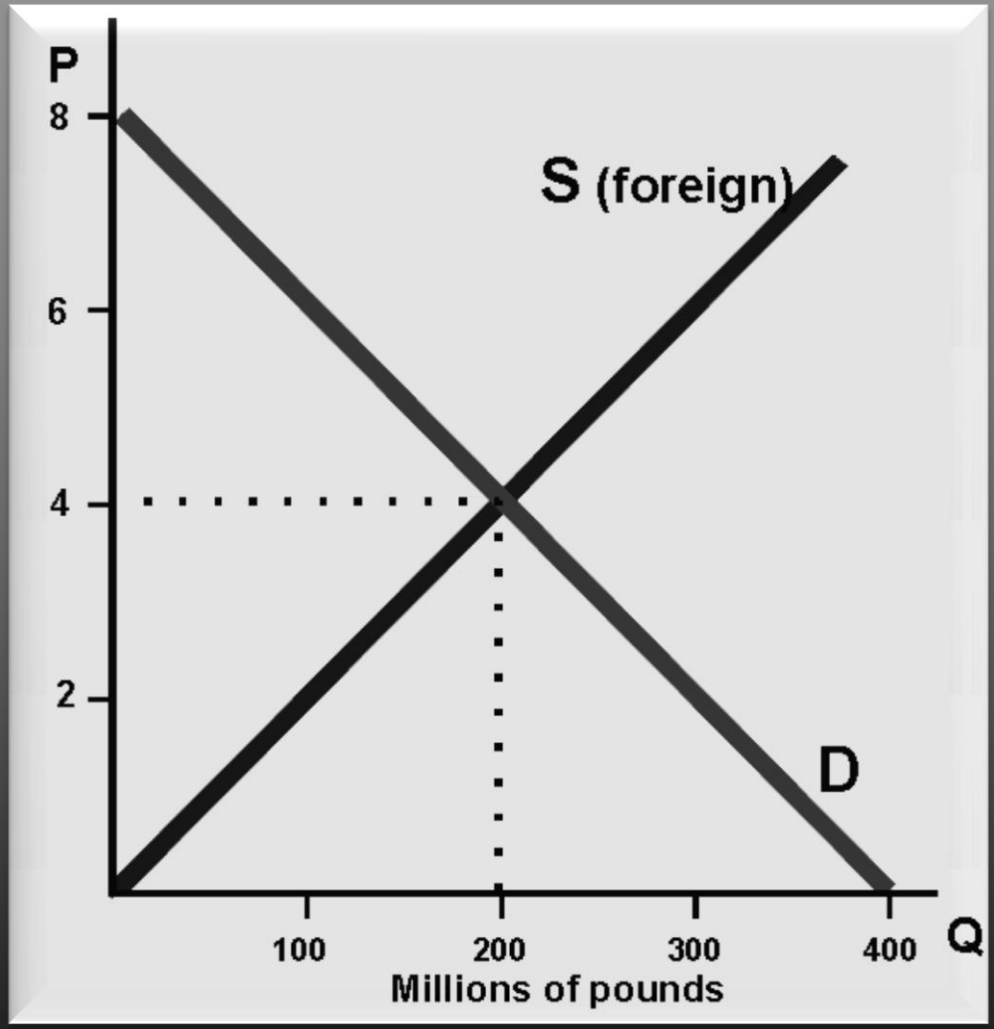
- Tariffs raise the price of imports and shifts the import supply curve upward.
- Domestic prices rise, domestic production rises and domestic consumption falls.

Impact of Trade Restrictions



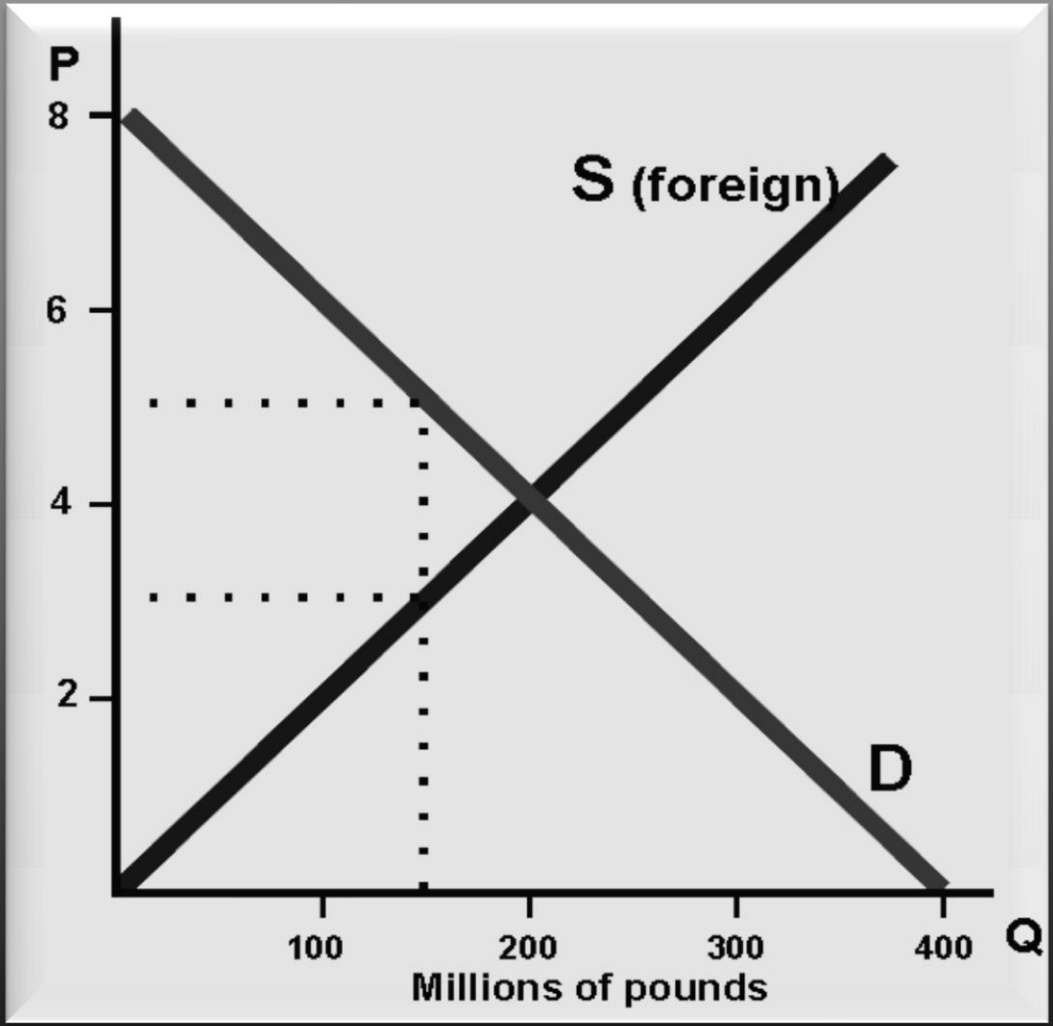
US Coffee Market

Let's suppose that, with no trade restrictions, the US will have a market equilibrium for coffee of $4 a pound (P) and 200 million pounds sold (Q).

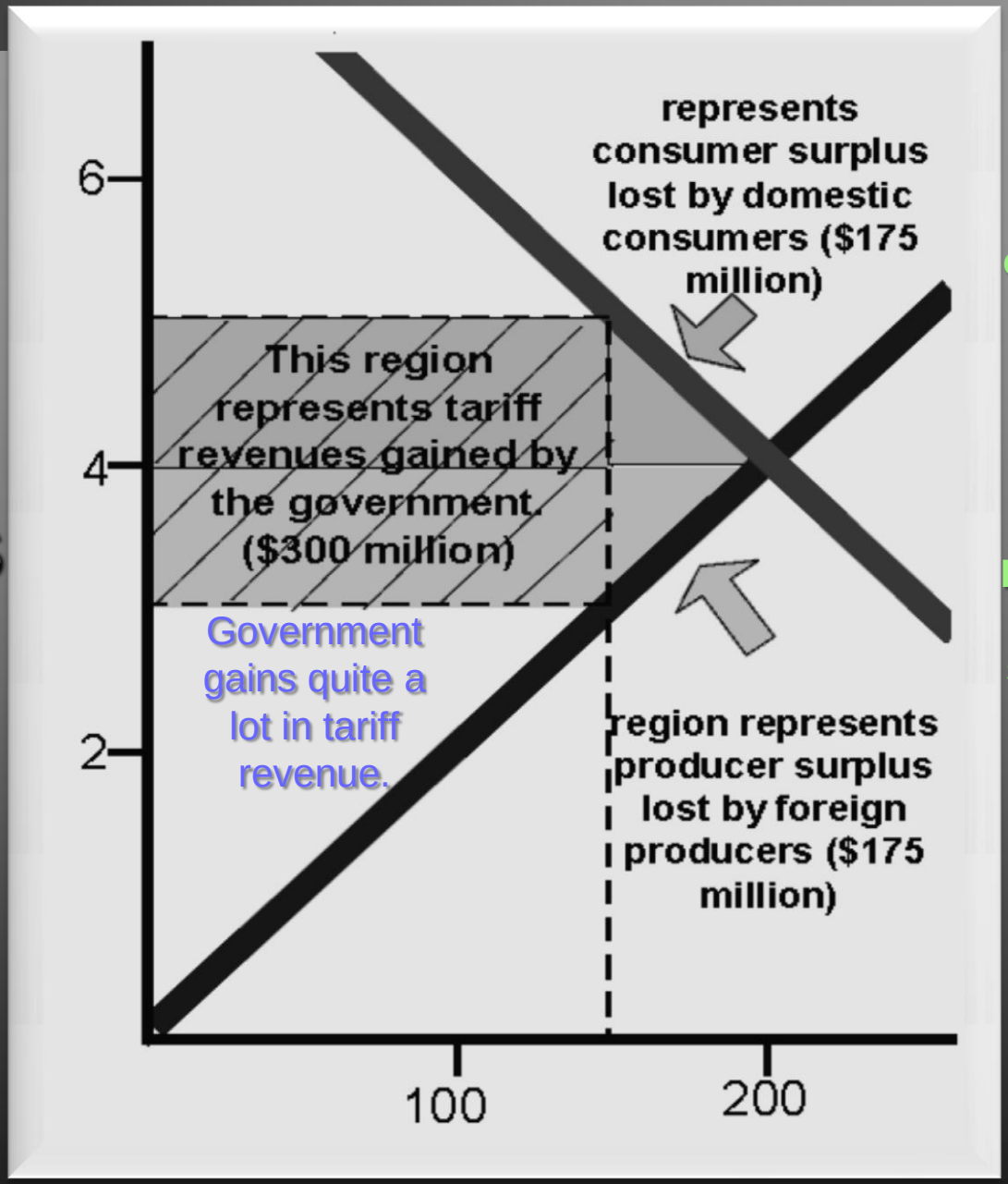


US Coffee Market

If the US government decides to impose a $2 **tariff** on every pound of coffee, US consumers will end up paying $2 more per pound than foreign producers receive. And the results?



US Coffee Market: Winners and Losers



Some buyers can no longer afford coffee. Those who can, pay more.

Forces sellers down their supply curve. They export less and sell at a lower price.

Barriers to Trade: Quotas

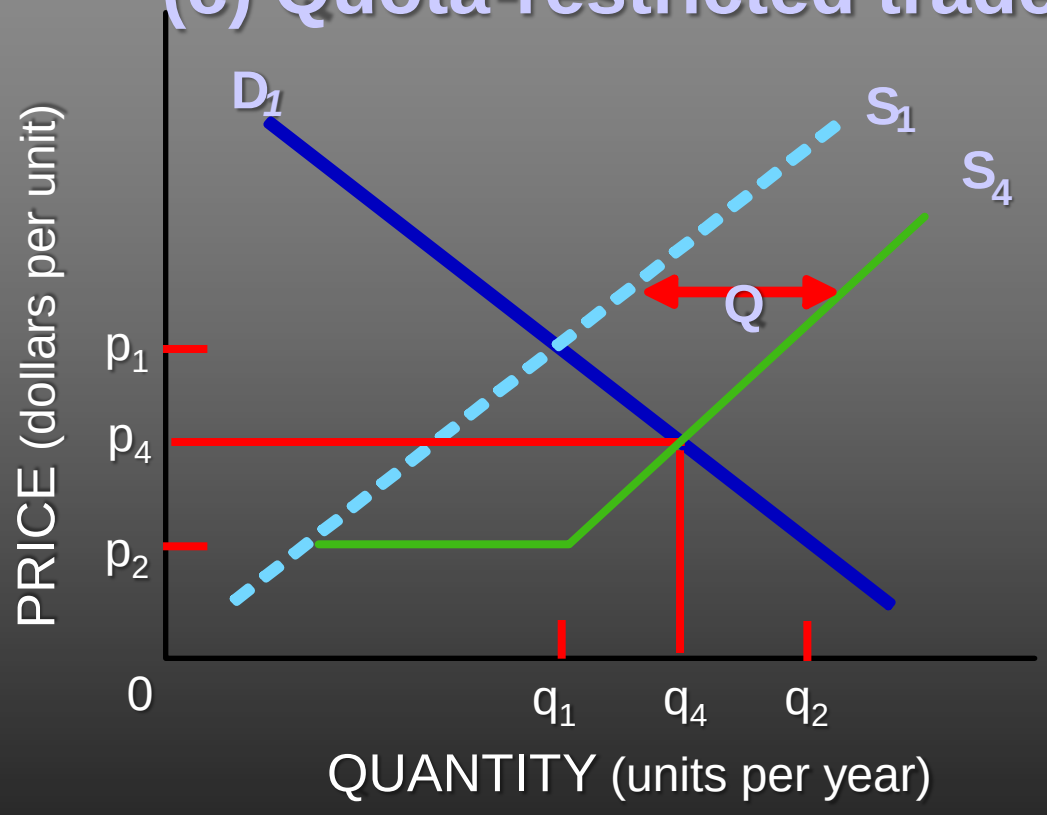
- The same effects of a tariff can be attained more directly by imposing an import quota.
- A ***quota*** is a limit on the quantity of a good that may be imported in a given time period.
- The effect of quotas on trade is different than the effect of tariffs.

Quota-Restricted Trade

Quotas are a greater threat to competition than tariffs because quotas preclude additional imports at any price.

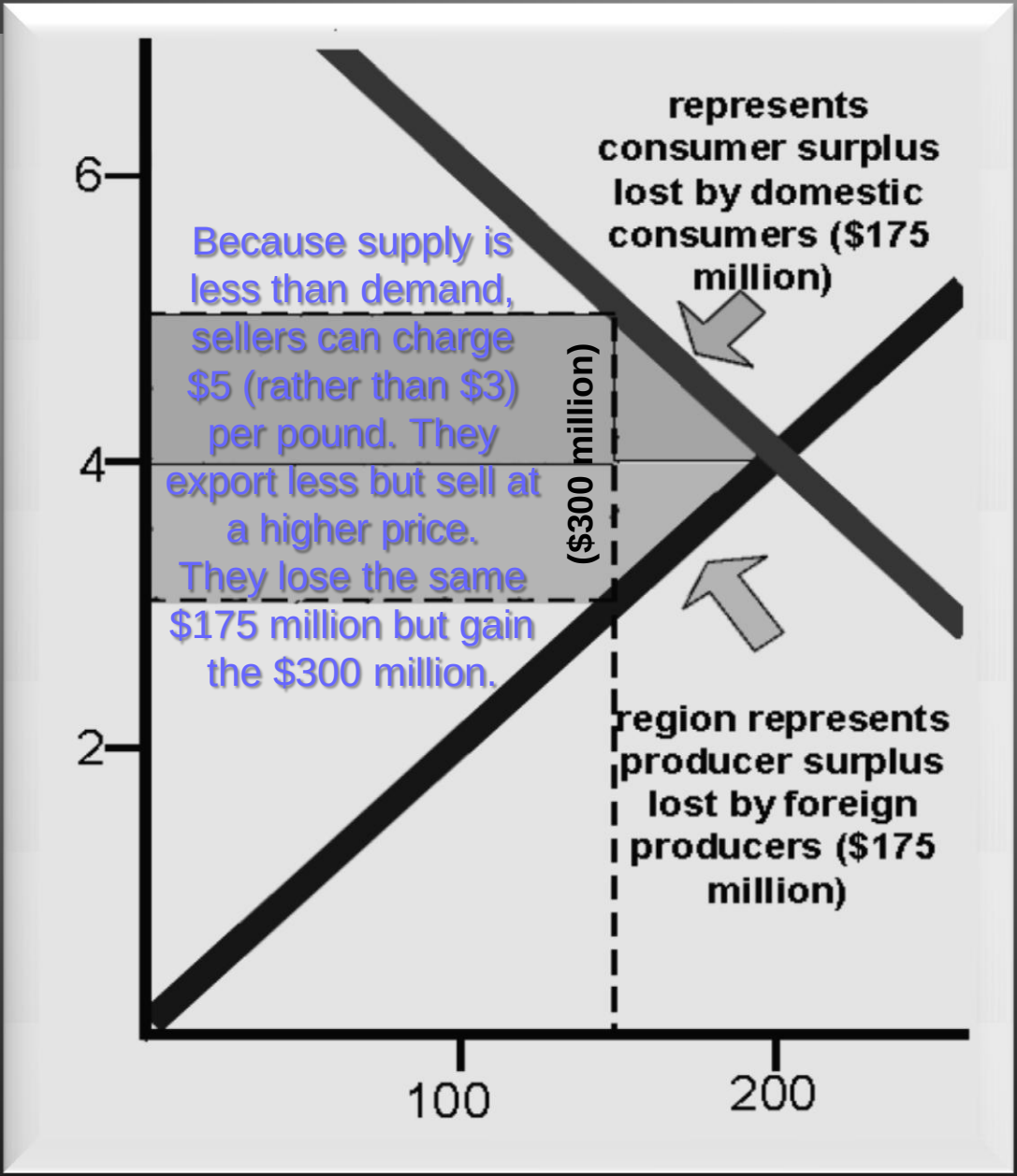
Impact of Trade Restrictions

(c) Quota-restricted trade



US Coffee Market: Winners and Losers

If the US government imposes a **quota**, allowing only 150 million pounds of coffee to be imported each year, what are the results?



Again, some buyers can no longer afford coffee. Those who can, pay more.

Barriers to Trade: Voluntary Restraint Agreements

- A slight variant of quotas has been used in recent years.
- A ***voluntary restraint agreement*** (***VRA***) is an agreement to reduce the volume of trade in a specific good – a "voluntary" quota.

Barriers to Trade: Nontariff Barriers

Embargoes, export controls, tariffs and quotas are the most visible barriers to trade, but they are only the tip of the iceberg.

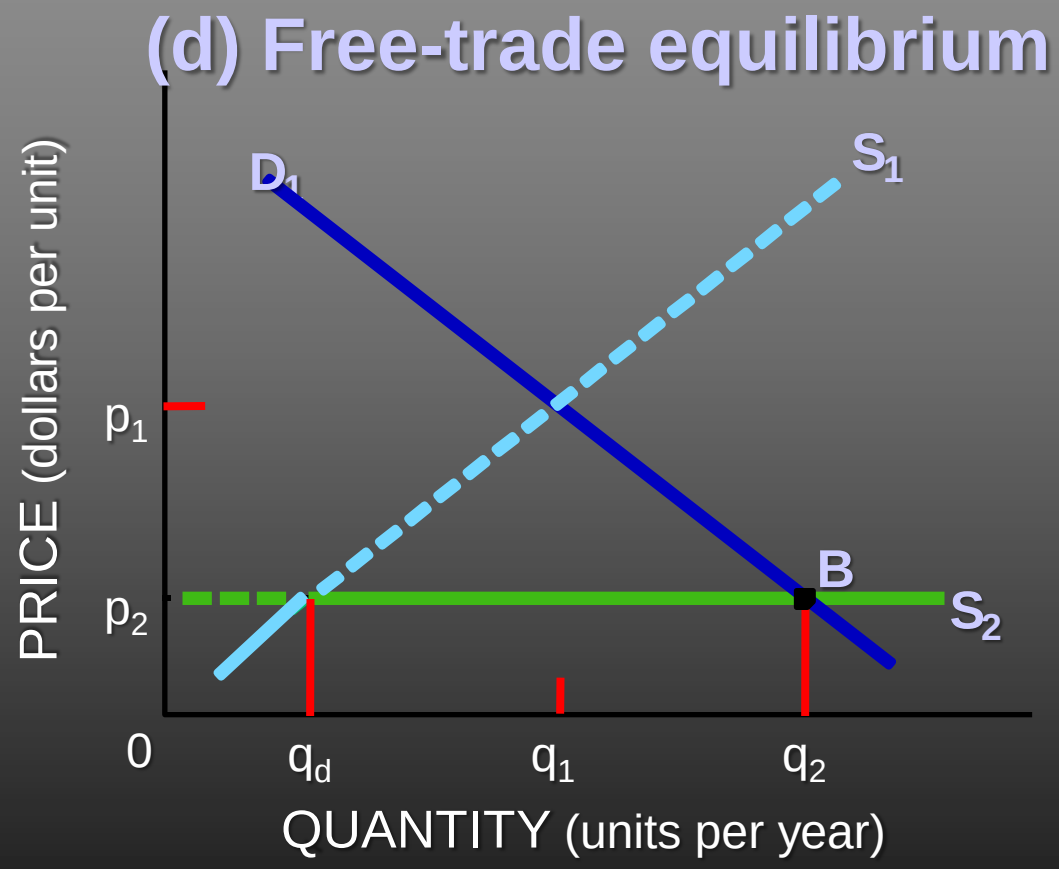
Nontariff Barriers

- The US restricts roughly 15% of imports using
  - product standards
  - licensing restrictions
  - restrictive procurement practices
  - other nontariff barriers

Free-Trade Equilibrium (No Barriers)

- Free trade allows the import of an unlimited quantity of foreign supplies at the world price.
- Free trade results in reduced prices and increased consumption.

Impact of No Trade Restrictions



An Increasingly Global Market

Trade policy is a continuing conflict between the proponents of free trade and the special interests that profit from trade protection.

Multilateral Trade Pacts

- The long-term trend is towards *lowering* trade barriers, thereby increasing global competition.
- Protectionist forces are being countered by the worldwide recognition of the gains from trade.

Global Pacts: GATT and the WTO

- The granddaddy of the multilateral, multiyear free-trade pacts was the General Agreement on Tariffs and Trade (GATT).
- The 1994 GATT pact created the World Trade Organization (WTO) to enforce free-trade rules.
- The WTO has become the world's trade police force.

WTO Protests

- Some people see free trade as a mixed blessing.
- Environmentalists worry about depletion of resources, congestion and pollution.
- Labor organizations worry about depressed wages and working conditions.
- Third World countries worry about an unfair trade playing field.

Regional Pacts: NAFTA and the EU

Groups of nations have moved even faster toward open markets by developing regional trade pacts.

NAFTA

- In December 1992, the United States, Canada and Mexico signed the North American Free Trade Agreement (NAFTA).
- The Ultimate goal of NAFTA is to eliminate all trade barriers between these three countries.

European Union

- The European Union (EU) is a regional pact that virtually eliminates national boundaries between 15 countries.
- The EU has not only eliminated trade barriers, but also permitted full inter-country mobility of workers and capital.

European Union

- In 1999, eleven of the EU nations also created a new currency (the euro) that replaced the German mark, the French franc and other national currencies.
- In effect, Europe has become one large unified market.

The End