

Chapter 2

The Dynamic Environment of International Trade



CHAPTER OUTLINE

Global Perspective: Trade Barriers—An International Marketer's Minefield

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CHAPTER LEARNING OBJECTIVES

What you should learn from Chapter 2:

- LO1** The basis for the reestablishment of world trade following World War II
- LO2** The importance of balance-of-payment figures to a country's economy
- LO3** The effects of protectionism on world trade
- LO4** The several types of trade barriers
- LO5** The provisions of the Omnibus Trade and Competitiveness Act
- LO6** The importance of GATT and the World Trade Organization
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Global Perspective

TRADE BARRIERS—AN INTERNATIONAL MARKETER'S MINEFIELD

We all know the story about U.S. trade disputes with Japan. Japan has so many trade barriers and high tariffs that U.S. manufacturers are unable to sell in Japan as much as Japanese companies sell in the United States. The Japanese claim that “unique” Japanese snow requires skis made in Japan, and U.S. baseballs are not good enough for Japanese baseball. Even when Japan opened its rice market, popular California rice had to be mixed and sold with inferior grades of Japanese rice. And, at this writing, the Japanese government continues to exclude American beef from the Japanese diet based on disputes about mad cow disease.¹

However, the Japanese are not alone; every country seems to take advantage of the open U.S. market while putting barriers in the way of U.S. exports. The French, for example, protect their film and broadcast industry from foreign competition by limiting the number of American shows that can appear on television, the percentage of American songs broadcast on radio, and the proportion of U.S. movies that can be shown in French theaters. Most recently, France launched its own “French” version of CNN with strong government financial support. Not only do these barriers and high tariffs limit how much U.S. companies can sell, they also raise prices for imported products much higher than they sell for in the United States.

Another trade protection tactic even involved Britain's Supreme Court of Judicature, which has finally answered a question that has long puzzled late-night dorm-room snackers: What, exactly, is a Pringle? With citations ranging from Baroness Hale of Richmond to Oliver Wendell Holmes, Lord Justice Robin Jacob concluded that legally it is a potato chip. The decision is bad news for Procter & Gamble U.K., which now owes \$160 million in value-added taxes to the state. It is thus good news for Her Majesty's Revenue

and Customs—and for fans of no-nonsense legal opinions. It is also a reminder, as conservatives in the United States attack Justice Sonia Sotomayor for not being a “strict constructionist,” of the pointlessness of such labels. In Britain, most foods are exempt from the value-added tax (VAT), but potato chips (known there as crisps) and “similar products made from the potato, or from potato flour” are taxable. Procter & Gamble, in what could be considered a strict constructionist plea, argued that Pringles are about 40 percent potato flour but also contain corn, rice, and wheat and therefore should not be considered potato chips or “similar products.” Rather, they are “savory snacks.”

The VAT and Duties Tribunal disagreed, ruling that Pringles, marketed in the United States as “potato chips,” are taxable. “There are other ingredients,” the Tribunal agreed, but a Pringle is “made from potato flour in the sense that one cannot say that it is not made from potato flour, and the proportion of potato flour is significant being over 40 percent.”

Barriers to trade, whatever form they take, both tariff and nontariff, are one of the major issues confronting international marketers. Nations continue to use trade barriers for a variety of reasons: some rational, some not so rational. Fortunately, tariffs generally have been reduced to record lows, and substantial progress has been made on eliminating nontariff barriers. And work continues around the world to further reduce these pesky hurdles to peace and prosperity.

Sources: Adapted from Todd G. Buchholz, “Free Trade Keeps Prices Down,” *Consumers' Research Magazine*, October 1995, p. 22; Tomas Kellner, “What Gaul!” *Forbes*, April 28, 2003, p. 52; Jonathan Lynn, “WTO Negotiators to Tackle Obstacles to Farm Deal,” *Reuters News*, January 3, 2008; Adam Cohen, “The Lord Justice Hath Ruled: Pringles Are Potato Chips,” *The New York Times*, June 1, 2009.

¹See James Day Hodgson, Yoshihiro Sano, and John L. Graham, *Doing Business in the New Japan, Succeeding in America's Richest Foreign Market* (Boulder, CO: Rowman & Littlefield, 2008) for the complete story.

Exhibit 2.1

Top Ten 2009 U.S. Trading Partners (\$ billions, merchandise trade)

Source: <http://www.census.gov/foreign-trade/top>, 2010.

| Country | Total Trade | Exports | Imports | Balance |
|----------------|-------------|---------|---------|---------|
| Canada | \$429.6 | \$204.7 | \$224.9 | \$-20.2 |
| China | 366.0 | 69.6 | 296.4 | -226.5 |
| Mexico | 305.5 | 129.0 | 176.5 | -47.5 |
| Japan | 147.1 | 51.2 | 95.9 | -44.7 |
| Germany | 114.6 | 43.3 | 71.3 | -28.0 |
| United Kingdom | 93.2 | 45.7 | 47.5 | -1.8 |
| South Korea | 67.9 | 28.6 | 39.2 | -10.6 |
| France | 60.6 | 26.5 | 34.0 | -7.5 |
| Netherlands | 48.4 | 32.3 | 16.1 | +16.2 |
| Taiwan | 46.8 | 18.4 | 28.4 | -10.0 |

Yesterday's competitive market battles were fought in western Europe, Japan, and the United States; now competitive battles have extended to Latin America, eastern Europe, Russia, China, India, Asia, and Africa as these emerging markets continue to open to trade. More of the world's people, from the richest to the poorest, will participate in the world's growing prosperity through global trade. The emerging global economy brings us into worldwide competition, with significant advantages for both marketers and consumers. Marketers benefit from new markets opening and smaller markets growing large enough to become viable business opportunities. Consumers benefit by being able to select from the widest range of goods produced anywhere in the world at the lowest prices.

Bound together by burgeoning international communications media and global companies, consumers in every corner of the world are demanding an ever-expanding variety of goods and services. As Exhibit 2.1 illustrates, world trade is an important economic activity. Because of this importance, the inclination is for countries to attempt to control international trade to their own advantage. As competition intensifies, the tendency toward protectionism gains momentum. If the benefits of the social, political, and economic changes now taking place are to be fully realized, free trade must prevail throughout the global marketplace. The creation of the World Trade Organization (WTO) is one of the biggest victories for free trade in decades.

This chapter briefly surveys the United States's past and present role in global trade and some concepts important for understanding the relationship between international trade and national economic policy. A discussion of the logic and illogic of protectionism, the major impediment to trade, is followed by a review of the General Agreement on Tariffs and Trade (GATT) and its successor, the World Trade Organization (WTO), two multinational agreements designed to advance free trade.

The Twentieth to the Twenty-First Century

At no time in modern economic history have countries been more economically interdependent, have greater opportunities for international trade existed, or has the potential for increased demand existed than now, at the opening of the 21st century. This statement remains true even with due regard to the global financial crisis that began in 2008. In contrast, in the preceding 100 years, world economic development was erratic.

The first half of the 20th century was marred by a major worldwide economic depression that occurred between two world wars that all but destroyed most of the industrialized world. The last half of the century, while free of a world war, was marred by struggles between countries espousing the socialist Marxist approach and those following a democratic capitalist approach to economic development. As a result of this ideological split, traditional trade patterns were disrupted.

After World War II, as a means to dampen the spread of communism, the United States set out to infuse the ideal of capitalism throughout as much of the world as possible. The Marshall Plan to assist in rebuilding Europe, financial and industrial development assistance to rebuild Japan, and funds channeled through the Agency for International Development and other groups designed to foster economic growth in the underdeveloped world

LO1

The basis for the reestablishment of world trade following World War II



Even though the John Deere tractors lined up for shipment from its Waterloo, Iowa, plant appear impressive, the Hyundai cars stacked up by the water in Ulsan, South Korea, headed for the United States dwarf their numbers. The juxtaposition of the two pictures aptly reflects the persistence of America's broader merchandise trade deficit.

were used to help create a strong world economy. The dissolution of colonial powers created scores of new countries in Asia and Africa. With the striving of these countries to gain economic independence and the financial assistance offered by the United States, most of the noncommunist world's economies grew, and new markets were created.

The benefits of the foreign economic assistance given by the United States flowed both ways. For every dollar the United States invested in the economic development and rebuilding of other countries after World War II, hundreds of dollars more returned in the form of purchases of U.S. agricultural products, manufactured goods, and services. This overseas demand created by the Marshall Plan and other programs² was important to the U.S. economy because the vast manufacturing base built to supply World War II and the swelling labor supply of returning military created a production capacity well beyond domestic needs. The major economic boom and increased standard of living the United States experienced after World War II were fueled by fulfilling pent-up demand in the United States and the demand created by the rebuilding of war-torn countries of Europe and Asia. In short, the United States helped make the world's economies stronger, which enabled them to buy more from us.

In addition to U.S. economic assistance, a move toward international cooperation among trading nations was manifest in the negotiation (1986–1994) of the General Agreement on Tariffs and Trade (GATT). International trade had ground to a halt following World War I when nations followed the example set by the U.S. passage of the Smoot-Hawley Act (1930), which raised average U.S. tariffs on more than 20,000 imported goods to levels in excess of 60 percent. In retaliation, 60 countries erected high tariff walls, and international trade stalled, along with most economies. A major worldwide recession catapulted the world's economies into the Great Depression when trade all but dried up.³

Determined not to repeat the economic disaster that followed World War I, world leaders created **GATT**, a forum for member countries to negotiate a reduction of tariffs and other barriers to trade. The forum proved successful in reaching those objectives. With the ratification of the Uruguay Round agreements, the GATT became part of the World Trade Organization (WTO) in 1995, and its 117 original members moved into a new era of free trade.

²The Organization for Economic Cooperation and Development (OECD) was a direct result of the Marshall Plan.

³David M. Kennedy, Lizabeth Cohen, and Thomas A. Bailey, *The American Pageant*, 13th ed. (Boston: Houghton Mifflin, 2006).

World Trade and U.S. Multinationals

The rapid growth of war-torn economies and previously underdeveloped countries, coupled with large-scale economic cooperation and assistance, led to new global marketing opportunities. Rising standards of living and broad-based consumer and industrial markets abroad created opportunities for American companies to expand exports and investment worldwide. During the 1950s, many U.S. companies that had never before marketed outside the United States began to export, and others made significant investments in marketing and production facilities overseas.

At the close of the 1960s, U.S. multinational corporations (MNCs) were facing major challenges on two fronts: resistance to direct investment and increasing competition in export markets. Large investments by U.S. businesses in Europe and Latin America heightened the concern of these countries about the growing domination of U.S. multinationals. The reaction in Latin American countries was to expropriate direct U.S. investments or to force companies to sell controlling interests to nationals. In Europe, apprehension manifested itself in strong public demand to limit foreign investment. Concerns, even in Britain, that they might become a satellite with manufacturing but no determination of policy led to specific guidelines for joint ventures between British and U.S. companies. In the European Community, U.S. multinationals were rebuffed in ways ranging from tight control over proposed joint ventures and regulations covering U.S. acquisitions of European firms to strong protectionism laws.

The threat felt by Europeans was best expressed in the popular book *The American Challenge*, published in 1968, in which the French author J. J. Servan-Schreiber wrote:

Fifteen years from now it is quite possible that the world's third greatest industrial power, just after the United States and Russia, will not be Europe but American Industry in Europe. Already, in the ninth year of the Common Market, this European market is basically American in organization.⁴

Servan-Schreiber's prediction did not come true for many reasons, but one of the more important was that American MNCs confronted a resurgence of competition from all over the world. The worldwide economic growth and rebuilding after World War II was beginning to surface in competition that challenged the supremacy of American industry. Competition arose on all fronts; Japan, Germany, most of the industrialized world, and many developing countries were competing for demand in their own countries and looking for world markets as well. Countries once classified as less developed were reclassified as newly industrialized countries (NICs). Various NICs such as Brazil, Mexico, South Korea, Taiwan, Singapore, and Hong Kong experienced rapid industrialization in select industries and became aggressive world competitors in steel, shipbuilding, consumer electronics, automobiles, light aircraft, shoes, textiles, apparel, and so forth. In addition to the NICs, developing countries such as Venezuela, Chile, and Bangladesh established state-owned enterprises (SOEs) that operated in other countries. One state-owned Venezuelan company has a subsidiary in Puerto Rico that produces canvas, cosmetics, chairs, and zippers; there are also Chilean and Colombian companies in Puerto Rico; in the U.S. state of Georgia, a Venezuelan company engages in agribusiness; and Bangladesh, the sixth largest exporter of garments to the United States, also owns a mattress company in Georgia.

In short, economic power and potential became more evenly distributed among countries than was the case when Servan-Schreiber warned Europe about U.S. multinational domination. Instead, the U.S. position in world trade is now shared with other countries. For example, in 1950, the United States represented 39 percent of world gross national product (GNP), but by 2010, it represented less than 25 percent. In the meantime, however, the global GNP grew much larger, as did the world's manufacturing output—all countries shared in a much larger economic pie. This change was reflected in the fluctuations in the growth of MNCs from other countries as well. Exhibit 2.2 reflects the dramatic changes between 1963 and 2009. In 1963, the United States had 67 of the world's largest industrial corporations. By 1996, that number had dropped to a low of 24, while Japan moved from having 3 of the largest to 29 and South Korea from 0 to 4. And following the great economic boom in the late 1990s in the United States, 36 of the largest companies were American, only 22 Japanese, and none were Korean. Most recently, GAZPROM, the Russian natural

⁴J. J. Servan-Schreiber, *The American Challenge* (New York: Atheneum Publishers, 1968), p. 3.

Exhibit 2.2

The Nationality of the World's 100 Largest Industrial Corporations (size measured by annual revenues)

Source: "2009 Global 500," *Fortune*, <http://www.fortune.com>, 2010.

| | 1963 | 1979 | 1984 | 1990 | 1996 | 2000 | 2005 | 2009 |
|----------------------------|------|------|------|------|------|------|------|------|
| United States | 67 | 47 | 47 | 33 | 24 | 36 | 33 | 30 |
| Germany | 13 | 13 | 8 | 12 | 13 | 12 | 15 | 14 |
| Britain | 7 | 7 | 5 | 6 | 2 | 5 | 10 | 6 |
| France | 4 | 11 | 5 | 10 | 13 | 11 | 10 | 10 |
| Japan | 3 | 7 | 12 | 18 | 29 | 22 | 12 | 10 |
| Italy | 2 | 3 | 3 | 4 | 4 | 3 | 3 | 5 |
| Netherlands–United Kingdom | 2 | 2 | 2 | 2 | 2 | 2 | 1 | 1 |
| Netherlands | 1 | 3 | 1 | 1 | 2 | 5 | 2 | 1 |
| Switzerland | 1 | 1 | 2 | 3 | 5 | 3 | 4 | 1 |
| Luxembourg | | | | | | | | 1 |
| Belgium | | 1 | 1 | 1 | | 1 | | 1 |
| Norway | | | | | | | 1 | 1 |
| Finland | | | | | | | | 1 |
| Brazil | | 1 | | 1 | | | | 1 |
| Canada | | 2 | 3 | | | | | |
| India | | | 1 | | | | | |
| Kuwait | | | 1 | | | | | |
| Mexico | | 1 | 1 | 1 | 1 | | 1 | 1 |
| Venezuela | | 1 | 1 | 1 | 1 | | | |
| South Korea | | | 4 | 2 | 4 | | 1 | 4 |
| Sweden | | | 1 | 2 | | | | |
| South Africa | | | 1 | 1 | | | | |
| Spain | | | | 2 | | | 1 | 3 |
| Russia | | | | | | | | 2 |
| China | | | | | | 2 | 1 | 5 |
| Malaysia | | | | | | | | 1 |

gas giant, was the first eastern European entrant into the top 100 global firms, ranking number 52 in the most recent *Fortune* list.⁵ The decline in Japanese and increase in Chinese companies' rankings are prominent as well.

Another dimension of world economic power, the balance of merchandise trade, also reflected the changing role of the United States in world trade. Between 1888 and 1971, the United States sold more to other countries than it bought from them; that is, the United States had a favorable balance of trade. By 1971, however, the United States had a trade deficit of \$2 billion that grew steadily until it peaked at \$160 billion in 1987. After that, the deficit in merchandise trade declined to \$74 billion in 1991 but began increasing again and by 2007 had surpassed \$700 billion. With the continued weakness in the U.S. dollar, the trade deficit began to abate some in the fall of 2007.⁶ The positive consequence of the global financial crisis that began in 2008 in the United States was the halving of the U.S. trade deficit during 2009 from its high in 2007.

The heightened competition for U.S. businesses during the 1980s and early 1990s raised questions similar to those heard in Europe two decades earlier: how to maintain the competitive strength of American business, to avoid the domination of U.S. markets by foreign MNCs, and to forestall the "buying of America." In the 1980s, the United States saw its competitive position in capital goods such as computers and machinery erode sharply. From 1983 to 1987, almost 70 percent of the growth of the merchandise trade deficit was in capital goods and automobiles. At the time, those were America's high-wage, high-skill industries. But U.S. industry got a wake-up call and responded by restructuring its industries, in essence, "getting lean and mean." By the late 1990s, the United States was once again holding its own in capital goods, particularly with trade surpluses in the high-tech category.

⁵"GASPROM Eyes 10% of French Gas Market in 4–5 Years," *Dow Jones International News*, January 3, 2008.

⁶Elizabeth Price and Brian Blackstone, "U.S. Trade Deficit Shrinks—Rising Prices Dampen Demand for Imports, Could Fuel Inflation," *The Wall Street Journal Asia*, November 12, 2007, p. 9.

Among the more important questions raised in the 1980s were those concerning the ability of U.S. firms to compete in foreign markets and the fairness of international trade policies of some countries. Trade friction revolved around Japan's sales of autos and electronics in the United States and Japan's restrictive trade practices. The United States, a strong advocate of free trade, was confronted with the dilemma of how to encourage trading partners to reciprocate with open access to their markets without provoking increased protectionism. In addition to successfully pressuring Japan to open its markets for some types of trade and investment, the United States was a driving force behind the establishment of the WTO.

By the last decade of the 20th century, profound changes in the way the world would trade were already under way. The continuing integration of the countries of the European Union, the creation of NAFTA⁷ and the American Free Trade Area (AFTA), and the rapid evolution of the Asia-Pacific Economic Cooperation Conference (APEC) are the beginnings of global trading blocks that many experts expect to dominate trade patterns in the future. With the return of Hong Kong in 1997 and Macao in 2000 to China, all of Asia is now controlled and managed by Asians for the first time in 400 years. During the decades since World War II, the West set the patterns for trade, but increasingly, Asia will be a major force, if not the leading force.

Beyond the First Decade of the Twenty-First Century

The unprecedented and precipitous growth of the U.S. economy in the late 1990s slowed dramatically in the last few years, and of course dramatically so in 2009. Growth in most of the rest of the world has followed suit, with the exception of China. The Organization for Economic Cooperation and Development (OECD) estimates that the economies of member countries will expand an average of 3 percent annually for the next 25 years, the same rate as in the past 25 years. Conversely, the economies of the developing world will grow at faster rates—from an annual rate of 4 percent in the past quarter century to a rate of 6 percent for the next 25 years. Their share of world output will rise from about one-sixth to nearly one-third over the same period. The World Bank estimates that five countries—Brazil, China,⁸ India, Indonesia, and Russia—whose share of world trade is barely one-third that of the European Union will, by 2020, have a 50 percent higher share than that of the European Union. As a consequence, economic power and influence will move away from industrialized countries—Japan, the United States, and the European Union—to countries in Latin America, eastern Europe, Asia, and Africa.

This shift does not mean that markets in Europe, Japan, and the United States will cease to be important; those economies will continue to produce large, lucrative markets, and the companies established in those markets will benefit. It does mean that if a company is to be a major player in the 21st century, now is the time to begin laying the groundwork. How will these changes that are taking place in the global marketplace impact international business? For one thing, the level and intensity of competition will change as companies focus on gaining entry into or maintaining their position in emerging markets, regional trade areas, and the established markets in Europe, Japan, and the United States.

Companies are looking for ways to become more efficient, improve productivity, and expand their global reach while maintaining an ability to respond quickly and deliver products that the markets demand. For example, large Chinese state-owned companies are investing heavily in developing economies. Nestlé is consolidating its dominance in global consumer markets by acquiring and vigorously marketing local-country major brands. Samsung of South Korea has invested \$500 million in Mexico to secure access to markets in the North American Free Trade Area. Whirlpool, the U.S. appliance manufacturer, which secured first place in the global appliance business by acquiring the European division of the appliance maker N. V. Philips, immediately began restructuring itself into its version of a global company. These are a few examples of changes that are sweeping multinational companies as they gear up for the rest of the 21st century.

⁷Jenalia Moreno, "Trade Tariffs End, Making NAFTA a Milestone," *Houston Chronicle*, January 2, 2008.

⁸"Fear of the Dragon," *The Economist*, January 9, 2010, pp. 73–74.

Global companies are not the only ones aggressively seeking new market opportunities. Smaller companies are using novel approaches to marketing and seeking ways to apply their technological expertise to exporting goods and services not previously sold abroad. A small midwestern company that manufactures and freezes bagel dough for supermarkets to bake and sell as their own saw opportunities abroad and began to export to Japan. International sales, though small initially, showed such potential that the company sold its U.S. business to concentrate on international operations. Other examples of smaller companies include Nochar Inc., which makes a re retardant it developed a decade ago for the Indianapolis 500. The company now gets 32 percent of its sales overseas, in 29 countries. The owner of Buztronics Inc., a maker of promotional lapel buttons, heard from a friend that his buttons, with their red blinking lights, would “do great” in Japan. He made his first entry in exporting to Japan, and after only a year, 10 percent of Buztronics sales came from overseas. While 50 of the largest exporters account for 30 percent of U.S. merchandise exports, the rest come from middle- and small-sized firms like those just mentioned. The business world is weathering a flurry of activity as companies large and small adjust to the internationalization of the marketplace at home and abroad.

Balance of Payments

When countries trade, financial transactions among businesses or consumers of different nations occur. Products and services are exported and imported, monetary gifts are exchanged, investments are made, cash payments are made and cash receipts received, and vacation and foreign travel occur. In short, over a period of time, there is a constant flow of money into and out of a country. The system of accounts that records a nation's international financial transactions is called its **balance of payments**.

LO2

The importance of balance-of-payment figures to a country's economy

A nation's balance-of-payments statement records all financial transactions between its residents and those of the rest of the world during a given period of time—usually one year. Because the balance-of-payments record is maintained on a double-entry bookkeeping system, it must always be in balance. As on an individual company's financial statement, the assets and liabilities or the credits and debits must offset each other. And like a company's statement, the fact that they balance does not mean a nation is in particularly good or poor financial condition. A balance of payments is a record of condition, not a determinant of condition. Each of the nation's financial transactions with other countries is reflected in its balance of payments.

A nation's balance-of-payments statement presents an overall view of its international economic position and is an important economic measure used by treasuries, central banks, and other government agencies whose responsibility is to maintain external and internal economic stability. A balance of payments represents the difference between receipts from foreign countries on one side and payments to them on the other. On the plus side of the U.S. balance of payments are merchandise export sales; money spent by foreign tourists; payments to the United States for insurance, transportation, and similar services; payments of dividends and interest on investments abroad; return on capital invested abroad; new foreign investments in the United States; and foreign government payments to the United States.

On the minus side are the costs of goods imported, spending by American tourists overseas, new overseas investments, and the cost of foreign military and economic aid. A deficit results when international payments are greater than receipts. It can be reduced or eliminated by increasing a country's international receipts (i.e., gain more exports to other countries or more tourists from other countries) and/or reducing expenditures in other countries. A balance-of-payments statement includes three accounts: the **current account**, a record of all merchandise exports, imports, and services plus unilateral transfers of funds; the *capital account*, a record of direct investment, portfolio investment, and short-term capital movements to and from countries; and the official *reserves account*, a record of exports and imports of gold, increases or decreases in foreign exchange, and increases or decreases in liabilities to foreign central banks. Of the three, the current account is of primary interest to international business.

The *current account* is important because it includes all international merchandise trade and service accounts, that is, accounts for the value of all merchandise and services

Exhibit 2.3

U.S. Current Account by Major Components, 2009 (\$ billions)

| | |
|--|---------|
| Exports | |
| Goods | \$ 1046 |
| Services | 509 |
| Income receipts | 561 |
| Imports | |
| Goods | -1563 |
| Services | -371 |
| Income payments | -472 |
| Unilateral current transfers, net | -130 |
| Current account balance | -420 |

imported and exported and all receipts and payments from investments and overseas employment.⁹ Exhibit 2.3 gives the current account calculations for the United States in 2009.

Since 1971, the United States has had a favorable current account balance (as a percentage of GDP) in only a few years—see Exhibit 2.4. The imbalances resulted primarily from U.S. demand for oil,¹⁰ petroleum products, cars, consumer durables, and other merchandise. Indeed, the merchandise trade deficit for 2009 was \$517 billion, a mega improvement over the two previous years.¹¹ Still, such imbalances have drastic effects on the balance of payments and therefore the value of U.S. currency in the world marketplace. Factors such as these eventually require an adjustment through a change in exchange rates, prices, and/or incomes. In short, once the wealth of a country whose expenditures exceed its income has been exhausted, that country, like an individual, must reduce its standard of living. If its residents do not do so voluntarily, the rates of exchange of its money for foreign monies decline, and through the medium of the foreign exchange market, the purchasing power of

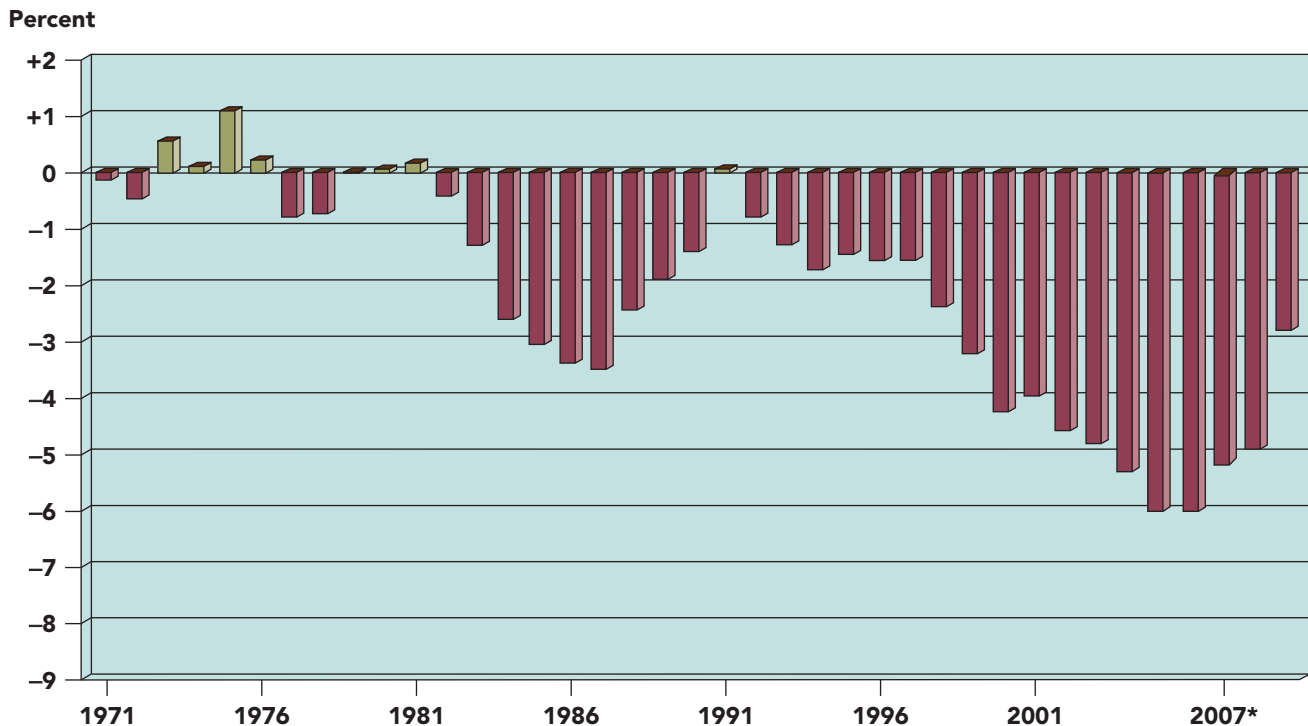
⁹“Financial Globalization and U.S. Current Account Deficit,” *US Fed News*, January 3, 2008.

¹⁰Terence Poon, “China to Steady Prices Amid Inflation Worries,” *The Wall Street Journal*, January 10, 2008.

¹¹www.bea.gov.

Exhibit 2.4

U.S. Current Account Balance (% of GDP)



Source: World Bank.

Exhibit 2.5**What Would One U.S. Dollar Buy?**Source: *The Wall Street Journal*, 2010.

| | 1985 | 1988 | 1992 | 1995 | 1999 | 2000 | 2005 | 2010 |
|---------------|--------|-------|-------|-------|--------|--------|-------|------|
| British pound | 0.86 | 0.54 | 0.56 | 0.63 | 0.62 | 0.68 | 0.57 | 0.63 |
| French franc | 9.6 | 5.4 | 5.29 | 4.95 | 6.49 | 7.28 | | |
| Japanese yen | 250.23 | 123.7 | 126.7 | 93.96 | 102.58 | 112.21 | 112.3 | 89.9 |
| Swiss franc | 2.25 | 1.29 | 1.41 | 1.18 | 1.58 | 1.68 | 1.31 | 0.96 |
| Euro | | | 1.01 | 0.90 | 0.92 | 1.08 | 0.79 | 0.71 |
| Mexico peso | 0.37 | 2.28 | 3.12 | 6.45 | 9.43 | 9.47 | 10.8 | 13.0 |

foreign goods is transferred from that country to another. As can be seen in Exhibit 2.5, the U.S. dollar strengthened against most of the other major currencies during the 1990s but has weakened during the last decade.

As the U.S. trade deficit has grown, pressures have begun to push the value of the dollar to lower levels. And when foreign currencies can be traded for more dollars, U.S. products (and companies) are less expensive for the foreign customer and exports increase, and foreign products are more expensive for the U.S. customer and the demand for imported goods is dampened. Likewise, investments in dollar-denominated equities and such investment goods become less attractive. Indeed, the dollar itself becomes less useful as a global currency.¹²

Protectionism**LO3**

The effects of protectionism on world trade

International business executives understand the reality that this is a world of tariffs, quotas, and nontariff barriers designed to protect a country's markets from intrusion by foreign companies.¹³ Although the World Trade Organization has been effective in reducing tariffs, countries still resort to measures of **protectionism**.¹⁴ Nations utilize legal barriers, exchange barriers, and psychological barriers to restrain the entry of unwanted goods. Businesses work together to establish private market barriers, while the market structure itself may provide formidable barriers to imported goods. The complex distribution system in Japan, as will be detailed in Chapter 15, is a good example of a market structure creating a barrier to trade. However, as effective as it is in keeping some products out of the market, in a legal sense, it cannot be viewed as a trade barrier.

Protection Logic and Illogic

Countless reasons to maintain government restrictions on trade are espoused by protectionists, but essentially all arguments can be classified as follows: (1) protection of an infant industry, (2) protection of the home market,¹⁵ (3) need to keep money at home, (4) encouragement of capital accumulation, (5) maintenance of the standard of living and real wages, (6) conservation of natural resources, (7) industrialization of a low-wage nation, (8) maintenance of employment and reduction of unemployment, (9) national defense, (10) increase of business size, and (11) retaliation and bargaining. Economists in general recognize as valid only the arguments regarding infant industry, national defense, and industrialization of underdeveloped countries. The resource conservation argument becomes increasingly valid in an era of environmental consciousness¹⁶ and worldwide shortages of raw materials and agricultural commodities. A case might be made for temporary protection of markets with excess productive capacity or excess labor when such protection could facilitate an orderly transition. Unfortunately such protection often becomes long term and contributes to industrial inefficiency while detracting from a nation's realistic adjustment to its world situation.

¹²Mark Whitehouse, "Foreign Investors View Dollar as 'Refuge Currency' Despite Recent Tumult," *The Wall Street Journal*, August 20, 2007, p. A2.

¹³Tor Korneliusson and Jorg Blasius, "The Effects of Cultural Distance, Free Trade Agreements, and Protectionism on Perceived Export Barriers," *Journal of Global Marketing* 21, no. 3 (2008), pp. 217–30.

¹⁴"The Nuts and Bolts Come Apart," *The Economist*, March 28, 2009, pp. 79–80.

¹⁵Alistair MacDonald and Cecilie Rohwedder, "U.K. Officials, Workers Troubled by Foreign Takeovers," *The Wall Street Journal*, January 20, 2010, p. B6.

¹⁶John Carey, "Global Warming, Suddenly the Climate in Washington Is Changing," *BusinessWeek*, June 27, 2005, p. 91.

CROSSING BORDERS 2.1

Trade Barriers, Hypocrisy, and the United States

The United States thinks of itself as the leader in free trade and frequently brings actions against nations as unfair trade partners. Section 301* of the Omnibus Trade and Competitiveness Act authorizes the U.S. government to investigate and retaliate against specific foreign trade barriers judged to be unfair and to impose up to 100 percent tariffs on exports to the United States from guilty nations unless they satisfy U.S. domestic demands. But critics in many countries say the United States is hypocritical in some of the stances taken, since it is just as guilty of protecting its markets with trade barriers. A Japanese government study alleges that the United States engages in unfair trade practices in 10 of 12 policy areas reviewed in the study. Notably, the United States imposes quotas on imports, has high tariffs, and abuses antidumping measures. Are the critics correct? Is the United States being hypocritical when it comes to free trade? You be the judge.

The United States launched a Section 301 investigation of Japanese citrus quotas. "The removal of Japan's unfair barriers could cut the price of oranges for Japanese consumers by one-third," said the U.S. trade representative. Coincidentally, the United States had a 40 percent tariff on Brazilian orange juice imports when the investigation was initiated.

The United States brought a 301 case against Korea for its beef import quotas even though the United States has beef import quotas that are estimated to

cost U.S. consumers \$873 million annually in higher prices. Another 301 case was brought against Brazil, Korea, and Taiwan for trade barriers on footwear even though the United States maintains tariffs as high as 67 percent on footwear imports.

Can you believe that we have two phone book-sized volumes of the U.S. customs code that include restrictions on such innocuous items as scissors, sweaters, leather, costume jewelry, tampons, pizzas, cotton swabs, ice cream, and even products we do not produce, such as vitamin B12? We also have restrictions on more sensitive products such as cars, supercomputers, lumber, and every type of clothing imaginable. Would-be Latin American exporters find hundreds of their most promising export products, such as grapes, tomatoes, onions, steel, cement, asparagus, and shoes, on the customs list. Visit www.usitc.gov/tata/index.htm and select the Interactive Tariff Database to see some other examples.

So, is the U.S. as guilty as the rest or not?

*Section 301, a provision of U.S. trade law, enables the U.S. government to take action against countries deemed to have engaged in "unreasonable, unjustifiable, or discriminatory" practices that restrict U.S. commerce.

Sources: Abstracted from James Bovard, "A U.S. History of Trade Hypocrisy," *The Wall Street Journal*, March 8, 1994, p. A10; Brian Hindley and Fredrik Erixon, "Dumping Protectionism," *The Wall Street Journal*, November 1, 2007, p. 12; "Chinese Dumping Duties," *Steel Times International*, October 2009, p. 4.

To give you some idea of the cost to the consumer, consider the results of a recent study of 21 protected industries. The research showed that U.S. consumers pay about \$70 billion per year in higher prices because of tariffs and other protective restrictions. On average, the cost to consumers for saving one job in these protected industries was \$170,000 per year, or many times the average pay (wages and benefits) for manufacturing workers. Unfortunately, protectionism is politically popular, particularly during times of declining wages¹⁷ and/or high unemployment, but it rarely leads to renewed growth in a declining industry. And the jobs that are saved are saved at a very high cost, which constitutes a tax that consumers unknowingly pay.

Trade Barriers

LO4

The several types of trade barriers

To encourage development of domestic industry and protect existing industry, governments may establish such barriers to trade as tariffs and a variety of **nontariff barriers** including, quotas, boycotts, monetary barriers, and market barriers. Barriers are imposed against imports and against foreign businesses. While the inspiration for such barriers may be economic or political, they are encouraged by local industry. Whether or not the barriers are economically logical, the fact is that they exist.

Tariffs. A **tariff**, simply defined, is a tax imposed by a government on goods entering at its borders. Tariffs may be used as revenue-generating taxes or to discourage the importation of goods, or for both reasons. Tariff rates are based on value or quantity or a

¹⁷Jane Sasseen, "Economists Rethink Free Trade," *BusinessWeek*, February 11, 2008, pp. 32–33.

CROSSING BORDERS 2.2

Underwear, Outerwear, Sony Playstations, and Pointed Ears—What Do They Have in Common?

What do underwear, outerwear, Sony Playstations, and pointed ears have in common? Quotas, that's what!

Call the first one the Madonna Effect. Madonna, the pop star, affected the interpretation of outerwear/underwear when the ever-vigilant U.S. Customs Service stopped a shipment of 880 bustiers at the U.S. border. The problem was quota and tariff violations. The shipper classified them as underwear, which comes into the United States without quota and tariff. Outerwear imports, however, have a quota, and the Customs official classified the fashion item inspired by Madonna as "outerwear" and demanded the appropriate quota certificates.

"It was definitely outerwear. I've seen it; and I've seen the girls wearing it, and they're wearing it as outerwear." It took the importer three weeks to obtain sufficient outerwear quota allowances to cover the shipment; by that time, several retailers had canceled their orders.

Call the second the Video/Computer Effect. EU officials originally classified Sony's Playstation a video game and thus subject to a higher tariff than it would be if it were classified as a computer, which was Sony's desired classification. The Court of First Instance ruled that "it is intended mainly to be used to run video games," thus subject to millions of euros in customs duties as a video game. The appeals court sided with Sony on a technical error and reversed the decision.

It really did not make much difference, because EU customs classifications were set to change six months later to allow computers and games consoles into the European Union with zero tariff.

Call the third the Vulcan Effect. EU officials applied the Vulcan death grip to *Star Trek* hero Spock. Likenesses of the pointy-eared Spock and other "nonhuman creatures" have fallen victim to an EU quota on dolls made in China. The EU Council of Ministers slapped a quota equivalent to \$81.7 million on nonhuman dolls from China—but it left human dolls alone.

British Customs officials are in the unusual position of debating each doll's humanity. They have black-listed teddy bears but cleared Batman and Robin. And though they turned away Spock because of his Vulcan origins, they have admitted *Star Trek's* Captain Kirk. The Official Fan Club for *Star Trek* said the Customs officials "ought to cut Spock some slack" because his mother, Amanda, was human. But Britain's Customs office said, "We see no reason to change our interpretation. You don't find a human with ears that size."

Sources: Rosalind Resnick, "Busting Out of Tariff Quotas," *North American International Business* (now published as *International Business*), February 1991, p. 10; Dana Milbank, "British Customs Officials Consider Mr. Spock Dolls to Be Illegal Aliens," *The Wall Street Journal*, August 2, 1994, p. B1; "EU Rejects Sony Customs Claim," (Salt Lake City) *Deseret News*, October 6, 2003.

combination of both. In the United States, for example, the types of customs duties used are classified as follows: (1) ad valorem duties, which are based on a percentage of the determined value of the imported goods; (2) specific duties, a stipulated amount per unit weight or some other measure of quantity; and (3) a compound duty, which combines both specific and ad valorem taxes on a particular item, that is, a tax per pound plus a percentage of value. Because tariffs frequently change, published tariff schedules for every country are available to the exporter on a current basis.¹⁸ In general, tariffs:

| | |
|----------|--|
| Increase | Inflationary pressures. Special interests' privileges. Government control and political considerations in economic matters. The number of tariffs (they beget other tariffs via reciprocity). |
| Weaken | Balance-of-payments positions. Supply-and-demand patterns. International relations (they can start trade wars). |
| Restrict | Manufacturers' supply sources. Choices available to consumers. Competition. |

In addition, tariffs are arbitrary, are discriminatory, and require constant administration and supervision. They often are used as reprisals against protectionist moves of trading partners.

¹⁸The entire Harmonized Tariff Schedule of the United States can be downloaded or accessed via an interactive tariff database at <http://www.usitc.gov>; select the Harmonized Tariff Schedule.

Exhibit 2.6

Types of Nontariff Barriers

| | |
|---|---|
| <p>Specific Limitations on Trade</p> <ul style="list-style-type: none"> Quotas Import licensing requirements Proportional restrictions of foreign to domestic goods (local-content requirements) Minimum import price limits Embargoes <p>Customs and Administrative Entry Procedures</p> <ul style="list-style-type: none"> Valuation systems Antidumping practices Tariff classifications Documentation requirements Fees <p>Standards</p> <ul style="list-style-type: none"> Standards disparities Intergovernmental acceptances of testing methods and standards Packaging, labeling, marking standards | <p>Governmental Participation in Trade</p> <ul style="list-style-type: none"> Government procurement policies Export subsidies Countervailing duties Domestic assistance programs <p>Charges on Imports</p> <ul style="list-style-type: none"> Prior import deposit requirements Administrative fees Special supplementary duties Import credit discriminations Variable levies Border taxes <p>Others</p> <ul style="list-style-type: none"> Voluntary export restraints Orderly marketing agreements |
|---|---|

Source: Reprinted from A. D. Cao, "Nontariff Barriers to U.S. Manufactured Exports," *Journal of World Business*, Vol. 15, p. 94. Copyright © 1980, with permission from Elsevier.

In a dispute with the European Union over pasta export subsidies, the United States ordered a 40 percent increase in tariffs on European spaghetti and fancy pasta. The European Union retaliated against U.S. walnuts and lemons. The pasta war raged on as Europe increased tariffs on U.S. fertilizer, paper products, and beef tallow, and the United States responded in kind. The war ended when the Europeans finally dropped pasta export subsidies. Less developed countries are increasingly voicing complaints about American and European tariffs on agricultural products.¹⁹

Quotas and Import Licenses. A quota is a specific unit or dollar limit applied to a particular type of good. Great Britain limits imported television sets; Germany has established quotas on Japanese ball bearings; Italy restricts Japanese motorcycles; and the United States has quotas on sugar, textiles, and, of all things, peanuts. Quotas put an absolute restriction on the quantity of a specific item that can be imported. When the Japanese first let foreign rice into their country, it was on a quota basis, but since 2000 the quotas have been replaced by tariffs.²⁰ Even more complicated, the banana war between the United States and the European Union resulted in a mixed system wherein a quota of bananas is allowed into the European Union with a tariff, then a second quota comes in tariff-free. In early 2010, as *Avatar* dominated cinema around the world, China ordered its movie houses to limit showings to the 3D version only.²¹ Like tariffs, quotas tend to increase prices.²² The U.S. quotas on textiles are estimated to add 50 percent to the wholesale price of clothing.

As a means of regulating the flow of exchange and the quantity of a particular imported commodity, countries often require import licenses. The fundamental difference between quotas and import licenses as a means of controlling imports is the greater flexibility of import licenses over quotas. Quotas permit importing until the quota is filled; licensing limits quantities on a case-by-case basis.

¹⁹Allan Odhiambo, "EAC States in Row over Wheat Import Tariffs," *All Africa*, August 30, 2007.

²⁰See the USA Rice Federation's Web site for details, <http://www.usarice.com>; also see Hodgson et al., *Doing Business in the New Japan*.

²¹Ian Johnson, "China's Homegrown Movies Flourish," *The Wall Street Journal*, January 20, 2010, pp. B1, B4.

²²Peter T. Leach, "Is China Losing Its Edge?" *Journal of Commerce*, December 3, 2007.

CROSSING BORDERS 2.3

Crossing Borders with Monkeys in His Pants

Robert Cusack smuggled a pair of endangered pygmy monkeys into the United States—in his pants! On June 13, 2002, a U.S. Fish and Wildlife Service special agent was called to Los Angeles International Airport after Cusack was detained by U.S. Customs on arrival from Thailand. Officials soon also discovered that Cusack had four endangered tropical birds and 50 protected orchids with him. “When one of the inspectors opened up his luggage, one of the birds flew out,” tells one official. “He had to go catch the bird.” After finding the other purloined birds and exotic flowers, the inspectors asked, “Do you have anything else you should tell us about?” Cusack answered, “Yes, I have monkeys in my pants.” The monkeys ended up in the Los Angeles Zoo, and the smuggler ended up in jail for 57 days. He also paid a five-figure fine.

Similarly, Wang Hong, a Chinese exporter, pleaded guilty to smuggling sea turtles into the United States. He didn’t have them in his pants; instead, the sea turtle “parts” came in the form of shells and violin bows, among other things.

Smuggling isn’t just a game played by sneaking individuals. Multinational companies can also get into the

act. During the last year alone, convictions have come down for smuggling cell phones into Vietnam, cigarettes into Iraq and Canada, and platinum into China. In perhaps the biggest ever corporate case, after a nine-year lawsuit, Amway Corporation agreed to pay the Canadian government \$38.1 million to settle charges it had avoided customs duties by undervaluing merchandise it exported from the United States to Canadian distributors over a six-year period. As long as there have been trade barriers, smuggling has been a common response. Indeed, Rudyard Kipling wrote some 100 years ago:

Five and twenty ponies trotting through the dark—
Brandy for the Parson, ‘baccy for the clerk;
Laces for a lady, letters for a spy;
And watch the wall, my darling, while the Gentlemen go by!

Sources: “Amway Pays \$38 Million to Canada,” *Los Angeles Times*, September 22, 1989, p. 3; Patricia Ward Biederman, “Smuggler to Pay for Pocketing Monkeys,” *Los Angeles Times*, December 19, 2002, p. B1; “Chinese National Pleads Guilty of Smuggling Protected Sea Turtles,” *Associated Press*, January 3, 2008; Raymond Fisman, “Measuring Tariff Evasion and Smuggling,” *NBER Reporter*, No. 3, 2009, pp. 8–10.

Voluntary Export Restraints. Similar to quotas are the **voluntary export restraints (VERs)** or *orderly market agreements (OMAs)*. Common in textiles, clothing, steel, agriculture, and automobiles, the VER is an agreement between the importing country and the exporting country for a restriction on the volume of exports. For many years Japan had a VER on automobiles to the United States; that is, Japan agreed to export a fixed number of automobiles annually. When televisions were still manufactured in the United States, Japan signed an OMA limiting Japanese color television exports to the United States to 1.56 million units per year. However, Japanese companies began to adjust their strategies by investing in television manufacturing in the United States and Mexico, and as a result, they regained the entire market share that had been lost through the OMA, eventually dominating the entire market. A VER is called voluntary because the exporting country sets the limits; however, it is generally imposed under the threat of stiffer quotas and tariffs being set by the importing country if a VER is not established.

Boycotts and Embargoes. A government boycott is an absolute restriction against the purchase and importation of certain goods and/or services from other countries. This restriction can even include travel bans, like the one currently in place for Chinese tourists; the Beijing government refuses to designate Canada as an approved tourism destination. Officials in Beijing have not been forthcoming with explanations, even after three years of complaints by and negotiations with their Canadian counterparts, but most believe it has to do with Canada’s unrelenting criticism of Chinese human rights policies.²³ An embargo is a refusal to sell to a specific country. A public boycott can be either formal or

²³“Canada Threatens China with WTO Action over Tourism Ban,” *Agence France-Presse*, January 8, 2008.



NYK Line (Nippon Yusen Kaisha) brings automobiles from Japan to Aqaba, Jordan, on the Red Sea for delivery to other countries in the area, but not for neighboring Israel. Because of the Arab boycott of Israel, separate shipments of cars are made to the adjacent port of Eilat.

informal and may be government sponsored or sponsored by an industry. The United States uses boycotts and embargoes against countries with which it has a dispute. For example, Cuba²⁴ and Iran still have sanctions imposed by the United States. Among U.S. policymakers, there is rising concern, however, that government-sponsored sanctions cause unnecessary harm for both the United States and the country being boycotted without reaching the desired results. It is not unusual for the citizens of a country to boycott goods of other countries at the urging of their government or civic groups. Nestlé products were boycotted by a citizens group that considered the way Nestlé promoted baby formula in less developed countries misleading to mothers and harmful to their babies.

Monetary Barriers. A government can effectively regulate its international trade position by various forms of exchange-control restrictions. A government may enact such restrictions to preserve its balance-of-payments position or specifically for the advantage or encouragement of particular industries. Two such barriers are blocked currency and government approval requirements for securing foreign exchange.

Blocked currency is used as a political weapon or as a response to difficult balance-of-payments situations. In effect, blockage cuts off all importing or all importing above a certain level. Blockage is accomplished by refusing to allow an importer to exchange its national currency for the sellers' currency.

Government approval to secure foreign exchange is often used by countries experiencing severe shortages of foreign exchange. At one time or another, most Latin American and East European countries have required all foreign exchange transactions to be approved by a central minister. Thus, importers who want to buy a foreign good must apply for an exchange permit, that is, permission to exchange an amount of local currency for foreign currency.

The exchange permit may also stipulate the rate of exchange, which can be an unfavorable rate depending on the desires of the government. In addition, the exchange permit may stipulate that the amount to be exchanged must be deposited in a local bank for a set period prior to the transfer of goods. For example, Brazil has at times required funds to be deposited 360 days prior to the import date. This requirement is extremely restrictive because funds are out of circulation and subject to the ravages of inflation. Such policies cause major cash flow problems for the importer and greatly increase the price of imports. Clearly, these currency-exchange barriers constitute a major deterrent to trade.

Standards. Nontariff barriers of this category include standards to protect health, safety, and product quality. The standards are sometimes used in an unduly stringent or discriminating way to restrict trade, but the sheer volume of regulations in this category is a problem in itself. A fruit content regulation for jam varies so much from country to country that one agricultural specialist says, "A jam exporter needs a computer to avoid one or another country's regulations." Different standards are one of the major disagreements between the United States and Japan. The size of knotholes in plywood shipped to Japan can determine whether or not the shipment is accepted; if a knothole is too large, the shipment is rejected because quality standards are not met. Other examples include the following: In the Netherlands, all imported hen and duck eggs must be marked in indelible ink with the country of origin; in Spain, imported condensed milk must be labeled to show fat content if it is less than 8 percent fat; and in the European Union, strict import controls have been placed on beef and beef products imported from the United Kingdom because of mad cow disease. Add to this list all genetically modified foods,

²⁴Cornelia Dean, "Cuba After the Embargo," *The New York Times News Service, Edmonton Journal*, January 6, 2008, p. E8.



Cracker Jack invented the toy-with-candy promotion back in 1912. However, the Italian chocolatier Ferrero took things much further. Its milk chocolate Kinder eggs contain “sopresas” that kids enjoy in 37 countries around the world. The product is unavailable in the United States because of concerns about choking hazards. The product pictured is produced in Argentina for sale in Mexico, and it includes a warning label regarding kids under three years of age. Cracker Jack has had to eliminate many of the cool little toys it put in the packages for the same reason. Nestlé introduced a product similar to Kinder eggs in the U.S. market in the late 1990s but had to withdraw it for safety reasons. Wonderball is the latest version, but it has edible chocolate figures inside. See www.ferrero.com.ar and www.crackerjack.com for more details. Toys must be larger than the diameter of the plastic tube pictured on the right to meet the U.S. safety standard.

which are meeting stiff opposition from the European Union as well as activists around the world.

The United States and other countries require some products (automobiles in particular) to contain a percentage of “local content” to gain admission to their markets. The North American Free Trade Agreement (NAFTA) stipulates that all automobiles coming from member countries must have at least 62.5 percent North American content to deter foreign car makers from using one member nation as the back door to another.

Antidumping Penalties. Historically, tariffs and nontariff trade barriers have impeded free trade, but over the years, they have been eliminated or lowered through the efforts of the GATT and WTO. Now there is a new nontariff barrier: antidumping laws that have emerged as a way of keeping foreign goods out of a market. Antidumping laws were designed to prevent foreign producers from “predatory pricing,” a practice whereby a foreign producer intentionally sells its products in the United States for less than the cost of production to undermine the competition and take control of the market. This barrier was intended as a kind of antitrust law for international trade. Violators are assessed “antidumping” duties for selling below cost and/or “countervailing duties” to prevent the use of foreign government subsidies to undermine American industry. Many countries have similar laws, and they are allowed under WTO rules.

Recent years have seen a staggering increase in antidumping cases in the United States. In one year, 12 U.S. steel manufacturers launched antidumping cases against 82 foreign steelmakers in 30 countries. In September 2009, the U.S. imposed antidumping duties of 35 percent on tires imported from China, despite President Barack Obama’s agreement with other G20 leaders “to avoid protectionist measures at a time of great economic peril” in April of that year.²⁵ Many economists felt that these antidumping charges were unnecessary because of the number of companies and countries involved; supply and demand could have been left to sort out the best producers and prices. And of course, targeted countries have complained as well. Nevertheless, antidumping cases are becoming de facto trade barriers. The investigations are very costly, they take a long time to resolve, and until they are resolved, they effectively limit trade. Furthermore,

²⁵“Economic Vandalism,” *The Economist*, September 19, 2009, p. 13.

the threat of being hit by an antidumping charge is enough to keep some companies out of the market.

Domestic Subsidies and Economic Stimuli. Agricultural subsidies in the United States and Europe have long been the subject of trade complaints in developing countries. However, the economic doldrums beginning in 2008 triggered new, huge, domestic bailout packages in the larger economies for banks and auto makers, to name just a couple. Developing countries complained that such subsidies of domestic industries gave companies in those countries unfair advantages in the global marketplace. Smaller countries defended themselves with a variety of tactics; for example, Malaysia limited the number of ports that could accept inbound goods, Ecuador increased tariffs on 600 types of goods, and Argentina and 15 other countries asked the WTO to examine whether stimuli and bailouts were “industrial subsidies,” in which case, under WTO rules, trading partners have the right to retaliate.²⁶ Similarly, the U.S. government complained about Chinese policies, including continuing currency controls, tax breaks on exports, and requirements that force government entities to buy Chinese products.²⁷

Easing Trade Restrictions Lowering the trade deficit has been a priority of the U.S. government for a number of years. Of the many proposals brought forward, most deal with fairness of trade with some of our trading partners instead of reducing imports or adjusting other trade policies. Many believe that too many countries are allowed to trade freely in the United States without granting equal access to U.S. products in their countries. Japan was for two decades the trading partner with which we had the largest deficit and which elicited the most concern about fairness. The Omnibus Trade and Competitiveness Act of 1988 addressed the trade fairness issue and focused on ways to improve U.S. competitiveness. At the turn of the century, China took over from Japan as America’s number one “trade problem,” as can be seen in Exhibit 2.1.

The Omnibus Trade and Competitiveness Act

LO5

The provisions of the Omnibus Trade and Competitiveness Act

The *Omnibus Trade and Competitiveness Act of 1988* is many faceted, focusing on assisting businesses to be more competitive in world markets as well as on correcting perceived injustice in trade practices.²⁸ The trade act was designed to deal with trade deficits, protectionism, and the overall fairness of our trading partners. Congressional concern centered on the issue that U.S. markets were open to most of the world but markets in Japan, western Europe, and many Asian countries were relatively closed. The act reflected the realization that we must deal with our trading partners based on how they actually operate, not on how we want them to behave. Some see the act as a protectionist measure, but the government sees it as a means of providing stronger tools to open foreign markets and to help U.S. exporters be more competitive. The bill covers three areas considered critical in improving U.S. trade: market access, export expansion, and import relief.

The issue of the openness of markets for U.S. goods is addressed as *market access*. Many barriers restrict or prohibit goods from entering a foreign market. Unnecessarily restrictive technical standards, compulsory distribution systems, customs barriers, tariffs, quotas, and restrictive licensing requirements are just a few. The act gives the U.S. president authority to restrict sales of a country’s products in the U.S. market if that country imposes unfair restrictions on U.S. products. Furthermore, if a foreign government’s procurement rules discriminate against U.S. firms, the U.S. president has the authority to impose a similar ban on U.S. government procurement of goods and services from the offending nation.

²⁶Carol Matlack, “The New Protectionism,” *BusinessWeek*, June 22, 2009, pp. 22–23.

²⁷Pete Engardio, “Beijing Bolsters the Barriers,” *BusinessWeek*, July 6, 2009, p. 26.

²⁸Caroline Baum, “China Isn’t a Currency Manipulator,” *Today* (Singapore), June 20, 2007, p. 35.



The billboard overlooking a busy shopping district in Beijing proclaims the importance of China's space technology to all passersby. Meanwhile, Boeing and Hughes have had to pay \$32 million in a settlement with the U.S. government for allegedly giving the Chinese sensitive space technology in the middle 1990s. The restrictions on technology sales have rendered American high-tech firms less competitive in international markets even beyond China, such as Canada.

Besides emphasizing market access, the act recognizes that some problems with U.S. export competitiveness stem from impediments on trade imposed by U.S. regulations and export disincentives. Export controls, the Foreign Corrupt Practices Act (FCPA), and export promotion were specifically addressed in the *export expansion* section of the act. Export licenses could be obtained more easily and more quickly for products on the export control list. In addition, the act reaffirmed the government's role in being more responsive to the needs of the exporter. Two major contributions facilitating export trade were computer-based procedures to file for and track export license requests and the creation of the National Trade Data Bank (NTDB) to improve access to trade data.

Export trade is a two-way street: We must be prepared to compete with imports in the home market if we force foreign markets to open to U.S. trade. Recognizing that foreign penetration of U.S. markets can cause serious competitive pressure, loss of market share, and, occasionally, severe financial harm, the *import relief* section of the Omnibus Trade and Competitiveness Act provides a menu of remedies for U.S. businesses adversely affected by im-

ports. Companies seriously injured by fairly traded imports can petition the government for temporary relief while they adjust to import competition and regain their competitive edge.

The act has resulted in a much more flexible process for obtaining export licenses, in fewer products on the export control list, and in greater access to information and has established a basis for negotiations with India, Japan, and other countries to remove or lower barriers to trade. However, since a 1999 congressional report (accusing China of espionage regarding defense technology), restrictions on exports of many high-tech products have again been tightened for national security reasons.²⁹

As the global marketplace evolves, trading countries have focused attention on ways of eliminating tariffs, quotas, and other barriers to trade. Four ongoing activities to support the growth of international trade are GATT, the associated WTO, the International Monetary Fund (IMF), and the World Bank Group.

General Agreement on Tariffs and Trade

LO6

The importance of GATT and the World Trade Organization

Historically, trade treaties were negotiated on a bilateral (between two nations) basis, with little attention given to relationships with other countries. Furthermore, they tended to raise barriers rather than extend markets and restore world trade. The United States and 22 other countries signed the *General Agreement on Tariffs and Trade (GATT)* shortly after World War II.³⁰ Although not all countries participated, this agreement paved the way for the first effective worldwide tariff agreement. The original agreement provided a process to reduce tariffs and created an agency to serve as watchdog over world trade. The GATT's agency director and staff offer nations a forum for negotiating trade and related issues. Member nations seek to resolve their trade disputes bilaterally; if that fails, special GATT panels are set up to recommend action. The panels are only advisory and have no enforcement powers.

The GATT treaty and subsequent meetings have produced agreements significantly reducing tariffs on a wide range of goods. Periodically, member nations meet to reevaluate trade barriers and establish international codes designed to foster trade among members.

²⁹Elaine Kurtenbach, "China Says Bids Due from Three Global Nuclear Power Companies," *Associated Press*, February 25, 2005.

³⁰Florence Chong, "As GATT Turns 60, Crean Pledges to Revive the Great Struggle for World Trade Liberalization," *The Australian*, January 2, 2008, p. 17.



According to the U.S. government, you can't call it a "catfish" unless it's grown in America. Vietnamese are producing filets in flooded rice paddies at about \$1.80 a pound at wholesale. American fish farmers are charging about \$2.80. Neither consumers nor ichthyologists can tell the difference between the Asian and American fish, but Uncle Sam has stepped in anyway. The congressional claim on the "catfish" name has forced the United States to stifle its own protests about Europeans claiming exclusive rights to the name "herring."
 (©Tom McHugh/Photo Researchers, Inc.)

In general, the agreement covers these basic elements: (1) trade shall be conducted on a nondiscriminatory basis; (2) protection shall be afforded domestic industries through customs tariffs, not through such commercial measures as import quotas; and (3) consultation shall be the primary method used to solve global trade problems.

Since GATT's inception, eight "rounds" of intergovernmental tariff negotiations have been held. The most recently completed was the Uruguay Round (1994), which built on the successes of the Tokyo Round (1974)—the most comprehensive and far-reaching undertaken by GATT up to that time. The Tokyo Round resulted in tariff cuts and set out new international rules for subsidies and countervailing measures, antidumping, government procurement, technical barriers to trade (standards), customs valuation, and import licensing. While the Tokyo Round addressed nontariff barriers, some areas that were not covered continued to impede free trade.

In addition to market access, there were issues of trade in services, agriculture, and textiles; intellectual property rights; and investment and capital flows. The United States was especially interested in addressing services trade and intellectual property rights, since neither had been well protected. On the basis of these concerns, the eighth set of negotiations (Uruguay Round) was

begun in 1986 at a GATT Trade Minister's meeting in Punta del Este, Uruguay, and finally concluded in 1994. By 1995, 80 GATT members, including the United States, the European Union (and its member states), Japan, and Canada, had accepted the agreement.

The market access segment (tariff and nontariff measures) was initially considered to be of secondary importance in the negotiations, but the final outcome went well beyond the initial Uruguay Round goal of a one-third reduction in tariffs. Instead, virtually all tariffs in 10 vital industrial sectors with key trading partners were eliminated. This agreement resulted in deep cuts (ranging from 50 to 100 percent) in tariffs on electronic items and scientific equipment and the harmonization of tariffs in the chemical sector at very low rates (5.5 to 0 percent).

An important objective of the United States in the Uruguay Round was to reduce or eliminate barriers to international trade in services. The *General Agreement on Trade in Services (GATS)* was the first multilateral, legally enforceable agreement covering trade and investment in the services sector. It provides a legal basis for future negotiations aimed at eliminating barriers that discriminate against foreign services and deny them market access. For the first time, comprehensive multilateral disciplines and procedures covering trade and investment in services have been established. Specific market-opening concessions from a wide range of individual countries were achieved, and provision was made for continued negotiations to liberalize telecommunications and financial services further.

Equally significant were the results of negotiations in the investment sector. *Trade-Related Investment Measures (TRIMs)* established the basic principle that investment restrictions can be major trade barriers and therefore are included, for the first time, under GATT procedures. As a result of TRIMs, restrictions in Indonesia that prohibit foreign firms from opening their own wholesale or retail distribution channels can be challenged. And so can investment restrictions in Brazil that require foreign-owned manufacturers to buy most of their components from high-cost local suppliers and that require affiliates of foreign multinationals to maintain a trade surplus in Brazil's favor by exporting more than they sell within.

Another objective of the United States for the Uruguay Round was achieved by an agreement on *Trade-Related Aspects of Intellectual Property Rights (TRIPs)*. The TRIPs agreement establishes substantially higher standards of protection for a full range of

intellectual property rights (patents, copyrights, trademarks, trade secrets, industrial designs, and semiconductor chip mask works) than are embodied in current international agreements, and it provides for the effective enforcement of those standards both internally and at the border.

The Uruguay Round also includes another set of improvements in rules covering anti-dumping, standards, safeguards, customs valuation, rules of origin, and import licensing. In each case, rules and procedures were made more open, equitable, and predictable, thus leading to a more level playing field for trade. Perhaps the most notable achievement of the Uruguay Round was the creation of a new institution as a successor to the GATT—the World Trade Organization.

World Trade Organization³¹

At the signing of the Uruguay Round trade agreement in Marrakech, Morocco, in April 1994, U.S. representatives pushed for an enormous expansion of the definition of trade issues. The result was the creation of the **World Trade Organization (WTO)**, which encompasses the current GATT structure and extends it to new areas not adequately covered in the past. The WTO is an institution, not an agreement as was GATT. It sets many rules governing trade among its 148 members, provides a panel of experts to hear and rule on trade disputes among members, and, unlike GATT, issues binding decisions. It will require, for the first time, the full participation of all members in all aspects of the current GATT and the Uruguay Round agreements, and, through its enhanced stature and scope, provide a permanent, comprehensive forum to address the trade issues of the 21st century global market.

All member countries will have equal representation in the WTO's ministerial conference, which will meet at least every two years to vote for a director general, who will appoint other officials. Trade disputes, such as that swirling around genetically modified foods, are heard by a panel of experts selected by the WTO from a list of trade experts provided by member countries. The panel hears both sides and issues a decision; the winning side will be authorized to retaliate with trade sanctions if the losing country does not change its practices. Although the WTO has no means of enforcement, international pressure to comply with WTO decisions from other member countries is expected to force compliance. The WTO ensures that member countries agree to the obligations of all the agreements, not just those they like. For the first time, member countries, including developing countries (the fastest growing markets of the world), will undertake obligations to open their markets and to be bound by the rules of the multilateral trading system.

The World Trade Organization provision of the Uruguay Round encountered some resistance before it was finally ratified by the three superpowers: Japan, the European Union (EU), and the United States. A legal wrangle among European Union countries centered on whether the EU's founding treaty gives the European Commission the sole right to negotiate for its members in all areas covered by the WTO.

In the United States, ratification was challenged because of concern for the possible loss of sovereignty over its trade laws to WTO, the lack of veto power (the U.S. could have a decision imposed on it by a majority of the WTO's members), and the role the United States would assume when a conflict arises over an individual state's laws that might be challenged by a WTO member. The GATT agreement was ratified by the U.S. Congress, and soon after, the European Union, Japan, and more than 60 other countries followed. All 117 members of the former GATT supported the Uruguay agreement. Since almost immediately after its inception on January 1, 1995, the WTO's agenda has been full with issues ranging from threats of boycotts and sanctions and the membership of Iran³² and Russia.³³ Indeed, a major event in international trade during recent years is China's

³¹See <http://wto.org>.

³²Tom Wright, "WTO to Open Talks on Iran's Membership," *International Herald Tribune*, May 27, 2005, p. 1.

³³"Mexico Backs Russia's WTO Bid, Welcomes Russian Energy Investment," *Agence France-Presse*, June 21, 2005.

2001 entry into the WTO. Instead of waiting for various “rounds” to iron out problems, the WTO offers a framework for a continuous discussion and resolution of issues that retard trade.

The WTO has its detractors, but from most indications it is gaining acceptance by the trading community. The number of countries that have joined and those that want to become members is a good measure of its importance. Another one is its accomplishments since its inception: It has been the forum for successful negotiations to opening markets in telecommunications and in information technology equipment, something the United States had sought for the last two rounds of GATT. It also has been active in settling trade disputes, and it continues to oversee the implementation of the agreements reached in the Uruguay Round. But with its successes come other problems: namely, how to counter those countries that want all the benefits of belonging to WTO but also want to protect their markets. Indeed, the latest multilateral initiative, dubbed the “Doha Round” for the city of Qatar where the talks began in 2001, has been stalled with little progress.³⁴

Skirting the Spirit of GATT and WTO

Unfortunately, as is probably true of every law or agreement, since its inception there have been those who look for loopholes and ways to get around the provisions of the WTO. For example, China was asked to become a member of the WTO, but to be accepted it had to show good faith in reducing tariffs and other restrictions on trade. To fulfill the requirements to join the WTO, China reduced tariffs on 5,000 product lines and eliminated a range of traditional nontariff barriers to trade, including quotas, licenses, and foreign exchange controls. At the same time, U.S. companies began to notice an increase in the number and scope of technical standards and inspection requirements. As a case in point, China recently applied safety and quality inspection requirements on such seemingly benign imported goods as jigsaw puzzles. It also has been insisting that a long list of electrical and mechanical imports undergo an expensive certification process that requires foreign companies but not domestic companies to pay for on-site visits by Chinese inspectors. Under WTO rules, China now must justify the decision to impose certain standards and provide a rationale for the inspection criteria. In 2009, the WTO ruled Chinese restrictions on imports of movies, music, and books to be illegal. The ruling is subject to appeal, but if affirmed, it will create huge opportunities for companies such as Apple and its iTunes.³⁵

The previously mentioned antidumping duties are becoming a favorite way for nations to impose new duties. Indeed, following the example of the United States, the region’s most prolific user of antidumping cases, Mexico and other Latin American countries have increased their use as well. The WTO continues to fight these new, creative barriers to trade.

Finally, frustrated with the slow progress of the most recent round of WTO trade negotiations, several countries are negotiating bilateral trade agreements.³⁶ For example, the United States has signed free-trade agreements with Peru, Colombia, Panama, and South Korea.³⁷ The European Union is engaged in similar activities with South American countries. Perhaps most notable, China and Taiwan have begun free trade talks.³⁸ South Korea and India³⁹ have also signed a free trade pact as have five East African countries.⁴⁰ To the

³⁴John W. Miller, “Blame Goes Global at WTO,” *The New York Times*, December 3, 2009.

³⁵Don Lee, “A Win for U.S. Media in China,” *Los Angeles Times*, August 13, 2009, pp. B1, B4.

³⁶Jayant Menon, “Dealing with the Proliferation of Bilateral Free Trade Agreements,” *World Economy* 32 (October 2009), pp. 1381–407.

³⁷<http://www.ustr.gov>, 2010.

³⁸Ting-I Tsai, “China, Taiwan Set Stage for a Landmark Pact on Trade,” *The Wall Street Journal—Eastern Edition*, December 19, 2009, p. A19.

³⁹Kanga Kong, “Trade Accord with India Will Cut or Eliminate Tariffs,” *The Wall Street Journal—Eastern Edition*, August 8, 2009, p. A9.

⁴⁰“It Really May Happen,” *The Economist*, January 2, 2010, p. 36.

extent that the bilateral talks ultimately lead to multilateral concessions, such activities are not inconsistent with WTO goals and aspirations.

The International Monetary Fund and World Bank Group

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The emergence of the International Monetary Fund and the World Bank Group

The **International Monetary Fund (IMF)**⁴¹ and the World Bank Group⁴² are two global institutions created to assist nations in becoming and remaining economically viable. Each plays an important role in the environment of international trade by helping maintain stability in the financial markets and by assisting countries that are seeking economic development and restructuring.

Inadequate monetary reserves and unstable currencies are particularly vexing problems in global trade. So long as these conditions exist, world markets cannot develop and function as effectively as they should. To overcome these particular market barriers that plagued international trading before World War II, the *International Monetary Fund (IMF)* was formed. Originally 29 countries signed the agreement; now 184 countries are members. Among the objectives of the IMF are the stabilization of foreign exchange rates and the establishment of freely convertible currencies to facilitate the expansion and balanced growth of international trade. Member countries have voluntarily joined to consult with one another to maintain a stable system of buying and selling their currencies so that payments in foreign money can take place between countries smoothly and without delay. The IMF also lends money to members having trouble meeting financial obligations to other members. Argentina, Turkey, and Greece have recently received such help from the IMF, but the results have been mixed.

To cope with universally floating exchange rates, the IMF developed *special drawing rights (SDRs)*, one of its more useful inventions. Because both gold and the U.S. dollar have lost their utility as the basic medium of financial exchange, most monetary statistics relate to SDRs rather than dollars. The SDR is in effect “paper gold” and represents an average base of value derived from the value of a group of major currencies. Rather than being denominated in the currency of any given country, trade contracts are frequently written in SDRs because they are much less susceptible to exchange-rate fluctuations. Even floating rates do not necessarily accurately reflect exchange relationships. Some countries permit their currencies to float cleanly without manipulation (clean float), whereas other nations systematically manipulate the value of their currency (dirty float), thus modifying the accuracy of the monetary marketplace. Although much has changed in the world’s monetary system since the IMF was established, it still plays an important role in providing short-term financing to governments struggling to pay current account debts.

Although the International Monetary Fund has some severe critics,⁴³ most agree that it has performed a valuable service and at least partially achieved many of its objectives. To be sure, the IMF proved its value in the financial crisis among some Asian countries in 1997. The impact of the crisis was lessened substantially as a result of actions taken by the IMF. During the financial crisis, the IMF provided loans to several countries including Thailand, Indonesia, and South Korea. Had these countries not received aid (\$60 billion to Korea alone), the economic reverberations might have led to a global recession. As it was, all the major equity markets reflected substantial reductions in market prices, and the rate of economic growth in some countries was slowed.

Sometimes confused with the IMF, the *World Bank Group* is a separate institution that has as its goal the reduction of poverty and the improvement of living standards by promoting sustainable growth and investment in people. The bank provides loans, technical assistance, and policy guidance to developing country members to achieve its

⁴¹<http://www.imf.org>.

⁴²<http://www.worldbank.org>.

⁴³Krishna Guha, “Watchdog Calls on IMF to Curb Loan Conditions,” *Financial Times*, January 4, 2008, p. 4.

objectives.⁴⁴ The World Bank Group has five institutions, each of which performs the following services: (1) lending money to the governments of developing countries to finance development projects in education, health, and infrastructure; (2) providing assistance to governments for developmental projects to the poorest developing countries (per capita incomes of \$925 or less); (3) lending directly to the private sector to help strengthen the private sector in developing countries with long-term loans, equity investments, and other financial assistance; (4) providing investors with investment guarantees against “noncommercial risk,” such as expropriation and war, to create an environment in developing countries that will attract foreign investment; and (5) promoting increased flows of international investment by providing facilities for the conciliation and arbitration of disputes between governments and foreign investors. It also provides advice, carries out research, and produces publications in the area of foreign investment law. Since their inception, these institutions have played a pivotal role in the economic development of countries throughout the world and thus contributed to the expansion of international trade since World War II.

Protests against Global Institutions Beginning in 1999, what some are calling “anticapitalist protesters” began to influence the workings of the major global institutions described previously. The basic complaint against the WTO, IMF, and others is the amalgam of unintended consequences of globalization: environmental concerns, worker exploitation and

Three kinds of antiglobalization protests: the photo on this page and the two photos on the next. Gifford Myers showed this sculpture *Object (Globalization)–2001* in Faenza, Italy, as a peaceful protest.



⁴⁴Thomas Pearmain, “Tanzanian Power Sector Faces Difficult Year,” *Global Insight*, January 2, 2008.

Starbucks may be replacing McDonald's as the American brand foreigners most love to hate. Here local police fail to stop anti-World Trade Organization rioters in Seattle from breaking windows close to home.



And, finally, protest of the deadly sort. Terrorists maim and kill those aboard the classic red London double-deck bus (you can see the pieces in the street).

domestic job losses, cultural extinction, higher oil prices, and diminished sovereignty of nations. The antiglobalization protests first caught the attention of the world press during a WTO meeting in Seattle in November 1999. Then came the World Bank and IMF meetings in April in Washington, DC, the World Economic Forum in Melbourne, Australia, in September, and IMF/World Bank meetings in Prague, also in September 2000. Some 10,000 protesters faced some 11,000 police in Prague. The protesters have established Web sites associated with each event, labeled according to the respective dates. The Web sites and the Internet have proved to be important media aiding organizational efforts. And the protests⁴⁵ and violence have continued at other meetings of world leaders regarding economic issues, such as the G20 meetings in London in 2009,⁴⁶ and in individual countries affected by the IMF. Tragically, the terrorism in London was most likely timed to coincide with the G8 meetings in Scotland in 2005.⁴⁷

The protest groups, some of them with responsible intent, have affected policy. For example, “antisweatshop” campaigns, mostly in America and mostly student-led, have had effects beyond college campuses. A coalition of nongovernmental organizations, student groups, and UNITE (the textile workers’ union) recently sued clothing importers, including Calvin Klein and The Gap, over working conditions in the American commonwealth of Saipan in the Pacific. Faced with litigation and extended public campaigns against their brands, 17 companies settled, promising better working conditions. Similarly, a World

⁴⁵“Pakistani Farmers Stage Protests in Lahore against WTO Regime,” *BBC Monitoring South Asia*, April 18, 2007.

⁴⁶Jennifer Martinez, “Anarchists Organize to Spread Word,” *The Wall Street Journal—Eastern Edition*, April 1, 2009, p. A8.

⁴⁷Mark Rice-Osley, “Overshadowed by Terrorism, G-8 Summit Still Secures Debt Relief,” *Christian Science Monitor*, July 11, 2005, p. 7.

Bank project in China, which involved moving poor ethnic Chinese into lands that were traditionally Tibetan, was abandoned after a political furor led by a relatively small group of pro-Tibetan activists.

Given the apparent previous successes associated with the generally peaceful grassroots efforts to influence policy at these global institutions, we can expect more of the same in the future. But predicting the consequences of the terrorism apparently being added to the mix of protestation is impossible.

Summary

Regardless of the theoretical approach used in defense of international trade, the benefits from an absolute or comparative advantage clearly can accrue to any nation. Heightened competitors from around the world have created increased pressure for protectionism from every region of the globe at a time when open markets are needed if world resources are to be developed and utilized in the most beneficial manner. And though market protection may be needed in light of certain circumstances and may be beneficial to national defense or the encouragement of infant industries in developing nations, the consumer seldom benefits from such protection.

Free international markets help underdeveloped countries become self-sufficient, and because open markets provide new customers, most industrialized nations have, since World War II, cooperated in working toward freer trade. Such trade will always be partially threatened by various governmental and market barriers that exist or are created for the protection of local businesses. However, the trend has been toward freer trade. The changing economic and political realities are producing unique business structures that continue to protect certain major industries. The future of open global markets lies with the controlled and equitable reduction of trade barriers.

Key Terms

GATT

Balance of payments
Current account

Protectionism

Nontariff barriers
Tariff

Voluntary export restraints
(VERs)

World Trade Organization (WTO)

International Monetary
Fund (IMF)

Questions

1. Define the key terms listed above.
2. Discuss the globalization of the U.S. economy.
3. Differentiate among the current account, balance of trade, and balance of payments.
4. Explain the role of price as a free market regulator.
5. "Theoretically, the market is an automatic, competitive, self-regulating mechanism which provides for the maximum consumer welfare and which best regulates the use of the factors of production." Explain.
6. Interview several local businesspeople to determine their attitudes toward world trade. Furthermore, learn if they buy or sell goods produced in foreign countries. Correlate the attitudes with their commercial experience and report on your findings.
7. What is the role of profit in international trade? Does profit replace or complement the regulatory function of pricing? Discuss.
8. Why does the balance of payments always balance, even though the balance of trade does not?
9. Enumerate the ways in which a nation can overcome an unfavorable balance of trade.
10. Support or refute each of the various arguments commonly used in support of tariffs.
11. France exports about 18 percent of its gross domestic product, while neighboring Belgium exports 46 percent. What areas of economic policy are likely to be affected by such variations in exports?
12. Does widespread unemployment change the economic logic of protectionism?
13. Review the economic effects of major trade imbalances such as those caused by petroleum imports.
14. Discuss the main provisions of the Omnibus Trade and Competitiveness Act of 1988.
15. The Tokyo Round of GATT emphasized the reduction of nontariff barriers. How does the Uruguay Round differ?
16. Discuss the impact of GATS, TRIMs, and TRIPs on global trade.

17. Discuss the evolution of world trade that led to the formation of the WTO.
18. Visit www.usitc.gov/taffairs.htm (U.S. Customs tariff schedule) and look up the import duties on leather footwear. You will find a difference in the duties on shoes of different value, material composition, and quantity. Using what you have learned in this chapter, explain the reasoning behind these differences. Do the same for frozen and/or concentrated orange juice.
19. The GATT has had a long and eventful history. Visit www.wto.org/wto/about/about.htm and write a short report on the various rounds of GATT. What were the key issues addressed in each round?