

International trade: trade issues

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Autumn 2017

There are a number of issues related to international trade that we haven't discussed in detail so far such as

1. Effect on inequality
2. Dumping
3. Labour standards
4. Effect on environment

Some people oppose trade liberalisation because of the effect it has on income, given that trade liberalisation will increase the relative returns of the abundant factor, which often is land or capital.

- ▶ i.e. not the workers, proletariat, etc.

Concerning trade and income inequality, following the HO-model we would expect to observe two things

1. Capital gains in developed countries
2. Labour gains in developing countries

This means that trade will increase inequality in industrialised states and reduce it in developing countries.

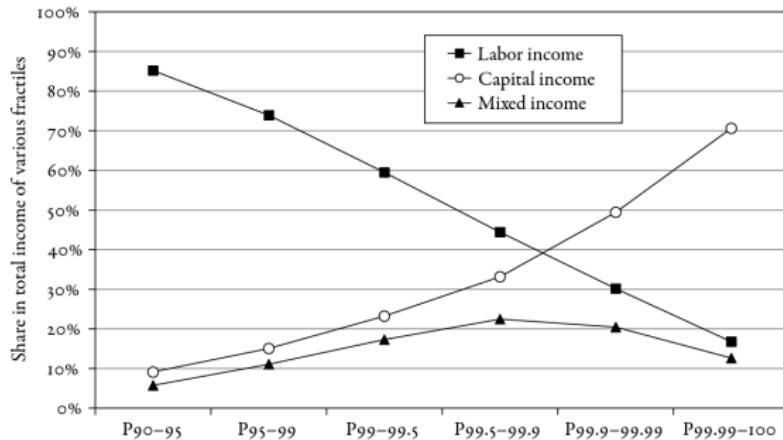


FIGURE 8.10. The composition of top incomes in the United States, 2007

Capital income becomes dominant at the level of top 0.1 percent in 2007, as opposed to the top 1 percent in 1929.

Sources and series: see piketty.pse.ens.fr/capital21c.

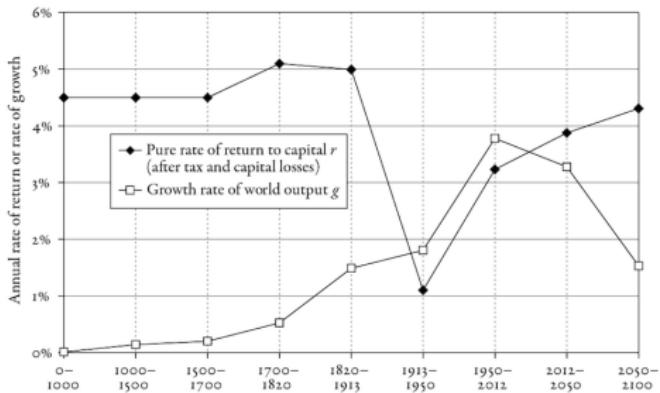


FIGURE 10.10. After tax rate of return versus growth rate at the world level, from Antiquity until 2100

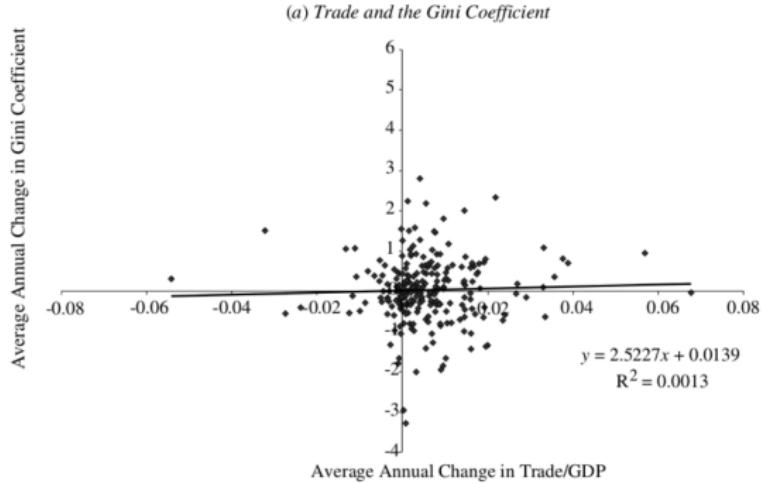


FIGURE 8.8. The transformation of the top 1 percent in the United States

The rise in the top 1 percent highest incomes since the 1970s is largely due to the rise in the top 1 percent highest wages.

What does the literature have to say on the topic of trade and income inequality?

- ▶ Globalisation linked to reduction in inequality between countries but not necessarily within
- ▶ Wages of high-skilled workers in developed countries have increased while those for unskilled labour have fallen



Dollar & Kraay, 2004, "Trade, Growth, and Poverty"

(b) *Trade and the Income Share of the Poor*



Dollar & Kraay, 2004, "Trade, Growth, and Poverty"

One negative side effect of free trade is **dumping**, which can be defined as

An exporting firm setting an export price below its domestic market price plus all per-unit trade costs

This is an example of price discrimination

- ▶ Firm can charge different prices to different consumers

Dumping requires two market conditions

1. Imperfect competition
2. Market segmentation

In international trade these arise due to fact that markets aren't perfectly integrated as a result of trade costs

- ▶ Protectionism, such as export subsidies, also leads to market distortions

What is the rationale behind dumping?

Let's assume that a country is faced with two different demand functions

1. Domestic
2. International

Due to transport costs and home bias, domestic firms will usually have a larger market share than foreign firms.

Table 2: Market shares by brand nationality

	Market share of brands from						
	DEU	ESP	FRA	GBR	ITA	USA	Other
BEL	0.34	0.02	0.26	0.02	0.04	0.09	0.23
BRA	0.23	-	0.11	0.00	0.23	0.31	0.12
CAN	0.07	-	-	0.01	-	0.34	0.58
DEU	0.55	0.02	0.09	0.01	0.03	0.08	0.21
ESP	0.26	0.09	0.26	0.01	0.03	0.11	0.22
FRA	0.19	0.02	0.52	0.01	0.04	0.07	0.16
GBR	0.23	0.02	0.13	0.18	0.02	0.16	0.25
ITA	0.24	0.01	0.15	0.02	0.30	0.12	0.17
USA	0.08	-	-	0.01	0.00	0.40	0.52

Notes: Each row presents the revenue-based market share of brands originating from countries listed in the columns, adding up to one subject to rounding error. - means that brands from the origin country are not sold in the market, and 0.00 implies a market share of less than one percent. Other includes Japan, Korea, China, India, Sweden, Malaysia, Czech Republic, Romania and Russia. The bottom panel excludes these "other" countries and presents market shares within the brand-owning producers in our dataset.

Now suppose that a larger market share is associated with a demand function that is less responsive to price changes.

- ▶ This means that firms will have lower markups and lower prices in foreign markets

i.e. an exporting firm will lower the markup for the export market due to higher marginal costs

Let's consider a single good which is sold at the domestic market for p and p^* is the price in the foreign market. The firm will face higher marginal costs in the export market adding $c + t$ to the price. We get

$$\begin{aligned} p - c \\ p^* - (c + t) \end{aligned}$$

Given that

$$p^* - t < p$$

the export price will be lower than the domestic price.

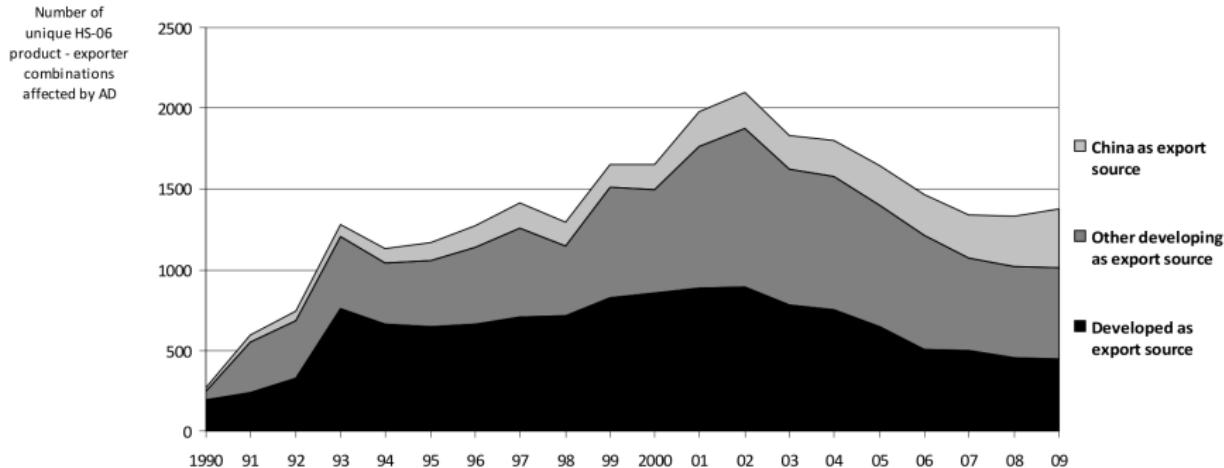
Dumping is natural firm behaviour but it is considered as unfair and potentially harmful to domestic producers.

- ▶ Anti-dumping laws can be used to discriminate against imports in market

Some dumping behaviour is facilitated by subsidies such as in China for steel,

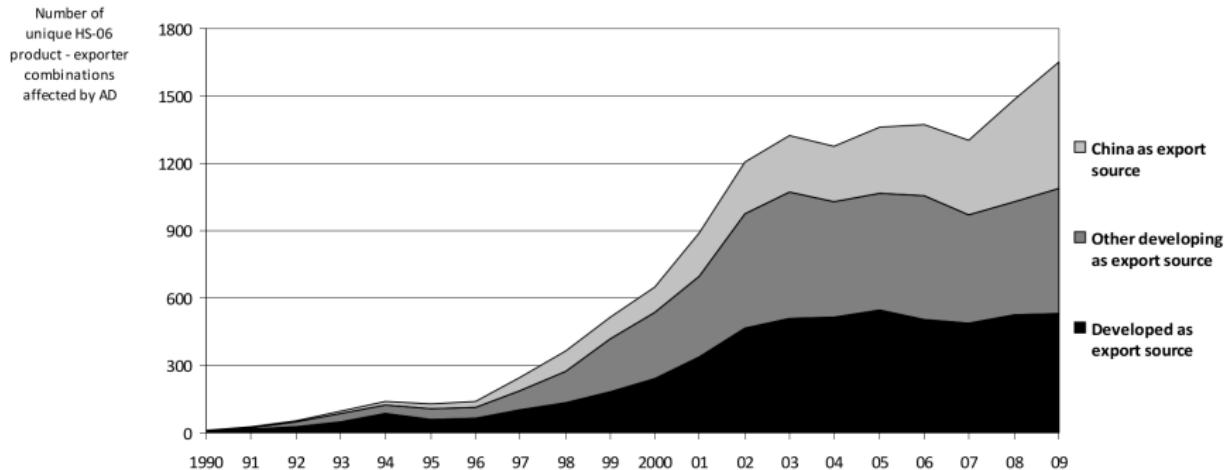
- ▶ Chinese firms have preferential lending rates and lower energy charges

a. Antidumping stock imposed by developed* (G20) economies, 1990-2009



"Taking Stock of Antidumping, Safeguards and Countervailing Duties, 1990-2009"

b. Antidumping stock imposed by developing* (G20) economies, 1997-2009



"Taking Stock of Antidumping, Safeguards and Countervailing Duties, 1990-2009"

There are two other main issues concerning trade

1. Relation to labour standards
2. Effect on environment

Does trade harm the environment and do labour standards and international competition have a negative effect?

- ▶ Note that in both cases weaker environmental regulations and less strict labour laws can be a comparative advantage



In 2013 the Rana Plaza garment factory collapsed killing 1,129 people.

- ▶ Building was converted to industrial use
- ▶ Little regard for workers safety, as safety precautions cost money

In response labour organisations, NGOs, and retailers signed the Accord on Fire and Building Safety in Bangladesh aimed at maintaining minimum safety standards in textile industry.

- ▶ Retailers don't check if firms comply, which isn't their job



Chinese Labor Strike: 5,000 Workers Strike At Factory Making Shoes For Nike, Timberland, Kenneth Cole; Police Dogs Deployed

By Angelo Young [@angeloyoung_](#) a.young@ibtimes.com on March 10 2015 3:32 PM EDT



Labour standards refer to all issues directly affecting workers

- ▶ Health and safety in Bangladesh, housing payment in China, minimum wage in South Africa

Global agreements on labour requires comparison of labour (and salary) standards across countries. These standards are generally not directly addressed in trade agreements.

- ▶ WTO does not deal with labour standards; International Labour Organisation is relevant body

Internationally regulated living wage is controversial as it is difficult to compare labour standards across countries

- ▶ Low wages are comparative advantage: risk of increased unemployment as higher wages mean less demand

Does not entail that other labour standards should be neglected.

Labour standards are basically a list of conventions and recommendations established by the International Labour Organisation (ILO). There are four main convention areas

1. Freedom of association
2. Abolition of forced labour
3. Equality
4. Elimination of child labour



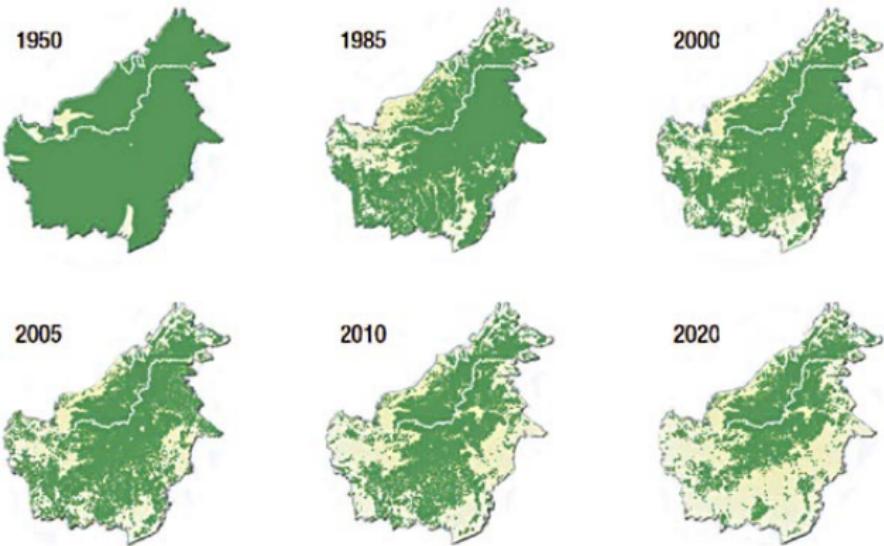
Improving labour conditions is often a slow process, and some argue that trade policy can be used to speed up the process.

- ▶ Trade is the only tool there is and it is wrong to benefit from the abuse of others.

However, although most agree that labour standards should be promoted there is disagreement about whether trade policy is the right tool.

- ▶ Trade restrictions will make countries poorer and could provide incentives for protectionism

Deforestation in Borneo, Indonesia, 1950-2005 and projections towards 2020



© WWF

Some concerns concerning trade and the environment

1. Increase in emissions due to transport of goods
2. Creation of pollution havens
3. Depletion of international natural resources due to lack of regulations

There are two main hypotheses linking trade and the environment

1. Pollution haven hypothesis: Being able to pollute is a comparative advantage
2. Factor endowment hypothesis: Rich countries will be dirtier due to polluting relatively capital-intensive industries

Trade affects the environment in three ways

1. Scale of economic activity: More trade means more production means more pollution
2. Level of income: Higher income means demand for cleaner production
3. Composition of output: Trade will alter output composition, based on comparative advantage

The scale and technique effect are indirect whereas the composition effect is direct.

The composition effect has two opposite predictions

1. Pollution haven: Poor countries more polluted, rich countries less
2. Factor endowment: Poor countries less polluted, rich countries more

The main problem of trade in context of the environment is that it generates externalities

- ▶ Some costs are not borne by the producer/consumer
 - ▶ e.g. pollution, global warming, extinction of species

One example of negative externalities is the pollution along the Mexican border, caused by production of goods for US market.

- ▶ Stimulated by 'maquiladoras' which are firms given a special tariff treatment carrying out production for US firms

In another case the US tried to implement some laws to curtail some negative effects such as banning imports from Mexico of tuna and shrimps

- ▶ Since this hurt the dolphin and turtle population

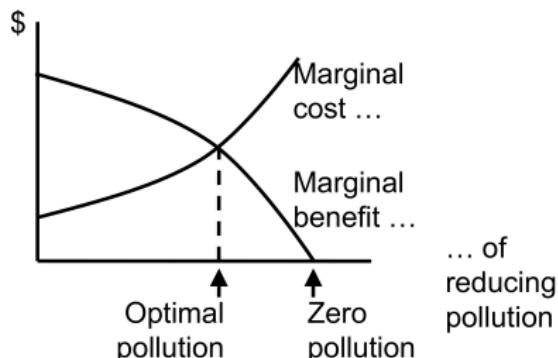
These laws were struck down by the WTO

There are a number of ways to deal with negative externalities

1. Regulate by prohibiting or limiting activity
2. Taxation by making the activity more costly
3. Or a hybrid form such as tradable licenses
 - ▶ Number of licenses is set up by regulator and market determines who uses one
 - ▶ Cap and trade

Economically speaking there is an optimal level for a negative externality which isn't zero. Instead, reducing the externality the optimal level is found when

$$\text{marginal benefit} = \text{marginal cost}$$



Some more examples of negative externalities

- ▶ Pollution of air and water
- ▶ Acid rain
- ▶ Global warming, due to CO_2 and MH_4 emissions
- ▶ Deforestation, specifically tropical forests in Brazil and Indonesia
- ▶ Destruction of species
- ▶ Overuse of natural resources

Externalities are often international problems, which makes them hard to solve

- ▶ No incentive to incur local costs to limit harm to foreigners

Needs international agreements

- ▶ Choroflorocarbons that caused the hole in the ozone layer were dealt with by the 1987 Montreal protocol

Regulations are sometimes difficult to implement as it will affect competitiveness.

- ▶ A pollution tax for example will raise costs of exports

When countries have weak regulations they can become pollution havens. There is a race to the bottom where countries compete by lowering environmental standards



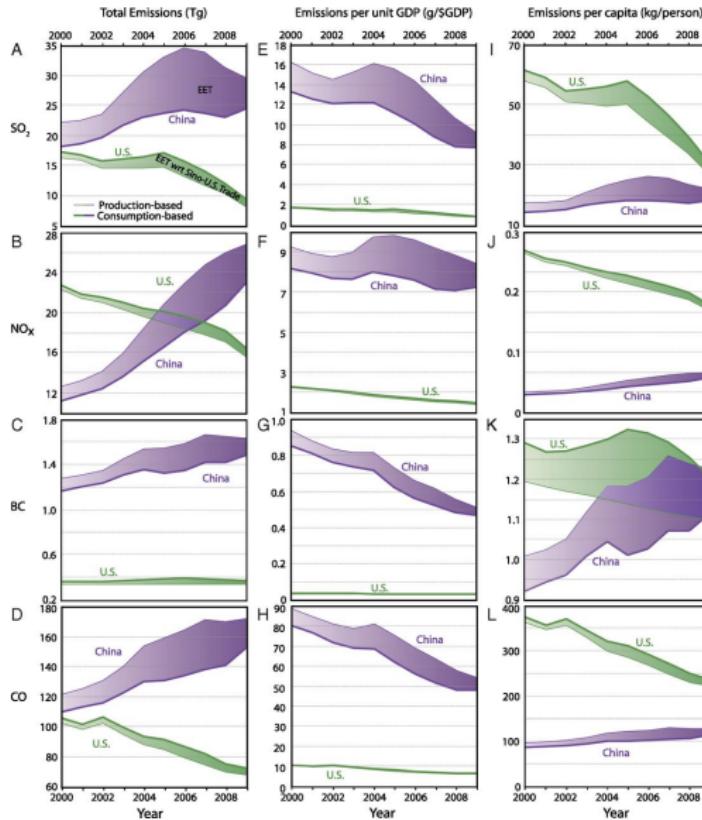
Following the pollution haven hypothesis low standards are a comparative advantage.

- ▶ When pollution control costs start to matter for some industries in some countries, other countries gain comparative advantage in those industries

This difference in environmental standards will affect the allocation of investments

1. In developing countries production and exports will become more pollution intensive
2. Pollution-intensive industries will leave high-standard countries

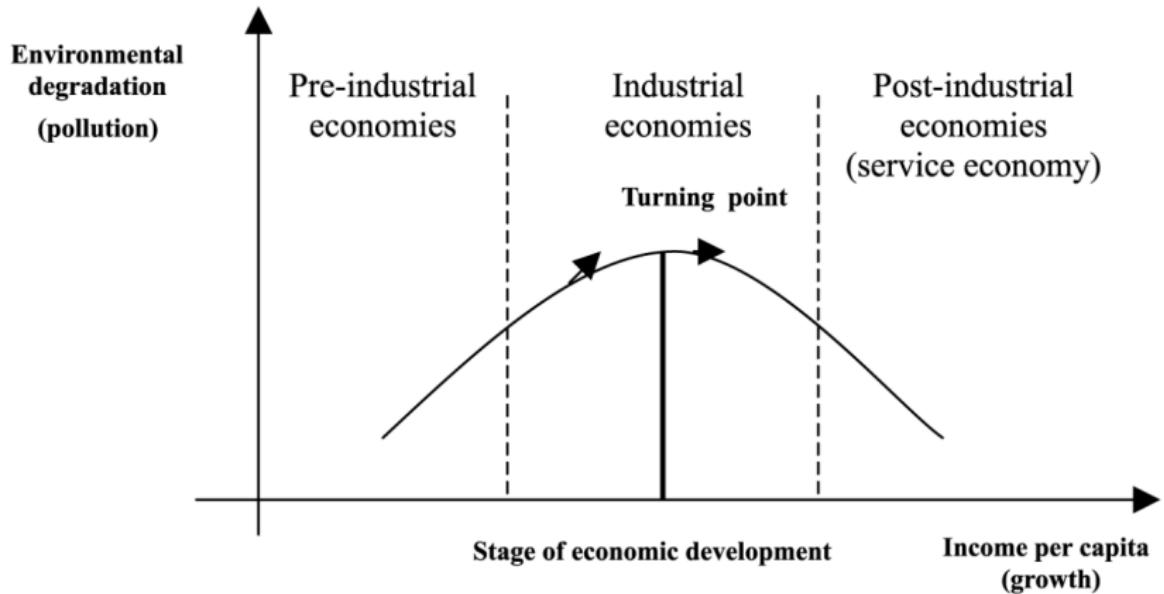
Empirically little evidence for this theory.



"China's international trade and air pollution in the United States"

The optimal policy depends on the country income's level as poor countries can't afford strict regulations

- ▶ The environment is income elastic, meaning that demand increases with income



Two channels through which trade and the environment are linked

1. Statically, for a given level
 - ▶ Race to the bottom in national regulation
2. Dynamically, via income growth
 - ▶ Shift to cleaner techniques and composition of economic activity

From first lecture: Mexico is the worlds largest exporter of fresh tomatoes; which country is the second largest?



Does the WTO allow limits on imports concerning environmental reasons?

- ▶ Yes, if the imported goods do damage inside the importing countries
- ▶ No, if the damage is done in the exporting country or abroad

Recall that policy does not allow discrimination, as such imports may not be limited based on the production process.

An example of a policy designed to discourage harmful production methods is the so called carbon tariff: These tariffs are implemented to limit CO₂ emissions, but not applied by all countries

- ▶ This kind of tariffs aims to rise the price of carbon

Some countries don't participate: could put tariff on exports of non-participating countries.

- ▶ Benefits to the world are the same but the costs are not

There are arguments for and against using this type of tariff

- ▶ Carbon tariff is protectionist and imposing them would lead to trade wars
- ▶ Not implementing this tariff would lead to consumer substitution towards products made in countries that do not tax/restrict CO₂ emissions
 - ▶ Can be implemented under WTO rules as border tax adjustments

Tragedy of the commons (Hardin, 1968)

The population problem has no technical solution; it requires a fundamental extension in morality

With common we generally mean a resource that is owned jointly

- ▶ e.g. the oceans, but also extractive industries

Although the benefits of using the resource are accrued individually, the costs are borne jointly

- ▶ The individual cost is therefore reduced

The imbalance between cost and benefit makes increasing exploitations a rational strategy; this will lead to overexploitation.

Hardin illustrated the tragedy of the commons using a open pasture which can be used by herdsmen for their cattle.

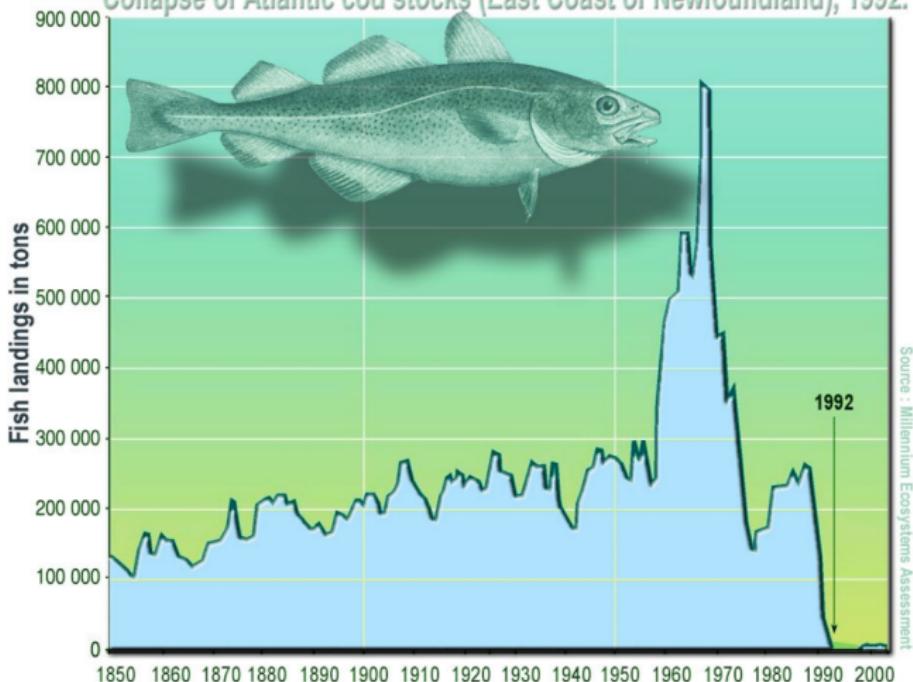
- ▶ Expectation is that each herder will try to keep as much cattle as possible

This strategy will work as long as other factors keep the population below the carrying capacity of the land until social stability is reached. Things will go pear-shaped when herders will try to maximise utility

1. Each herder will add one more animal to herd which gives positive utility of +1
2. Extra animal will lead to overgrazing with utility of -1, shared by all herdsmen

This will lead to a theoretically unlimited increase on a limited resource.

Collapse of Atlantic cod stocks (East Coast of Newfoundland), 1992.

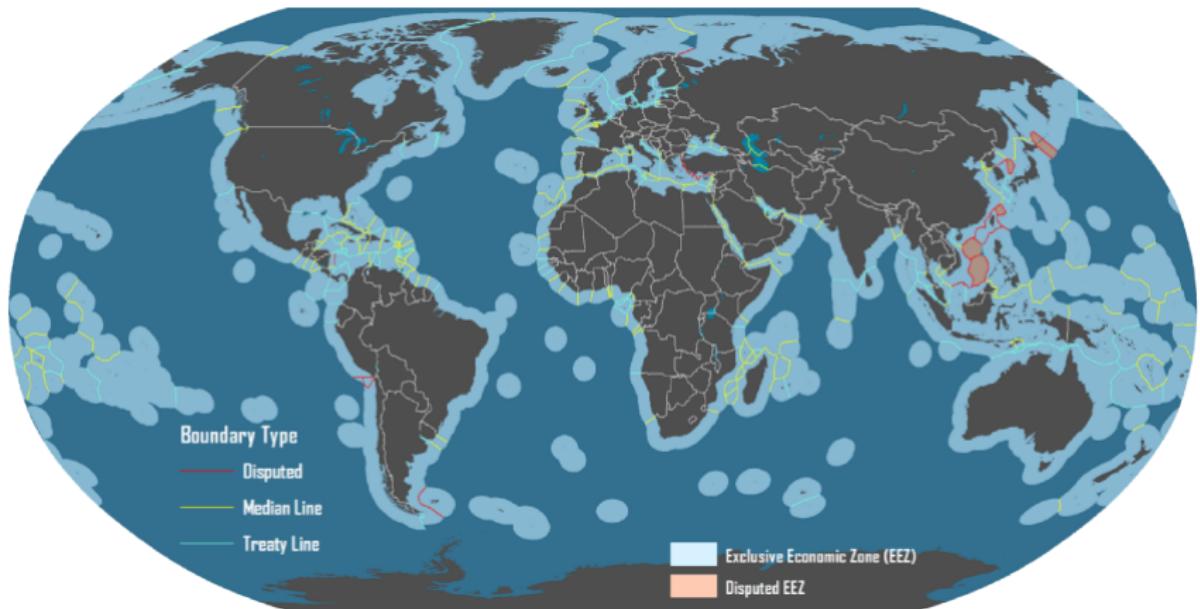


Source : Millennium Ecosystems Assessment

There are a number of ways to manage the commons such as

1. Converting it into private property
2. Allocating rights to using the commons
3. Coercion

Some of these are hard to apply at international level



The tragedy of the commons is a so called no technical solutions problem.

- ▶ Instead it requires a change in morality of human values

This is because rational actors will continue to exploit the commons.

- ▶ Therefore a change in values is needed which makes exploiting the resource past carrying-capacity no longer rational