CHAPTER 11

INTERNATIONAL TRADE: POLICIES AND RELATIONS

Chapter Outline

(A) Introduction;
(B) Tariffs;
(C) Subsidies;
(D) Import Quotas;
(E) Voluntary Export Restraints;
(F) Local Content Requirements;
(G) Administrative Policies;
(H) Government Intervention in Formulating Trade Policies;
(I) International Trade Relations;
(J) International Law and Business Firms.

Learning Objectives

After studying this chapter, you should be able to –

- Understand the need for international trade policy;
- Analyse the instruments of trade policy;
- Discuss the need for government intervention in formulating trade policies;
- Understand the instruments of international economic relations;
- Explain the impact of diplomacy and foreign policy on international business;
- Analyse the need for peace and role of UNO in maintaining peace;
- Understand the impact of international law on international business.

(A) INTRODUCTION

Trade policies also aim at protecting the domestic industry from the competition of advanced countries through imposing quotas.

Managing any business strategically needs an understanding of the business policies. But in case of global companies, a greater understanding of trade policies is essential. International trade policies deal with the policies of the national governments relating to exports of various goods and services to various countries either on equal terms and conditions or on discriminatory terms and conditions.

For example, Russia's trade policy indicates that it allows Indian imports, though the price and quality are unfavourable compared to those of other countries. *Similarly,* China imports goods from Pakistan on preferential terms like fewer rates of tariffs, etc.

Trade policies also aim at protecting the domestic industry from the competition of advanced countries through imposing quotas. Trade policies of some countries aim at building competencies of the domestic companies by providing subsidies. Thus, the countries announce trade policies from time-to-time. An understanding of these policies enables the MNCs to formulate their strategies regarding entry and conduct of business in various countries.

Government announce their trade policies with regard to the following from time-to-time. These are also called the instruments of trade policy. They are:

- Tariffs
- Subsidies
- Import Quotas
- Voluntary Export Restraints
- Local Content Requirements, and
- Administrative Policies.

Now, we shall discuss each of the areas of trade policies.

(B) TARIFFS

Tariffs refer to the tax imposed on imports.

Tariffs refer to the tax imposed on imports. Tariffs are of two types, viz., specific tariffs and *ad valorem* tariffs. Specific tariffs are levied as a fixed charge for each unit of the product imported. *For example,* a tariff of ₹ 1,000 on each TV imported.

The tariff levied as a proportion of the value of the imported goods is called '*ad valorem*' tariff. *For example,* imposition of 30 per cent tax on the value of computers imported.

The purpose of tariffs is to protect the domestic industry by increasing the cost of imported goods. Government of India imposed tariffs to protect domestic automobile industry, sugar industry, cement industry and steel industry.

The following parties gain from the tariffs:

- Government of the importing country: Government of the importing country gets the revenue in the form import duties.
- Industry of the importing country: The products of the importing country would find market as the cost of imported goods is higher than that of domestic goods.
- Jobs in the domestic country are saved.
- Business for the ancillary industry, servicing, market intermediation, etc., is also protected.

However, the following parties are adversely affected by the tariffs:

- Consumers of the domestic country lose as they have to pay a higher price. Thus, the customers pay for the inefficiency of the domestic industry.
- The industry of the exporting country loses the demand for its product, sales and profit.

Ultimately, tariffs enhance the efficiency of some countries and curtail the growth of the most efficient countries. Thus, tariffs reduce the efficiency of world economies. This process results in inefficient utilisation of all kinds of resources.

Table 11.1 presents the average tariff rates on manufactured products.

TABLE 11.1 AVERAGE TARIFF RATES ON MANUFACTURED PRODUCTS *(Percentage of Value)*

Country	*1913*	*1950*	*1990*	*2011+*
USA	44	14	4.8	3.9
UK	–	23	5.9	3.9
France	21	18	5.9	3.9
Germany	20	26	5.9	3.9
Italy	18	25	5.9	3.9
Japan	30	–	5.3	3.9
Sweden	20	9	4.4	3.9
Holland	5	11	5.9	3.9

+ Related for 2007 based on full implementation of Uruguay Agreement.

Source: "*Who Wants To Be A Giant?" The Economist: A Survey of Multinationals and http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm2_e.htm*

The member countries of WTO under the Agreement on Agricultural (AOA) committed to educe tariff rates on agricultural products as presented in *Table 11.2*

TABLE 11.2 REDUCTION COMMITMENTS UNDER AoA OF WTO MEMBER COUNTRIES

Particulars	*for Developed countries*	*for Developing countries*
Period of commitment	6 years 1995-2000	10 years 1995-2004
Tariffs average cut for agricultural products	36%	15%
Minimum cut for product	24%	10%
Domestic support total cuts for agricultural sector Box year 1986-88	20%	13.3%
Exports value of subsidies	36%	21%
Subsidised Quantities	24%	14%

Soures: Angadi *et. al., "Glimpses of emerging trade".* IIPH, 2007, p. 105.

(C) SUBSIDIES

In order to encourage domestic production or to protect the domestic producer from the foreign competitors, government pays to a domestic producer by reducing operations cost. Such payments are called subsidies.

In order to encourage domestic production or to protect the domestic producer from the foreign competitors, government pays to a domestic producer by reducing operations cost. Such payments are called subsidies. Subsidies are in different forms. They are: cash grants, loans and advances at low rates of interest, tax holidays, government procurement of output at a higher rate, equity participation and supply of inputs at lower prices.

Subsidies help the domestic producers in the following ways:

- Acquire the character of a low cost producer and have all the advantages of a low cost producer like high profit margin or fixing the price at lower level.
- Compete with a foreign producer in the domestic market.
- Enter the foreign markets.

♦ SUBSIDIES IN ADVANCED COUNTRIES

The government of not only developing countries but also advanced countries provides subsidies.

The government of not only developing countries but also advanced countries provides subsidies. *Similarly*, subsidies are provide by the government not only to the agricultural sector, but also to the industrial sector. Subsidies provided by different countries are as follows:

- Most industrialised countries provided subsidy between 2 to 3.0 per cent of their industrial output during 2000s.
- The average rate of subsidy provided in the USA is 0.5 per cent of the output, it is one per cent in Japan, 2 per cent in UK and Germany, 6 to 7 per cent in Sweden and Ireland. These subsidies are only in the form of cash grant.
- Subsidies including different forms are 2 per cent in UK, 14.6 per cent in Greece during 2000s.
- Subsidies in Italy are 3 times more than that of UK, two times more than that of Germany and 1.5 times more than that of France in 2006. *(Table 11.2)*

♦ ADVANTAGES AND DISADVANTAGES OF SUBSIDIES

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As stated earlier, subsidies enhance the international competitiveness of the domestic industry. Therefore, the domestic business, industry and advocates of strategic international trade favour subsidies. Subsidies, in turn, help the firms to have large scale economies and advantages of low-cost production. In addition, these advantaged firms can enter the foreign markets before the firms of other countries and can this also have the advantages of the first mover. Dr. Reddy's Lab. got the advantages of low-cost producer and the first mover advantages in Asian and African countries. *Similarly*, US subsidies helped Boeing to have the first mover advantages. The first mover advantages, in their turn, bring the advantages of employment and tax gains to the domestic country.

Subsidies are paid by the government by taxing the individuals. Thus, subsidies are a national cost. Therefore, subsidies should produce national benefit more than the national cost. Otherwise, subsidies are a national waste. In fact, subsidies do not enhance international competitiveness of the domestic companies. In such cases, subsidies protect the inefficiency and lethargy of the domestic firms. Hence, the World Trade Organisation proposed phased withdrawal of subsidies.

♦ SUBSIDIES IN DEVELOPING COUNTRIES

In fact, the Indian government has already started withdrawing the subsidies on fertilisers, pesticides, prices of agricultural output, output of small-scale industries, etc. Withdrawal of these subsidies with regard to agricultural sector and small-scale industrial sector led to the closure of certain small-scale industrial units. It led to increased losses to the Indian farmers and also suicide deaths of Indian farmers owing to indebtedness.

Indian experience shows that subsidies in developing countries basically reduce losses and provide insurance against crop failure, market fluctuations, shifts in customer tastes and technology changes. Thus, it is viewed that subsidies in developing countries are aimed at providing sustainability for the agriculture sector and small-scale industrial sector in order to provide employment and livelihood for masses.

As such, the farmers, small-scale industrialists, unemployed and advocates of subsidies criticise the WTO policy of phasing out subsidies.

(D) IMPORT QUOTAS

Import quota is a direct restriction on the quantity of goods which are imported into a country. These restrictions are imposed by issuing import licenses to certain firms and individuals to import a certain quantity of the goods. India had quotas of imports of various goods like cars, motor cycles, milk, etc., up to 31st March, 2001. Import quotas provide protection to the domestic firms from the foreign competitors.

A voluntary export restraint is the opposite form of import quotas.

(E) VOLUNTARY EXPORT RESTRAINTS

A voluntary export restraint is the opposite form of import quotas. A voluntary export restraint is a quota on exports of the domestic firm imposed by the exporting country. Exporting country imposes such restriction, mostly at the request of the importing country. *For example*, Japanese automobile exporters had such restraint in 1981 due to the request of the US government. Foreign exporters mostly accept for the voluntary export restraint as its violation leads to imposition of import tariffs, import quotas, etc.

Import quotas and voluntary export restraints help the domestic firms by providing protection from the foreign competitors. These enhance the prices of import goods and make the domestic goods cheap.

Another form of restrictions imposed on the imports is the local content requirements.

(F) LOCAL CONTENT REQUIREMENT

Local content requirement is a condition that requires some specific fraction of a product imported be produced domestically. The requirement may be in physical terms (50% of the components should be from the domestic country) or in value terms (50% of the value of the product should be produced domestically).

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Most of the developing countries insist on the local content requirements in order to shift at least certain part of manufacturing base in their country. This helps the country to enhance the employment opportunities, utilisation of local resources and economic activities.

This factor protects the domestic producer as in case of quotas.

(G) ADMINISTRATIVE POLICIES

Governments, in addition to the quotas and other restrictions, use formal and informal policies to restrict imports and boost exports. Administrative policies are bureaucratic rules and procedures which are formulated to make it difficult for imports to enter the country. Formal trade barriers like tariffs and quotas are the lowest in Japan. Japan mostly uses the administrative policies.

It is a quite contradicting issue to study trade policies in these days of globalisation. Some argue that government should intervene in formulating trade policies while others reject it. As such, we now analyse the argument for government intervention in formulating trade policies.

(II) GOVERNMENT INTERVENTION IN FORMULATING TRADE POLICIES

Government intervention in international business sometimes is necessary.

Traditionally, it had been viewed that government is the custodian of the nation including industry and business. Consequently, business has become inefficient due to heavy protection provided by the government. The other school of thought is that the business can run efficiently and creatively in order to give more value for the customer's money, when it is free from government intervention and protection.

Now, we shall discuss the arguments of politicians for government intervention.

♦ POLITICAL ARGUMENTS FOR GOVERNMENT INTERVENTION

Politicians argue for government intervention from the point of view of national security, protecting industries, protecting jobs, etc.

National Security: Strategic industries from the point of view of national security should be run by the government. These industries include: defence, aerospace, electronics, semi-conductors, posts, railways and the like. Government runs these industries even in earlier market economies like the USA and Japan. Even after liberalisation and globalisation of Indian economy, Government in India reserved eight strategic industries (from the national security point of view) for exclusive public sector operation.

Protecting Industries: One of the major objectives of the government is to protect the domestic industry from the foreign competitors. This can be done only if the government runs the industry as the foreign competitors easily kill the private industry or business. This is clearly evident from the Indian experience. Most of the sick small-scale industrial units have become mortal and the healthy small and medium industries have become sick after the entry of foreign industries. This is more so, after the entry of cheap products from China and East Asian countries (like Thailand, South Korea and Malaysia) into the Indian market. Therefore, politicians argue that government should interfere in the business.

Protecting Jobs: The economic liberalisation in India led to the closure of many small industries, downsizing of the large industries, outsourcing of employees, privatisation (or disinvestment) of public sector units, etc. This in turn, reduced the number of jobs in the country. This is true with all other countries which liberalised and globalised their economies. Hence, politicians argue that the government should interfere in business in order to protect the basic right of the people, *i.e.*, right for job.

Retaliation: The foreign businesses need to be threatened and should be dealt with a *'tough approach'*. Only governments can deal with a *'tough approach and attitude'* with the foreign businesses. Governments can do this due to the power to take tough decisions and availability of machinery to implement the decisions. Otherwise, the foreign businesses control the domestic business firms. As such, the politicians argue for the government in business.

Having discussed the political arguments, we shall discuss the economic arguments for government intervention in the business.

♦ ECONOMIC ARGUMENTS FOR GOVERNMENT INTERVENTION

Economic arguments include infant industry argument and strategic trade policy.

Infant Industry Argument: When the industry is in the infant stage of its life cycle, it needs protection from the foreign competitors. In fact, Indian government protected our industry