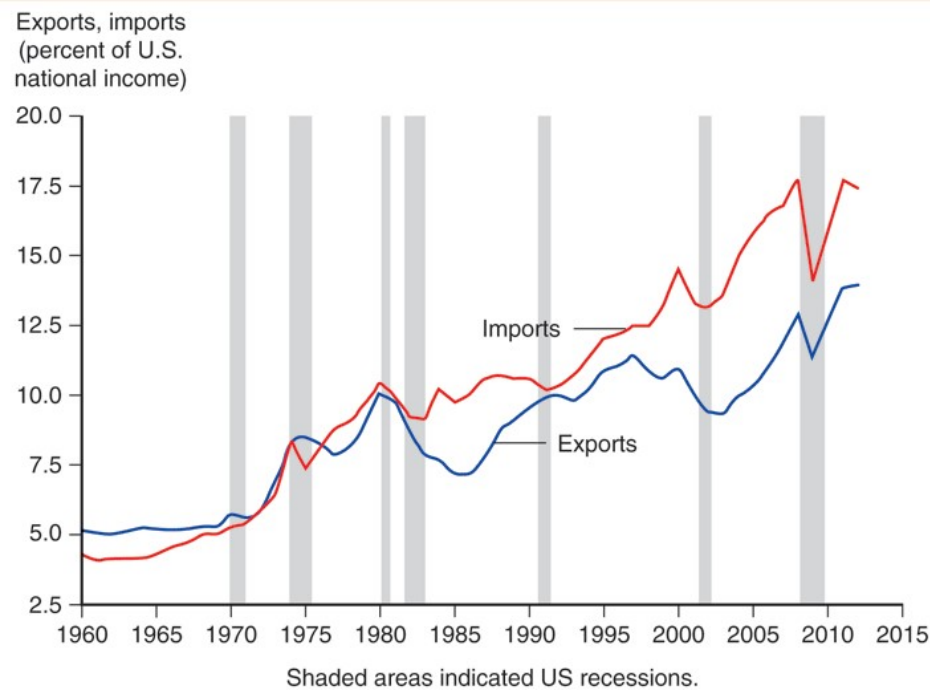




# Lessons on International Trade and Policy

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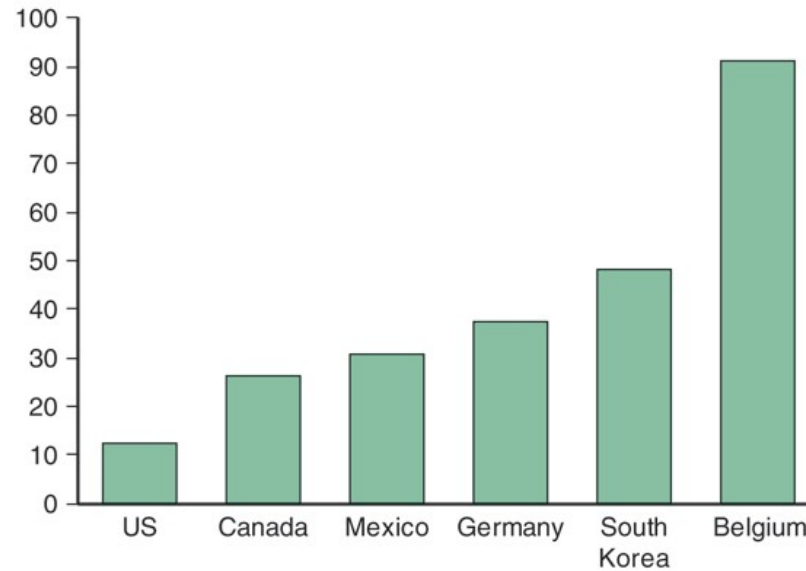
# Exports and Imports as a Percentage of U.S. National Income



Source: U.S. Bureau of Economic Analysis. 2013 research. [stlouised.org](http://stlouised.org)

# Average of Exports and Imports as Percentage of National Income in 2011

Exports, imports  
(percent of  
national income)



Source: Organization for Economic  
Cooperation and Development.

# Gains from Trade

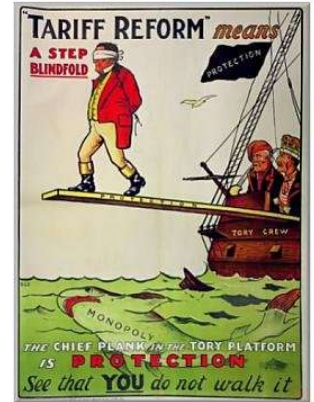


Countries selling goods and services to each other almost always generates mutual benefits.

1. When a buyer and a seller engage in a voluntary transaction, both can be made better off.
2. How could a country that is the most (least) efficient producer of everything gain from trade?
3. Trade benefits countries by allowing them to export goods made with relatively abundant resources and imports goods made with relatively scarce resources.
4. When countries specialize, they may be more efficient due to larger-scale production.
5. Countries may also gain by trading current resources for future resources (international borrowing and lending) and due to international migration.
6. Increase in the variety of products is also a gain from trade.

# Effects of Government Policies on Trade

- Policy makers affect the amount of trade through
  1. *tariffs*: a tax on imports or exports,
  2. *quotas*: a quantity restriction on imports or exports,
  3. *export subsidies*: a payment to producers that export,
  4. or through other regulations (ex., product specifications) that exclude foreign products from the market, but still allow domestic products.
- What are the costs and benefits of these policies?



# Types of Tariffs



- An import tariff is a tax levied when a good is imported.
  1. A **specific tariff** is levied as a fixed charge for each unit of imported goods.
  2. An **ad valorem tariff** is levied as a fraction of the value of imported goods.
- Cost and benefits of tariffs:
  1. A tariff raises the price of a good in the importing country, so it hurts consumers and benefits producers there.
  2. In addition, the government gains tariff revenue.
- How to measure these costs and benefits?

# Export Subsidy



- An export subsidy can also be *specific* or *ad valorem*:
  1. A specific subsidy is a payment per unit exported.
  2. An ad valorem subsidy is a payment as a proportion of the value exported.
- An export subsidy raises the price in the exporting country, decreasing its consumer surplus (consumers worse off) and increasing its producer surplus (producers better off).
- An export subsidy damages national welfare.

# Import Quota

- An import quota is a restriction on the quantity of a good that may be imported.
- This restriction is usually enforced by issuing licenses or quota rights.
- A binding import quota will push up the price of the import because the quantity demanded will exceed the quantity supplied by Home producers and from imports.
- When a quota instead of a tariff is used to restrict imports, the government receives no revenue.
  - Instead, the revenue from selling imports at high prices goes to quota license holders.
  - These extra revenues are called **quota rents**.





# Voluntary Export Restraint

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- A **voluntary export restraint** works like an import quota, except that the quota is imposed by the exporting country rather than the importing country.
- These restraints are usually requested by the importing country.
- The profits or rents from this policy are earned by foreign governments or foreign producers.
  - Foreigners sell a restricted quantity at an increased price.



# Effects of trade policies

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<b>Policy</b>	<b>Tariff</b>	<b>Export Subsidy</b>	<b>Import Quota</b>	<b>Voluntary Export Restraint</b>
Producer surplus	Increases	Increases	Increases	Increases
Consumer surplus	Falls	Falls	Falls	Falls
Government revenue	Increases	Falls (government spending rises)	No change (rents to license holders)	No change (rents to foreigners)
Overall national welfare	Ambiguous (falls for small country)	Falls	Ambiguous (falls for small country)	Falls

# Local Content Requirement

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- A **local content requirement** is a regulation that requires a specified fraction of a final good to be produced domestically.
- It may be specified in value terms, by requiring that some minimum share of the value of a good represent home value added, or in physical units.
- Local content requirement provides neither government revenue (as a tariff would) nor quota rents.
- Delays!

# Other Trade Policies

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- Export credit subsidies
  - A subsidized loan to exporters
  - U.S. Export-Import Bank subsidizes loans to U.S. exporters.
- Government procurement
  - Government agencies are obligated to purchase from home suppliers, even when they charge higher prices (or have inferior quality) compared to foreign suppliers.
- Bureaucratic regulations (red tape)
  - Safety, health, quality, or customs regulations can act as a form of protection and trade restriction.



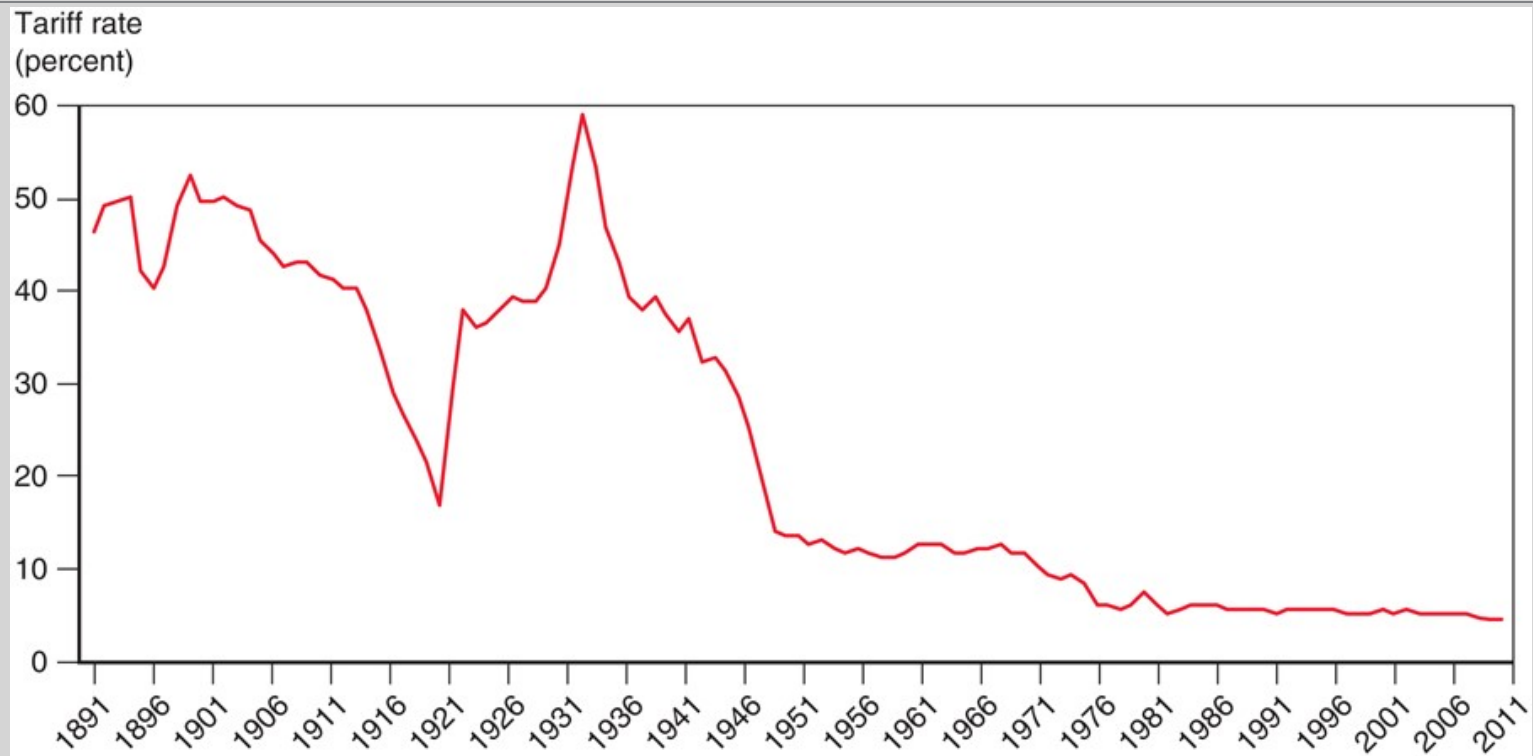
Through foreign policy, governments try to improve trade investment opportunities and contribute to the security and safety of their own firms abroad.

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## Strategic effect of trade policies



# The U.S. Tariff Rate





# International Trade Agreements: A Brief History



- 1930, the Smoot-Hawley Act → Tariff rates rose steeply and U.S. trade fell sharply.
- Initial attempts to reduce tariff rates were undertaken through bilateral trade negotiations
- In 1947, a group of 23 countries began trade negotiations under a provisional set of rules that became known as the General Agreement on Tariffs and Trade, or GATT.
- In 1995, the **World Trade Organization**, or **WTO**, was established as a formal organization for implementing multilateral trade negotiations (and policing them).

# World trade organization

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WTO negotiations address trade restrictions in at least 3 ways:

1. Reducing tariff rates
2. Binding tariff rates
3. Eliminating nontariff barriers





# Preferential Trading Agreements



# Preferential Trading Agreements

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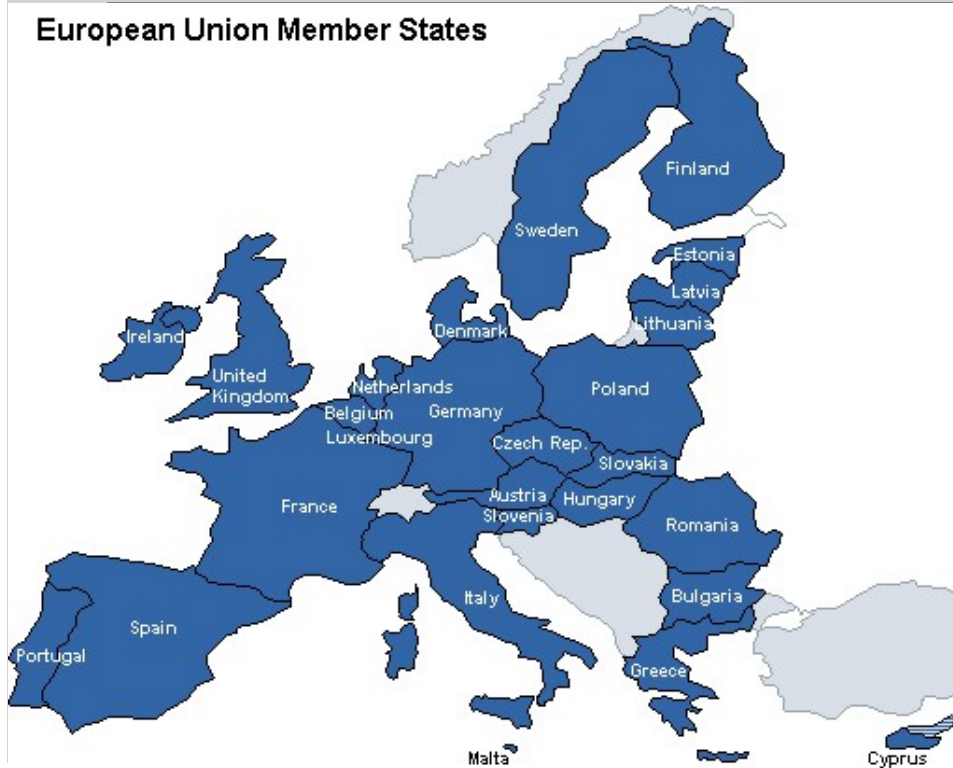
2 types of preferential trading agreements in which tariff rates are set at or near zero:

1. A **free trade area**: an agreement that allows free trade among members, but each member can have its own trade policy towards non-member countries.
2. A **customs union**: an agreement that allows free trade among members and requires a common external trade policy towards non-member countries.

# European Union



European Union Member States



- The European Economic Community was created in 1957 (noncommunist Western European Countries)
- 1989: reunification of Germany. The idea of a monetary union was accepted.
- 1991: Maastricht Treaty
- 1999: Single currency (Euro) was adopted and the European Central Bank (ECB) became its sole policymaking central bank.

## Important events

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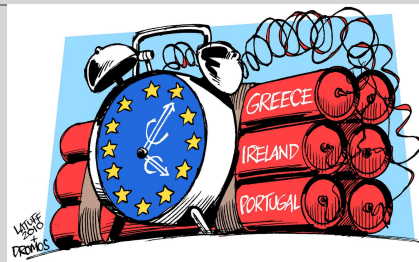
- 2000's bursting of the dot-com bubble
- 9/11 terrorist attacks
- War in Iraq and Afghanistan
- Financial crisis of 2007-2009
  - Led to Global Credit Crisis in 2008
  - Euro Crisis in 2009



# European Crisis



Greece  
Portugal  
Italy  
Spain  
Ireland  
United Kingdom  
France  
Germany  
Syria!!!



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# Brexit





## BREXITING (*verb*)

/brekziting/

1. Telling everyone at the party that you are leaving, but actually staying.

*Ex: Theresa is at the party, brexiting near the fridge for over an hour now*





# Some Economic Consequences of Brexit



## IS YOUR SUPPLY CHAIN **READY FOR BREXIT?**

### POTENTIAL BREXIT EFFECT ON SUPPLY CHAINS



#### **TARIFFS**

New tariffs may affect UK exports or imported raw materials and intermediate products



**NEGATIVE**



#### **FOREIGN EXCHANGE**

If the pound depreciates, import costs could rise but exports may become more attractive



**MIXED**



#### **UK LABOR MARKET**

Stricter immigration laws could make it more difficult and costly to hire workers



**NEGATIVE**



#### **SUPPLY CHAIN DELAYS**

New customs requirements could cause a bottleneck at UK ports



**NEGATIVE**



#### **TAXES**

Lawmakers in the UK could choose to lower corporate tax rates



**POSITIVE**

# A HARD BREXIT POSES MAJOR RISKS

Supply chain disruptions could reduce profits by 30% across key industries

Sector	Total UK sales	Profit pool	Moderate scenario	Hard Brexit
 Food (grocery)	£158B	£1B-£2B	-£6.1B (to be offset by price increases)	-£19.8B (to be offset by price increases)
 Automotive	£36B	£1B	-£50M (-5%)	-£2B (-300%)
 Technology	£25B	£2B	-£320M (-20%)	-£660M (-35%)
 Chemical	£30B	£2B	-£80M (-4%)	-£170M (-8%)
 Pharma	£39B	£4B	£70M (2%)	£130M (3%)
 Aerospace	£30B	£1B	£40M (4%)	£80M (8%)
<b>Total</b>	<b>£318B</b>	<b>£11B-£12B</b>	<b>-£0.3B (-3%)</b>	<b>-£3B (-30%)</b>

Negative

Impact of hard Brexit

Positive

Note: Profit pool is defined as profit after tax, based on margins of the top four or five players by industry  
Sources: ONS; S&P Capital IQ; World Trade Organization; company annual reports; literature search; Bain analysis

Source: Forbes.com

# A STRATEGY FOR BREXIT UNCERTAINTY



Define the uncertainties your company might face



Identify probable scenarios and their economic impact



Identify a clear set of signposts for action and track them



Devise a specific set of strategic options given these uncertainties

Source: Forbes.com

# U.S. and the trade war with ...



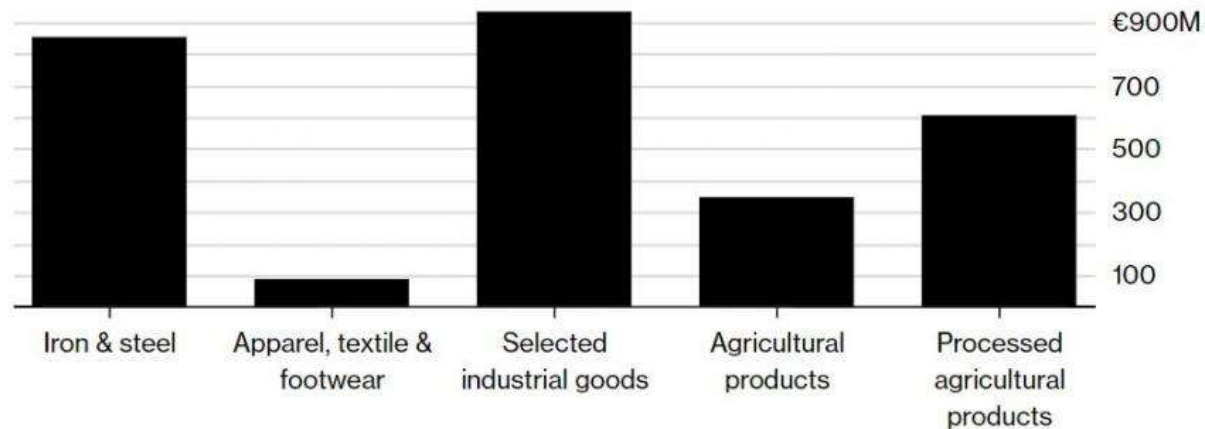


# U.S. and the trade war with ...

## The EU Strikes Back

Some 2.8 billion euros of U.S. goods are targeted in retaliatory tariff

■ EU imports from U.S. in 2017



Source: European Commission



# Trade wars create uncertainty

## How risk affects decision makers?

Volatility and uncertainty → Costly Disruptions

## How do antiglobalization movements affect the supply chain?

### 4 Guideposts:

Pay close attention to changes in economic institutions.

Beware of populist rhetoric

Closely monitor economic policy uncertainty

