Macroeconomics

Trade Reality

Roadmap

- Trade fallacies
- If trade is so great...
- Offshoring
- Trade restrictions

The fallacy game

- Think about how this works in Ricardo’s model
- Add anything you think is missing

Trade fallacies

Fallacy #1

- Trade costs us jobs
- Why a fallacy?
  - Trade is about what jobs, not how many
  - What they’re really saying: “I lost my job, and I’m mad”
  - In most countries, trade is a small factor in job creation and destruction [in US, replace “small” with “tiny”]

Fallacy #2

- Our tariffs are good for us – they protect our industry
- Why a fallacy?
  - Inefficient production
  - Higher prices for consumers
  - Note: still a fallacy if other countries have tariffs [they can make their own mistakes]
Fallacy #3

• We should subsidize local producers to help them compete
• Why a fallacy?
  – Costs us money
  – Encourages inefficient production

Fallacy #4

• High-wage countries can’t compete
• Why a fallacy?
  – Competitiveness depends on relation between wages and productivity
  – If wages reflect productivity, high wages are a sign of strength, not weakness

Fallacy #5

• Free trade creates trade deficits
• Why a fallacy?
  – My deficit is someone else’s surplus
  – Trade deficits are really about capital flows

If trade is so great…

… why are so many people against it?

• Lou Dobbs
  – The shipment of American jobs to cheap foreign labor markets threatens not only millions of workers and their families, but also the American way of life. Corporate America isn’t doing all this alone: Big business and Washington are in cahoots, trading our nation’s livelihood for short-term gain.
  – Do you agree? Disagree?

… why are so many people against it?

• AFL-CIO
  – America’s policies do little or nothing to safeguard the rights of workers and the environment here and around the world. They fuel a race to the bottom in living standards. That needs to change. We need policies that support good jobs at home and sustainable development abroad. We need to blatant abuses by countries that stack the decks against US workers.
  – Do you agree? Disagree?
... why are so many people against it?

- Pew Research Center via Marginal Revolution
  - Out of 44 countries surveyed, only one – Israel – tends to believe that increased trade will foster competition and deliver lower prices for consumers.
  - On whether trade with other countries is a good thing, 68% of Americans agree and 76% of people worldwide.
- What you’d expect? Why or why not?

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... why are so many people against it?

- Dave Barry
  - Q: You are a large US car maker. You have been losing sales to Japanese producers, whose cars tend to be extremely well made. You should:
    a) Have Congress restrict Japanese imports
    b) Have Congress give you money
    c) Have Congress allow you to kidnap consumers’ children unless they buy your cars.
    d) Remind everyone about Pearl Harbor.
  - A: These are all pretty good.

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... why are so many people against it?

- Political process
  - Democratic leaders often protect their supporters
  - Dictators often protect their friends
- Trade adds
  - Protect us from foreign competitors who don’t vote
- Gains outweigh losses, but
  - Losses clear and concentrated (5k people lose 100k jobs)
  - Gains fuzzy and dispersed (300m people gain $10 each)

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Offshoring

- Terminology
  - Outsourcing: buy something you previously produced yourself
  - Offshoring: usually means imports of services [eg, business process outsourcing]
- Technology makes this much easier than before
  - Internet connections, Skype, etc
  - Communication virtually free to anywhere
- Feels more threatening to many of us

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Krugman’s example

- You work for Deutsche Bank, make $100k/year
- They fire you, pay 20k to Indian producer, save 80k
- Who gains? Who loses?
Krugman’s example, cont’d

- You work for Deutsche Bank, make $100k/year
- You pay 20k to Indian producer, pocket 80k
- Who gains? Who loses?
- Someone did this (search: “outsource your own job”)

US trade in services

- Insourcing: exports of services
- Outsourcing: imports of services

US trade in services

- Insourcing of financial services
- Outsourcing of financial services

US trade in services

- Insourcing of film and television
- Outsourcing film and television

Managing markets

- There are times markets don’t work well
- But hard-earned experience makes us modest about chances of doing better
- See for yourself…
Ways to restrict trade

- Tariffs limited by treaty, so use
  - Subsidies to local producers
  - Health and safety regulations
  - Quotas
  - Antidumping suits

Subsidies to sugar producers

- US policy
  - Guaranteed prices for sugar (18-22 cents per lb.)
  - World price for sugar around 9 cents per lb.
  - Estimated cost: $2.15b over 10 years

  - Who gains?
    - 5,980 sugar and sugar beet farms in 2002 census (600k per)

  - Who loses?
    - Consumers: they pay $1.9b over world price
    - Taxpayers: they pay for price supports

  - Who’s the pirate?

Subsidies to sugar producers, cont’d

- Why does this work?
- Accidental byproducts
  - High-fructose corn syrup
  - Ethanol

Subsidies to cotton producers

- US policy
  - Agreed to $1.6b cap in 1995
  - Current subsidy: >$2b
  - Brazil argued they violate trade rules
  - WTO agreed in 2004
  - Resolution: we subsidize Brazilian producers, too

  - Who gains? Who loses? Who’s the pirate?
  - Planet Money podcast (search: “cotton wars”)

Norway

- Smuggling milk and butter into Norway

Agricultural subsidies

Source: OECD numbers, reported in The Economist.
Health and safety

- EU bans hormone-treated meat
- US bans unpasteurized cheese
  - Cheese must be made with pasteurized milk or aged for 60 days
- Many countries ban genetically-modified rice
  - Only approved for consumption in US, Canada
- China bans US GMO corn (they were mad at us)

Health and safety

- UPS enters Mexico in 1992 for post-NAFTA boom
- Mexicans protect locals (big trucks “unsafe” – for UPS)
- NAFTA arbitration panel sides with UPS – 3+ times
- UPS asks Clinton for help
- Clinton drags feet when Teamsters protest Mexican truckers entering US (“unsafe”!)
- Mexico drags its feet in return
- 20 years later little has changed

Quotas

- Limit quantity of a good that can be imported
- Voluntary export restraints: quotas imposed by the exporting country (“voluntarily”!)

Voluntary export restraints

- In 1980s, US “persuaded” Japan to limit car exports
- Similar to a tariff, but
  - “Voluntary”
  - US collected no revenue (where did it go?)
- Limits on numbers benefited Japanese producers
  - Eliminated competition among them, prices rose
  - Instigated increase in quality
- What were we thinking?

Dumping

- Dumping
  - When foreign firms use “predatory” pricing
  - Predatory means price below domestic price or estimated cost
  - Domestic firms may file for protection
  - Must show foreign firms pricing “unfairly” and “injury to domestic firms”
    - Unfair = price below domestic market or production cost
    - If so, compensating tariff imposed
- Who wins? Who loses? Who’s the pirate?
- How can we tell dumping from competition?
- What does “unfair” mean?

Chinese furniture dumping

- Stickley builds huge plant in Vietnam
- Files dumping suit against Chinese producers
- US producers divided
  - Retailers against suit, producers in favor
  - Production leaves US anyway
- Chinese firms hire US lawyers, settle
- China passes dumping law, files suits against Americans
- Who gains? Who loses? Who’s the pirate?
Solar panels

• Ongoing saga, similar to furniture

Save US wire hangers!!

• One remaining US-based hanger producer...
• … files petition against Chinese producers
• US's International Trade Commission investigates
• Finds: hangers sold below "fair market value"
• Duties assessed range from 33% to 165%
• Hanger prices double in US market
• Who wins? Who loses? Who’s the pirate?

Save hangers, cont’d

• Who wins?
  – Domestic hanger producers
  – Wisconsin hanger plant reopens
• Who loses?
  – Dry cleaners
  – People who use dry cleaners
• Unintended consequence
  – Hanger recycling

World Trade Organization

• 1947 General Agreement on Trade and Tariffs
  – 23 original signers
  – Major cornerstone: nondiscrimination
• 1995 GATT becomes the World Trade Organization
  – Enforcement mechanism: none
  – Exemptions: health and safety arguments
• Current issues
  – Tariffs on non-agriculture very low
  – General Agreement on Trade in Services (in the works)
  – Trade Related Aspects of Intellectual Property Rights (in the works)

WTO principles

• Tariff “binding”
  – A negotiated tariff is bound: it cannot be increased in the future
  – Nondiscrimination
• Member grant each other most favored nation status … now called normal trade relations (NTR)
  – Tariff rates the same for all
  – Exception: regional trade agreements (eg, NAFTA)
  – Exception: “escape clauses” (China and tires)

What have we learned?

• Strong arguments for trade
  – And open competitive markets in general
• But political opposition is a fact of life
• Many ways to protect friends and locals
  – Tariffs, quotas, dumping, health and safety, …
• International business remains a challenge
For next week

• How is the US economy doing?
• What does that mean for your business?