chapter 7

Government Intervention in International Business

Learning Objectives

In this chapter, you will learn about:

1. Government intervention in international business
2. Rationale for government intervention
3. Instruments of government intervention
4. Government intervention, economic freedom, and ethical concerns
5. Evolution of government intervention
6. How firms should respond to government intervention

India's Path Away from Government Intervention and Bureaucracy

India is a study in contrasts. On the one hand, it is the world's leading emerging economy in IT and e-business. On the other hand, it is awash in trade barriers and business regulations. Not only does the Indian federal government impose countless regulations, standards, and administrative hurdles on businesses, each of India's 28 states imposes its own local bureaucracy and red tape. Import taxes and controls on foreign investment are substantial, with import tariffs averaging 12 percent on nonagricultural products, as compared to less than roughly 4 percent in Europe, Japan, and the United States. Hundreds of commodities, from cement to household appliances, can be imported only after receiving government approval. Licensing fees, testing procedures, and other hurdles can cost an importer thousands of dollars.

In the past, foreign firms have filed thousands of investment proposals worth hundreds of billions of dollars with the Indian government. However, bureaucratic hurdles prevented all but a fraction of these proposals from being approved. Foreign firms encountered hurdles at every turn in areas such as getting power and water connections, land use and environmental approvals, and paperwork required to demonstrate regulatory compliance. To compound matters, most regions in India

suffer from poor infrastructure—inadequate roads, bridges, airports, and telecommunications.

In 1991, to correct this situation, India began to liberalize its trading regulations and the structure of its economy. The government abolished import licenses and reduced tariffs substantially. The government also implemented numerous reforms to free the economy from state control, selling off state enterprises to the private sector and foreign investors.

Loosening bureaucracy and falling trade barriers may be paying off. The economy of the world's second-most-populous nation is expanding rapidly, averaging more than seven percent annual economic growth in the decade through 2006. Nevertheless, such transformations have not occurred without problems. In 2001, strikers opposing the Indian government's sale of an aluminum company threatened to go on a hunger strike.

India's economic revolution is helping to unleash the country's entrepreneurial potential. The Indian government is establishing Special Economic Zones (SEZs), virtual foreign territories that offer foreign firms the benefits of India's low-cost,

high-skilled labor. In a typical SEZ, firms are exempt from trade barriers, sales and income taxes, licensing requirements, FDI restrictions, and customs clearance procedures. The Mahindra City SEZ, an 840-acre development, is focusing on a $277 million software development complex constructed by Infosys Technologies, India's leading IT firm.

Meanwhile, in Europe and the United States, the outsourcing of jobs to India has generated calls for protectionism—that is, trade barriers and defensive measures intended to minimize the export of jobs abroad. U.S. and European trade unions have created numerous Web sites that denounce outsourcing and offshoring. Trade barriers and government bureaucracy in India, as well as calls for protectionism in Europe and the United States, exemplify the complex world of government intervention.

Sources: Asiamoney. (2005). "India Plays Catch Up." (April): 1; Central Intelligence Agency. (2006). *World Factbook*, at *www.cia.gov/cia/publications/factbook*; *Economist* (2004). "Survey: A World of Opportunity." (November 13): 15; Evans, Bob. (2004). "Silos Of Protectionism: Raise Or Raze Them?" *InformationWeek* (March 15): 94. Irwin, Douglas. (2004). "Free-Trade Worriers" *Wall Street Journal* (August 9): A12; Solomon, Jay, and Joanna Slater. (2004). "India's Economy Gets a New Jolt from Mr. Shourie." *Wall Street Journal* (January 9): A1; United States Trade Representative. (2005). National Trade Estimate Report on Foreign Trade Barriers, at *www.ustr.gov*.

As we learned in Chapter 4, economists have long used trade theories to make the case for *free trade*, the unrestricted flow of products, services, and physical and intellectual capital across national borders. Classical trade theorists argue that countries should trade with each other in order to make optimal use of national resources and to increase living standards. FDI-based explanations reveal how firms obtain advantages by locating factories and subsidiaries in attractive locations abroad. In short, contemporary economic theory argues that international trade and investment are good for the world.

There is much empirical evidence in support of free trade. One study of over 100 countries in the 50-year period after 1945 found a strong association between market openness—that is, unimpeded free trade—and economic growth. Countries with an open economy enjoyed average annual per capita GDP growth of 4.49 percent, while relatively closed countries—those with largely unfree trade—grew at only 0.69 percent per year.[1] Other studies have confirmed that market liberalization and free trade are best for supporting economic growth and national living standards.[2]

In reality, however, there is no such thing as unimpeded free trade. Well before economists recognized the value of free trade, governments began intervening in business and the international marketplace in ways that obstruct the free flow of trade and investment. Intervention can take many forms. The government may impose tariffs and quotas, restrictions on international investment, bureaucratic procedures and red tape, and regulations that restrict types of business and value-chain activities. In addition, governments can provide subsidies and financial incentives intended to sustain domestic firms and industries.

Government Intervention in International Business

Governments intervene in trade and investment to achieve political, social, or economic objectives. Barriers are often created to benefit specific interest groups, such as domestic firms, industries, and labor unions. A key rationale is to create jobs by protecting industries from foreign competition. Governments may also intervene to support home-grown industries or firms. In various ways, government intervention alters the competitive position of companies and industries and the status of citizens. As highlighted in Exhibit 7.1, government intervention is an

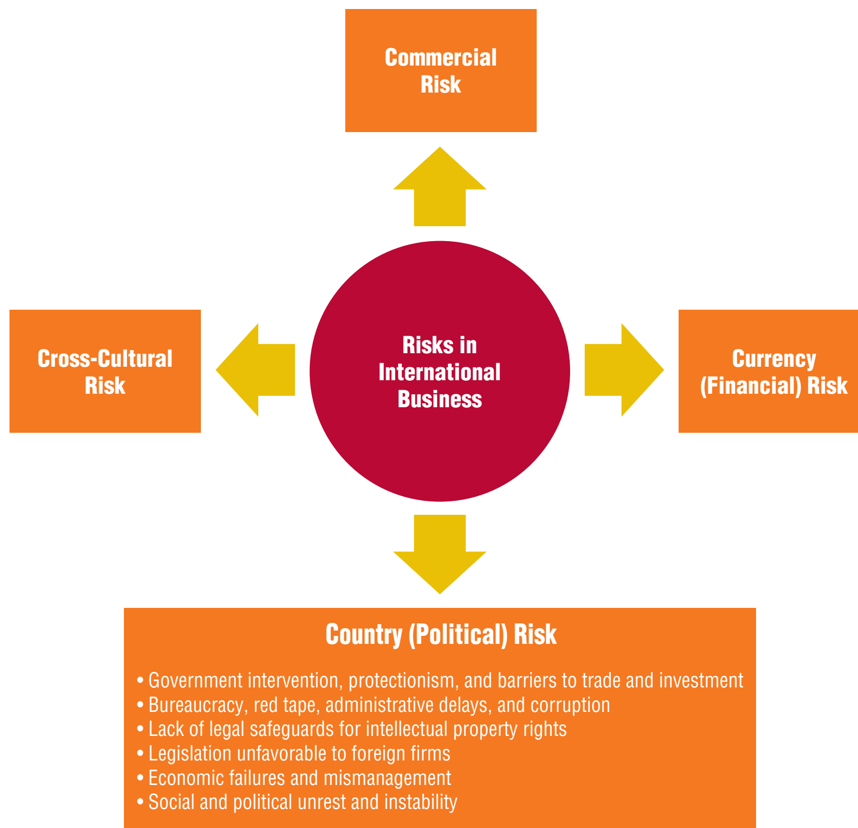


Exhibit 7.1

Government Intervention as a Component of Country Risk

important dimension of *country risk*, which we introduced in Chapter 1 and revisited in Chapter 6.

Government intervention often results from protectionism. **Protectionism** refers to national economic policies designed to restrict free trade and protect domestic industries from foreign competition. Governments may restrain foreign investment in order to protect domestic business interests. Protectionism often leads to such specific types of intervention as tariffs, nontariff barriers such as quotas, and arbitrary administrative rules designed to discourage imports. A **tariff** (also known as a *duty*) is a tax imposed by a government on imported products, effectively increasing the cost of acquisition for the customer. A **nontariff trade barrier** is a government policy, regulation, or procedure that impedes trade through means other than explicit tariffs. Trade barriers are enforced as products pass through **customs**, the checkpoints at the ports of entry in each country where government officials inspect imported products and levy tariffs. An often-used form of nontariff trade barrier is a **quota**—a quantitative restriction placed on imports of a specific product over a specified period of time. Government intervention may also target FDI flows through *investment barriers* that restrict the operations of foreign firms.

Government intervention affects the normal operation of economic activity in a nation by hindering or helping the ability of its firms to compete internationally. Often, companies, labor unions, and other special interest groups convince governments to adopt policies that benefit them. For example, in the early 2000s, the Bush administration imposed tariffs on the import of foreign steel into the United States. This was done because competition from foreign steel manufacturers had bankrupted numerous U.S. steel firms, and the U.S. steel industry was ailing. The rationale was to give the U.S. steel industry time to restructure and revive itself. This action may have saved hundreds of jobs. On the downside, however, the barriers also increased the production cost of firms that use steel, such as Ford,

Protectionism National economic policies designed to restrict free trade and protect domestic industries from foreign competition.

Tariff A tax imposed on imported products, effectively increasing the cost of acquisition for the customer.

Nontariff trade barrier A government policy, regulation, or procedure that impedes trade through means other than explicit tariffs.

Customs Checkpoints at the ports of entry in each country where government officials inspect imported products and levy tariffs.

Quota A quantitative restriction placed on imports of a specific product over a specified period of time.

Whirlpool, and General Electric. Higher material cost made these firms less competitive and reduced prospects for selling their products in world markets.[3] The steel tariffs were removed within two years, but in the process of attempting to do good, the government also did harm.

Another example of intervention can be illustrated by the U.S. government's response to the growing threat of Japanese car imports in the 1980s, when it established "voluntary export restraints" on the number of Japanese vehicles that could be imported into the United States. This move helped insulate the U.S. auto industry for several years. In the protected environment, however, the Detroit automakers had less of an incentive to improve quality, design, and overall product appeal. Much like the athlete who performs best when faced with formidable opponents, companies also fight harder to succeed when confronted with stiff competition. Thus, government intervention motivated by protectionism has been one of several factors that, over time, weakened Detroit's ability to compete in the global auto industry.

Protectionist policies may also lead to price inflation. This results because, all else being equal, when tariffs restrict the supply of a particular product, the domestic price of the product has a tendency to rise. Tariffs may also reduce the choices available to buyers, by restricting the *variety* of imported products available for sale.

These examples illustrate that government intervention often leads to adverse *unintended consequences*—unfavorable outcomes of policies or laws. In a complex world, legislators and policymakers lack the ability to foresee all possible outcomes of an action, or the extent to which outcomes will occur. The problem of unintended consequences suggests that government intervention should be planned and implemented with great care.

Rationale for Government Intervention

Why does a government intervene in trade and investment activities? In the broadest terms, there are four main motives for government intervention. First, tariffs and other forms of intervention can generate a substantial amount of revenue. For example, Ghana and Sierra Leone generate more than 25 percent of total government revenue from tariffs. Second, intervention can ensure the safety, security, and welfare of citizens. For example, governments may pass laws to ensure a safe food supply and to prevent sale of products that threaten public safety. Third, intervention can help a government pursue broad-based economic, political, or social objectives. For example, a government may enact policies that aim to increase national employment or promote economic growth. Fourth, intervention can help better serve the interests of the nation's firms and industries. For example, a government may devise regulations to stimulate development of home-grown industries.

Special interest groups often serve as strong advocates for trade and investment barriers that protect their self-interests. Consider the recent trade dispute between Mexico and the United States over Mexican cement. The U.S. government imposed duties of roughly $50 per ton on the import of Mexican cement after U.S. cement makers lobbied the U.S. Congress. The stakes are huge, as Mexican imports can reach 10 percent of U.S. domestic cement consumption. The United States is one of the world's largest cement consumers and, ironically, often suffers from shortages, which are exacerbated by import restrictions. Mexico has proposed substituting import quotas in place of the high cement import tariffs. The Mexican and U.S. governments negotiated for years to resolve the dispute.[4]

Rationale for trade and investment barriers can be considered in two major categories: defensive and offensive. Governments impose *defensive* barriers to safeguard industries, workers, and special interest groups, and to promote national security. Governments impose *offensive* barriers to pursue a strategic or public policy objective, such as increasing employment or generating tax revenues.

Defensive Rationale

Four major defensive motives are particularly relevant: protection of the nation's economy, protection of an infant industry, national security, and national culture and identity. Let's address each of these motives in turn.

Protection of the national economy Proponents argue that firms in advanced economies cannot compete with those in developing countries that employ low-cost labor. In the opening vignette, labor activists have called for government intervention to prevent the outsourcing of jobs from Europe and the United States to India. Activists also call for trade barriers to curtail import of cheap products, fearing that advanced-economy manufacturers will be undersold, wages will fall, and home-country jobs will be lost. Therefore, the argument goes, governments should impose trade barriers to block imports. In response, critics counter that protectionism is at odds with the theory of comparative advantage, according to which nations should engage in *more* international trade, not less. Trade barriers interfere with country-specific specialization of labor. When countries specialize in the products that they can produce best and then trade for the rest, they perform better in the long run, delivering superior living standards to their citizens. Critics also charge that blocking imports reduces the availability and increases the cost of products sold in the home market. Industries cannot access all the input products they need. Finally, protection can trigger retaliation, whereby foreign governments impose their own trade barriers, reducing sales prospects for exporters.

Protection of an infant industry In an emerging industry, companies are often inexperienced and lack the latest technologies and know-how. They may also lack the scale typical of larger competitors in established industries abroad. Therefore, an infant industry may need temporary protection from foreign competitors. Accordingly, governments can impose temporary trade barriers on foreign imports, ensuring young firms gain a large share of the domestic market until they are strong enough to compete on their own. Protecting infant industries has allowed some countries to develop a modern industrial sector. For example, government intervention allowed Japan to become extremely competitive in automobiles early in the development of this industry. Similarly, it allowed South Korea to achieve great success in consumer electronics.

However, once in place, such protection may be hard to remove. Industry owners and workers tend to lobby to preserve government incentives indefinitely. Infant industries in many countries (especially in Latin America, South Asia, and Eastern Europe) have shown a tendency to remain dependent on government protection for prolonged periods. The industry may remain inefficient even after years of government support. Meanwhile, the nation's citizens end up paying higher taxes and higher prices for the products produced by the protected industry.[5]

National security Countries impose trade restrictions on products viewed as critical to national defense and security, such as military technology and computers. Trade barriers can help maintain domestic productive capacity in security-related products, such as computers, weaponry, and certain transportation equipment. For example, in 2005, Russia blocked a bid by German engineering giant Siemens to purchase the Russian turbine manufacturer OAO Power Machines, on grounds of national security. The Russian government has strict legislation that limits foreign investment in sectors considered vital to Russia's national interests.[6] In addition, countries impose **export controls**—government measures intended to manage or prevent the export of certain products or trade with certain countries. For instance, many countries do not allow the export of plutonium to North Korea because it can be used to make nuclear weapons.

Export control A government measure intended to manage or prevent the export of certain products or trade with certain countries.

National culture and identity Governments seek to protect certain occupations, industries, and public assets that are considered central to national

culture and identity. Consequently, government can prohibit or curtail imports of certain types of products or services. For example, Switzerland has imposed trade barriers to preserve its long-established tradition in watch-making. The Japanese restrict the import of rice because this product is central to the nation's diet and food culture. In the United States, authorities opposed Japanese investors' purchase of the Pebble Beach golf course in California, New York's Rockefeller Center, and the Seattle Mariners baseball team, because these assets are believed to be part of the national heritage. France does not allow significant foreign ownership of its TV stations because of concerns that foreign influences will taint French culture.

Offensive Rationale

Offensive rationale for government intervention fall into two categories: national strategic priorities and increasing employment.

National strategic priorities Government intervention sometimes aims to encourage the development of industries that bolster the nation's economy. It is a *proactive* variation of the infant industry rationale, and related to national industrial policy, highlighted in Chapter 4. Countries with many high-tech or high-value-adding industries—such as information technology, pharmaceuticals, car manufacturing, or financial services—create better jobs and higher tax revenues than economies based on low-value-adding industries—such as agriculture, textile manufacturing, or discount retailing. Accordingly, some governments—for example, Germany, Japan, Norway, and South Korea—devise policies that promote the development of relatively desirable industries. The government may provide financing for investment in high-tech or high-value-adding industries, encourage citizens to save money to ensure a steady supply of loanable funds for industrial investment, and fund public education to provide citizens the skills and flexibility that they need to perform in key industries.[7]

Nevertheless, such intervention is not without its challenges. It requires skillful, large-scale industrial planning and favoritism toward industries deemed critical. Deciding which industries to support is challenging because it is difficult to predict which industries will produce comparative advantages. If poor choices are made, the government may find itself continuously subsidizing industries that never reach a critical threshold of profitability and national advantage.

This U.S. Customs Inspector uses a Vehicle Access Container Initiative System, right, a nonintrusive inspection tool, to examine a container at the Port of Los Angeles.

Increasing employment Governments often impose import barriers to protect employment in designated industries. By insulating domestic firms from foreign competition, national output is stimulated, leading to more jobs in the protected industries. The effect is usually strongest in import-intensive industries that employ much labor to produce products that are normally imported. For example, the Chinese government has traditionally required foreign companies to enter its huge markets through joint ventures with local Chinese firms. The policy creates jobs for Chinese workers. A joint venture between Shanghai Automotive Industry Corporation (SAIC) and Volkswagen created jobs in China. The SAIC later partnered with General Motors and is now producing top-selling cars in China.

Instruments of Government Intervention

The main instruments of trade intervention and the classic forms of protectionism are tariffs and nontariff trade barriers. Individual countries or groups of countries, such as the European Union, can impose these barriers. In aggregate, barriers constitute a serious impediment to cross-border business. The United Nations estimates that trade barriers alone cost developing countries over $100 billion in lost trading opportunities with developed countries every year.[8] Exhibit 7.2 highlights the most common forms of government intervention and their effects.

Intervention Type	*Definition*	*Practical Effect on Customers, Firms, or Government*	*Contemporary Examples*
Tariff	Tax imposed on imported products	Increases cost to the importer, exporter, and usually the buyer of the product. Discourages imports of products. Generates government revenue.	Switzerland charges a tariff of 34% on agricultural product imports. Cote d'lvoire charges a tariff on most finished products.
Quota	Quantitative restriction on imports of a product during a specified period of time	Benefits early importers, giving them monopoly power and the ability to charge higher prices. Harms late importers, who may be unable to obtain desired products. Usually results in higher prices to the buyer.	The United States imposes a quota of 120 million pairs on socks imported from China.
Local content requirements	Requirement that a manufacturer include a minimum percentage of added value that is derived from local sources	Discourages imports of raw materials, parts, components, and supplies, thereby reducing sourcing options available to manufacturers. May result in higher costs and lower product quality for importers and buyers.	The Nigerian government requires that products and services used by foreign firms in the oil industry in Nigeria must contain 50% Nigerian content.
Regulations and technical standards	Safety, health, or technical regulations; labeling requirements	May delay or block the entry of imported products, and reduce the quantity of available products, resulting in higher costs to importers and buyers.	Regulations in Honduras block imports of raw poultry from various countries. The Philippines restricts imports of certain chemicals, penicillin, and tires.
Administrative and bureaucratic procedures	Complex procedures or requirements imposed on importers or foreign investors that hinder their trade or investment activities	Slows the import of products or services. Hinders or delays firms' investment activities.	Bureaucratic delays in Costa Rica hinder or prevent the import of rice, onions, potatoes, and other agricultural products.

Exhibit 7.2 Types and Effects of Government Intervention (continues on next page)

SOURCE: Adapted from the Office of the United States Trade Representative, accessed at www.ustr.gov

Intervention Type	*Definition*	*Practical Effect on Customers, Firms, or Government*	*Contemporary Examples*
FDI and ownership restrictions	Rules that limit the ability of foreign firms to invest in certain industries or acquire local firms	Reduces the amount of money that a foreigner can invest in a country, and/or the proportion of ownership that a foreigner can hold in an existing or new firm in the country. May require a foreign firm to invest in the country in order to do business there.	Switzerland requires that foreign insurance firms seeking to establish a subsidiary or branch office there do so via FDI.
Subsidy	Financing or other resources that a government grants to a firm or group of firms, intended to ensure their survival or success	Increases the competitive advantage of the grantee while diminishing the competitive advantages of those that do not receive the subsidy.	Turkey grants an export subsidy of up to 20% for local producers of wheat and sugar.
Countervailing duty	Increased duties imposed on products imported into a country to offset subsidies given to producers or exporters in the exporting country	Reduces or eliminates the competitive advantage provided by subsidies.	Mexico imposes countervailing duties to offset competitive advantages enjoyed by foreign firms that receive subsidies from their governments.
Antidumping duty	Tax charged on an imported product that is priced below normal market prices or below cost	Reduces or eliminates the competitive advantage of imported products priced at abnormally low levels.	The United States has imposed antidumping duties on the import of low-cost steel in order to support U.S. based steel manufacturers.

Exhibit 7.2 Continued

Tariffs

Some countries impose *export tariffs,* taxes on products exported by their own companies. For instance, Russia charges a duty on oil exports, intended to generate government revenue and maintain higher stocks of oil within Russia. However, the most common type of tariff is the *import tariff,* a tax levied on imported products. The amount of a tariff is determined by examining a product's *harmonized code*. Products are classified under approximately 8,000 different codes in the *harmonized tariff* or *harmonized code* schedule, a standardized system used worldwide. The system is necessary because without it, firms and governments might have differing opinions on product definitions and the tariffs charged on imported products. Each is identified by a unique number that can be looked up from public sources such as the Internet.

Tariffs are usually *ad valorem*—that is, assessed as a percentage of the value of the imported product. Alternatively, the government may impose a *specific tariff*—a flat fee or fixed amount per unit of the imported product—based on weight, volume, or surface area (such as barrels of oil or square meters of fabric). A *revenue tariff* is intended to raise money for the government. A tariff on cigarette imports,

Exhibit 7.3

A Sampling of Import Tariffs

SOURCES: World Trade Organization statistics database accessed at stat.who.org; United States Trade Representative reports, accessed at www.ustr.org

	Average Import Tariff	
Country/Region	*Agricultural Products*	*Nonagricultural Products*
Australia	1.2	4.6
Canada	3.0	4.0
China	15.8	9.1
European Union	5.8	3.9
India	37.4	15.0
Japan	6.9	2.3
Mexico	24.5	17.1
United States	6.9	3.2

Note: Tariff rate expressed as percentage of the product's value (ad valorem).

for example, produces a steady flow of revenue. A *protective tariff* aims to protect domestic industries from foreign competition. A *prohibitive tariff* is one so high that no one can import any of the items.

Import tariffs can generate substantial revenue for national governments. This helps explain why tariffs tend to be fairly common in the developing economies. Even in advanced economies, tariffs provide a significant source of revenue for the government. The United States charges tariffs on many consumer, agricultural, and labor-intensive products. Interestingly, the United States often collects more tariff revenue on shoes than on cars ($1.63 billion versus $1.60 billion in 2001). The European Union applies tariffs of up to 236 percent on meat, 180 percent on cereals, and 17 percent on tennis shoes.[9]

Exhibit 7.3 provides a sample of import tariffs in selected countries. Under the terms of the North American Free Trade Agreement (NAFTA), Mexico gradually eliminated nearly all tariffs on product imports from the United States. However, Mexico maintains higher tariffs with the rest of the world, with rates of 24.5 percent for agricultural products and 17.1 percent for nonagricultural products. India's tariffs are relatively high, especially in the agricultural sector, where the rate is 37.4 percent. India's tariff system lacks transparency, and officially published tariff information is sometimes hard to find. China has reduced its tariffs significantly since joining the World Trade Organization (WTO) in 2001, but trade barriers remain high in many areas. China and India are characterized by low per capita income and high import tariffs. Ironically, as predicted by trade theory, high import tariffs tend to exacerbate national poverty.

Just as people want to avoid paying taxes, firms try to avoid paying tariffs. Because tariffs have their greatest affect on imports, firms may enter countries via nonexporting entry modes, such as FDI. In the long run, governments collect less revenue from firms if tariffs are too high. High tariffs have been known to trigger smuggling. For instance, high duties on cigarettes in Canada have led to smugglers transporting contraband tobacco across the Great Lakes of the northern United States into the Canadian frontier.

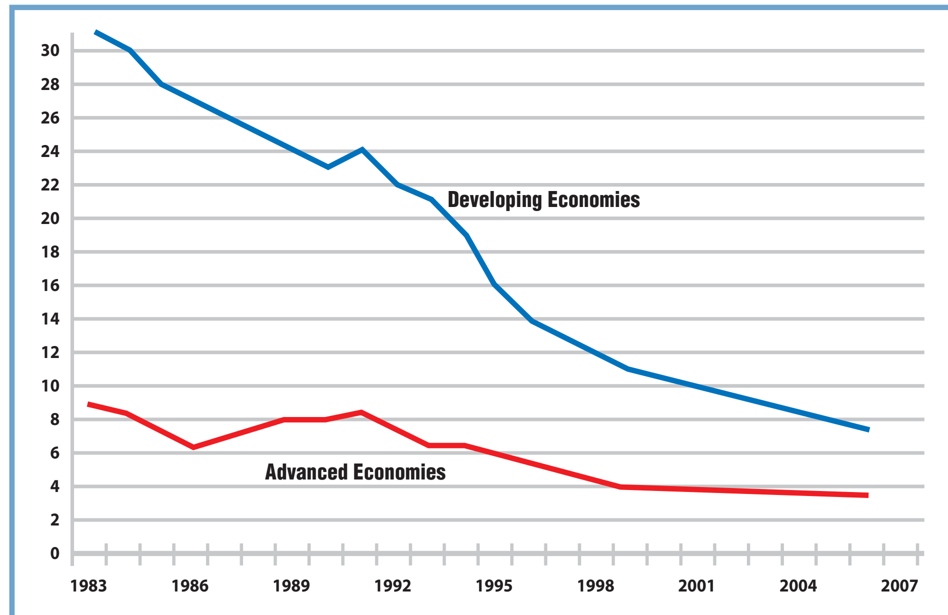
Because high tariffs inhibit free trade and economic growth, governments have tended to reduce tariffs over time. In fact, this was the primary goal of the General Agreement on Tariffs and Trade (GATT; now the WTO). Countries as diverse as Chile, Hungary, Turkey, and South Korea have liberalized their previously protected markets, lowering trade barriers and subjecting themselves to greater competition from abroad. Exhibit 7.4 illustrates trends in average world tariff rates over time. Notice that developing economies have been lowering their tariff rates since the 1980s. Continued reductions in tariffs represent a major driver of market globalization.

Exhibit 7.4

Trends over Time in Average Tariff Rates (Percentages)

Note: Rates shown are unweighted.

SOURCES: International Monetary Fund. "World Economic Outlook: Globalization and External Imbalances," April 2005 accessed at www.inf.org: United Nations Conference on Trade and Development. *UNCTAD Handbook of Statistics 2005.*



Nontariff Trade Barriers

Nontariff trade barriers are government policies or measures that restrict trade without imposing a direct tax or duty. These barriers include quotas, import licenses, local content requirements, government regulations, and administrative or bureaucratic procedures. Compared to tariffs, the use of nontariff barriers has grown substantially in recent decades. Governments sometimes prefer nontariff barriers because they are easier to conceal from the WTO and other organizations that monitor international trade. Let's now review the most common nontariff trade barriers.

Quotas restrict the physical volume or value of products that firms can import into a country. In a classic type of quota, the U.S. government imposes an upper limit of roughly two million pounds on the total amount of sugar that can be imported into the United States each year. Sugar imports that exceed this level face a tariff of several cents per pound. The upside is that U.S. sugar producers are protected from cheaper imports, giving them a competitive edge over foreign sugar producers. The downside is that U.S. consumers and producers of certain types of products—such as Hershey's and Coca-Cola—pay more for sugar. It also means that companies that manufacture products containing sugar can save money by moving production to countries that do not impose quotas or tariffs on sugar.

Governments can impose voluntary quotas, under which firms agree to limit exports of certain products. These are also known as *voluntary export restraints,* or *VERs*. For example, in 2005, import quotas in the European Union led to an impasse in which millions of Chinese-made garments piled up at ports and borders in Europe. The EU impounded the clothing because China had exceeded the voluntary import quotas it had negotiated with the EU. The action created hardship for European retailers, who had ordered their clothing stocks several months in advance. The voluntary quotas in both Europe and the United States were expected to expire in 2008.[10]

Import license Government authorization granted to a firm for importation of a product.

Governments occasionally require importing firms to obtain an **import license**, a formal permission to import, which restricts imports in a way that is similar to quotas. Do not confuse import licenses with the licensing strategy for entering foreign markets, in which a firm allows a foreign firms to use its intellec-

tual property in return for a fee. Governments sell import licenses to companies on a competitive basis or grant the licenses on a first-come, first-served basis. This process tends to discriminate against smaller firms, which typically lack the resources to purchase the licenses. Obtaining a license can be costly and very complicated. In some countries, importers must pay hefty fees to government authorities. In other countries, importers must deal with bureaucratic red tape. For instance, in Russia a complex web of licensing requirements limits imports of alcoholic beverages.

Local content requirements require manufacturers to include a minimum of local value added—that is, production that takes place locally. Local content requirements are usually imposed in countries that are members of an economic bloc, such as the European Union and NAFTA. The so called "rules of origin" requirement specifies that a certain proportion of products and supplies, or of intermediate goods used in local manufacturing, must be produced within the bloc. For a car manufacturer, the tires or windshields it purchases from another firm are intermediate goods. When the firm does not meet this requirement, the products become subject to trade barriers that member governments normally impose on nonmember countries. Thus, producers within the NAFTA zone of Canada, Mexico, and the United States pay no tariffs, as compared to countries such as China or the United Kingdom, which are not part of NAFTA. Roughly two-thirds of the value of a car manufactured within NAFTA must originate within the NAFTA member countries. If this condition is not met, the product becomes subject to the tariffs charged to non-NAFTA countries.

Government regulations and technical standards are another type of nontariff trade barrier. Examples include safety regulations for motor vehicles and electrical equipment, health regulations for hygienic food preparation, labeling requirements that indicate a product's country of origin, technical standards for computers, and bureaucratic procedures for customs clearance, including excessive red tape and slow approval processes.

In most cases, regulations and standards are legitimate efforts to protect citizens. However, occasionally governments seek to protect domestic firms by imposing red tape that creates hardships for foreign firms. For example, the European Union strictly regulates food that has been genetically modified (GM), a policy that has led to trade disagreements with the United States, whose GM food regulations are relatively lax. The United States claims that Europe's regulations violate WTO rules. GM foods such as soybeans, maize, and canola oil have been modified to make them more resistant to disease and insect pests, or to increase growth yields. Europe's strict GM food regulations are based on consumer apprehension about food safety and public distrust of government oversight of the food industry. In China, the government requires foreign firms to obtain special permits to import GM foods. China, Japan, and Taiwan require that imported agricultural products undergo strict testing, a process that may require considerable time and expense.

Some years ago, Japan prohibited the import of snow skis on the improbable grounds that Japanese snow is different from snow in other countries. Although Canada is officially bilingual (English and French), the provincial government of Quebec requires that all product labeling be in the French language. The law can be a substantial barrier to smaller firms that lack the resources to translate their labeling. Even the requirement that products clearly indicate their country of origin (for example, "Made in Costa Rica ") may constitute a barrier because people often prefer to buy domestically made products.

Governments may impose *administrative or bureaucratic procedures* that hinder the activities of importers or foreign firms. For instance, the opening vignette revealed how India's business sector is burdened by countless regulations, standards, and administrative hurdles at the state and federal levels. In Mexico, the

government-imposed bureaucratic procedures led United Parcel Service to temporarily suspend its ground delivery service across the U.S.-Mexican border. Similarly, the United States barred Mexican trucks from entering the United States on the grounds that they were unsafe. Some years ago the French government restricted the import of Japanese video recording equipment by requiring that it be cleared through a single customs office in Poitiers, a town in the middle of France. This caused enormous delays and substantial additional cost to importers.

Saudi Arabia is home to various restrictive practices that hinder international commerce. For instance, every foreign business traveler to the Arab kingdom must hold an entry visa that can be obtained only by securing the support of a sponsor—a Saudi citizen who vouches for the visitor's actions. Because few Saudis are willing to assume such responsibility, foreign businesspeople who want to do business in Saudi Arabia face great difficulty.[11]

Convoluted administrative procedures are widespread in national customs agencies. The revenue generated by tariffs depends on how customs authorities classify imported products. Products often appear to fit two or more tariff categories. For example, a sport utility vehicle could be classified as a truck, a car, or a van. Each of these categories might entail a different tariff. Depending on the judgment of the customs agent, the applicable tariff might end up being high or low. Some agents try to classify products in categories that result in higher tariff revenues. Because thousands of categories exist for customs classification, a product and its corresponding tariff can be easily misclassified, either by accident or intention.

Investment Barriers

Currency control Restrictions on the outflow of hard currency from a country, or the inflow of foreign currencies.

As we saw in the opening vignette on India, countries also impose *FDI and ownership restrictions* that restrict the ability of foreign firms to invest in some industry sectors or acquire local firms. Excessive restrictions in India prevented the approval of countless investment proposals that would have resulted in billions of dollars in revenue to the local economy and government. Around the world, FDI and ownership restrictions are particularly common in industries such as broadcasting, utilities, air transportation, military technology, and financial services, as well as industries that involve major national holdings, such as oil, fisheries, and key minerals. For example, the Canadian government restricts foreign ownership of local movie studios and TV shows to protect its indigenous film and TV industry from excessive foreign influence. The Mexican government restricts FDI by foreign investors to protect its oil industry, which is deemed critical to the nation's security. FDI and ownership restrictions are particularly burdensome in the services sector because services usually cannot be exported and providers must establish a physical presence in target markets to conduct business there. Occasionally, governments impose investment barriers aimed at protecting home-country industries and jobs.

State-owned oil company PEMEX (Petroleos de Mexico) benefits from Mexico's investment barriers.

Currency controls restrict the outflow of hard currencies (such as the U.S. dollar, the euro, and the yen), and occasionally the inflow of foreign currencies. The controls are used to conserve valuable hard currency or reduce the risk of capital flight. They are particularly common in developing countries. Some countries employ a system of dual official exchange rates in which the rate offered to exporters is relatively favor-

able, to encourage exports, while the rate offered to importers is relatively unfavorable, to discourage imports. Such controls both help and harm firms that establish foreign subsidiaries through FDI. The controls favor companies when they export their products from the host country, but harm companies that rely heavily on imported parts and components. Currency controls also restrict the ability of MNEs to *repatriate* their profits—that is, transfer revenues from profitable operations back to the home country.

As an example, Bangko Sentral Pilipinas (BSP), the central bank of the Philippines, required foreign portfolio investors to deposit their pesos (the Philippine currency) in local banks for a minimum of 90 days. The policy helped monetary authorities monitor the inflow and outflow of foreign investments and helped ensure that foreign funds would not be used for currency speculation that could harm the Philippine economy.

Subsidies and Other Government Support Programs

Subsidies are monetary or other resources a government grants to a firm or group of firms, usually intended either to ensure their survival by facilitating the production and marketing of products at reduced prices or to encourage exports. Subsidies come in the form of outright cash disbursements, material inputs, services, tax breaks, the construction of infrastructure, and government contracts at inflated prices. For example, the French government has provided large subsidies to Air France, the national airline. The *Closing Case* focuses on European government support of Airbus S.A.S., the leading European manufacturer of commercial aircraft. Perhaps the ultimate example of subsidized firms is in China. Several leading corporations, such as China Minmetals ($12 billion annual sales) and Shanghai Automotive ($12 billion annual sales), are in fact state enterprises wholly or partly owned by the Chinese government, which provides these firms with huge financial resources.[12]

Subsidy Monetary or other resources a government grants to a firm or group of firms, usually intended to ensure their survival by facilitating the production and marketing of products at reduced prices or to encourage exports.

Critics argue that subsidies reduce the cost of business for the recipient, providing it with unfair advantages. The WTO prohibits subsidies when it can be proven that they hinder free trade. However, subsidies are hard to define. For example, when a government provides the needed land, infrastructure, telecommunications systems, or utilities on behalf of firms in a corporate park, this is technically a subsidy. Yet most would agree that providing this type of support is an appropriate public function.

In Europe and the United States, governments provide agricultural subsidies to supplement the income of farmers and help manage the supply of agricultural commodities. The U.S. government grants subsidies for over two dozen commodities, including wheat, barley, cotton, milk, rice, peanuts, sugar, tobacco, and soybeans. In Europe, the Common Agricultural Policy (CAP) is a system of subsidies that represents about 40 percent of the European Union's budget, amounting to tens of billions of euros annually. The CAP and U.S. subsidies have been criticized for promoting unfair competition and high prices. The CAP and other subsidies tend to prevent developing countries from exporting their agricultural goods to the west. Subsidies encourage overproduction, and therefore lower food prices, which makes agricultural imports from developing countries less competitive.

Governments sometimes retaliate against subsidies by imposing **countervailing duties**—a duty imposed on products imported into a country to offset subsidies given to producers or exporters in the exporting country. In this way, the duty serves to cancel out the effect of the subsidy by converting it into a direct income transfer by the exporting country to the rest of the world.

Countervailing duty A duty imposed on products imported into a country to offset subsidies given to producers or exporters in the exporting country.

Subsidies may allow a manufacturer to charge a lower price for exported products, sometimes lower than it charges its domestic or third-country customers or below manufacturing cost.[13] The practice is known as **dumping**—pricing exported products at less than their normal value, generally for less

Dumping Pricing exported products at less than their normal value, generally for less than their price in the domestic or third-country markets, or at less than production cost.

Agencies such as Canada's Foreign Affairs and International Trade work to facilitate international activities.

than their price in the domestic or third-country markets, or at less than production cost. For example, the European Union gives a subsidy of nearly two billion euros per year to EU sugar producers, which has allowed Europe to become one of the world's largest sugar exporters. Ironically, without the subsidy Europe would be the world's biggest sugar importer. The subsidy allows EU farmers to dump massive amounts of sugar at artificially low prices onto world markets.

Dumping is against WTO rules because it amounts to unfair competition. A large MNE that charges very low prices could conceivably drive competitors out of a foreign market, thereby achieving a monopoly, and then raise its prices. Governments in the importing country often respond to dumping by imposing an **antidumping duty**—a tax imposed on products deemed to be dumped and causing injury to producers of competing products in the importing country. The WTO allows governments to impose antidumping duties on products that are deemed to be dumped and causing injury to producers of competing products in the importing country.[14] The duties are generally equal to the difference between the product's export price and their normal value. Nevertheless, dumping is hard to prove because firms usually do not reveal data on their cost structure or pricing strategies.

Antidumping duty A tax imposed on products deemed to be dumped and causing injury to producers of competing products in the importing country.

Government subsidies are not always direct or overt. For example, governments may support home country businesses by funding R&D initiatives, giving tax exemptions, and offering business development services, such as market information, trade missions, and privileged access to key foreign contacts. Indeed, most countries have agencies and ministries that provide such services to facilitate the international activities of their own firms. Examples include the Department of Foreign Affairs and International Trade in Canada (www.dfait-maeci.gc.ca), U.K. Trade & Investment in Britain (www.uktradeinvest.gov.uk), and the International Trade Administration of the U. S. Department of Commerce (www.doc.gov).

Investment incentive Transfer payment or tax concession made directly to foreign firms to entice them to invest in the country.

Related to subsidies are governmental **investment incentives**, transfer payments or tax concessions made directly to individual foreign firms to entice them to invest in the country. For example, the Hong Kong government put up most of the cash to build the Hong Kong Disney park. While the theme park and associated facilities cost about $1.81 billion, the Hong Kong government provided an investment of $1.74 billion to Walt Disney to develop the site.

In 2006, Austin, Texas and Albany, New York competed for the chance to have the Korean manufacturer Samsung Electronics build a semiconductor plant in their regions. Austin offered $225 million worth of tax relief and other concessions in its successful bid to attract Samsung's $300 million plant, estimated to create nearly 1,000 new jobs locally.

These incentives often help the economic development in a particular region or community. In the 1990s, Germany encouraged foreign companies to invest in the economically disadvantaged East German states by providing tax and investment incentives. Also in the 1990s, Ireland achieved an economic renaissance through proactive promotion by its Industrial Development Authority of Ireland as a place to do business. The group targeted foreign companies in the high-tech sector—including medical instruments, pharmaceuticals, and computer software. The Irish government offered foreign firms preferential corporate tax rates of 12 percent. These targeted efforts paid handsome dividends in terms of diversifying the Irish economy away from agricultural activities and creating substantial new employment.

Government procurement policies constitute an indirect form of nontariff trade barrier. In most countries, government purchases account for a substantial portion of GDP. Governments support domestic industries by adopting procurement policies that restrict purchases to home-country suppliers. For example, several governments require that air travel purchased with government funds be with home-country carriers. Government procurement policies are especially common in countries with large public sectors, such as China, Russia, and various Middle Eastern countries. In the United States, government agencies favor domestic suppliers unless their prices are high compared to foreign suppliers. In Japan, government agencies often do not even consider foreign bids, regardless of pricing. Public procurement agencies may impose requirements that effectively exclude foreign suppliers.

Government Intervention, Economic Freedom, and Ethical Concerns

One way of evaluating the effects of government intervention is to examine each nation's level of *economic freedom*, which is defined as the "absence of government coercion or constraint on the production, distribution, or consumption of goods and services beyond the extent necessary for citizens to protect and maintain liberty itself. In other words, people are free to work, produce, consume, and invest in the ways they feel are most productive. "[15] An *Index of Economic Freedom* is published annually by the Heritage Foundation (www.heritage.org) that measures economic freedom in 161 countries.

Exhibit 7.5 shows the degree of economic freedom for each country in the Index for 2007. For each country, the Index assesses criteria such as the level of trade barriers, rule of law, level of business regulation, and protection of intellectual property rights.[16] The Index classifies virtually all the advanced economies as "free," all of the emerging markets as either "free" or "mostly free," and virtually all of the developing economies as "mostly unfree" or "repressed." The study underscores the close relationship between limited government intervention and economic freedom. Economic freedom flourishes when government supports the institutions necessary for that freedom and provides an appropriate level of intervention. Clearly, excessive regulation of business activity is detrimental to economic growth.

Government intervention and trade barriers also raise ethical concerns that affect developing economies. For example, in the United States, import tariffs on clothing and shoes often range as high as 48 percent. The resulting revenue to the U.S. government, in the billions of dollars per year, imposes a burden on clothing and shoe exporters, which tend to be concentrated in poor countries. For example, in 2001, on imports of $2.5 billion from Bangladesh (a major clothing exporter), the United States collected duties of more than $310 million. In fact, poor countries like Bangladesh—which are beginning to move from subsistence sectors such as agriculture into higher wealth-producing activities such as light manufacturing—face high tariffs, often four or five times those faced by the richest countries.[17]

Government intervention can also be used to offset harmful effects. For example, governments can use trade barriers to create or protect jobs that increase living standards for low-income groups. Governments provide subsidies that help counterbalance harmful consequences that disproportionately affect the poor. In Denmark, for example, globalization has affected thousands of workers whose jobs have been shifted to other countries with lower labor costs. The Danish government provides generous subsidies to the unemployed, aimed at retraining workers to upgrade their job skills or find work in other fields.[18]

Exhibit 7.5

Countries Ranked by Level of Economic Freedom

Source: The Heritage Foundation, accessed at www.heritage.org

Level of economic freedom

- 80-100% free
- 70-79.9% free
- 60-69.9% free
- 50-59.9% free
- 0-49.9% free
- Not ranked

Evolution of Government Intervention

At the beginning of the twentieth century, world trade was characterized by formidable trade barriers. The trading environment worsened through two world wars and the Great Depression. The United States passed the Smoot-Hawley Tariff Act in 1938, which raised U.S. tariffs to near-record heights of more than 50 percent, compared to only about three percent today. Tariffs that other countries imposed in retaliation for Smoot-Hawley choked off foreign markets for U.S. agricultural products, leading to plummeting farm prices and countless bank failures.[19] In an effort to revive trade, the U.S. government began to reduce restrictive tariffs.[20] Progressive international trade policies led to substantial tariff reductions worldwide by the late 1940s.

In 1947, 23 nations signed the General Agreements on Tariffs and Trade (GATT), the first major effort to systematically reduce trade barriers worldwide. The GATT created: (1) a process to reduce tariffs through continuous negotiations among member nations, (2) an agency to serve as a watchdog over world trade, and (3) a forum for resolving trade disputes. The GATT introduced the concept of *most favored nation* (renamed *normal trade relations* in 1998), according to which each signatory nation agreed to extend the tariff reductions covered in a trade agreement with a trading partner to all other countries. Thus, a concession to one country became a concession to all. Eventually, the GATT was superseded by the WTO in 1995 and grew to include about 150 member nations. The organization proved extremely effective and resulted in the greatest global decline in trade barriers in history. The *Global Trend* feature highlights what is perhaps the most important contemporary development in international trade, the founding and progress of the WTO.

In the 1950s, Latin America and other developing nations adopted protectionist policies aimed at industrialization and economic development. Governments imposed high tariffs and quotas on imports from the developed world, established government-supported enterprises to make the products they formerly imported, and sought to substitute local production for imports. Known as *import substitution*, the plan did not succeed. Quasi-public-private enterprises lived behind high quotas and tariffs and enjoyed big government subsidies. However, these enterprises never became competitive in world markets or raised living standards to the levels of free-trading countries . Meanwhile, the protected industries required ongoing subsidies.[21] Most countries that experimented with import substitution eventually rejected it.

By contrast, from the 1970s onward, Singapore, Hong Kong, Taiwan, and South Korea achieved rapid economic growth by encouraging the development of export-intensive industries. Their model, known as *export-led development*, proved much more successful than import substitution. These countries, along with others in East Asia, such as Malaysia, Thailand, and Indonesia, gained substantial prosperity and strong international trading links. Standards of living improved substantially, and a rising middle class helped transform these countries into competitive economies.

Elsewhere in Asia, Japan had already launched an ambitious program of industrialization and export-led development following World War II. The country's rise from poverty in the 1940s to become one of the world's wealthiest countries by the 1980s has been called the *Japanese miracle*. The feat was partly achieved with national strategic policies, including tariffs that fostered and protected Japan's infant industries—such as automobiles, shipbuilding, and consumer electronics.

Bangladesh is a major clothing exporter that faces high tariffs. Here, women work at Dhaka, a shirt exporter.

The World Trade Organization and International Services: The Doha Round

Based in Geneva, Switzerland, the World Trade Organization is the main watchdog for world trade, and counts some 150 countries as its members.

The WTO's goals include working to ensure that world trade operates smoothly, fairly, and with as few restrictions as possible. For example, since joining the WTO in 2001, China has gradually reduced import tariffs and quotas. The WTO is working to reduce trade barriers in the agricultural sector. However, more work needs to be done. For example, import tariffs exceed 100 percent on butter in Canada, fresh vegetables in the EU, and powdered milk in the United States.

The Doha Development Agenda, a WTO round of negotiations launched in Qatar in November 2001, aims for further reductions in world agricultural trade barriers, because they are particularly burdensome to developing countries, which comprise over three-quarters of WTO members. For instance, WTO negotiations led Japan to eliminate import barriers on beef, fruit juice, and apples.

The latest frontier in the WTO's battle against trade barriers is in international services. Because services are largely intangible, it is hard for governments to impose tariffs on them. Services do not pass through ports or customs stations. The "product" that a lawyer or an accountant offers is intangible—knowledge and expertise. Thus, services have become subject to an array of nontariff trade barriers. In transportation, for example, many countries require their own merchandise fleets to carry a certain proportion of their internationally traded cargo. Such laws favor home-country firms, but are a barrier to foreign-based cargo handlers. In banking, trade barriers often discriminate against foreign banks. The insurance industry in many developing economies is owned by the national government. Several European countries refuse to license foreign insurance companies.

Governments also restrict international business in services by setting technical and professional standards that may be difficult for foreign firms and individuals to meet. By requiring licenses and developing educational systems, governments ensure that professions such as law, medicine, and accounting are undertaken largely by people who are educated locally, speak the national language, and are socialized according to local standards and norms. The licensing and professional standards of one country are usually not recognized beyond its national borders. Lawyers, doctors, accountants, and numerous other professionals therefore face restrictions when they attempt to do business abroad.

Negotiations under the Doha Agenda have contributed to reducing trade and investment barriers in services. Under WTO rules, banks, insurance firms, tour operators, hotel chains, and transport companies increasingly enjoy the same trade and investment freedoms that originally applied only to products. A recent agreement significantly lowered international barriers within the telecommunications industry. Other multilateral agreements have covered computer software and financial services. The General Agreement on Trade in Services (GATS) provides new rules for trade and investment in intellectual property, covering copyrights, patents, and trademarks. Key issues the WTO-member countries are negotiating include harmonization of professional standards, acceptable levels of accreditation between member countries, movement of labor in relation to provision of services, licensing, and certification of service suppliers.

Much work remains to be done. In 2006, the trade negotiations under the Doha Development Round were suspended, primarily due to the reluctance of the United States, Japan, and the European countries to reduce farm subsidies and lower import tariffs. However, trade ministers resumed negotiations in 2007.

Sources: United States Trade Representative. (2004). "National Trade Estimate Report," available at www.ustr.gov; U.S. and Foreign Commercial Service and U.S. Department of State. (2007). *Doing Business in Japan: A Country Commercial Guide for U.S. Companies.* Washington, DC: Government Printing Office World Trade Organization. (2007). Accessed at www.wto.org

Since gaining independence from Britain in 1947, India adopted a quasi-socialist model of isolationism and strict government control. High trade and investment barriers, state intervention in labor and financial markets, a large public sector, heavy regulation of business, and central planning all contributed to the nation's poor economic performance over several decades. Beginning in the early 1990s, India began to open its markets to foreign trade and investment. Free-trade reforms, combined with privatization of state enterprises, have progressed slowly. Protectionism has declined, but high tariffs (averaging 20 percent) and FDI limitations are still in place.

Another pivotal country, China, relied on centralized economic planning since Mao Tse-Tung established a communist regime with the 1949 revolution. Agriculture and manufacturing were long controlled by inefficient state-run industries. A focus on national self-sufficiency ensured that China remained closed to international trade until the 1980s, when the nation began to liberalize its economy. In 1992, China joined the Asia-Pacific Economic Cooperation (APEC) group, a free-trade organization similar to the European Union. In 2001, China joined the WTO and committed to reducing trade barriers and increasing intellectual property protection. Trade has stimulated the Chinese economy. By 2004, China's GDP was four times the level it was in 1978, and foreign trade exceeded $1 trillion. The country has become a leading exporter of manufactured products.

How Firms Should Respond to Government Intervention

Although a manager's first inclination might be to avoid markets with high trade and investment barriers or excessive government intervention, this is not usually practical. Depending on the industry and country, firms generally must cope with protectionism and other forms of intervention. For example, in extractive industries such as aluminum and petroleum, foreign firms often enter nations that have formidable barriers. The food-processing, biotechnology, and pharmaceutical industries encounter countless laws and regulations abroad.

Strategies for Managers

Firms that want to do business in emerging markets such as China and India face seemingly endless government intervention. Developing economies in Africa, Latin America, and elsewhere feature numerous trade barriers and government involvement in business. Many firms target emerging markets and developing economies that hold long-term potential despite the challenges that they pose. Managers are not without choices, however. The following strategies are prudent.[22]

Research to gather knowledge and intelligence. Experienced managers continually scan the business environment to identify the nature of government intervention and to plan market-entry strategies, host-country operations, and government support opportunities, accordingly. Trade barriers can be costly and increase the risk of cross-border business. Managers should review their return-on-investment criteria to account for increased cost and risk. Managers should also evaluate alternative foreign market entry strategies in light of both existing and potential risks. For example, while trade barriers are low in the European Union, conditions are evolving as the member states consider a range of legislative initiatives that affect trade and investment within the single market. The European Parliament, the European Commission, and other EU bodies are devising new guidelines that affect company operations in areas ranging from product liability laws to standards for investment in European industries.

Choose the most appropriate entry strategies Tariffs and most nontariff trade barriers apply to exporting, whereas investment barriers apply to FDI. Most firms choose exporting as their initial entry strategy. However, if high tariffs are

present, managers should consider other strategies, such as FDI, licensing, and joint ventures that allow the firm to produce directly in the target market, thereby avoiding import barriers. For instance, the Fuji Company built a factory in South Carolina to manufacture film for cameras. Previously, Fuji had exported film to the United States from its factories in Europe and Japan. By establishing a production base in the United States, Fuji was able to avoid U.S. tariffs and deflect claims that it was unfairly dumping Japanese-made film there.

However, even investment-based entry is affected by tariffs if it requires importing raw materials and parts to manufacture finished products in the host country. Tariffs often vary with the *form* of an imported product. For example, U.S. food processor Conagra imports cooked tuna into the United States, which it then separates and converts into canned tuna, under the Bumble Bee brand. Conagra could have the tuna canned abroad, but the tariff on canned tuna is higher than the tariff on cooked tuna. Thus, Conagra cans the tuna in the United States as a strategy to minimize paying import tariffs.[23] In the case of manufactured products, companies can ship products "knocked-down" and then assemble them in the target market. For example, in countries with relatively high tariffs on imported personal computers, importers often bring in computer parts and then assemble the computers locally.

Take advantage of foreign trade zones In an effort to create jobs and stimulate local economic development, governments establish foreign trade zones (FTZs; also known as *free trade zones* or *free ports*). A **foreign trade zone** is an area within a country that receives imported goods for assembly or other processing, and subsequent re-export. Thus, exported products receive preferential tariff treatment.[24] Products brought into an FTZ are not subject to duties, taxes, or quotas until they, or the products made from them, enter into the non-FTZ commercial territory of the country where the FTZ is located. Firms use FTZs to assemble foreign dutiable materials and components into finished products, which are then re-exported. Alternatively, firms may use FTZs to manage inventory of parts, components, or finished products that the firm will eventually need at some other location. Some firms obtain FTZ status within their own physical facilities. In the United States, for example, Japanese carmakers store vehicles at the port of Jacksonville, Florida. The cars remain in the Jacksonville FTZ, without having to pay duties, until they are shipped to U.S. dealerships.

Foreign trade zone (FTZ) An area within a country that receives imported goods for assembly or other processing, and re-export. For customs purposes the FTZ is treated as if it is outside the country's borders.

FTZs exist in more than 75 countries, usually near seaports or airports. They can be as small as a factory or as large as an entire country. There are several hundred FTZs in the United States alone, used by thousands of firms. The Colon Free Zone, an enormous FTZ, is located on the Atlantic side of the Panama Canal. Products may be imported, stored, modified, repacked, and re-exported without being subject to any tariffs or customs regulations in the FTZ. Many private companies and warehousing operations have set up shop inside the huge zone. Most of the zone's merchandise is transshipped from Panama to other parts of the Western Hemisphere and Europe.

A successful experiment with FTZs has been the **maquiladoras**—export-assembly plants in northern Mexico along the U.S. border that produce components and typically finished products destined for the United States. Maquiladoras began emerging in the 1960s to assemble such products as electronics, clothing, plastics, furniture, appliances, and vehicles. Today, several thousand export-assembly plants in northern Mexico employ millions of Mexican workers. Later brought into the NAFTA (North American Free Trade Agreement), the collaboration enables companies from the United States, Asia, and Europe to tap low-cost labor, favorable taxes and duties, and government incentives, while serving the U.S. market.

Maquiladoras Export-assembly plants in northern Mexico along the U.S. border that produce components and typically finished products destined for the United States.

Seek favorable customs classifications for exported products. One approach for reducing exposure to trade barriers is to have exported products classified in the appropriate harmonized product code. As we noted earlier in this chapter,

many products can be classified within two or more categories, each of which may imply a different tariff. For example, some telecommunications equipment can be classified as electric machinery, electronics, or measuring equipment. The manufacturer should analyze the trade barriers on differing categories to ensure that exported products are classified properly—ideally under a lower tariff code.

Alternatively, the manufacturer might be able to modify the exported product in a way that helps minimize trade barriers. For example, South Korea faced a quota on the export of nonrubber footwear to the United States. By shifting manufacturing to rubber-soled shoes, Korean firms greatly increased their footwear exports. Another strategy is to upgrade the quality of exported products, a quality-instead-of-quantity approach. For example, because Japanese automakers faced export quotas in Britain and the United States, they changed their strategy to export higher-priced, higher-quality automobiles (such as Acura and Lexus) instead of lower-priced vehicles (such as Honda and Toyota). The approach allowed the Japanese to earn higher profit margins while exporting fewer cars.

Take advantage of investment incentives and other government support programs Obtaining economic development incentives from host- or home-country governments is another strategy for reducing the cost of trade and investment barriers. For example, Mercedes built a factory in Alabama in part to benefit from reduced taxes and direct subsidies provided by the Alabama state government. Siemens established a semiconductor plant in Portugal in part to obtain subsidies from the Portuguese government and the European Union. Incentives cover nearly 40 percent of Siemens' investment and training costs. Governments in Europe, Japan, and the United States increasingly provide incentives to companies that set up shop within their national borders. In addition to direct subsidies, incentives can include reduced utility rates, employee training programs, construction of new roads and communications infrastructure, and tax holidays.

Lobby for freer trade and investment More and more nations are liberalizing markets in order to create jobs and to increase tax revenues. The Doha round of WTO negotiations in the mid-2000s aimed to make trade fairer for developing countries. Tariffs in Australia, Canada, Europe, Japan, and the United States have declined considerably over time, reaching single digits for most products. Emerging markets such as Brazil, China, India, Mexico, and various Eastern European countries are liberalizing their trade and investment restrictions.

These trends have resulted partly from the efforts of firms to petition governments, at home and abroad. Firms can lobby foreign governments to lower trade and investment barriers. This might seem far-fetched, but the Japanese, for example, have achieved considerable success with such an approach in Europe and the United States. Japanese industry officials directly lobby U.S. and European governments. In China, domestic and foreign firms have lobbied the government for relaxation of protectionist policies and regulations that make China a difficult place to do business. To increase the effectiveness of their lobbying efforts, foreign firms often hire former Chinese government officials to help lobby their former colleagues.[25] European automakers such as BMW have obtained various concessions by lobbying individual state governments in the United States. For example, the 1,039-acre site of BMW's production facilities in South Carolina is leased to the firm at an annual rent of one dollar. The private sector lobbies federal authorities to undertake government-to-government trade negotiations, aimed at lowering barriers. Private firms bring complaints to world bodies, especially the WTO, to address potentially unfair trading practices of key international markets. At a broader level, managers should take a seat at the table of public-sector decision makers who conduct negotiations with foreign governments regarding their interventionist activities. Particularly in the longer term, such efforts hold the promise of supporting company performance abroad.

CLOSING CASE

Airbus versus Boeing: When is Intervention Not Intervention?

For over 50 years, many European governments have pursued public policies based on democratic socialism. Under this system, the government plays a strong role in the national economy and provides key services such as health care, utilities, mass transit, and sometimes banking and housing. Many European countries support worker and consumer cooperatives, generous social welfare policies, and strong labor unions. In Germany, labor unions are large and powerful. Layoffs and worker dismissal are complex processes that can take firms up to seven months to complete. In France, the government regulates the private sector and labor markets, and has instituted a mandatory 35-hour workweek. Corporate tax rates in France and Germany are high compared to other industrial countries. Most Europeans are accustomed to government intervention and expect government to play a significant role in guiding the national economy.

Boeing versus Airbus: The Complex Global Commercial Aircraft Industry

In the 1960s, United States companies such as Boeing and McDonnell Douglas were the dominant players in global aircraft manufacturing. Boeing was founded in 1916, in Seattle, and had many years to develop the critical mass necessary to become the world's leading aerospace manufacturer. During World War II and the subsequent Cold War years, Boeing was the recipient of many lucrative contracts from the U.S. Department of Defense.

In Europe, no single country possessed the means to launch an aerospace company capable of challenging Boeing. Manufacturing commercial aircraft is an extremely capital-intensive and complex industry that necessitates a highly skilled work force. In 1970, the governments of France and Germany formed an alliance, supported with massive government subsidies, to create Airbus S.A.S. The governments of Spain and Britain joined Airbus later. By 1981, the four-country alliance succeeded in becoming the number-two civil aircraft maker in the world. Airbus launched the A300, among the best-selling commercial aircraft of all time. Airbus also created the A320, receiving more than 400 orders before its first flight and becoming the fastest-selling large passenger jet in aviation history. By 1992, Airbus had captured roughly one-third of the global market in commercial aircraft.

Airbus has benefited from tens of billions of dollars of subsidies and soft loans from the four founding country governments and the European Union (EU). Airbus has to repay the loans only if it achieves profitability. By 2005, government aid had financed, in whole or part, every major Airbus aircraft model. European governments have forgiven Airbus' debt, provided huge equity infusions, dedicated infrastructure support, and financed R&D for civil aircraft projects.

Airbus is currently a stock-held company jointly owned by the British, Germans, French, and Spanish. It is based in Toulouse, France, but has R&D and production operations scattered throughout Europe. European governments justify their financial aid to Airbus on several grounds. First, Airbus R&D activities result in new technologies of considerable value to the EU. Second, Airbus provides jobs to some 53,000 skilled and semiskilled Europeans. Third, Airbus' value-chain activities attract massive amounts of capital into Europe. Finally, Airbus generates enormous tax revenues.

Complaints about Unfair Government Intervention

Boeing and the U.S. government long have complained about the massive subsidies and soft loans that were responsible not only for Airbus' birth, but also for its ongoing success. The outcry became louder in the early 2000s, when Airbus surpassed Boeing in annual sales terms to become the world's leading commercial aircraft company. Boeing has argued that Airbus never would have gotten this far without government support. In 1992, the EU and the United States signed the Agreement on Trade in Large Civil Aircraft, which restricted European governments to providing direct support for no more than one third of the total cost of developing new aircraft. This agreement requires Airbus to repay government loans within 17 years. In return, Boeing agreed that any indirect aid it received from the U.S. Department of Defense and other government sources would be capped at four percent of its annual revenues.

However, U.S. officials eventually cancelled the agreement and demanded an end to Airbus subsidies. A key reason for the tough stance was that Airbus had begun to outsell Boeing and had launched plans for the A380, a monster aircraft likely to grab market share in the large-scale, long-haul market.

In 2005, the U.S. Trade Representative brought its case to the World Trade Organization (WTO). It arose because EU member states approved $3.7 billion in new subsidies and soft loans to Airbus. The case alleged that financial aid for the A350, A380, and earlier aircraft qualified as subsidies under the WTO's Agreement on Subsidies and Countervailing Measures (ASCM) and that the subsidies were actionable because they caused adverse effects to international trade. Under the ASCM,

subsidies to specific firms or industries from a government or other public bodies are prohibited. If a WTO member provides such support, it is subject to official sanction. Airbus confirmed that it had applied to the governments of Britain, France, Germany, and Spain for launch aid for its model A350. Officials of the European Commission countered that government subsidies are permissible and that it is up to individual EU countries to decide whether to provide them.

The EU argues that the United States long has indirectly subsidized Boeing through massive defense contracts that, after all, are paid with tax dollars. The United States has given Boeing approximately $23 billion dollars in indirect government subsidies by means of R&D funding and other indirect support from the Pentagon and from NASA, the nation's space agency. Boeing is at liberty to use the knowledge acquired from such projects to produce civilian aircraft. European officials also complained that the state of Washington, Boeing's manufacturing headquarters, has provided the firm with tax breaks, infrastructure support, and other investment incentives, amounting to billions of dollars.

The EU also has a strong case at the WTO regarding Boeing's relations with its Japanese business partners. The new Boeing 787 Deamliner is built in an alliance with the heavy-industry divisions of Japanese MNEs like Mitsubishi, Kawasaki, and Fuji. The EU argues that the Japanese government provided at least $1.5 billion in soft loans, repayable only if the aircraft is a commercial success, just like the soft loans given to Airbus. In a sense, Boeing has turned the tables on Airbus subsidies by going out and getting its own subsidies, this time from the Japanese. The U.S. government does not see contracts with the military as equivalent to direct government grants.

The New Airbus A380

An experimental version of the new Airbus A380 first flew in April, 2005 from Toulouse, France. The A380's upper deck extends along the entire length of the fuselage. Its cabin provides more than 50 percent more floor space than the next largest airliner, the Boeing 747-400. The A380 provides seating for up to 853 passengers in full economy class configuration or up to 555 people with three classes of seating. It has a maximum range of 15,000 kilometers (8,000 nautical miles).

The new A380 received some $3 billion in subsidies and soft loans from various European governments. In France, a government official stated that the French state has given its financial support to the A380 program. Reports suggest that the total cost of developing and launching the A380 has reached 15 billion euros ($19.5 billion). By late 2006, the Airbus A380 was in trouble. Production had become seriously delayed, partly due to the use of two incompatible versions of computer-aided design software (one in France and one in Germany), the high degree of customization for each airline, and managerial failures. Parts are currently manufactured in 16 plants throughout Europe and shipped to Toulouse for final assembly. The delays are estimated to have cost Airbus more than 4.8 billion euros ($6.2 billion) in profit. Meanwhile, Boeing successfully launched its Boeing 787 Dreamliner in July 2007 and appears to be six years ahead of Airbus in bringing out an innovative and fuel-efficient aircraft. The U.S. officials, on the other hand, concluding that EU subsidies and soft loans to Airbus constitute unfair trade practices, were going ahead with their action at the WTO.

AACSB: Reflective Thinking, Ethical Reasoning

Case Questions

1. Where do you stand? Do you think EU subsidies and soft loans to Airbus are fair? Why or why not? What advantages does Airbus gain from free financial support from the EU governments? Are complaints about the EU's government intervention fair in light of Europe's long history of democratic socialism?
2. Under the WTO Subsidies Agreement, do you think U.S. military contracts with Boeing amount to subsidies? Have these types of payments provided Boeing with unfair advantages? Justify your answer.
3. What about the infrastructure development and investment incentives provided by the state of Washington to Boeing over the years? Are these fair? Do they give Boeing unfair competitive advantages?
4. Assuming that Airbus cannot compete without subsidies and loans, is it likely that the EU will discontinue its financial support of Airbus? What are the EU's vested interests in continuing to support Airbus?
5. In the event the WTO rules against Airbus and tells it to stop providing subsidies and soft loans, how should Airbus management respond? What new approaches can they pursue to maintain Airbus' lead in the global commercial aircraft industry?

Sources: Airbus A380. (2007). Accessed at www.wikipedia.org.; Done, Kevin. (2005). "How Airbus Flew Past Its American Rival," *Financial Times,* March 17: 6; *Economist.* (2005). "Airbus versus Boeing: The Super-jumbo of All Gambles," (January 22): 55–56; *Economist.* (2005). "Boeing versus Airbus: See You in Court," (March 26): 62–-63; Frost, Laurence. (2007). *Airbus Flight Shows Troubled A380,* Accessed February 8, 2007, at www.businessweek.com; Global Business. (2006). *Wayward Airbus,* October 23, 2006, at www.businessweek.com; Lunsford, J., and D. Michaels. (2006). "Bet on Huge Plane Trips Up Airbus," *Wall Street Journal,* (June 15): A1; Malveaux, Suzanne. (2005)."U.S. takes Airbus dispute to WTO," *CNN,* May 31, accessed at edition.cnn.com; Michaels, Daniel. (2005). "Airbus Will Fete Its Giant New Jet," *Wall Street Journal,* (January 18): A8; /; U.S. Commercial Service. (2005). *Doing Business in France*, at www.buyusa.gov/france/en/; U.S. Commercial Service. (2005). *Doing Business in Germany,* accessed at www.buyusa.gov/germany/en; U.S. Trade Representative. (2005). "United States Takes Next Step in Airbus WTO Litigation," accessed at www.ustr.gov; Vives, Xavier. (2007). "Airbus and the Damage Done by Economic Patriotism," *Financial Times,* (March 7): 17.

This case was written by Dr. Gary Knight, with the assistance of Stephanie Regales.

CHAPTER ESSENTIALS

Key Terms

antidumping duty, p. 206
countervailing duty, p. 205
currency control, p. 204
customs, p. 195
dumping, p. 205
export control, p. 197
foreign trade zone (FTZ), p. 213
import license, p. 202
investment incentive, p. 206
maquiladoras, p. 213
nontariff trade barrier, p. 195
protectionism, p. 195
quota, p. 195
subsidy, p. 205
tariff, p. 195

Summary

In this chapter, you learned about:

1. Government intervention in international business

Despite the value of free trade, governments often intervene in international business. **Protectionism** refers to national economic policies designed to restrict free trade and protect domestic industries from foreign competition. Government intervention arises typically in the form of tariffs, nontariff trade barriers, and *investment barriers*. **Tariffs** are taxes on imported products, imposed mainly to collect government revenue and protect domestic industries from foreign competition. **Nontariff trade barriers** consist of policies that restrict trade without directly imposing a tax. An example of a nontariff trade barrier is a **quota**—a quantitative restriction on imports. Managers find out what tariffs apply to their products by consulting *harmonized code* schedules, available from government agencies.

2. Rationale for government intervention

Governments impose trade and investment barriers to achieve political, social, or economic objectives. Such barriers are either defensive or offensive. A key rationale is the protection of the nation's economy, its industries, and workers. **Export controls** limit trade in sensitive products deemed critical to national security. Governments also impose barriers to protect infant industries.

3. Instruments of government intervention

Governments also impose *regulations* and *technical standards*, as well as *administrative* and *bureaucratic procedures*. Countries may also impose **currency controls** to minimize international withdrawal of national currency. *FDI* and *ownership restrictions* ensure that the nation maintains partial or full ownership of firms within its national borders. Governments also provide **subsidies**, a form of payment or other material support. Foreign governments may offset foreign subsidies by imposing **countervailing duties**. With **dumping**, a firm charges abnormally low prices abroad. A government may respond to dumping by imposing an **antidumping duty**. Governments support home-grown firms by providing **investment incentives** and biased *government procurement policies*.

4. Government intervention, economic freedom, and ethical concerns

Economic freedom refers to the extent of government intervention in the national economy. It can be accessed using the Heritage Foundation's Index of Economic Freedom. Government intervention and trade barriers can raise ethical concerns that affect developing economies and low-income consumers. However, government intervention also can be used to offset such harmful effects.

5. Evolution of government intervention

Intervention has a long history. In the late 1800s, many countries imposed substantial protectionism. From the 1930s onward, countries reduced trade barriers worldwide. In Latin America, import substitution delayed eventual transition to free trade. Following World War II, Japan embarked on industrialization and export-led development. India pursued protectionist policies, and China had little foreign involvement until the 1980s. The most important development for reducing trade barriers of the last several decades was the General Agreement on Tariffs and Trade (GATT), which was replaced in 1995 by the World Trade Organization (WTO). The 150 members of the WTO account for nearly all world trade.

6. How firms should respond to government intervention

Firms should first undertake research to understand the extent and nature of trade and investment barriers abroad. When trade barriers are substantial, FDI or joint ventures to produce products in target countries are often the most appropriate entry strategies. Where importing is essential, the firm can take advantage of **foreign trade zones**, areas where imports receive preferential tariff treatment. Management should try to obtain a favorable export classification for the firm's exported products. Government assistance in the form of subsidies and incentives helps reduce the impact of protectionism. Firms sometimes lobby the home and foreign governments for freer trade and investment.

Test Your Comprehension AACSB: Reflective Thinking

1. Discuss the relationship between government intervention and protectionism.
2. What are the differences among the following: tariffs, nontariff trade barriers, investment barriers, and government subsidies?
3. What are the major types of nontariff trade barriers? Suggest business strategies for minimizing the effect of nontariff trade barriers.
4. Distinguish between countervailing duties and antidumping duties.
5. In what ways do government subsidies and procurement policies amount to protectionism?
6. What is the rationale for intervention? Why do governments engage in protectionism?
7. What was the nature of government intervention in the first half of the twentieth century? How did this change in the latter half of the twentieth century?
8. Describe various company strategies to manage government intervention.
9. What is the role of FDI, licensing, and joint ventures in reducing the impact of import tariffs?

Apply Your Understanding
AACSB: Ethical Reasoning, Reflective Thinking, Communication

1. The United States steel industry, once the world leader, now produces less steel than either China or Japan. American steel producers have come under threat from price-competitive suppliers in Brazil, Russia, and other emerging markets. The U.S. steel industry dealt with this threat by launching a lobbying campaign aimed at persuading the U.S. government to impose barriers on the import of foreign steel. The following are excerpts from advertisements used by the steel industry in this effort:

   During the past year, America lost more than 1.1 million manufacturing jobs . . . because domestic factories have shifted their operations to low-wage countries. Manufacturing assures our national defense, our global leadership, and the living standards of more than 17 million workers.

   (Other nations subsidize their domestic steel industries). Longer-term, subsidized imports will destroy a vital American industry and U.S. jobs.

   In an uncertain and dangerous world, does America really want to become dependent on Russia, Japan, China, Brazil and developing countries for something so basic as steel? (*Source:* Crafted with Pride in USA Council, accessed at www.craftedwithpride.org; *Wall Street Journal*, November 9, 2001: A15).

   a. Evaluate this statement. How valid is the argument?
   b. Should the U.S. government impose trade barriers on the import of steel from abroad?
   c. What is the effect of barriers on U.S. steel producers?
   d. What is the effect of barriers on companies that use large amounts of steel in the manufacture of finished products?
   e. What is the effect of barriers on consumers of products that are made with U.S. steel?

2. AgriCorp is a large trading company that exports various agricultural commodities and processed foods to developing countries. Ms. Bonnie Walters is a confident

but inexperienced manager, who is often frustrated that developing countries impose high tariff and nontariff trade barriers. These barriers raise AgriCorp's cost of doing business, making the firm's pricing less competitive in its target markets. How would you explain the rationale for government intervention to Ms. Walters? Why do governments, particularly in developing economies, intervene in trade and investment activities? What are the various defensive and offensive rationale?

3. TelComm Corporation is a manufacturer of components for the cell phone industry. TelComm's founder, Mr. Alex Bell, is interested in exporting the firm's products to China. He has heard that China has the world's largest population of cell phone users, and wants to enter the market. But TelComm has little international business experience. Mr. Bell is unaware of the various types of nontariff trade barriers that TelComm might face in China and other foreign markets. How would you summarize major nontariff trade barriers to Mr. Bell? What types of investment barriers might TelComm face in the event management decided to establish a factory in China to manufacture cell phone components? What can TelComm management do to minimize the threat of these nontariff trade and investment barriers?

globalEDGE Internet Exercises

(http://globalEDGE.msu.edu)

AACSB: Reflective Thinking, Analytical Skills, Ethical Reasoning

Refer to Chapter 1, page 27, for instructions on how to access and use globalEDGE™.

1. Your firm is considering exporting to two countries: Kenya and Vietnam. However, management's knowledge about the trade policies of these countries is limited. Conduct a search at globalEDGE™ to identify the current import policies, tariffs and restrictions in these countries. Prepare a brief report on your findings. In addition to globalEDGE™, other useful sites include UNCTAD-Trains (once there, click on Country Notes) and the U.S. Commercial Service (http://www.buyusa.gov/).

2. The Office of the U.S. Trade Representative (USTR) is responsible for developing and coordinating the international trade and investment policies of the United States. Visit the USTR Web site from globalEDGE™ or directly (www.ustr.gov). Once in Document Library, search for "National Trade Estimate Report on Foreign Trade Barriers" for the latest year. This document summarizes trade barriers around the world. See the reports for the country of your choice. What are the country's import policies and practices? What are its nontariff trade barriers? What about barriers in the services sector? Are there any sectors that seem to be particularly protected (for example, aviation, energy, telecommunications)? What is the nature of government restrictions on e-commerce? If you were a manager in a firm that wanted to export its products to the country, how would you use the USTR report to develop international business strategies?

3. Visit the following web portals and review their perspectives on the debate about free trade and government policies on trade barriers. Given the inherent conflict between national interests, special interests, asymmetries in world wage rates and other economic conditions, what is the best path forward for national governments? That is, should governments generally favor free trade, or should they intervene to protect national interests?

   www.heritage.org/Research/TradeandForeignAid/index.cfm

   www.wto.org/english/thewto_e/whatis_e/tif_e/fact3_e.htm

   www.citizen.org/trade/index.cfm

   www.aflcio.org/globaleconomy/

   www.sierraclub.org/trade/environment/index.asp

   www.ncpa.org/pd/trade/trade8.html

CKR Cavusgil Knight Riesenberger

Management Skill Builder©

Harmonized Code Tariffs as Trade Barriers for Developing Country Exporters

A critical step in assessing the international marketability of a company's products is to determine the extent to which they are subject to tariffs and other trade barriers. A tariff is a tax on imported products that governments impose to achieve various policy objectives. Managers must determine what tariffs they face in foreign markets. Tariff rates are particularly high for food, agricultural products, textiles, and leather. This is often a point of contention for developing countries, whose exports tend to concentrate in such primary products.

AACSB: Reflective Thinking, Analytical Skills

Managerial Challenge

Almost all countries use the system to figure out what tariffs to charge on internationally traded products. In most cases, managers use harmonized codes to find out what tariffs the firm faces in importing and exporting. Managers often use harmonized codes to determine the price competitiveness of their products in export markets and to investigate ways of differentiating or modifying their products so that they may potentially qualify for lower tariffs.

Background

The harmonized code system is necessary because, without it, firms and governments might have differing opinions on what tariffs to charge on imported goods. All products in the system are classified according to a unique six- to ten-digit number. The manager conducts research to determine what trade barriers, if any, are applicable. Data can be obtained by researching online sites, such as the U.S. Department of Commerce (www.doc.gov), ministries of commerce, and other government trade agencies worldwide.

Managerial Skills You Will Gain

In this C/K/R Management Skill Builder©, as a prospective manager, you will:

1. Learn about harmonized classification codes and how to look up tariffs, using harmonized codes.
2. Research the role of high tariffs as a trade barrier.
3. Understand the challenges faced by developing-country exporters of primary products such as food, textiles, and leather.
4. Formulate strategies for potentially reducing tariffs on exported products.

Your Task

Assume that you work for a developing-country company that exports primary products to advanced economies. Your firm is based in an emerging market or developing economy that exports various products to advanced economies. You wish to export such products as coffee, sugar, apparel, footwear, and toys. Your task is to look up the harmonized codes and applicable tariffs for each of these products. Next, you will recommend strategies to your management for possibly avoiding high tariffs by differentiating or modifying the product.

Go to the C/K/R Knowledge Portal©

www.prenhall.com/cavusgil

Proceed to the C/K/R Knowledge Portal© to obtain the expanded background information, your task and methodology, suggested resources for this exercise, and the presentation template.