8. Government Intervention

Asst. Prof. Dr. Ilke Kardes
Read chapter 8
Learning Objectives

1. The nature of government intervention
2. Rationale for government intervention
3. Instruments of government intervention
4. Consequences of government intervention
5. Evolution of government intervention
6. Intervention and the global financial crisis
7. Firm’s responses to government intervention
Agenda

- The nature of government intervention
- Instruments of government intervention
- Strategies to manage risks associated with government intervention
The nature of government intervention

- Instruments of government intervention
- Strategies to manage risks associated with government intervention
The Nature of the Government Intervention

**Protectionism**
- National economic policies that restrict free trade.
- Usually intended to raise revenue or protect domestic industries from foreign competition.

**Trade barriers**
- Tariffs: taxes imposed on imported products
- Nontariff barriers: government policies, regulations, or procedures

**Customs**
The checkpoint at national ports of entry where officials inspect imported goods and levy tariffs
Why Government Intervention?

### National objectives
- Political, social, or economic

### Interest groups
- Domestic firms/industries, and labor unions

### The competitive landscape
- Hindering or helping the ability of firms to compete internationally

!!! An important dimension of country risk !!!
Consequences of Protectionism

- Reduced supply of goods to buyers
- Reduced variety, fewer choices available to buyers
- Price inflation
- Reduced industrial competitiveness
Empty shelves, like these at a supermarket in Caracas, are a common sight in Venezuela. People can shop only on designated days at government-run stores. They’re limited in what they can buy and must undergo fingerprint scanning to prove their identity.

In a country long plagued by food and medicine shortages, the newer hardships are water scarcity and increasingly critical power blackouts—a byproduct of the lack of water in a country dependent on hydroelectric dams.
Rationale for Government Intervention

**Defensive Rationale**
- Protection of the national economy
- Protection of an infant industry
- National security
- National culture and identity

**Offensive Rationale**
- National strategic priorities
- Increase employment
Rationale: National Security

Russian senators released a list of 12 foreign NGOs such as the National Endowment for Democracy (NED), the International Republican Institute (IRI) and Freedom House whose work they believe

- poses a threat to national security, and

- who should thus be declared "undesirable"

and prohibited from operating in the country.

→ a "threat to the foundations of the constitutional system of the Russian Federation, its defense capabilities and its national security."


Agenda

The nature of government intervention

Instruments of government intervention

Strategies to manage risks associated with government intervention
Instruments of government intervention

(1) **Tariffs**: taxes on imports

(2) **Nontariff trade barrier**: government policy, regulation, or procedure that impedes trade

(3) **Investment barriers**: rules or laws that hinder foreign direct investment

(4) **Duties**: countervailing and antidumping
(1) Types of tariffs

<table>
<thead>
<tr>
<th>Types of Tariffs</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Export tariffs</td>
<td>Taxes on products exported by country’s own companies (e.g. Russia charges a duty on its oil exports).</td>
</tr>
<tr>
<td>Import tariffs</td>
<td>Taxes on imported products. Are assessed as a percentage of the value of the imported product (&gt;&gt; ad valorem).</td>
</tr>
<tr>
<td>Specific tariffs</td>
<td>A flat fee or fixed amount per unit of the imported product (based on weight, volume, or surface area).</td>
</tr>
<tr>
<td>Revenue tariffs</td>
<td>To raise money for the government.</td>
</tr>
<tr>
<td>Protective tariffs</td>
<td>To protect domestic industries from foreign competition.</td>
</tr>
<tr>
<td>Prohibitive tariffs</td>
<td>No one can import any of the items.</td>
</tr>
</tbody>
</table>

*Harmonized tariff/harmonized code.* Standardized worldwide system that determines tariff amount.
Import tariffs have been declining.

Economic integration leads to lower tariffs, especially within economic blocs.
- Under NAFTA, Mexico eliminated nearly all tariffs on imports from the U.S., but maintains tariffs with the rest of the world.

Firms may bypass tariffs by entering countries via FDI.
- Toyota built factories in the U.S. partly to avoid tariffs.

Governments have reduced tariffs over time, mainly via the General Agreement on Tariffs and Trade (GATT), which became the World Trade Organization (WTO).
- China reduced its tariffs since joining the WTO in 2001.

!!! Read “Evolution of government intervention” (pp. 206-207) !!!
Map of the Trade Freedom

Video: US Eases Cuba Travel, Trade Restrictions

(2) Types of nontariff export barriers

**Quotas.** Restriction on the physical volume or value of products that firms can import into a country.

E.g., the U.S. government imposed an upper limit of roughly two million pounds on the total amount of sugar that can be imported into the United States each year.

**Local content requirements.** Manufacturing with a minimum of local value added (=> rules of origin requirement).

**Regulations and technical standards.** Safety regulations, health regulations, labeling requirements.

**Administrative or bureaucratic procedures.** To hinder commercial activities and business start-ups (e.g. entry visa).
U.S. Steelmakers Again Ask for Tariffs on Imports

Target is hot-rolled coil from Australia, Brazil, Japan, South Korea, the Netherlands, Turkey and the U.K.

American steelmakers on Tuesday filed another petition demanding tariffs on imports of foreign steel, and warned that China’s devaluation of the yuan could have severe repercussions on their industry.

Six of the nation’s biggest steelmakers—U.S. Steel Corp., Nucor Corp., AK Steel Holdings Corp., ArcelorMittal USA LLC, SSAB Enterprises LLC and Steel Dynamics Inc.—filed their third trade complaint of the summer, as they attempt to stem what Nucor Chief Executive John Ferriola has called a “tsunami of foreign imports.”

The request targeted imports of hot-rolled coil—used in making cars—from Australia, Brazil, Japan, South Korea, the Netherlands, Turkey and the U.K. China wasn’t named in the petition because the U.S. already has tariffs on imports of that kind of steel from China. The petition was filed with the U.S. Commerce Department and the U.S. International Trade Commission.

Overall steel imports into the U.S. have tapered off after rising 7% in the first quarter. For the first six months, they were off 4.6% from a year earlier at 20.9 million tons, according to Global Trade Information Services.

Problem for U.S. steelmakers is sluggish prices, which are held down by inexpensive imports. The U.S. index price for hot-rolled coil, a benchmark product, has fallen more than 20% this year to $468 per ton.

Ecuador to Set Import Tariffs to Mitigate Oil-Price Drop, Stronger U.S. Dollar

Updated March 6, 2015 9:59 p.m. ET

QUITO—Ecuador announced on Friday that it will impose import tariffs of between 5% and 45% for 2,800 products, in a bid to mitigate effects of falling oil prices as well as a strengthening U.S. dollar.

Minister of Foreign Trade Diego Aulestia said at a news conference that the new tariffs, which will affect 32% of Ecuadorean imports, will be charged for 15 months will take effect starting Wednesday.

Mr. Aulestia added that the measure complies with World Trade Organization rules and the local private sector has been consulted on the issue.

More on
https://www.pinterest.com/drkardes/ch-8-government-intervention/
### Local content requirements for the oil and gas sector

<table>
<thead>
<tr>
<th>Country</th>
<th>Legislation/Policy</th>
<th>Year enacted</th>
<th>Focus</th>
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<tbody>
<tr>
<td>Brazil</td>
<td>Local Content Legislation</td>
<td>2003</td>
<td>Oil concession</td>
</tr>
<tr>
<td>Trinidad &amp; Tobago</td>
<td>Local Content &amp; Local Participation Framework</td>
<td>2004</td>
<td>In-country fabrication</td>
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<tr>
<td>Indonesia</td>
<td>Local Content Rules</td>
<td>2009</td>
<td>Procurement of domestic inputs</td>
</tr>
<tr>
<td>Nigeria</td>
<td>Local Content Act</td>
<td>2010</td>
<td>Indigenous participation and domiciliation</td>
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In general, textile and apparel products sold in the U.S. must be labeled with the following information: the fiber content, the country of origin, the manufacturer or dealer identity, and the care instructions.

Although non-mandatory, the 'Green Dot' recycling symbol is found on all products sold in Germany.

Administrative or bureaucratic procedures

To hinder commercial activities and business start-ups; e.g. entry visa

Open doors, for some

Number of countries that can be visited without a visa, by citizens of:
Selected countries, 2014

United States
Germany
Britain
Sweden
Finland
Russia
India
China
Pakistan
Somalia
Iraq
Afghanistan

Source: Economist 2016, Jan 2

(3) Investment Barriers

Restrictions on FDI and ownership. Restrict the ability of foreign firms to invest in some industry sectors or acquire local firms.

- Usually in strategic industries such as broadcasting, air transportation, military technology, financial service, and raw material.

Currency controls. Restrictions on the outflow of widely used currencies (e.g. dollar, euro) and occasionally the inflow of foreign currencies.

- Controls can help conserve especially valuable currency or reduce the risk of capital flight.

Also see Investment Freedom at [http://www.heritage.org/index/heatmap](http://www.heritage.org/index/heatmap)
Map of the Investment Freedom

Argentina Extends Currency Controls on Tourism to Shore Up Reserves

- Argentina's government has increased the tax Argentines pay to travel and shop abroad to 35% as it tries to stem the slide in the country's foreign-currency reserves.
- Businesses that want to buy imported equipment or people planning an overseas trip have to obtain government approval to legally purchase the foreign currency they need.

China Loosens Currency Controls for Multinationals

- ... as part of efforts to free up the movement of capital, cut corporate costs and address market needs.
- The new rules would allow domestic and foreign firms with at least US$100 million in foreign-exchange income in the past year to transfer capital more freely.

Source: Wall Street Journal 2013, Dec 3


Countervailing duty (CVD). Tariff on imported products by subsidies.

- is established when a foreign government provides assistance and subsidies, such as tax breaks to manufacturers that export goods, enabling the manufacturers to sale the goods cheaper than domestic manufacturers. CVD cases are country specific.

Antidumping duty (AD). Respond by governments in the importing country to dumping. The duties are generally equal to the difference between the product’s export price and their normal value. AD is company specific.

- Dumping. The product is exported at a price that is lower than the price it normally charges in its own home market.
**Government supports**

**Subsidy.** Government grants to firm(s), intended to ensure their survival or success by facilitating production at reduced prices, or encouraging exports. Grants include cash, tax breaks, infrastructure construction, or government contracts at inflated prices.

**Examples:**
- In China, numerous MNEs are partly owned by the Chinese government, and receive huge financial resources.
- Europe and the U.S. provide huge agricultural subsidies to farmers. EU subsidies represent 40% of the EU budget.

**Investment incentive.** Transfer payment or tax concession for foreign firms encouraging them to invest in the country.

**Example:**
The Hungarian parliament passed the film law in 2004, which grants a 20% state subsidy to those international productions that select Hungary as filming location. The goal of the legislators was to improve the Hungarian film industry and to make it more competitive.
## Key Takeaways

<table>
<thead>
<tr>
<th>Type</th>
<th>Definition</th>
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<tbody>
<tr>
<td><strong>Tariffs</strong></td>
<td>Taxes on imported products</td>
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<tr>
<td><strong>Non-tariff barriers</strong></td>
<td></td>
</tr>
<tr>
<td>Quota</td>
<td>Quantitative restrictions on imports</td>
</tr>
<tr>
<td>Local content requirements</td>
<td>Locally-sourced inputs in the production</td>
</tr>
<tr>
<td>Regulations</td>
<td>Safety, health, or technical regulations, labeling requirements</td>
</tr>
<tr>
<td>Procedures</td>
<td>Administrative and bureaucratic requirements</td>
</tr>
<tr>
<td><strong>Investment Barriers</strong></td>
<td></td>
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<tr>
<td>FDI and ownership restrictions</td>
<td>Limitation on the investment and the number of foreign investors in certain industries</td>
</tr>
<tr>
<td>Currency controls</td>
<td>Restrictions on the outflow and inflow of foreign currencies</td>
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<tr>
<td><strong>Duties</strong></td>
<td></td>
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<tr>
<td>Countervailing</td>
<td>Tariff on imported products by subsidies to reduce or eliminate competitive advantages provided by subsidies</td>
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<tr>
<td>Anti-dumping</td>
<td>Taxes on imported products whose price is below usual prices in the local market</td>
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Agenda

The nature of government intervention

Instruments of government intervention

Strategies to manage risks associated with government intervention
**Firm’s Response to Government Interventions**

<table>
<thead>
<tr>
<th>Research to gather knowledge and intelligence.</th>
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<tr>
<td>Scan the business environment to understand trade and investment barriers abroad.</td>
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<tr>
<td>- identify the nature of government intervention.</td>
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<thead>
<tr>
<th>Take advantage of foreign trade zones (FTZs).</th>
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<tr>
<td>FTZs -&gt; areas where imports receive preferential tariff treatment, intended to stimulate local economic development.</td>
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<td>e.g., Export-assembly plants in northern Mexico.</td>
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<th>Choose the most appropriate entry strategies.</th>
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<td>Exporting vs. licensing vs. FDI vs. JV</td>
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<table>
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<tr>
<th>Seek favorable customs classifications for exported products.</th>
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<td>Reduce exposure to trade barriers.</td>
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<table>
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<tr>
<th>Take advantage of investment incentives and other government support programs.</th>
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<tbody>
<tr>
<td>e.g., When Mercedes built a factory in Alabama, it benefitted from reduced taxes and direct subsidies provided by the Alabama state government.</td>
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<tr>
<th>Lobby for freer trade and investment.</th>
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<tr>
<td>Increasingly, nations are liberalizing markets in order to create jobs and increase tax revenues.</td>
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Video: World's first Barbie store opens in China

https://www.youtube.com/watch?v=Ys3xDCEfTkc
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