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The Political Economy of International Trade

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Exercise 1

Your company is considering exporting its products to Egypt. Yet, management's current knowledge of this country's trade policies and barriers is limited. Before your company's management decides to export, a more detailed analysis of the political and economic conditions in Egypt is required. In fact, you have heard that the *National Trade Estimate Report on Foreign Trade Barriers* may be a good place to start. Begin your search and identify Egypt's current import policies with respect to fundamental issues such as tariffs and restrictions. Prepare an executive summary of your findings.

Exercise 2

The number of member nations of the *World Trade Organization* (WTO) has increased considerably in recent years. Additionally, some nonmember countries have observer status. Such status requires accession negotiations to begin within five years of attaining this preliminary position. Identify the current total number of WTO members. Also, prepare a list of current observer countries. Do you notice anything in particular about the countries that have observer status?

CLOSING CASE

Why Did Global Food Prices Rise?

For the last 25 years global food prices have been falling, driven by the increased productivity and output of the farm sector worldwide. In 2007, this came to an abrupt end as global food prices soared. By September 2007, the world price of wheat rose to over $400 a ton—the highest ever recorded and up from $200 a ton in May. The price of corn (maize) surged to $175 a ton, some 60 percent above its average for 2006. An index of food prices, adjusted for inflation, which *The Economist* magazine has kept since 1845, hit its highest level ever in December 2007.

One explanation for rising food prices has been increased demand. The increased demand has been driven by greater food consumption in rapidly developing nations, most notably China and India. Rising consumption of meat, in particular, has driven up demand for grains; it takes eight kilograms of cereals to produce one kilogram of beef, so as demand for meat rises, consumption of grains by cattle surges. Farmers now feed 200 to 250 million more tons of grain to their animals than they did 20 years ago, driving up grain prices.

Then there is the issue of bio-fuel subsidies. Both the United States and the European Union have adopted policies to increase production of ethanol and bio-diesel in order to slow down global warming (both products are argued to produce fewer CO_2 emissions, although exactly how effective they are at doing this is actively debated). In 2000, around 15 million tons of American corn was turned into ethanol; in 2007 the figure reached 85 million tons. To promote increased production, governments have given subsidies to farmers. In the United States subsidies amount to between $0.29 and $0.36 per liter of ethanol. In Europe the subsidies are as high as $1 a liter. Not surprisingly, the subsidies have created an incentive for farmers to plant more crops that can be turned into bio-fuels (primarily corn and soy beans). This has diverted land away from production of corn and soy for food, and reduced the supply of land devoted to growing crops that don't receive bio-fuel subsidies, such as wheat. This highly subsidized source of demand seems to be having a dramatic effect on demand for corn and soy beans. In 2007, for example, the U.S. increase in demand for corn-based ethanol accounted for more than half of the global increase in demand for corn.

What is complicating the situation is that high tariffs are shutting out producers of alternative products that can be turned into bio-fuels, most notably sugar cane, from the U.S. and EU markets by high tariffs. Brazil, the world's most efficient producer of sugar cane, confronts import tariffs of at least 25 percent by value in the United States and 50 percent in the European Union, raising the price of imported sugar cane and making it uncompetitive with subsidized corn and soy beans. This is unfortunate because sugar cane is widely seen as a more environmentally friendly raw material for bio-fuels than either corn or soy. Sugar cane uses less fertilizer than corn or soy and produces a higher yield per hectare in terms of its energy content. Ethanol is also produced from what used to be considered a waste product, the fiber removed from the cane during processing.

If policy makers have their way, however, the situation may get even worse. Plans in both the United States and the European Union call for an increase in the production of bio-fuels, but neither political entity has agreed to reduce tariff barriers on sugar cane or to remove the trade-distorting subsidies given to those who produce corn and soy for bio-fuels. Brazil is not sitting on the sidelines; in 2007 it asked the World Trade Organization to probe U.S. subsidies to corn farmers for ethanol production.[52]

Case Discussion Questions

1. Who benefits from government policies to (*a*) promote production of ethanol and (*b*) place tariff barriers on imports of sugar cane? Who suffers as a result of these policies?
2. One estimate suggests that if food prices rise by one-third, they will reduce living standards in rich countries by about 3 percent, but in very poor ones by about 20 percent. According to the International Food Policy Research Institute, unless policies change, cereal prices will rise by 10 to 20 percent by 2015, and the expansion of bio-fuel production could reduce calorie intake by 2 to 8 percent by 2020 in many of the world's poorest nations. Should rich countries do anything about this potential problem? If so, what?
3. The argument for giving subsidies to ethanol producers rests upon the assumption that ethanol results in lower CO2 emissions than gasoline and therefore benefits the environment. If we accept that global warming is a serious problem in itself, should we not be encouraging government to increase such subsidies? What are the arguments for and against doing so? On balance, what do you think is the best policy?

Notes

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5. World Trade Organization, *World Trade Report 2006*, (Geneva: WTO: 2006).
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17. Bill Lambrecht, "Monsanto Softens Its Stance on Labeling in Europe," *St. Louis Post-Dispatch*, March 15, 1998, p. E1.
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