SECTION 3

Restrictions on World Trade

READER'S GUIDE

Terms to Know

- tariff
- revenue tariff
- protective tariff
- import quota
- embargo
- protectionists
- General Agreement on Tariffs and Trade (GATT)
- World Trade Organization (WTO)
- North American Free Trade Agreement (NAFTA)
- European Union (EU)

Reading Objectives

1. How can a nation restrict imports?
2. What are three arguments for and against free trade?
3. What are some current international and regional trade agreements?

COVER STORY

***BUSINESS WEEK*, JANUARY 18, 1999**

The mood was giddy just about everywhere on the Continent as Europe's new currency, the euro, made its grand debut. . . . After years of skepticism from critics on the Continent and abroad, Europe has its common currency.

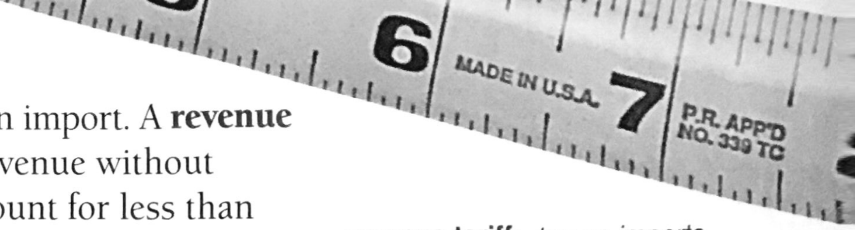
The long-term effects of melding an 11-nation, $6.5 trillion, 290 million-person region into one economic and financial bloc are giving Continental Europe new [power]. Companies around the world are eager to exploit what they hope will become a true single market.

To trade or not to trade? The difficulties that different currencies cause are only one problem of world trade. There are also natural barriers, which include the differences in languages and cultures between various trading partners. As you read this section, you'll learn that some nations may set restrictions to discourage or limit trade.

Three Ways to Restrict Imports

Three major barriers to world trade are tariffs, quotas, and embargoes. The most commonly used barrier to free trade is the **tariff**, a tax on imports.

<u>tariff:</u> *tax placed on an imported product*



Tariffs Two types of tariffs can be applied to an import. A **revenue tariff** is used primarily to raise government revenue without restricting imports. Although tariffs today account for less than 2 percent of the federal government's income, they were the major sources of federal funding until the early 1900s.

A **protective tariff** is one designed to raise the cost of imported goods and thereby protect domestic producers. Some protective tariff rates have been as high as 62 percent of the value of the imported goods.

revenue tariff: *tax on imports used primarily to raise government revenue without restricting imports*

protective tariff: *tax on imports used to raise the cost of imported goods and thereby protect domestic producers*

Quotas An alternative method for restricting imports is the quota system. An **import quota** usually restricts the number of units of a particular good that can be brought into the country. The United States has placed quotas on imports of sugar, dairy products, various types of apparel, and cloth.

import quota: *restriction imposed on the number of units of a particular good that can be brought into the country*

Embargoes An **embargo** is a complete restriction on the import or export of a particular good. Often embargoes are enacted for political reasons. For example, in 1998 an embargo was ordered against Serbia for its actions in neighboring Kosovo.

The United States has also ordered embargoes on goods *from* certain countries. An embargo on trade with Cuba has been in place for more than four decades because that country's leader is Communist.

embargo: *complete restriction on the import or export of a particular good*

protectionists: *people who argue for trade restrictions to protect domestic industries*

Arguments Against Free Trade

The pros and cons of trade restrictions are still often the subject of intense public debate. **Protectionists** are those who argue *for* trade restrictions. There are three main arguments for trade protection.

Job Security Protectionists argue that many domestic workers will be unemployed if foreign competitors sell goods at lower prices than American firms. In the 1980s, for example, American steel mills laid off many workers because of foreign competition.

National Economic Security Protectionists argue that certain industries are crucial to the economy of the United States. They believe that

CAREERS

Customs Inspector

Job Description
- Inspect cargo and collect appropriate duties or fees
- Ensure that all goods entering the United States comply with U.S. laws

Qualifications
- U.S. citizen at least 20 years of age
- Bachelor's degree, civil service exam

Average Salary: Not Available

Job Outlook: Average

—*Occupational Outlook Handbook, 2002–03*

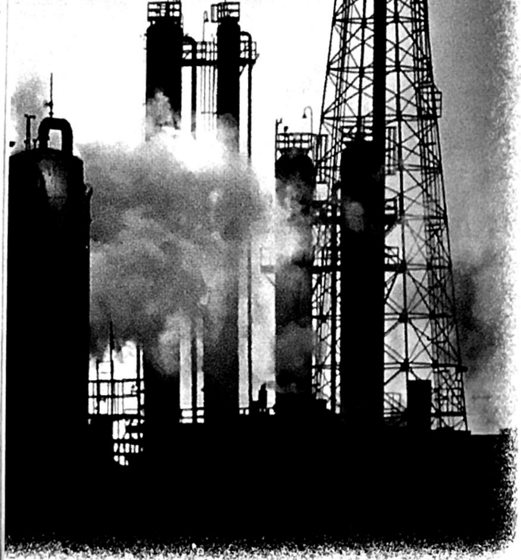


FIGURE 18.6

National Security
Protectionists believe that certain industries, such as those that are energy-based, should be protected so that the United States is not vulnerable to other nations during times of crises.

entire industries, such as oil, should be protected against foreign competition. See **Figure 18.6.**

Infant Industries Protectionists believe that tariffs and quotas are needed as temporary protection for new, infant industries. If foreign competition is restricted for a time, a young industry may become strong enough to compete in the world market.

Arguments For Free Trade

People who argue for free trade believe that exports and imports should not be restricted. There are three main arguments in support of free trade.

Improved Products Foreign competition encourages United States firms to improve their technology and production methods. As you learned in Chapter 7, better technology increases the production and supply of goods and services available, which raises our standard of living.

Export Industries American workers involved in export industries are hurt or may become unemployed when trade restrictions are implemented. One reason is that when the United States imports fewer goods, there is less American money available outside the United States to buy American exports. Another reason is that when the United States restricts imports, other nations may retaliate and restrict their own imports.

Specialization and Comparative Advantage Those in favor of free trade admit that too much economic specialization allows the country to be at the mercy of world demand. However, some specialization benefits consumers because comparative advantage in production results in more goods at lower prices.

Trade Agreements

After World War II, numerous bilateral trade agreements were brought together in the **General Agreement on Tariffs and Trade (GATT).** Under GATT, countries met periodically to negotiate tariff reductions that were mutually advantageous to all members. In 1994, GATT members signed a treaty establishing the **World Trade Organization (WTO)**, which came into being the following year with 76 member nations. The WTO constitutes the most far-reaching global trade agreement in history.

General Agreement on Tariffs and Trade: *trade agreement under which countries met periodically to negotiate tariff reductions that were mutually advantageous to all members*

World Trade Organization: *world's largest trade agreement currently with more than 140 nations*

Regional Trade Agreements In many parts of the world, regional trade agreements have been reached in order to increase free trade. Certain nations in Southeast Asia as well as in Central and South America have such regional trade agreements. The United States formed one with Canada and Mexico called the **North American Free Trade Agreement (NAFTA).** The U.S. Congress approved NAFTA in 1993. Since then, trade has increased among the 3 nations to the general benefit of all.

Perhaps the most important regional trade agreement in the world today is the **European Union (EU).** Currently, the EU consists of France, Germany, Great Britain, Denmark, Italy, Spain, Greece, Portugal, Luxembourg, Belgium, the Netherlands, Finland, Sweden, Austria, and Ireland. Starting in 2004, 10 additional countries planned to join the EU. On January 1, 1993, the EU began eliminating most of its restrictions on trade among its member countries. On January 1, 1999, 11 of the 15 member nations started putting into place the euro as a common currency. Those 11 nations and Greece abandoned their own national currencies as of January 1, 2002. Eventually, the EU will have a common currency for over 370 million European consumers. It will rival the United States in market size. See pages 494–495.

North American Free Trade Agreement: *trade agreement designed to reduce and gradually eliminate tariff barriers among Mexico, Canada, and the United States*

European Union: *organization of European nations whose goal is to encourage economic integration as a single market*

Practice and **assess** key skills with ***Skillbuilder Interactive Workbook, Level 2.***

SECTION 3 Assessment

Understanding Key Terms

1. **Define** tariff, revenue tariff, protective tariff, import quota, embargo, protectionists, General Agreement on Tariffs and Trade, World Trade Organization, North American Free Trade Agreement, European Union.

Reviewing Objectives

2. How can a nation restrict imports?
3. What are three arguments for and against free trade?
4. **Graphic Organizer** Create a chart like the one below to list and describe at least three trade agreements.

Agreement	Purpose

Applying Economic Concepts

5. **Free Trade** Assume you are (a) a startup computer software producer, (b) the owner of a retail dress shop, (c) a steelworker whose company just closed, (d) a student working in fast-food service. Write a short argument for or against free trade from the standpoint of each individual.

Critical Thinking Activity

6. **Summarizing Information** Research the benefits and costs of the North American Free Trade Agreement (NAFTA) on the Internet. Scan several articles to identify which groups support NAFTA and which groups oppose the trade agreement. Evaluate the reasons each group gives for supporting or opposing NAFTA.