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## **Lecture 7: Competition and International Trade**

- 1. Cartels in International Trade**
- 2. OPEC**
- 3. Other International Commodity Agreements**
- 4. International Dumping**
- 5. Link between International Dumping and Economy of Scale**
- 6. Export subsidies**

# 1. Cartels in International Trade

- ✓ A **cartel** is defined as a group of firms that gets together to make output and price decisions.
- ✓ Cartels tend to arise in markets where there are few suppliers and each supplier has a significant share of the market.
- ✓ Internationally, there are no restrictions on cartel formation.
- ✓ By working together, the cartel members are able to behave like a monopolist.

The cartel's **profit-maximizing decision** is the same as that of a monopolist. The cartel members choose their combined output at the level where their **combined marginal revenue** equals their **combined marginal cost**.

## A) Impact of an International Cartel on the Global Market

**Marginal revenue** constitutes the difference in total **revenue** incurred by the sale of one additional unit.

Change in total **revenue** (TR) by the change in quantity (Q) sold, which is calculated as  $\Delta TR / \Delta Q$ .

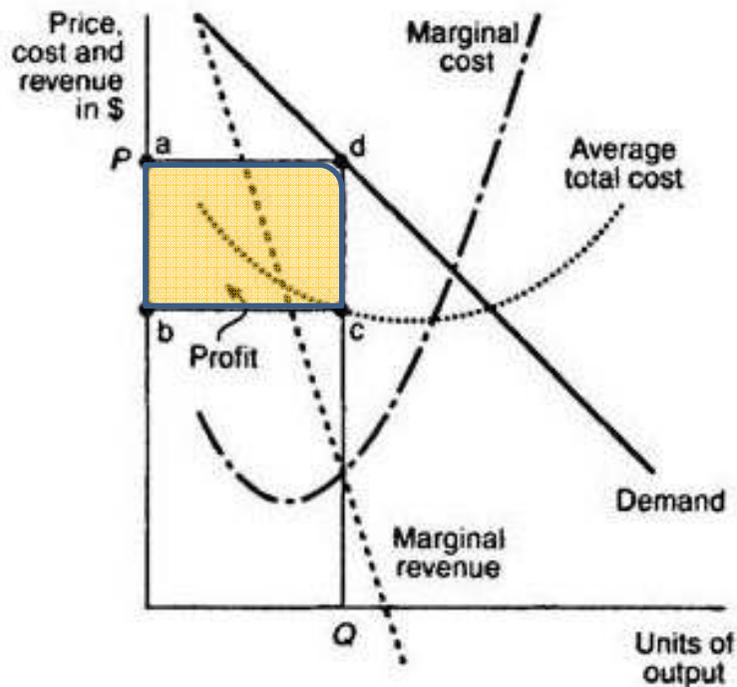


Figure 1

Profit maximization by oligopolistic cartel

$$\text{Marginal Cost (MC)} = \frac{\Delta TC}{\Delta Q}$$

Where

$\Delta$  = Change  
TC = Total Cost  
Q = Quantity

The cartel price is determined by market demand curve at the level of output chosen by the cartel.

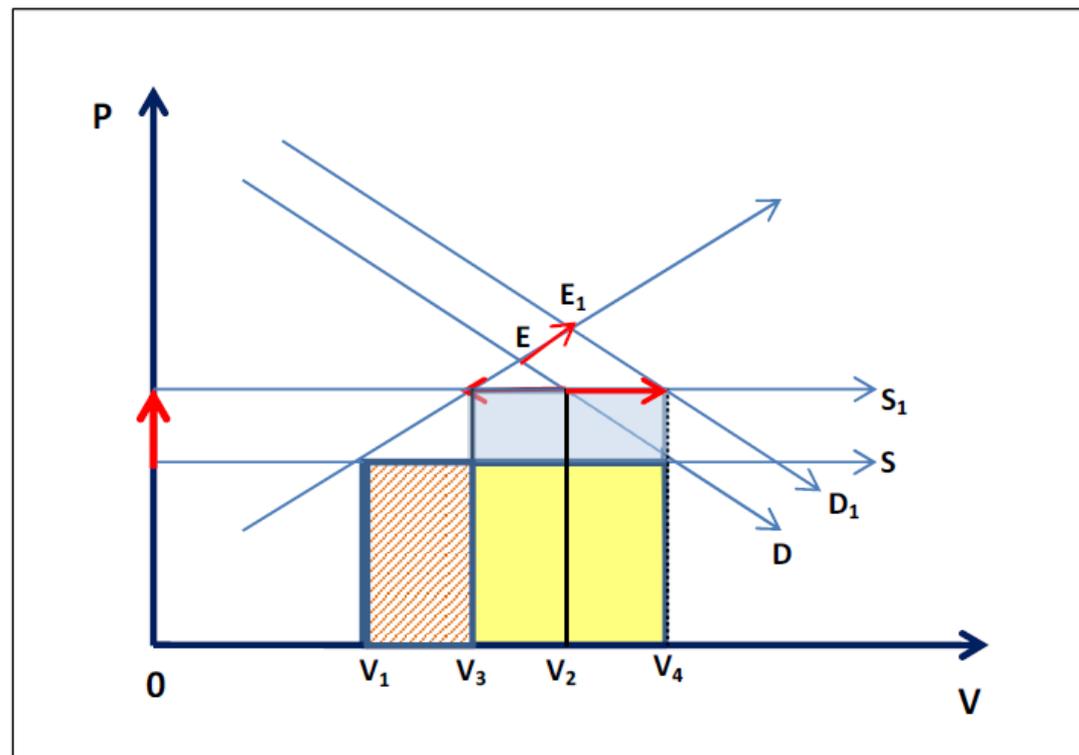
The cartel's profits are equal to the area of the rectangular box labeled *abcd* in figure.

A cartel, like a monopolist, will choose to produce less output and charge a higher price than would be found in a perfectly competitive market.

## B) Impact of International Cartel on Domestic Market in Importing Country

The restriction of supply by the cartel has the same impact as the introduction of import quota.

The effect depends on elasticity of demand.  
The effect will be strongest if the elasticity is zero.



## 2. OPEC

The organization of petroleum-exporting countries (OPEC) is perhaps the best-known example of an international cartel.

OPEC members meet regularly to decide how much oil each member of the cartel will be allowed to produce.



Indonesia and Gabon joined OPEC in 2016.  
Now they are 14 OPEC member countries.

## 2. OPEC

OPEC share in global oil production (2016) is 43% and in proven reserves – 73%.  
World total proved reserves are 1 217 billion barrel and world total annual oil production is 29.2 billion barrel.



**Q: Which factors determine the movement of the oil prices?  
Is the current price of around 45 USD/barrel the normal price?**

## 2. Other International Commodity Agreements

### ➤ International Coffee Agreement

The International Coffee Organization (ICO) is the main intergovernmental organization for coffee. ICO exporting members account for more than 97 percent of world coffee production, and its **importing Members**, are responsible for around 80 percent of world coffee consumption.

### ➤ International Tropical Timber Agreement

The International Tropical Timber Agreement (ITTA) is often described as a "hybrid" agreement because it combines a traditional commodity trade agreement with objectives that include sustainable management of tropical forests. The ITTA established the International Tropical Timber Organization (ITTO), an intergovernmental organization with 59 members who collectively account for about 80 percent of the world's tropical forests and 90 percent of the annual trade in tropical timber trade

**Association of Natural Rubber Producing Countries ANRPC** [www.anrpc.org](http://www.anrpc.org)



**International Grain Council**  
[www.igc.int](http://www.igc.int)



International Grains Council

**International Cotton Advisory Committee**  
[www.icac.org](http://www.icac.org)



**International Jute Study Group**  
[www.jute.org](http://www.jute.org)



**International Sugar Organization**  
[www.isosugar.org](http://www.isosugar.org)



## 4. International Dumping

### Definition of “International Dumping”

There is international dumping if the export price of some goods ( $P_x$ ) is below its normal value ( $V_n$ ).

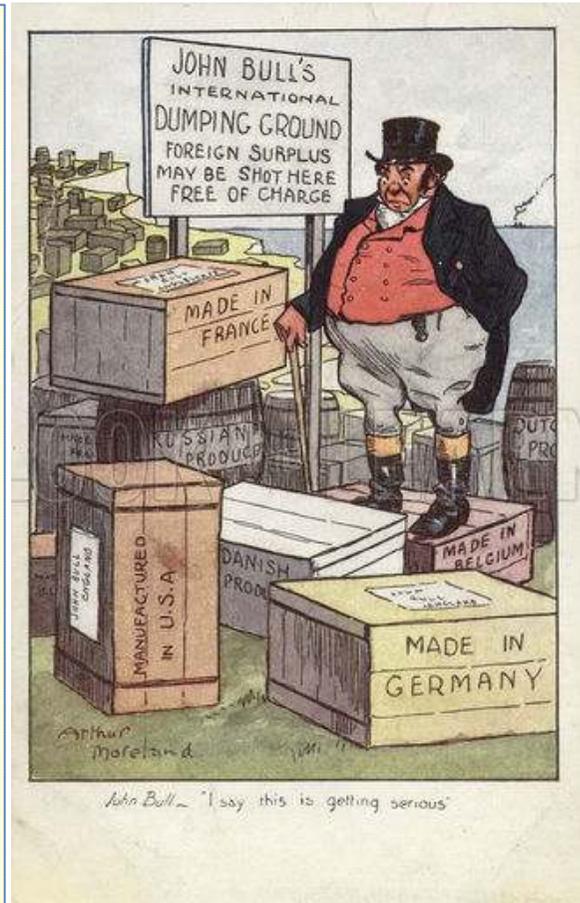
$$M = \frac{V_n - P_x}{P_x} \quad \text{dumping margin (M)}$$

But how is the normal value to be estimated?

Usually this is the domestic price (without taxes) paid for the goods by independent buyers.

But what would happen if the exporting country is too small, or the exported goods are not traded on the domestic market, or the exporting country is a non-market economy country, **like China**?

**In this case the importing country has to estimate the normal value itself!**



International Dumping has a long history...

## ❖ Investigation

If the domestic price can not be used as a normal value, the normal value should be estimated by the staff of the European Commission using statistical data collected from similar enterprises. The formula is as follows:

$$V_n = C_v + \frac{C_f}{n} + P_n$$

where  $C_v$  are the variable costs per unit of output,  $C_f$  are the fixed costs for all units produced,  $n$  is the number of units produced, and  $P_n$  is the average profit per unit (normal profit).

**Important: Fixed costs are increasing!**

Fixed costs often include costs for rent, buildings, machinery, but also R&D, advertisement, distribution channels, etc.



## ❖ Completion of investigation

### They are 5 possible outcomes:

- ✓ Voluntary undertaking by the exporter to revise its prices and to cease exports at dumped prices. This is the most used outcome, which obliges the exporter not to drop the export price under some limit!
- ✓ Imposition of definitive duty equivalent to preliminary duty;
- ✓ Imposition of definitive duty lower than preliminary duty (overpayment to be returned);
- ✓ Imposition of definitive duty higher than preliminary duty (the difference shall not be collected);
- ✓ Termination of proceedings without measures (almost never happens).

The maximum duration of definitive anti-dumping duty is 5 years. Decision must be taken by the EU Council. It is possible to appeal to the Court of Justice.

## ❖ Reviews and Reinvestigations

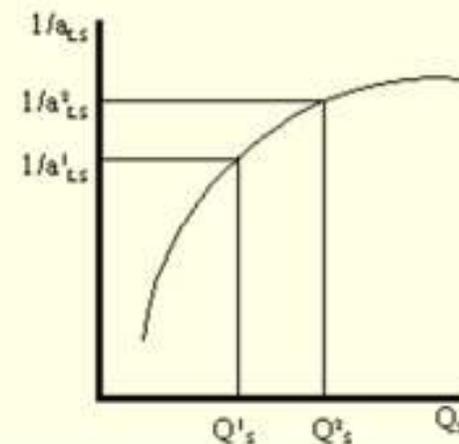
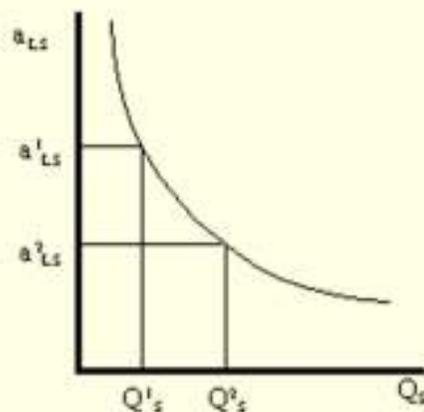
## 5. Link between international dumping and economy of scale

	Turnover			Variable costs			Fixed costs		Total costs per unit	Profit
	Units	Price per unit	Total sum	Units	per unit	Total sum	Total sum	per unit		
Only domestic sales	1000	400	400000	1000	200	200000	200000	200	400	0
Only exports	2000	300	600000	2000	200	400000	200000	100	300	0
Domestic sales and exports	3000	333	1000000	3000	200	600000	200000	67	267	198 000 = 3000 x (333-267)

Export price may fall below the domestic price in order to achieve additional economy of scale. Is this also unfair competition? There is no easy answer to this question.

China, India, Indonesia and other developing countries insist that selling internationally goods under their domestic price should not be considered always as dumping. These developing countries have a limited domestic market for some expensive products and have to export a large part of them in order to achieve economy of scale.

As quantity of production increases the average cost of each unit decreases. Accordingly increases economic efficiency.



## 6. Export Subsidies

### An export subsidy may take different forms:

- a direct or potential transfer of funds (grants, equity injections, guarantees);
- government revenues (which are otherwise due) foregone or not collected (e.g. tax credits);
- government provision of goods and services (other than general infrastructure);
- government purchase of goods without tender, etc.

**Large-scale subsidization of exports is done mostly from large emerging countries (China, India, Brazil, South Africa, etc.). These are also the countries with large state participation.**

## **PROHIBITED SUBSIDIES (WTO “Red basket”)**

- Any subsidy aimed at increasing exports by reducing costs and increasing competitiveness of exports (so-called Export subsidies)
- Any specific subsidy which is limited to certain enterprise or enterprises of an industry.

## **AUTHORIZED SUBSIDIES (WTO “Green basket”)**

- Assistance for research activities.** It is allowed to subsidize up to 75% in science and 50% in Development; it is not allowed to subsidize marketing and compensation of employees.

## **AUTHORIZED SUBSIDIES (WTO “Green basket”)**

- ❑ Assistance to disadvantaged regions.** GDP per capita in these regions must not be above 85 per cent of the average or unemployment rate must be at least 110 per cent of the average.
- ❑ Assistance for SMEs** but limited to some amount, indicated in the national legislation.
- ❑ Assistance for environmental protection.** Allowed are only lump-sum grants to partially cover specific new regulations.
- ❑ Agricultural subsidies** are beyond the effects of the WTO Agreement on Subsidies and Countervailing Measures.

### **WTO “Yellow basket”**

Neither explicitly prohibited nor explicitly authorized. For example state aid for shipbuilding industry or for the car industry.

**These are non-specific subsidies to support sectors in transition or in crisis.**

## China's Currency Manipulation

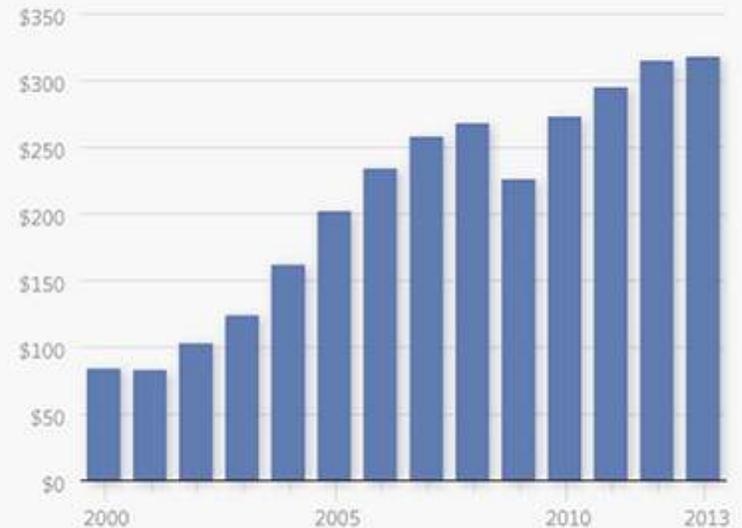
Central bank intervention in foreign exchange markets may, under some conditions, stimulate exports and retard imports. China has for example regularly intervened to prevent the local currency from appreciating relative to other currencies (**undervaluation**), and over the same period has developed large global and bilateral trade surpluses.

Numerous public officials and commentators argue that China has engaged in impermissible "currency manipulation," and various proposals for stiff action against China have been advanced.



U.S. Trade Deficit with China

IN BILLIONS OF U.S. DOLLARS



Source: U.S. Census Bureau.