TRADE POLICY-ESSENTIAL OBJECT OF THE ECONOMIC AND LEGAL FRAMEWORK OF INTERNATIONAL RELATIONS

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Abstract:
Nowadays it is widely accepted in theory and practice of international economic relations that trade policy measures are the object of international trade negotiations performed ab initio, in a bilateral framework, which evolved later towards regionalism and multilateralism. In our opinion international trade negotiations have as their object the coordination of the trade policies of participating countries in order to achieve mutual benefits. On the other hand, the concluding of trade agreements, conventions and treaties, defining elements of the economic and legal framework of international relations confirms the proper completion of international trade negotiations.

Key words*: trade policy; international trade; international economic relations; economic and legal framework; international trade negotiations*

JEL classification**:** *F01, F05, F13, F52, F59*

1. GENERAL CONSIDERATIONS

Participation in international trade agreements is not compulsory and the governments are assumed to enter into such agreements voluntarily. This means that agreements must allow all participants to obtain a part of trade benefits.

In these circumstances, we mention that with the appearance of preferential agreements these advantages may, at least in part, to be transferred from non-participants, to participants, one possibility that is shown below. However, in case of the multilateral agreements the benefits of participants should not be obtained from those who are not actually trading partner. Multilateral Trade Agreements, should generate mutually advantageous earnings which adds to the obtained benefits. [1]

The economic traditional approach illustrates the shortcomings and trade externalities between states or, in other words, the fact that a country can improve its welfare by using modern commercial instruments, through the use of taxes and tariffs, and not just the classic free trade

Thus, we consider two large trading partners, A and B, facing two policy options. Each of them can either choose a free trade policy or impose a tariff that raises its own real income but reduces its trading partner's income.[5]

Assume also that governments can assign numerical values to the satisfaction they will derive from each policy outcome. Table below shows the corresponding payoff matrix depending on whether or not the trading partners choose to cooperate. The first figure in each square is the payoff for country A, while the second is the payoff for country B.

The payoffs in the matrix reflect the idea that each of the two countries can raise its welfare compared to the free trade position at the expense of its partner. This is an application of what economists call the terms-of-trade argument for a tariff. This argument, which plays a crucial role in the received theory, goes as follows. A country may apply a tariff to lower the price of its imports and thereby generate a terms-of-trade benefit.[6]

Table 1 - Matrix results of free trade or protection

		B Free trade	B Protection
A	Free trade	10/10	-10/20
A	Protection	20/-10	-5/-5

Source: Krugman, P. R., Obstfeld, M., International Economics: Theory and Policy, Forth Edition, Published by De Boeck, Bruxelles, 2004, p. 274

To do this, the country needs to be large enough to affect the prices of foreign exporters. When a large country imposes a tariff on imports of product X, it reduces world demand for this product sufficiently to depress its price on the world market. The large country thus obtains its imports of product X at a lower price. By analogy with a domestic tax that is partly paid by domestic producers, the tariff can be thought of as a tax on imported goods which is partly paid by foreign producers who cannot fully pass it on to domestic consumers and so end up bearing part of the burden. Obviously, this "terms-of-trade" benefit must be set against the costs of the tariff, which arises because of the distortion that the tariff introduces. It can be shown, however, that large countries can be better off with a tariff than with free trade. In short, the terms-of-trade case is an argument for using a strong market position to extract gains at a partner's expense.

Given those payoffs, each country is better off choosing to protect if it takes its partner's strategy as given. This captures the idea that countries, if they act unilaterally, end up in a trade war. Predatory behaviour by one of the trading partners induces retaliation by the other. A "trade war" is a stable equilibrium (Nash equilibrium) as once protection is in place neither one nor the other country would have an incentive to reduce its tariff unilaterally.

This is because it has no reason to expect the other to reciprocate and if the other does not reciprocate, the country that liberalizes is worse off. [4] At the same time, however, both countries would be better off if they both chose free trade. This reflects the fact that one country's net terms-of-trade gain is less than the cost it imposes on its partner. Eliminating the tariffs on both sides thus yields a net gain for both countries. AII this means that if the two countries do not cooperate, they end up in the lower right corner of the matrix, whereas they would both be better off in the upper left corner. This situation is known as a prisoners' dilemma. Cooperation, in the form of a trade agreement, offers an escape from the prisoners' dilemma.[7]

A trade agreement does not eliminate the beggar-thy-neighbour temptations of its signatories. This means that enforcement is a key issue. In order for the signatories' tariff reduction commitments to be credible, the agreement must be effectively enforceable. In the absence of other forms of punishment, this means that the short term gain of deviating from the commitment must be balanced by the long term loss from retaliation. Applying game theory, enforcement issues have been analysed using a repeated game setting with an infinite number of periods. A number of interesting insights can be drawn from this approach.

First, the "most-cooperative" tariffs that can be achieved will depend on the enforcement constraint. The more they differ from the Nash equilibrium, the larger the incentive to cheat.

Second, this perspective sheds an interesting light on the GATT/WTO dispute settlement procedures. They can be seen as an attempt to move from a non-cooperative equilibrium to a cooperative equilibrium by limiting the use of retaliation along the equilibrium path and repositioning it as a threat that serves to enforce the cooperative equilibrium.

The literature distinguishes between two approaches to trade negotiations. These approaches explain how governments can escape the prisoners' dilemma and move from the inefficient non-cooperative equilibrium to the political optimum.

Third a power-based approach is one where governments bargain over tariffs without having previously agreed upon principles of negotiation. Under a rules-based approach, on the other hand, governments identify and agree upon certain principles by which subsequent negotiations must abide. The negotiations approach embodied in the GATT/WTO is of the latter type. The inefficiency reflected in excess protection and too little market access - which trade agreements address - arises because foreign exporters' interests are not taken into account in domestic trade policy decisions. When country A imposes a tariff on imports from country B, it inflicts a cost on country B exporters in terms of lower prices. The inefficiency arises because A's government does not take this cost into account when setting its tariff.

In conclusion we can consider that the example presented above is one simplified, but in the real world, there are many countries with various intermediate levels in the trade policy between free trade and total protection.[8]

However, the example used highlights two important aspects: on one hand it is necessary to harmonize trade policies by international agreements, and on the other hand these Agreements make, in fact, the difference between results.

2. TRADE POLICY – MOST IMPORTANT COMPONENT OF THE INTERNATIONAL ECONOMIC RELATIONS SPHERE

Great Financial Crisis of 1929-1933, has revealed a need for stronger international arrangements, to harmonize regulations on foreign trade policy to accelerate the liberalization of exports and imports between states. After the Second World War, decisive contribution to establishing the basic principles of foreign trade policy has been brought through the General Agreement on Tariffs and Trade (GATT, which came into operation in 1948). Over nearly 50 years of the GATT (until 01/01/1995) basic principles of trade between Member States were following: non-discrimination, using the duty to protect national economies and to prohibit the use of quantitative restrictions, elimination or limitation of export subsidies, use of dispute settlement consultations and decision, usually by consensus.[2]

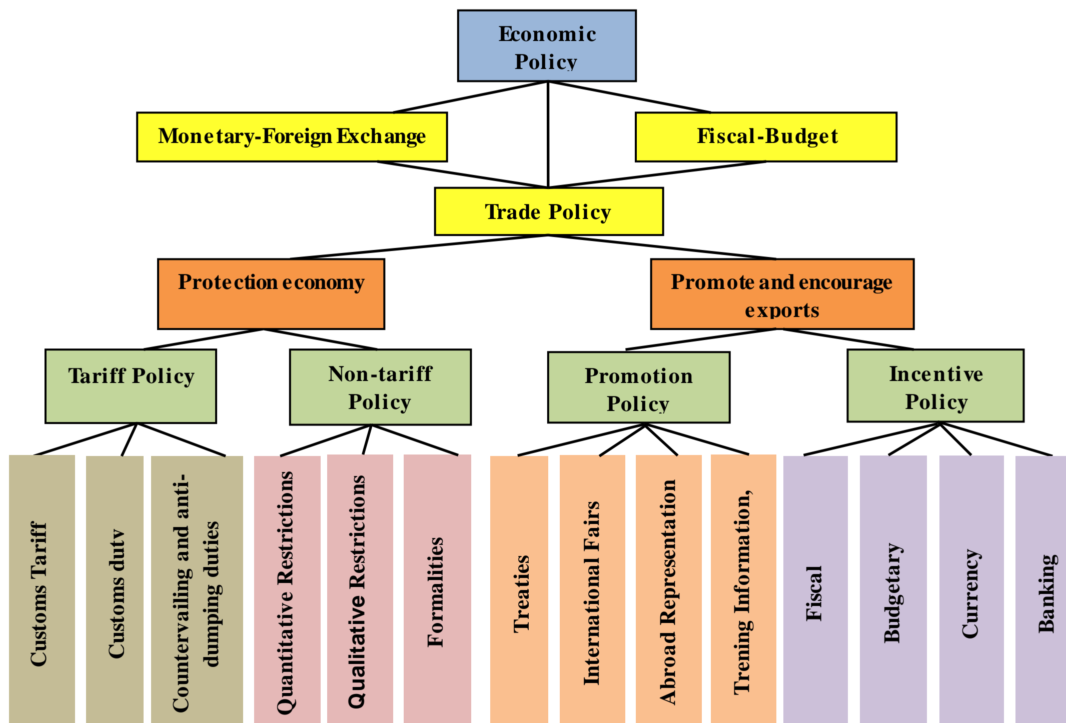
Trade policy is a part of state economic policy which aims the sphere of its external economic relations. As same as economic policy, it is an attribute of sovereignty of any independent state. In a broader sense, trade policy means all rules adopted by the State, (legal, administrative, fiscal, budgetary, financial, banking, currency, etc.) to promote or restrict foreign trade and to protect the national economy against foreign competition. In other news we believe that trade policy is a set of rules adopted by countries to regulate its foreign trade and external payments.

As shown in literature, we believe that the main trade policy instruments are: tariff instruments, (tariff policy), nontariff instruments (non-tariff policy), and means to promote and stimulate exports (promotion and incentive policy) as shown in the figure 1.

Regarding the tariff policy should be noted that this is done mostly by means of customs tariffs, considered by international trade rules (General Agreement on Tariffs and Trade (GATT) incorporated in 1995, the World Trade Organization - WTO), as the main tool to protect the national economy, mainly aimed on the import, trying to discourage or even stop it, directing consumers to domestic products.

Non-tariff trade policy encompasses a myriad of regulations and practices that lead to discrimination, or the restriction of imported goods when circumstances require in relation to the domestic products.[3]

Figure 1 - Components of trade policy



Fota, C. International trade and international trade policies, Sitech Publishing House, Craiova, 2007,

From this perspective, even habits and consumer preferences could be stigmatized by the term non-tariff barriers in the way of imports. Conversely, promotion incentive policy aimed at export which proposes to develop it as much as possible. Nowadays, more and more states do not focus so much on the import restriction policies but especially on the export development and promotion policies, because it is well known that a country is more prosperous, when it has the ability to import more, in terms of higher exports. Given that external economic relations are an important factor of economic growth, main long term objective which states pursue through their trade policy measures and instruments is to stimulate the national economy in relation to foreign competition. Hence the trade policy of any country needs to fulfill three main functions:

- Promotion of foreign economic relations, meaning boost exports;
- To protect the national economy against foreign competition, meaning regulation and control of imports in the spirit of agreements to which that country is a party;
- To achieve a dynamic balance of trade and payments at the same time as increasing foreign exchange reserves of the state.

It is significant that these objectives may differ significantly from state to state, depending on the major directions pursued by it, respectively:

- The substantial increase in export production;
- Selectively encouraging of the export certain product groups, to diversify sales of goods abroad with higher value added and high labor productivity;
- The trade stimulation with certain countries and regions, to improve sensitive the exchange ratio, by increasing the purchasing power of exports;
- The protection of national economy against foreign competition;
- Equilibrating the negative trade balance, by reducing imports;

3. CONCLUSIONS

The ultimate goal of any policy must be to obtain commercial gain from international trade, namely a working economy and a substantial contribution of foreign trade activity in the economic growth country.

In terms of external trade policy principles, it should be noted also that, initially, these principles have resulted from the interests of States to develop a favorable foreign trade to respond the desideratum of their internal development and promotion of beneficial international trade relations. In a long time regulations, measures and actions in commercial transactions with other countries, were taken unilaterally, or taking into account the terms of the bilateral trade agreements or conventions between these countries.

Finally we can consider that on the basis of external trade policy states is the legal and economic framework of international relations.

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