



GROUP OF EIGHT

Energy and Trade Policy

By John James Snidow

Introduction

Economists are typically opposed to the use of **tariffs** to **bolster** domestic industries or to block foreign goods. They point to the negative efficiency consequences tariffs have on an economy and point to tariffs—particularly energy tariffs that concern the energy sector of the economy—as a major stumbling block to a country’s economic development.

Curiously, however, policymakers often do not heed economists’ warnings, and many countries have tariffs firmly in place. The phenomenon is not recent, either. Tariffs have been with the world since time immemorial. The Romans had tariffs on goods produced in certain parts of their empire. The British taxed and levied **excise fees** on goods from their colonies in the Americas, Australia and India. Even within the United States, tariffs have been important historically. The American Civil War was motivated in part by the South’s distaste for the Northern tariffs on foreign manufactured goods, which they thought disproportionately hurt the more **agrarian** southern states.

And tariffs are still with us today. Many primary exports—minerals, agricultural products, energy sources—are taxed at very high rates. However, even many processed goods—clothing, food, automobiles—carry substantial tariffs, leading to the spread of the so-called “duty free shop” that can be found in every international airport in the world.

In the last decade, trade negotiations have focused on steel and steel-based products. The US and Japan, being large exporters of steel and cars, respectively, have worked to try to reduce the barriers to trade between them with limited success. The same can be said for energy products, which are still often taxed in their raw form—crude oil, unprocessed coal, and liquid natural gas—and in their processed form—gasoline and **coke coal**.

As the global economy enters what could be a very pronounced downturn accompanied by skyrocketing energy prices, the reduction of tariffs may be a way to inject some additional vitality into the economy. Unfortunately, however, the theory is not always so simple, and, worse, the practice of geopolitics makes gaining consensus on energy tariffs nearly impossible.

Tariffs—*A tax on certain imported goods.*

Bolster—*To give a boost to.*

Excise fees—*A tax on the manufacture of certain goods.*

Agrarian—*Rural or relating to farming.*

Coke coal—*A part of coal used for fuel.*

Explanation of the Problem

Economists dislike tariffs because they distort the prices faced by producers and consumers, and subsequently cause a reduction in output of the taxed goods. For instance, let us take a simple example: a tax on steel. Basic economic theory predicts that, under a tariff, the price that buyers pay would increase, price that sellers receive would decrease and the overall quantity of steel produced would also decrease.

The link between output and tariffs, then, is one of prices. To take an even simpler example, imagine a city's demand for ice cream. If the price of ice cream goes up, we expect buyers to consume fewer cones of ice cream. Since a tariff is, at its core, an artificial **inflation** of the commodity's price, it also results in lower output.

Inflation—A rise or increase.

While trade theory is difficult and the specifics beyond the scope of this briefing, there are some major takeaway points:

- In general, tariffs present a drag on the world economy. Even the country who levies the tariff is better off without one in total.
- Although the net effect of a tariff is negative, some in a country will gain from it. For instance, if a tariff is levied on non-US automobiles, Chrysler will be very happy, but automobile consumers will be hurt. Thus, while tariff reduction is good overall, it makes things better for some and worse for others.
- There are certain assumptions about an economy that can allow for a net gain as the result of a tariff. However, these assumptions are complicated and very rare. In general, economists are in agreement that tariffs are bad economic policy.

The difficulty in trade barrier reduction, then, is convincing those that are hurt by the trade liberalization to accept the loss in favor of the general or greater good. This is more complicated than it seems when the “losers” from trade barrier reduction are often large multinational corporations with large financial stakes in preventing tariffs from being lifted.

In general, consumers benefit from the reduction of tariffs, while export firms lose. Thus, policymakers with corporate **constituents** vote against trade liberalization and are pitted against policymakers with consumer constituents.

Constituent—One who authorizes another to act as their agent.

Besides considering voters, leaders consider the basic characteristics of their country in making these tough economic decisions. For example, countries that are primarily exporters are against tariffs in other countries, but they are in favor of tariffs in their own countries. The more an economy is based on primary exports, the more a country tends to favor trade liberalization. For instance, much of South America, which thrives on its agricultural exports—coffee, timber, and me-

dicinal plants—favors the reduction of tariffs. On the other hand, US coffee producers and timber firms support the tariffs because they protect them from outside competitors. Conversely, US **pharmaceutical** manufacturers—who rely upon the crops of South America as ingredients—oppose the tariffs as it makes their drugs more expensive to manufacture.

As you can see, the politics of trade are highly complex. It is difficult to determine whether a country will be in favor of or opposed to tariffs. Their stance inevitably depends on the business structure of their country (exports vs. service sector), their location in the world (landlocked vs. island nations), the tastes of their citizens for foreign or domestic goods, the demographics of their country (urban vs. rural, ethnic composition, **socioeconomic** status), and a host of other factors. Even within the country, regional differences in geography and business structure make building a consensus difficult at the national level.

Despite the entrenched special interests that make it extraordinarily difficult for governments to change trade policy, one overarching principle motivates governments to continue to try: the belief that free trade can be good for everyone. Governments have faith that through each country's self-interested but mutual transaction, everyone's income can increase. Economists believe that trade may be the developing world's best hope; by liberalizing the terms of trade, it is hoped that the poor of the world may be raised, through time and discipline and good governance, into affluence.

Pharmaceutical—*Relating to drugs, medicines, and other pharmaceuticals.*

Socioeconomic—*A combination of social and economic factors, in this context referring to personal wealth.*

Recent Developments

Energy Crisis

The recent energy crisis of the 2000s has provided several circumstances that will likely affect member states' views on energy tariffs. Due to the incredibly high prices, it may no longer be in the best interest of a country to refuse energy products, such as oil, from foreign producers. There is a tipping point for every country when cheaper prices for its citizens becomes more important than attempting to preserve domestic jobs by implementing protective tariffs, and several countries have reached this point in recent months.

H.R. 6401

While not a G8 action, a piece of legislation introduced in the US House of Representatives is a good example of how energy “feed-in” tariffs can be utilized to **incentivize** certain behaviors in the energy industry.

A feed-in tariff offers a long-term guaranteed price contract—usually about 15-20 years—to any entity that contributes electricity to the grid via renewable sources like solar, wind, biomass, landfill gas,

Incentivize—*To provide with an incentive, or an impetus to action.*

small hydro, geothermal and methane. Whereas existing policy mechanisms like the production tax credit favor large corporations with sizable tax liability, and investment tax credits favor those folks who can afford a large upfront cost that comes with a 20-30 year payoff, this policy tool encourages the distributed generation of renewable energy and it levels the playing field by providing long-term investment security for small businesses, homeowners, churches, schools and others, so they are more willing to make the financial commitment that is necessary for installing renewable energy themselves.

In terms of their success, feed-in tariffs have performed remarkably well throughout Europe, and especially in Germany, where some 55% of the world's solar power capacity resides. During this recent energy crisis, these special types of tariffs may prove to be the solution for some members of the G8.

Focus of the Debate

Canada

Canada's major natural resource lies in its large petroleum reserves of its northern provinces. Because Canada exports so much of its oil, the country will likely be in favor of a reduction in energy tariffs; however, it is not so simple. Canada is also a liberal democracy with quite a bit of political **fractionalization**. The more liberal and urban provinces—Quebec, Ontario, and the Maritimes—feel that the liberalization of energy tariffs has led to an overconsumption of energy that may be fueling the world's current environmental problems. Thus, the leaders of Canada will have to weigh the economic interest of the oil-producing provinces—Yukon, Northwest Territory, British Columbia, and Alberta—against some of the less pro-oil political interests of the rest of the country.

Fractionalization—
Broken into many pieces or sections.

France

France is one of the most energy-independent countries in the world due to its heavy investment in nuclear power over more traditional fossil fuels. Because France does not have large amounts of exportable natural resources—such as oil or natural gas—and because French consumers still need some energy to heat their homes and fuel their cars, the country has little to lose from a full-throated support of tariff reduction in the energy sector.

Italy

Italy has a diverse and complicated economy. The north of Italy is dominated by private firms who export to foreign markets. Many of these industries, namely luxury automobiles, such as Ferrari, Lamborghini, luxury boats, such as Azimut and Ferretti, as well as luxury food,

like Campari and Ferrero, are very sensitive to the price of transportation and fuel costs. These industries would favor the rest of the world reducing tariffs but maintaining Italy's own.

Southern Italy, on the other hand, has a much more agrarian economy. These areas, because food prices are so dependent upon transportation and fuel prices, would likely be in favor of dramatic reductions in tariffs across the board. Italy, too, will have to balance both international concerns as well as domestic disagreement as to the proper course of action.

Japan

Japan imports some 85% of their energy from abroad. They have much to gain from tariff reduction because there is little interest in maintaining **protectionist tariffs** since there are few producers to actually protect. Because they rely on imports for their energy supply, it would make little sense for Japan to effectively increase the cost of this import by supporting a tariff.

Protectionist tariffs—
Tariffs whose purpose is to protect domestic industries from foreign competition.

Russia

Russia has enormous oil reserves. This oil wealth will likely dominate any Russian discourse on terms of trade. However, remember again that even the politics in an energy-based country are complicated: oil companies wish domestic tariffs to remain high in order to shield domestic sales from outside, foreign competition, but want international tariffs to be removed so that foreign markets will stay fertile and purchase from them.

United Kingdom

The UK is in a similar position to the United States and Canada. It has some significant energy resource, such as oil reserves in the North Sea and coal reserves in South Wales. However, the UK actually imports much of its energy needs. The British G8 delegation will need to balance these opposing interests when considering support for energy tariffs.

United States

The US is all over the map in terms of tariff reduction. While the US exports much of its oil, natural gas and especially coal, the US is also dependent on foreign sources of energy. Consumers of that energy within the US would benefit from a tariff reduction on the gasoline and heating oil that powers their cars and their homes, respectively.

There is a geographic component to the United States' stance as well. Texas, Louisiana and the Appalachian region—West Virginia, Kentucky, Tennessee, and some parts of Virginia—whose economies are based on energy will likely be in favor of the tariff reduction in the

rest of the world. However, these same populations will not want the US to reduce its own tariffs on similar commodities, which would cause their businesses to decline. On the other hand, more liberal, coastal populations of Americans are typically critical of energy industry prices and practices and would not prefer them to receive any sort of help from the government.

NGO Perspectives

Greenpeace

Greenpeace is generally ambivalent toward trade in theory. However, because Greenpeace is opposed to many of the energy industry's practices—coal mining, coal electricity production, and sometimes oil spills—they are opposed to lifting tariffs. They argue that lifting tariffs will encourage and incentivize many of the unsustainable energy practices that they oppose, such as increased carbon emission and increased greenhouse gas production.

Amnesty International

Amnesty International is also not opposed to trade and lifting tariffs. However, as with several other issues at HMCE, there are human rights implications associated with potential trade liberalization policies. Amnesty opposes allowing freer trade with regimes that it finds to be chronic abusers of human rights, which would include man oil-exporting nations. On the other hand, trade sometimes leads to human rights being more permanently cemented in a society because as a country opens and becomes richer, it often becomes freer.

Oxfam

Oxfam, an abbreviation of Oxford Committee on Famine Relief, is a conglomerate of 13 international organizations dedicated to a central mission of eradicating poverty. Oxfam believes that “poverty is not inevitable” and firmly supports the ideals of “fair trade,” which does not necessarily mean the same thing as free trade.

In addition to lobbying for more foreign aid, the organization often lobbies against multinational corporations. In one especially high-profile event, Oxfam became embroiled in a spat with Starbucks over the price given to Ethiopian farmers for their coffee beans. Starbucks claimed that their purchase of Ethiopian coffee was ultimately beneficial to the farmers and most economists agreed. The British magazine *The Economist* disagreed, however, and published a fairly scathing critique of Oxfam's stance in November of 2006.

Oxfam's position on trade is very **nuanced** and depends on the situation and context in question. If the terms of trade are what they consider “fair,” then they will likely support the tariff reduction as a

Nuanced—Full of subtle distinctions.

means to eradicate poverty. However, in several instances, Oxfam has actually opposed liberalization of trade.

Possible Solutions

Lift All Energy Tariffs

One approach to resolving this issue is to lift all tariffs on energy multilaterally. Proponents of this solution point to the fact that trade, if allowed to operate freely, is beneficial to everyone in the long run and in the aggregate. Opponents of this cite the shocks that an economy may experience as a result of lifting tariffs on this grand scale. As some industries are helped and some hurt, an economy can **porpoise** up and down as the system begins to stabilize.

Porpoise—To rise and fall repeatedly.

Partially Lift Tariffs

A less drastic approach would be to lift some of the tariffs on energy, while strategically maintaining others. Proponents of this solution argue that some tariffs are good because they encourage each country to produce energy at home, which many countries prefer for security reasons. Selective tariffs allow policymakers to target exactly what commodities need to be traded more freely. In addition, the differential lifting may also limit the shock to the affected industries and overall economies.

Preserve Status Quo

Still other economists believe that tariffs should be preserved as they stand today. In today's economic climate, tariff reduction may cause shocks in the global economy. Some argue that while in the long-run trade liberalization is desirable, right now it would be more hurtful than helpful. This is an argument, of course, about timing, rather than overall efficacy.

Raise Tariffs

The use of fossil fuels causes pollution. Many, particularly those in the more left-wing environmental camp, feel that taxes limit the amount of carbon and greenhouse emissions. They argue that raising tariffs would be helpful to the environment, and, thus, be desirable.

Questions for Policymakers

How much are we going to reduce tariffs? And, if so, by what standard? Should all countries be required to reduce tariffs the same amount or will some countries be shielded on the basis of poverty, affluence or economic characteristics?

And even after the ideal system is devised, there is the question

of enforcement. Because countries have the incentive to cheat and raise tariffs, enforcing and maintaining a low-tariff regime becomes extremely difficult. What punishments will be placed on those who defect from the agreement—and who will punish them?

Finally, there are questions of implementation. Is this the right time? The economy of the world is a complicated and interwoven fabric, and today's rocky economic times only highlight the uncertainty surrounding any structural shocks to the global terms of trade. Systemic changes such as tariff reductions must be carefully studied and carefully timed as even small **perturbations** of the economic balance can have rippling effects that can plunge entire nations into poverty or flood dictators with millions of war-funding dollars.

Perturbation—A disturbance of motion, course, arrangement, or state of equilibrium.

Conclusion

The task that lies before you will prove to be a very difficult one as there are many different viewpoints from the various member states of this committee. There are economic, political, national, and environmental aspects to weigh during the legislation process, and you, as the representative in the G8, must voice your country's primary concerns in addressing this serious issue.

Guide to Further Research

Trade theory is very complicated, but there are a few sources that will be helpful to gain an elementary understanding of the economic implications of trade barriers. There are many economists who do work on international trade, including Richard Cooper, Maurice Obstfeld, Greg Mankiw, Paul Krugman and Kenneth Rogoff.

Professor Mankiw has written two textbooks with chapters on international trade and the economics of tariff reduction: *Principles of Economics*, an introductory text, and *Macroeconomics*, which covers the same material with a more analytical focus.

Krugman and Obstfeld have written an excellent, but very dense, textbook on international economics, aptly named *International Economics*. The book covers many topics but spends the first chapters with an extensive examination of the mechanics of trade. However, this book is highly technical and is far beyond what is required of a delegate.

If you are more interested in the political side of the trade debate, the Office of the US Trade Representative is an excellent resource. Their website contains information on the current US trade policies as well as other resources. Many countries have **analogous** government offices that should give information as to each country's view on tariff reduction.

Analogous—Having similarities and likenesses.

Finally, there are a few popular books and publications that discuss trade extensively. For those lucky enough to have access to *The Economist* magazine, it typically has many articles in each issue on trade and ways to promote or discourage it. In addition, New York Times columnist Thomas Friedman—who has been referred to as the “high priest” of trade **fundamentalism**—has published several popular press books on trade, globalization and the interconnectedness of economies in the new millennium. The two best titles are *The Lexus and the Olive Tree* and *The World is Flat*.

Fundamentalism—A movement or attitude stressing strict and literal adherence to a set of basic principles .

Bibliography

American Red Cross. <www.redcross.org>.

Amnesty International USA. <<http://www.amnestyusa.org>>.

Friedman, Thomas. The Lexus and the Olive Tree. Anchor, 2003.

Friedman, Thomas. The World is Flat. Picador, 2007.

Krugman, Paul, and Maurice Obstfeld. International Economics. 8th ed. Addison Wesley, 2008.

Mankiw, N. G. Macroeconomics. 2nd ed. Worth, 2006.

Mankiw, N. G. Principles of Economics. 4th ed. Southwestern College, 2003.

Office of the United States Trade Representative. US Government. <<http://ustr.gov>>.

Oxfam International Website. <<http://www.oxfam.org>>.

USA GreenPeace. Greenpeace. <<http://www.greenpeace.org>>.

"Various." The Economist Magazine. All years.

"The World Factbook." CIA Fact File. Central Intelligence Agency. <<https://www.cia.gov/library/publications/the-world-factbook/>>.