全国高等院校经管专业双语教材
全国高等院校商务英语专业规划教材（本科）
“十三五”高等院校国际经济与贸易专业规划教材

# 国际贸易理论与实务

## （英文版）（第五版）

## International Trade Theory and Practice (The Fifth Edition)

张素芳 编著



对外经济贸易大学出版社
University of International Business and Economics Press

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中国·北京

# 出版说明

随着中国与世界日益频繁的经济互动，用国际上的通用语言来思考、交流、工作的能力也越来越受到重视，既具有扎实专业知识又掌握娴熟外语的复合型人才成为现今市场的主要需求。双语教学就是在这种背景下顺应时代的产物。

根据教育部高等教育司的定义，双语教学是指将母语外的另一种外国语言直接应用于非语言类课程教学，并使外语与学科知识同步获取的一种教学模式。双语教学体现了现代教育思想，融外语与学科知识教学于一体，注重提高学生专业外语水平和直接使用外语从事科研的能力；注重促进学生专业知识、外语水平及能力素质的全面发展，增强学生直接使用外语从事国际经贸的涉外能力、适应能力以及国际商务实战技能。

为了适应市场需求和高校教学需要，对外经济贸易大学出版社组织编写了这套全国高等院校经管专业双语教材。这套教材主要适用于全国高等院校经管、金融、法律等专业、商务英语专业和英语专业的商务/应用/外贸英语方向的学生。

本系列每本教材的编著均遵循“user-friendly”（方便使用者）的指导思想，从体例安排到语言风格均旨在满足使用者（包括教授方与学习方）的实际需求，力图避免外文原版教材在体例与内容上使中国学习者“水土不服”的弊端。整套教材内容包括《国际贸易理论与实务（英文版）（第五版）》《国际商务谈判（英文版）（第二版）》《国际贸易实务（英文版）（第四版）》《国际贸易实务（英文版）（第二版）辅导用书）》《国际金融（英文版）（第二版）》《国际贸易法（英文版）（第二版）》《国际商务管理概论（英文版）》《基础会计（英文版）（第二版）》《基础会计（英文版）（第二版）教师用书）》《新编国际结算与案例（英文版）》等。本系列教材将从国内高等院校的教学实际出发，随着高校双语教学的发展而扩充完善。

本套教材的编写队伍来自全国重点高等本科院校，编写教师均有着双语实际教学经验，这是本套教材编写质量的重要保证。

对外经济贸易大学出版社

2018年1月

# 前　言

承蒙广大读者的厚爱，本教材自第四版出版以来，已经屡次重印。近几年国际贸易中出现了一些新趋势和新特点，因此，此第五版对相关内容进行了补充或更新。与第四版一样，本书仍分为两大部分：第一部分为国际贸易理论与政策，第二部分为国际贸易实务。两部分既可单独使用，也可同时使用。“国际贸易”课程可使用第一部分，即第1章至第10章；“国际贸易实务”课程可使用第二部分，即第11章至第18章；“国际贸易理论与实务”课程则可使用整本教材。

本教材适合国际经济与贸易专业、金融学专业及国际经济学专业的本科生，以及具有大学英语四级水平和微观经济学基本知识、从事或准备从事国际经济贸易工作的读者使用。

本书得以出版，感谢对外经济贸易大学出版社的大力支持！感谢教育部国家级双语教学示范课程项目（项目号：XM0823）提供的经费资助！感谢GOOGLE公司提供的极其丰富的英文电子图书！编写过程中笔者参考了大量国内外文献，在此向各位作者一并致谢！

书中不妥和疏漏之处，恳请读者指正！

此外，本书配有教学课件（PPT），供教师教学参考，请登录对外经济贸易大学出版社资源网下载。

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运费付至（……指定目的地）

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装运港船边交货（……指定装运港）

3.DAP—Delivered at Place （...named place of destination）
目的地指定地点交货（……指定目的地）

4.DPU—Delivered at Place Unloaded （...named place of destination）
目的地指定地点交货，已卸货（……指定目的地）

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# Section I International Trade Theory and Policy

# Chapter 1 Introduction to International Trade

Learning Objectives

In this chapter, you will learn:

- Reasons for international trade
- Differences between international trade and domestic trade
- Basic concepts concerning international trade

International trade is the exchange of goods and services across national borders or territories.It is also known as world trade， import and export trade or overseas trade in island nations such as Great Britain， Japan， etc.In most countries， it represents （占） a significant share of gross domestic product （GDP）.While international trade has been present throughout much of history， its economic， social， and political importance has been on the rise only in recent centuries.Industrialization， advanced transportation， globalization， and multinational corporations are all having a major impact on the international trade system.Increasing international trade is crucial to the continuance of globalization.International trade is a major source of economic revenue for any nation that is considered as a world power. Without international trade， nations would be limited to the goods and services produced within their own borders or territories.

This chapter firstly illustrates the reasons for international trade, and then discusses the major differences between international trade and domestic trade.Finally, it makes an introduction to some of the basic concepts concerning international trade.

## 1.1 The Reasons for International Trade

Why does international trade take place? There are numerous reasons.

## 1.Resources reasons

No nation has all of the commodities that it needs.Some countries are abundant in certain resources， while other nations may lack them.For example， the Colombia and Brazil have the ideal climate for growing coffee beans.The United States is a major consumer of coffee， yet it does not have the climate to grow any on its own.Consequently （因此）， this has made Colombia and Brazil big coffee exporters， and the United States a big coffee importer.Raw materials are scattered （分散） around the world.Large deposits （矿产） of copper are mined （开采） in Peru and Zaire and diamonds are mined in South Africa.Countries that do not have these resources within their own boundaries must import from countries that export them.In short， the uneven （参差不齐的） distribution （分布） of resources around the world is one of the most basic reasons why nations trade with each other.

## 2.Economic reasons

Along with the development of manufacturing and technology， there arose another incentive （诱因） for nations to trade， i.e.， economic benefits.In addition to getting the products they need， countries also wish to gain economically by trading with each other.China has been able to export large quantities of radios and television sets because it can produce them more efficiently than other countries.It is cheaper for countries like the United States and European countries to buy these than to produce them domestically.According to economic theory，China should produce and export those items from which it derives （获得） a comparative advantage （比较利益）.It should also buy and import what it needs from those countries that have a comparative advantage in the desired items[1].

## 3.Other reasons

A country often does not have enough quantity of a particular item to meet its needs.Although China is a producer of oil， it consumes more than it can produce internally （内部）and thus must import oil.Even though a country can produce enough quantity of an item at reasonable costs to meet its own demand， it may still import some from other countries for innovation or a variety of style.For example， the United States produces more automobiles than any other country； it still imports large quantities of autos from Germany， Japan， and Sweden， primarily because there is a market for them in the United States.Sometimes，political objectives can outweigh （超过） economic considerations between countries.One country might trade with another to support the latter's government which upholds （坚持） the same political doctrine （信仰）.

To sum up, in today's complex economic world, neither individuals nor nations are self-sufficient.Nations have utilized different economic resources; people have developed different skills.This is the foundation of international trade and economic activities.

# 1.2 The Differences between International Trade and Domestic Trade

International trade is in principle not different from domestic trade as both are exchange activities.The fundamental characteristic that makes international trade different from domestic trade is that international trade involves activities that take place across national borders.Problems that are not normally experienced when trading at home may arise（出现）in international trade.

## 1.More complex context

Under the context （环境） of international trade， deals might have to be transacted in foreign languages and under international or foreign laws， customs （习惯） and regulations.Numerous cultural differences may have to be taken into account when trading with other nations.Before a corporation begins exporting products to other countries， it must first examine the norms， taboos （禁忌） and values of those countries.Control and communication systems are normally more complex for foreign than for domestic operations.Foreign currency transactions will be necessary.Exchange rate variations （汇率变动） can be very wide and create many problems for international trade.

## 2.More difficult and risky

Due to the complex context of international trade, it is generally much more difficult and risky than domestic trade.In international trade, information on foreign countries needed by a particular firm may be difficult to obtain.

Risk levels might be higher in foreign markets.The risks include political risks such as war risks， risk of expropriation （征收） or confiscation （没收） of the importer’s company， risk of the imposition （实施） of an import ban after the shipment of the goods， transfer risk （the imposition of exchange controls by the importer’s country or foreign currency shortages） and risk of different tax rates， etc.； economic risks like risk of insolvency （破产） of the importer，risk of protracted （拖延的） default （the failure of the importer to pay the amount due within six months after the due date） （拖欠债务）， risk of non-acceptance， risk of exchange rate as well as susceptibility （敏感性） to changing standards and regulations within other countries.

## 3.Higher skills required

Business professionals engaged in international trade need a broader ra nge of professional skills than those who are only concerned with domestic problems.

# 1.3 Basic Concepts Concerning Internati onal Trade

## 1.Visible trade and invisible trade （有形贸易与无形贸易）

Visible trade and invisible trade refer to merchandise trade and trade in commercial services respectively.As shown in Figure 1-1, the value of merc handise trade and trade in commercial services in 2019 was nearly twice as high as in 2005.

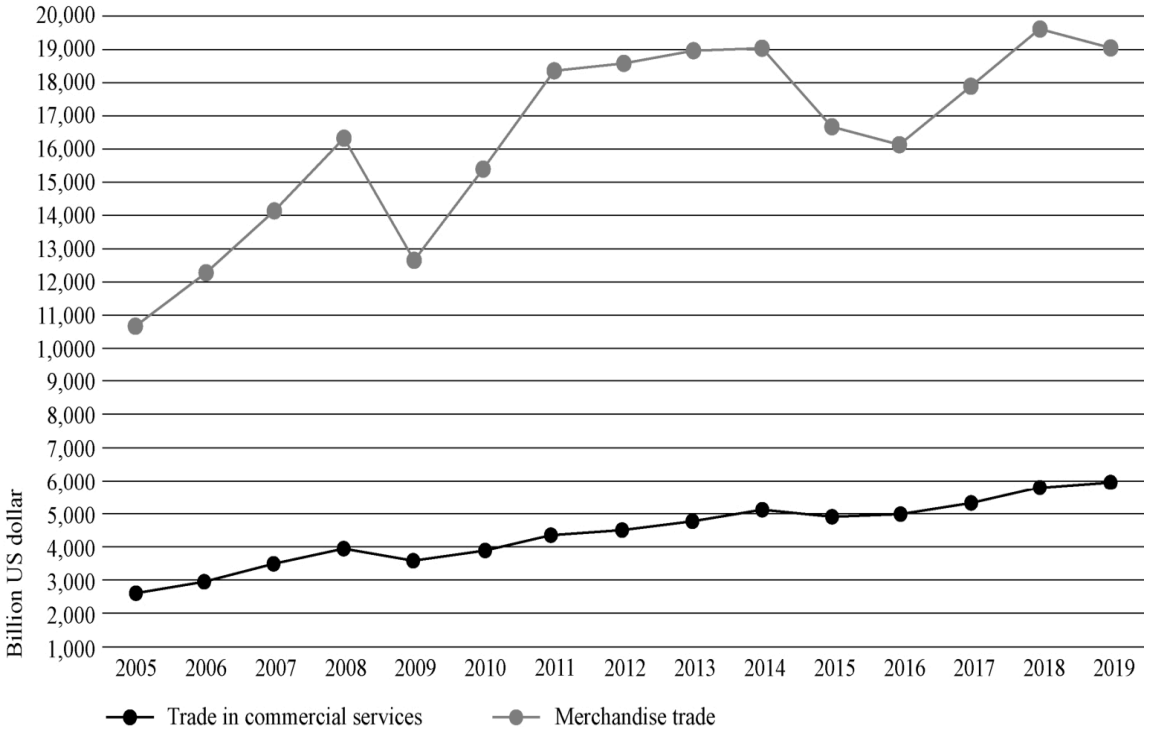



Figure 1-1 World merchandise trade and trade in commercial services, 2005-2019

Source: https://data.wto.org/

(1) Visible trade: trade in merchandise[2]

When nations import or export goods， customs formalities （海关手续） have to be carried out.Thus goods transactions are observable （能观察到的）.The usual customs records or data are available for valuing these transactions.That is why these transactions are called visible trade.At present， the share of international visible trade is around 80％ of the total value of international trade.In 2019， merchandise exports of World Trade Organization （WTO）members[3] totaled US$18.5 trillion.

For the purpose of collecting statistics of many varieties of goods in international trade，the UN Secretariat （秘书处） drafted the Standard International Trade Classification （SITC）[4]（国际贸易标准分类） in 1950， and made amendments to it in 1960， 1974， 1985 and 2006.The current version （Version 4） of SITC classifies international trade commodities into 10 sections，67 divisions， 262 groups， 1023 sub-groups and 1924 basic headings.The 10 sections are： food and live animals （0）； beverages and tobacco （1）； crude materials， inedible， except fuels （2）；mineral fuels， lubricants and related raw material （3）； animal and vegetable oils， fats and wax（4）； chemicals and related products， n.e.s[5]（5）； manufactured goods chiefly classified by material （6）； machinery and transportation equipment （7）； miscellaneous manufactured articles（8）； commodities and transactions not classified elsewhere in the SITC （9）.

(2) Invisible Trade: trade in commercial services

It is extremely difficult to obtain accurate estimates of the value of the transactions of trade in services.This results from the fact that there is no agreed definition of what constitutes traded services， and the ways in which these transactions are measured are less precise （精确）than in the case for merchandise trade.Estimates are obtained by examining foreign exchange records and/or through surveys of establishments （企业）.Since many services are not observable （hence they are referred to as the“invisible” in international trade）， the usual customs records or data are not available for valuing these transactions.Thus it is likely that the value of trade in commer

cial services is underestimated （被低估）.However， there may also be i nstances （情况） where firms may choose to overvalue trade in service s， so reported figures must be viewed with some caution.

International trade in services broadly consists of commercial service s， investment income and government services， with the first two catego ries accounting for the bulk （占绝大部分） of services.Discussions of tra de in services generally refer to trade in commercial services.During the 19 70s， this category grew more slowly in value than merchandise exports di d.However， during the 1980s， exports of commercial services outgrew （发展速度超过）merchandise exports， and the relative importance of c ommercial services is roughly the same today as it was in the early 1980s.T oday， especially in developed societies， services account for large portio ns of national outputs （产量）.

Exports of commercial services by WTO members in 2019 totaled US $5.98 trillion,accounting for 24％ of the total value of international trade.Al though trading of services is still of a relatively small part of the internation al trade, its growth rate is getting more and more rapid.In 2015, the top ten t raders accounted for 54.2％, and developing economies accounted for 38％ of the world’s total trade in commercial services.The two main categories of world trade in commercial services are travel and transportation services.

Trade in services has been virtually ignored in trade negotiations and tr ade agreements.However， because of its increasing importance， there ha s been a growing concern for the need to establish some general guidelines f or international transactions in services.Consequently， discussions regardi ng the nature of trade in services and various country restrictions that may i nfluence it were included in the last completed round of trade negotiations （the Uruguay Round[6]） （乌拉圭回合） conducted under the auspices （在……支持下） of the General Agreement on Tariffs and Trade （关税与贸易总协定） （GATT）， which became the WTO in 1995.Achieving a General Agreement on Trade in Services （服务贸易总协定） （GAT S） was a major focus of the Uruguay Round of GATT negotiations.Develo ping nations （led by India and Brazil） opposed such an agreement becau se they viewed it as a one-way street benefiting the developed world， parti

cularly its banking， insurance， telecommunications and professional bus inesses.GATS does not define“services”， but does define“trade in service s”.Paragraph 2 of Article I defines“trade in services” as the supply of a servi ce through any of the four modes of supply： cross border supply of service s （跨境交付服务）， consumption abroad （境外消费），commercial presence in the consuming country （设在消费国的商业存在）， and pre sence of natural persons （自然人存在）.

1） Cross border supply of services （or“Mode 1”）.Cross border sup ply of services corresponds with the normal form of trade in goods.It is in m any ways the most straightforward （简单） form of trade in services， be cause it resembles （像） the familiar subject matter of the GATT， not le ast （尤其） in maintaining a clear geographical separation between seller and buyer： only the service itself crosses national frontiers.

2) Consumption abroad (or“Mode 2”).Consumption abroad means the supply of a service“in the territory of one Member to the service consumer of another Member”.Typically, this will involve the consumer traveling to t he supplying country, perhaps for tourism or to attend an educational establi shment.Another example of consumption abroad would be the repair of a sh ip or aircraft outside its home country.Like cross border supply, this is a stra ightforward form of trade which raises few problems, since it does not requi re the service supplier to be admitted to the consuming country.

3) Commercial presence (or“Mode 3”).This is the supply of a service t hrough the commercial presence of the foreign supplier in the territory of an other WTO member.Examples would be the establishment of branch offices or agencies to deliver such services as banking, legal advice or communicat ions.This is probably the most important mode of supply of services, at leas t in terms of future development.

4） Presence of natural persons （or“Mode 4”）.Mode 3 does not nec essarily require the presence of foreigners （the foreign supplier’s office m ay be staffed （配备） entirely by local personnel）.However， the suppli er may well feel a need to employ some foreign managers or specialists.Wh en this is the case， Mode 3 will be found together with“Mode 4”： the pre

sence of natural persons， or in less opaque （晦涩的） language， the admission of foreign nationals （国民） to another country to provide services there.Mode 4 may also be found alone， with no permanent （永久的） commercial presence， and the visiting persons involved may be employees of a foreign service supplier， or independent individuals who provide services.

Some of these services can be supplied in several of the four ways, while many others by their nature cannot.For instance, the services of a professional adviser may possibly be supplied through a visit to him by his foreign client, by mail, through an office maintained in the client's country, or by a personal visit to that country.On the other hand, a tourist can only enjoy a foreign country's beaches by going there, and street cleaning services obviously must be provided on the spot.Unlike market access for a shipment of goods going from one country to another, which is principally a matter of customs duties and other formalities at the border,the ability to provide a service to another country depends crucially on government regulations that may be quite different for one of the four modes of supply than for another.

## 2.International trade value and international trade volume （国际贸易额与国际贸易量）

(1) International trade value

International trade value refers to the value (usually in US dollar terms) of international trade in merchandise and services.Since one nation's export is another nation's import, the total value of international trade in merchandise and services is the aggregated value of either the imports or exports of all nations all over the world.As exports of goods are usually valued at transaction value which excludes the cost of transportation and insurance to bring the merchandise to the frontier of the importing country or territory ("free on board"[7] valuation), and imports are valued at transaction value plus the cost of transportation and insurance to the port of destination of the importing country or territory ("cost, insurance and freight"[8] valuation), the tota

l value of international exports of merchandise is therefore the aggregated v alue of exports rather than imports of all nations throughout the world.

Figure 1-2 shows the world merchandise trade growth in value terms, 2005-2019.It is worthy noting that except the years 2009, 2015, 2016 and 2019, the value of international trade in merchandise has been growing.The decline in world merchandise prices had significant negative impacts on the value of international trade in merchandise in 2009, 2015, 2016 and 2019[9].

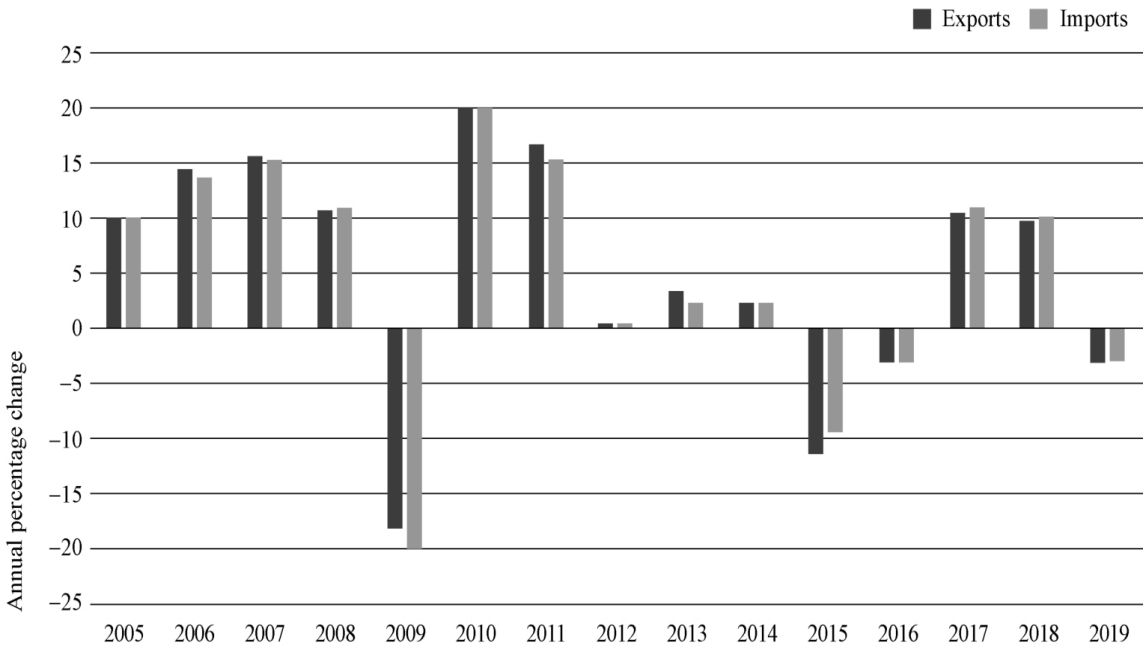



Figure 1-2 World merchandise trade growth in value terms, 2005-2019

Source: https://data.wto.org/.

(2) International trade volume

International trade has grown rapidly in recent decades.A large part of the increase,however, was due to inflation.For the purpose of reflecting the real trend of international trade,international trade volume index is designed to analyze changes in international trade in real terms.To calculate trade volume, the trade value is divided by unit value indices using data collected from national sources.A unit value index is a price index which measures the change in the average value of units that are not homogeneous and which may therefore be affected by changes in the mix of items as well as by changes

in their prices[10].The unit value of a set of homogeneous products is the tota l value of the purchases/sales divided by the sum of the quantities.It is there fore a quantity-weighted average of the different prices at which the product is purchased/sold.Unit values may change over time as a result of a change i n the mix of the products sold at different prices, even if the prices do not c hange[11].The average growth of world merchandise trade in volume terms h as outgrown the world average real GDP since 1990 (see Figure 1-3).

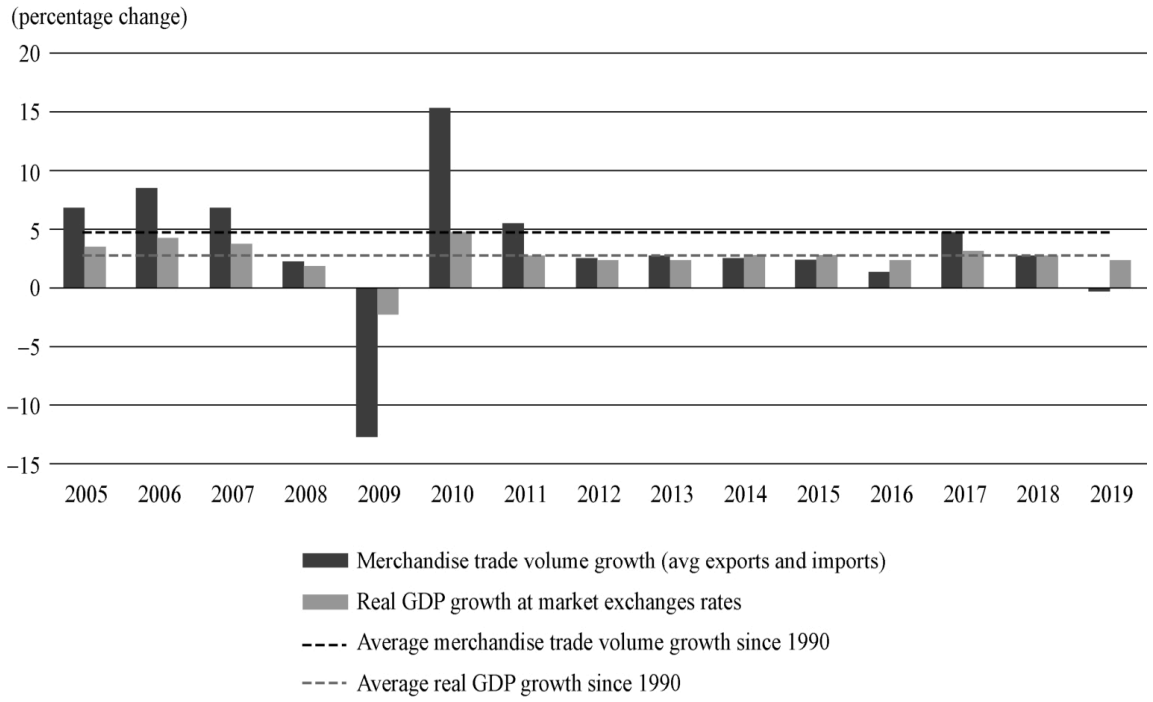



Figure 1-3 The growth in volume of world merchandise trade and real GDP, 2005-2019

Source: WTO, World Trade Statistical Review 2020, P18
https://data.wto.org/
https://unstats.un.org/unsd/snaama/limited

## 3.Favorable balance of trade and unfavorable bal ance of trade （贸易顺差与贸易逆差）

The balance of trade （or net exports， sometimes symbolized as N X） is the difference between the monetary value of exports and imports of output （产品） in an economy （经济体）over a certain period.A favora

ble balance of trade is known as a trade surplus （贸易盈余） or positive b alance of trade and consists of exporting more than is imported.An unfavora ble balance of trade is known as a trade deficit （贸易赤字） or negative b alance of trade or，informally， a trade gap.The balance of trade is someti mes divided into a merchandises and a services balance.

The balance of trade is an important part of the current account （经常账户） of a nation’s balance of payment （国际收支平衡表）.The current account includes other transactions such as income from the international in vestment position as well as international aid.If the current account is in sur plus， the country’s net international asset position increases corresponding ly（相应地）.Conversely （反之）， a deficit decreases the net internatio nal asset position.

Factors that can affect the balance of trade include the cost of producti on （land， labor，capital， taxes， incentives， etc.） in the exporting e conomy vis-à-vis （相对于） those in the importing economy； exchange rate movements； multilateral， bilateral and unilateral taxes or restriction s on trade； non-tariff barriers such as environmental， health or safety sta ndards； the availability （可获性） of adequate foreign exchange with w hich to pay for imports， etc.In addition， the trade balance is likely to diff er across the business cycle.In export led （带动的）growth （such as oil and early industrial goods）， the balance of trade will improve during an economic expansion.However， with domestic demand led growth （as in the United States and Australia）， the trade balance will worsen at the sa me stage in the business cycle.

In China, the trade in goods was in deficit for most of the years prior to 1994.Since 1994,with large-scale industrial outsourcing and relocation, Chi na enhanced its competitiveness in manufactured goods.Growth in exports overtook that of imports, turning the overall deficit to a surplus in trade in g oods.In 2005, China’s surplus in trade in goods reached US$ 100 billion for the first time, which was followed by vigorous growth for four consecutive years.In 2015,the surplus amounted to US$ 594.50 billion, the highest durin g 1978-2019 (see Table 1-1 and Figure 1-4).

A higher savings rate generally corresponds to a trade surplus.Correspondingly, the United States with its lower savings rate has tended to run high trade deficits, especially with Asian nations.Since the mid-1980s, the United States has had a growing deficit in tradable goods, especially with Asian nations (China and Japan) which now hold large sums of U.S debt that has funded the consumption of the United States.

Table 1-1 China's merchandise imports and exports, 1978-2019

(US$ billion)

| Year | Total | Export | Import | Balance |
|---|---|---|---|---|
| 1978 | 20.64 | 9.75 | 10.89 | **–1.14** |
| 1979 | 29.34 | 13.66 | 15.68 | **–2.02** |
| 1980 | 37.82 | 18.27 | 19.55 | **–1.28** |
| 1981 | 44.02 | 22.01 | 22.02 | **–0.01** |
| 1982 | 41.61 | 22.32 | 19.29 | 3.04 |
| 1983 | 43.62 | 22.23 | 21.39 | 0.84 |
| 1984 | 53.55 | 26.14 | 27.41 | **–1.27** |
| 1985 | 69.60 | 27.35 | 42.25 | **–14.90** |
| 1986 | 73.85 | 30.94 | 42.90 | **–11.96** |
| 1987 | 82.65 | 39.44 | 43.22 | **–3.78** |
| 1988 | 102.78 | 47.52 | 55.27 | **–7.75** |
| 1989 | 111.68 | 52.54 | 59.14 | **–6.60** |
| 1990 | 115.44 | 62.09 | 53.35 | 8.74 |
| 1991 | 135.70 | 71.91 | 63.79 | 8.12 |
| 1992 | 165.53 | 84.94 | 80.59 | 4.35 |
| 1993 | 195.70 | 91.74 | 103.96 | **–12.22** |
| 1994 | 236.62 | 121.01 | 115.62 | 5.39 |
| 1995 | 280.86 | 148.78 | 132.08 | 16.70 |
| 1996 | 289.88 | 151.05 | 138.83 | 12.22 |
| 1997 | 325.16 | 182.79 | 142.37 | 40.42 |

to be continued

continued

| Year | Total | Export | Import | Balance |
|---|---|---|---|---|
| 1998 | 323.95 | 183.71 | 140.24 | 43.47 |
| 1999 | 360.63 | 194.93 | 165.70 | 29.23 |
| 2000 | 474.30 | 249.20 | 225.09 | 24.11 |
| 2001 | 509.65 | 266.10 | 243.55 | 22.55 |
| 2002 | 620.77 | 325.60 | 295.17 | 30.43 |
| 2003 | 850.99 | 438.23 | 412.76 | 25.47 |
| 2004 | 1,154.55 | 593.33 | 561.23 | 32.10 |
| 2005 | 1,422.12 | 762.00 | 660.12 | 101.88 |
| 2006 | 1,760.69 | 969.07 | 791.61 | 177.46 |
| 2007 | 2,173.83 | 1,218.01 | 955.82 | 262.19 |
| 2008 | 2,561.63 | 1,428.55 | 1,133.09 | 295.46 |
| 2009 | 2,207.22 | 1,201.66 | 1,005.56 | 196.10 |
| 2010 | 2,972.76 | 1,577.93 | 1,394.83 | 183.10 |
| 2011 | 3,642.06 | 1,898.60 | 1,743.46 | 155.14 |
| 2012 | 3,866.76 | 2,048.93 | 1,817.83 | 231.10 |
| 2013 | 4,160.33 | 2,210.04 | 1,950.29 | 259.75 |
| 2014 | 4,303.04 | 2,342.75 | 1,960.29 | 382.46 |
| 2015 | 3,958.64 | 2,276.57 | 1,682.07 | 594.50 |
| 2016 | 3,684.93 | 2,097.44 | 1,587.48 | 509.96 |
| 2017 | 4,104.47 | 2,263.49 | 1,840.98 | 422.51 |
| 2018 | 4,623.04 | 2,487.40 | 2,135.64 | 351.76 |
| 2019 | 4,575.30 | 2,498.40 | 2,076.89 | 421.51 |

Source: Author's composition based on the data from http://www.mofcom.gov.cn.

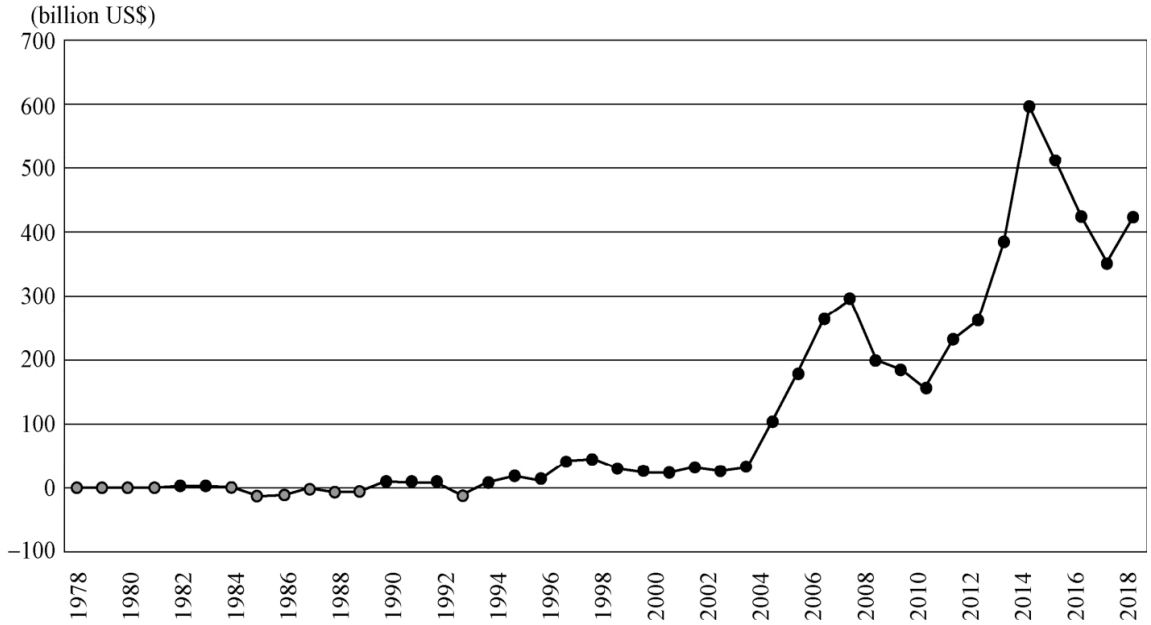



Figure 1-4　Balance of trade in China, 1978-2019

Source: Author's composition based on the data on http://www.mofcom.gov.cn.

Box 1-1

Focus on China's Trade Surplus

The fact that China is enjoying a surplus in trade in goods reflects its p osition in the international division of labor at the current stage.China has n ow relatively big advantages in the processing（加工）and assembling （装配）of industrial products， and is the largest producer and exporter o f industrial products.The United States， European Union and some other c ountries and regions are the major end consumer markets.With the transfer of large numbers of labor-intensive processing and assembling sectors to Ch ina from Japan， Republic of Korea（Hereinafter referred to as"kore a"）， Singapore， Taiwan Province of China， Hong Kong Special Admi nistrative Region（香港特别行政区）and other nations and regions， thei r surpluses with the United States and Europe were also transferred to Chin a.The result is that while China is currently enjoying a surplus in trade in go ods primarily with the United States and Europe， it also has long-term tra de deficits with Japan， Republic of Korea， ASEAN and other major inter mediate producers.

To produce and export industrial products, China needs to import large quantities of primary goods, thus creating a deficit in trade in goods with ce rtain exporters of primary goods.It is the country's different level and status of participation in the international division of labor in manufacturing and t he services industry that leads to China's big surplus in trade in goods but a long-term deficit in services trade.

China's surplus in trade in goods mainly comes from foreign-invested enterprises and processing trade.With the spread of economic globalization as well as the refinement （完善）of the division of labor and the develop ment of economies of scale， an increasing amount of international trade—intra-industry （产业内） trade or processing trade based on value-chain s pecialization—is predominated by multinationals.Since the adoption of the reform and opening up policy in 1978， China has experienced rapid growt h in attraction of foreign direct investment.For a fairly long period of time t he import and export business of foreign-invested enterprises and processin g trade mainly operated by foreign-invested enterprises accounted for about 50 percent of China's trade volume in goods， and were also the major sour ce of the country's surplus in trade in goods.While foreign-invested enterpri ses and processing trade enjoyed a big favorable trade balance， the import and export of China's state-owned enterprises， general trade and other for ms of trade were in deficit.

The limits on certain high-tech trade set by developed countries also af fect the trade balance between China and some of its trading partners.As Ch ina is currently accelerating its pace of industrialization, it needs to import a dvanced equipment and technologies from developed countries.Unfortunate ly, some developed countries, sticking to their old way of thinking, impose various restrictions on the export of high-end equipment and advanced tech nologies to China, resulting in slow growth in the export of these sectors.To a certain extent such limits hinder China's imports from these countries, pos ing an unfavorable impact on bilateral trade balance.

As China turned its trade deficit into a surplus, the country improved it s international balance of payments and enhanced its resistance to external r isks.However, the sharp increase in surplus also created trouble for the Chin

ese economy.The large volume of RMB input in export settlement complica tes macroeconomic control, and the rapid expansion of China's surplus in tr ade in goods also results in more trade frictions between China and its tradi ng partners, as well as persistent pressure on the RMB to appreciate.

The Chinese government attaches great importance to the imbalance in the development of foreign trade， and has adopted a series of policies and measures to curb overheated surplus growth.First， it proactively adjusts th e economic structure， strives to expand domestic demand， and especiall y increases investment in projects to improve the people's livelihood and sti mulate household consumption.Second， it enacts a series of policies to ex pand imports， simplify the procedures of import administration and impor t payment， lower the temporary tax rates on certain imported commoditie s， improve the import promotion system and facilitate（便利）import bu sinesses.Third， it has adjusted the export tax rebates（出口退税）polic y， lowered or canceled export tax rebates for some products that consume too much energy and cause serious pollution and certain resource-based pro ducts.Fourth， it has amended the prohibited and restricted categories of pr ocessing trade， expanding the scope of the prohibited category and promo ting this sector's restructuring and upgrading.Fifth， it has changed the situ ation of the pegged exchange rate of the yuan against the US dollar since th e Asian financial crisis， and adopted the administered floating exchange ra te system based on market demand， and adjusted it with reference to a bas ket of currencies from July 21， 2005.During the period from the exchange rate reform in July 2005 to the end of August 2011， the nominal exchange rate of the yuan against the dollar appreciated（升值）by about 30 percent.

China's measures to promote balanced foreign trade growth have achie ved obvious effects.The nation's surplus in trade in goods has been on a stea dy decline since 2009, and the proportion of surplus in the total import and export trade volume and the GDP also started to drop in 2008, moving towa rd a balance in foreign trade.China's efforts not only serve the development of its own economy, but are also practical moves to promote the structural a djustment and the rebalancing of the global economy Source: China's Forei gn Trade released by Information Office of the State Council of the People's

Republic of China on December 7, 2011, available at http://www.china.org.cn/government/whitepaper/node_7143951.

## 4.General trade system and special trade system（总贸易体系与专门贸易体系）

Two systems of recording merchandise exports and imports are in common use：general trade system and special trade system.

1） General trade system.According to the definition of the Organization of Economic Cooperation and Development （OECD）， the general trade system is in use when the statistical territory of a country coincides with （一致） its economic territory.An economic territory of a country consists of the geographical territory administered by a government.This system covers all types of inward and outward movement of goods through an economic territory including movements through customs warehouses[12] （海关仓库） and free trade zones[13].

2） Special trade system.The special trade system is in use when the statistical territory comprises only a particular part of the economic territory， i.e.， the customs territory （关境）.A customs territory is a geographic territory with uniform customs regulations， for instance， a trade bloc that has a customs union， and an autonomous or dependent territory that is granted by the sovereign government some degree of independence in foreign trade and customs policy.Certain territorial possession and special economic zones （such as free trade zones） are often considered outside the customs territory of a nation.

The general trade system provides a more comprehensive recording of the external trade flows than does the special trade system.It is recommended， therefore， by the UN that countries use the general system for compilation （编辑） of their merchandise trade statistics and international reporting.The statistical territory of China is， generally， defined by the economic territory， comprising of areas of bonded warehouses and free trade zones.

# 5.Commodity composition of international trade（国际贸易商品构成）

Commodity composition of international trade refers to the share of all categories or kinds of merchandise in international trade within a certain per iod of time.It consists of the commodity composition of both exports and im ports.The commodity composition of international trade usually reflects the level of world economic development as well as the industrial structure.As shown in Figure 1-5, over the past decade manufactured goods has taken th e largest share in the three categories of world merchandise trade, i.e., manu factured goods, fuels and mining products, and agricultural goods.

For a particular nation, the commodity composition of its foreign trade is the share of each category or kind of goods in the nation's foreign trade w ithin a certain period of time.It also consists of the commodity composition of exports and imports.For instance, in China,while the exports of primary g oods (SITC 0-4) amounted to US$133.93, accounting for 5.36％in the total exports of the country, the exports of manufactured goods (SITC 5-9) amou nted to US$2365.11, accounting for 94.64％ in the total exports in 2019.In t erms of the 10 categories classified by SITC, in 2019, SITC (6), SITC (7), a nd SITC (8), namely, manufactured goods chiefly classified by material, ma chinery and transportation equipment, and miscellaneous manufactured arti cles, are the three main categories of China's merchandise exports (see Figu re 1-6).

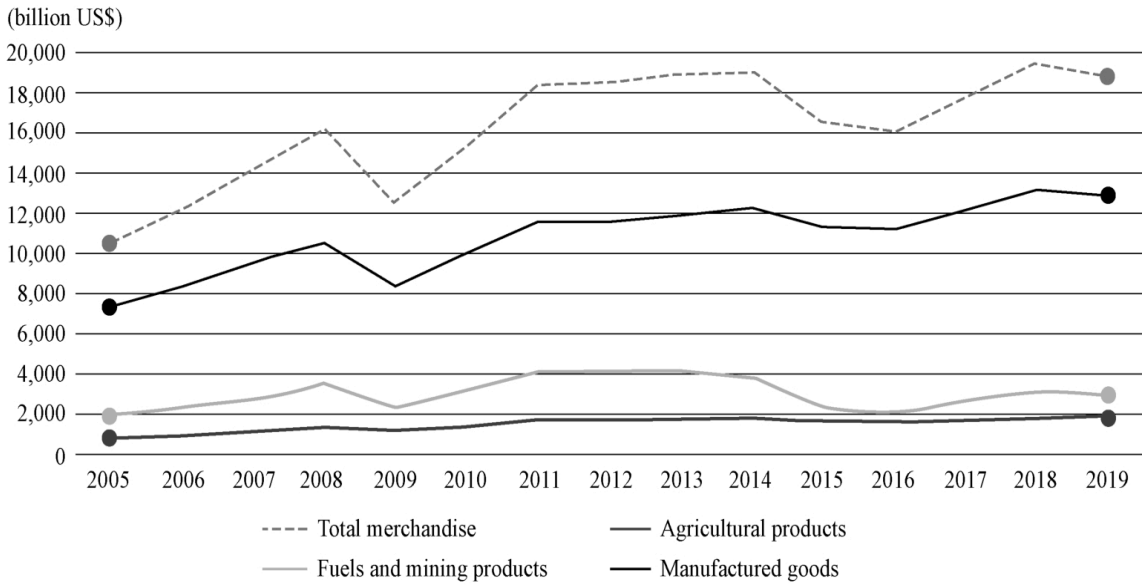



Figure 1-5 World merchandise exports, 2005-2019

Source: WTO, World Trade Statistical Review 2020, P12.

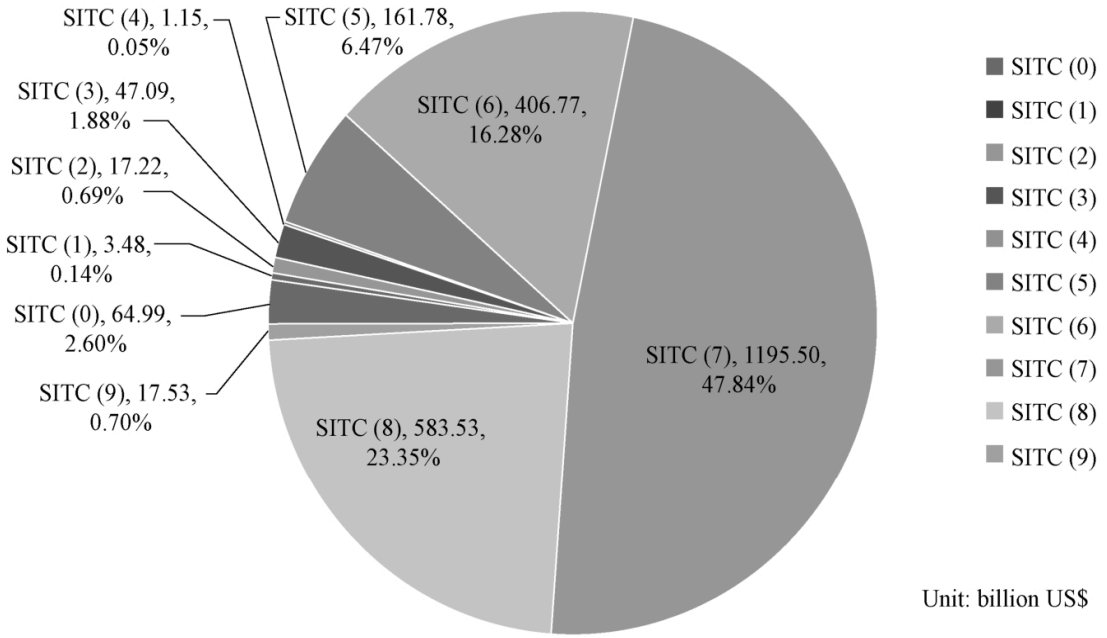



Figure 1-6 Commodity composition of exports in China in 2019

Source: Author's composition based on the data from http://data.stats.gov.cn/easyquery.htm?cn=C01

# 6.Geographical composition of international trade（国际贸易地理构成）

Geographical composition of international trade or direction of internat ional trade, refers to the share of nations, regions or economies in internatio nal trade.At country level, in 2019,China, the United States, German and N etherlands remained the top four traders of both merchandise exports and i mports.China was the leading exporter, with total exports of US$2.50 trillio n and a 13 percent share of world exports, followed by the United States(U S$1.65 trillion, 9 percent), Germany (US$1.49 trillion, 8 percent), Japan (U S$706 billion, 4 percent), and the Netherlands (US$709 billion, 4 percent).

The leading importer was the United States, with imports totaling US $2.57 trillion,representing a 13 percent share of the global total, followed b y China (US$2.08 trillion, 11 percent), Germany (US$1.23 trillion, 6 percen t), Japan (US$721 billion, 4 percent), and the United Kingdom (US$692 bill ion, 4 percent).

Merchandise trade of WTO members by region during 2005-2019 is sh own in Figure 1-7.

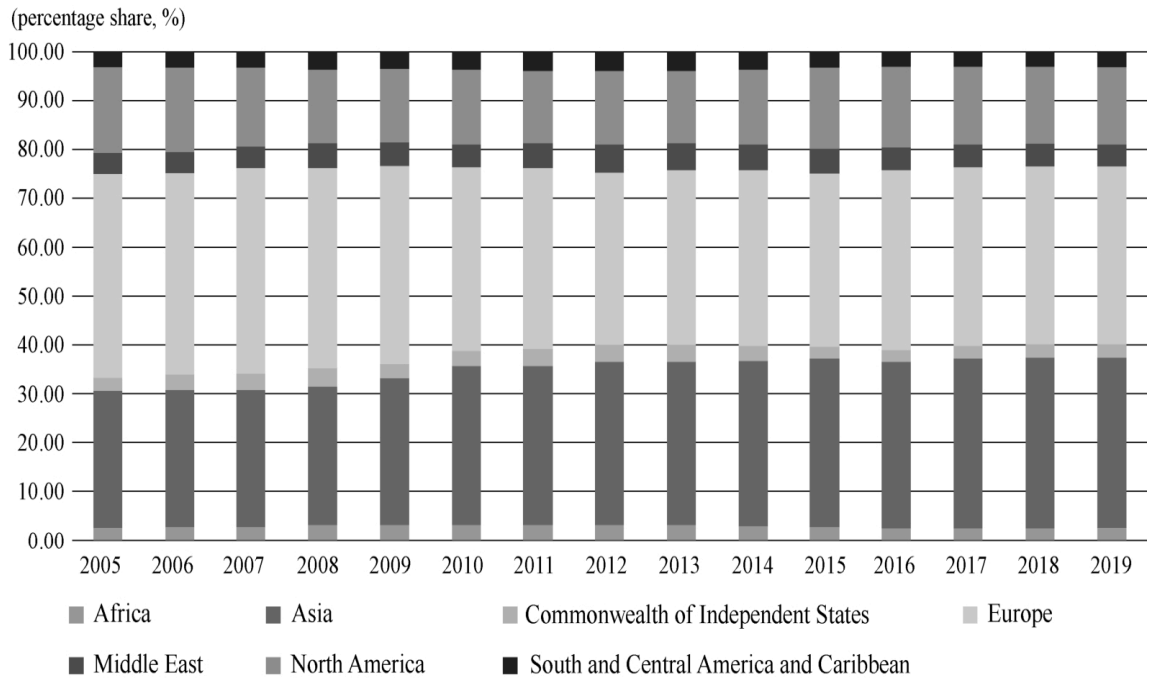



Figure 1-7 Merchandise trade of WTO members by region: 2005-2019

Source: WTO, World Trade Statistical Review 2020, P128-135 https://data.wto.org/

For a particular country, the share of each region or country in its expo rts or imports, or in both exports and imports, constitute the geographical co mposition of its exports or imports.Figure 1-8 and Figure 1-9 show the main destinations of China’s merchandise exports and the main origins of China’s merchandise imports in 2019 respectively.Further, Figure 1-10 shows the bil ateral trade between China and its main trading partners in 2019.

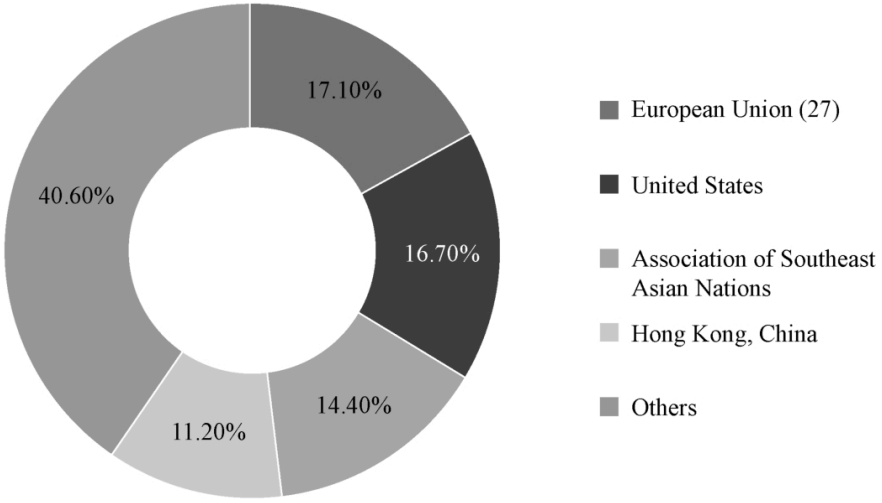



Figure 1-8 Main destinations of China’s merchandise exports in 2019

Source: http://data.mofcom.gov.cn/hwmy/imexCountry.shtml

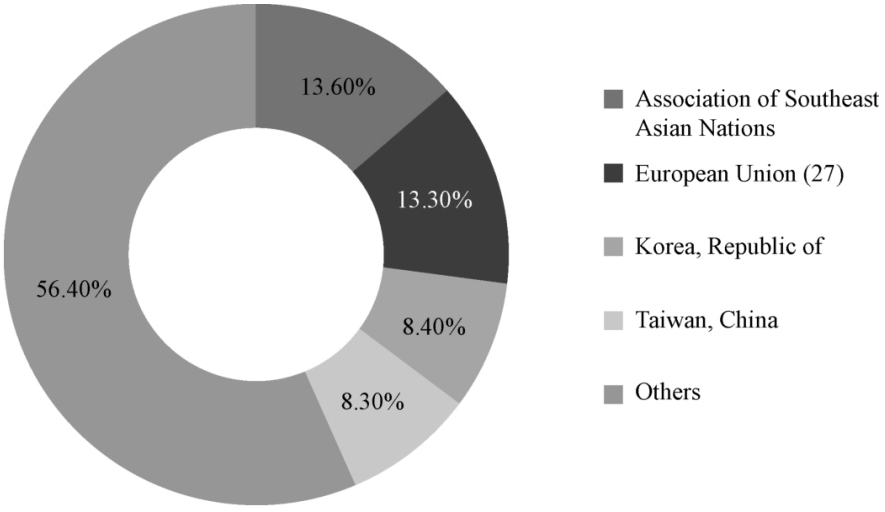



Figure 1-9 Main origins of China’s merchandise imports in 2019

Source: http://data.mofcom.gov.cn/hwmy/imexCountry.shtml

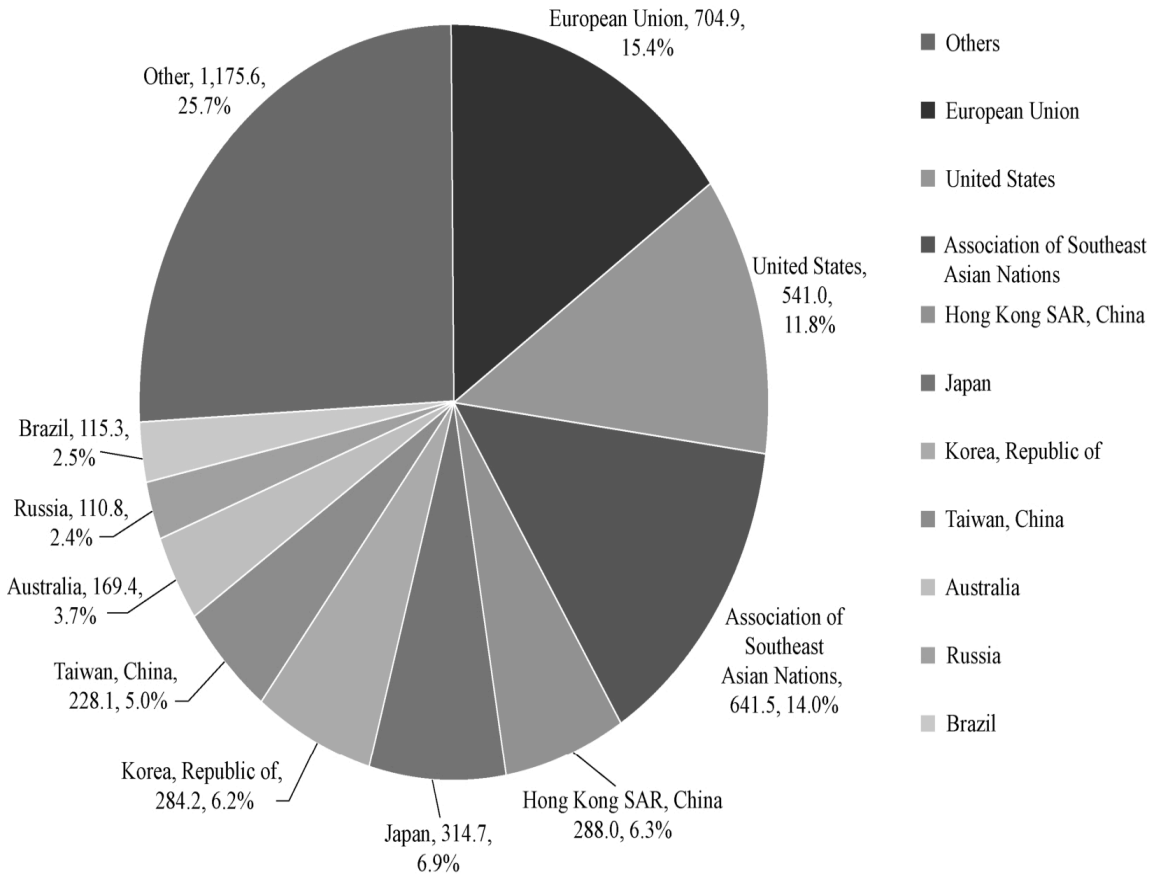



Figure 1-10 Bilateral trade between China and its trading partners in 2019 (Unit: US$)

Source: Author's composition based on the data from Report on China's Foreign Trade Situati on, Spring 2020, P3

## Box 1-2

### China Stresses All-around Development in Its Foreign Trade

China enjoys steady growth in its trade with developed countries.Chin a's trade with the European Union has been developing steadily in recent ye ars.The European Union mainly exports manufactured products to China, in cluding advanced mechanical and electronic products, transport vehicles, co mplete plants, core parts and components, precision components and other high-tech products which are highly competitive in the Chinese market.Fore ign trade between China and the United States has a solid development bas e.China exports a large variety of consumer goods to meet the demands of American consumers, while satisfying its own need for development by con stantly expanding imports of electronic,aerospace, biological, medical, agric

ultural and services trade items from the United States.China and Japan are geographically proximate to each other and this is an advantage in bilateral trade.Sino-Japanese trade promotes continuous cooperation and progress in industry while spurring the development of regional economic comparative advantages and cooperation in East Asia.China's trade and investment coop eration with developed countries such as Canada, Australia, Switzerland an d New Zealand also maintain a good momentum of development.

China's trade with emerging economies and developing countries is ex periencing robust growth, with huge development potential.With the compr ehensive implementation of the China-ASEAN Free Trade Agreement in 20 10, tariffs have been canceled for 90% of the commodities traded between t hem, vigorously promoting the rapid growth of bilateral trade between Chin a and ASEAN.Foreign trade between China and Republic of Korea keeps gr owing constantly and steadily.In recent years, China's trade with the other B RIC countries has been enjoying rapid growth.China has seen relatively fast growth in its trade with other developing countries.

Source: China's Foreign Trade released by Information Office of the St ate Council of the People's Republic of China on December 7, 2011, availa ble at http://www.china.org.cn/government/whitepaper/node_7143951.

## 7.Ratio of merchandise trade to GDP

It is important to recognize not only the absolute level of international trade but also the relative importance of trade.The relative size of trade is of ten measured by comparing the size of a country's merchandise trade with it s GDP， i.e.， the total value of exports and imports to GDP， represented by the following formula （公式）：

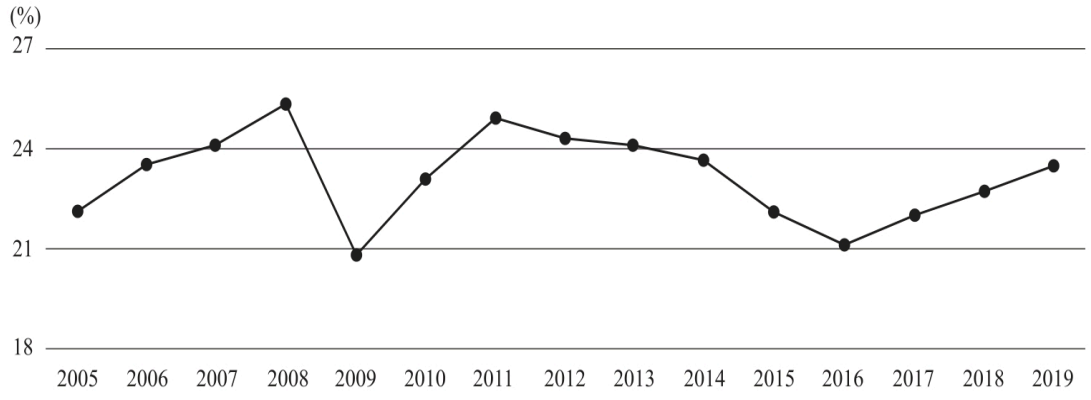
$$Z = \frac{X + M}{GDP} \times 100\%$$

Where Z is the ratio of the value of exports and imports to GDP, X is t he value of exports and M is the value of imports.

Although the ratio of merchandise trade to GDP varies considerably among countries, the relative importance of exports has increased in almost all individual cases and for every country grouping where data are available. This means not only that individual countries are experiencing the economic benefits but also that their own economic prosperity is dependent upon the economic prosperity of the world as a whole.

The ratio of merchandise exports and imports to GDP is often used to indicate the openness of an economy.However， results should not be interpreted as a trade policy indicator.For example， the United States shows a relatively low ratio despite its openness to trade—as reflected， for example， by its low tariffs.This reflects the fact that service-oriented and larger economies tend to show a relatively small ratio.An increase in the value of trade may not be a consequence of trade liberalization.For example， oil price increases lead to an increase in the value of exports of oil exporters that do not fully reflect an increase in an economy’s GDP.The situation is even more marked （明显的） for importing countries because the rise in the value of fuel imports may depress （使萧条） domestic economic activity， leading to a higher trade to GDP ratio.Exchange rate fluctuations also have an impact on making comparisons among countries.

The ratio of merchandise trade to GDP fell sharply in 2009 following the economic crisis but bounced back quickly in 2010-2011.In 2012-2014 it declined gradually, before falling significantly in 2015, and then going up during 2016-2019.




Note: Merchandise trade to GDP ratio is estimated as merchandise trade (average of exports and imports values) divided by GDP, measured in nominal dollar terms at market exchange rates.

Figure 1-11 Ratio of world merchandise trade to GDP, 2005-2019

Source: https://unstats.un.org/unsd/snaama/limited
https://data.wto.org/

Figure 1-12 and Figure 1-13 show the ratio of merchandise trade to GDP and the ratio of exports to GDP in China respectively during 1978-2019.

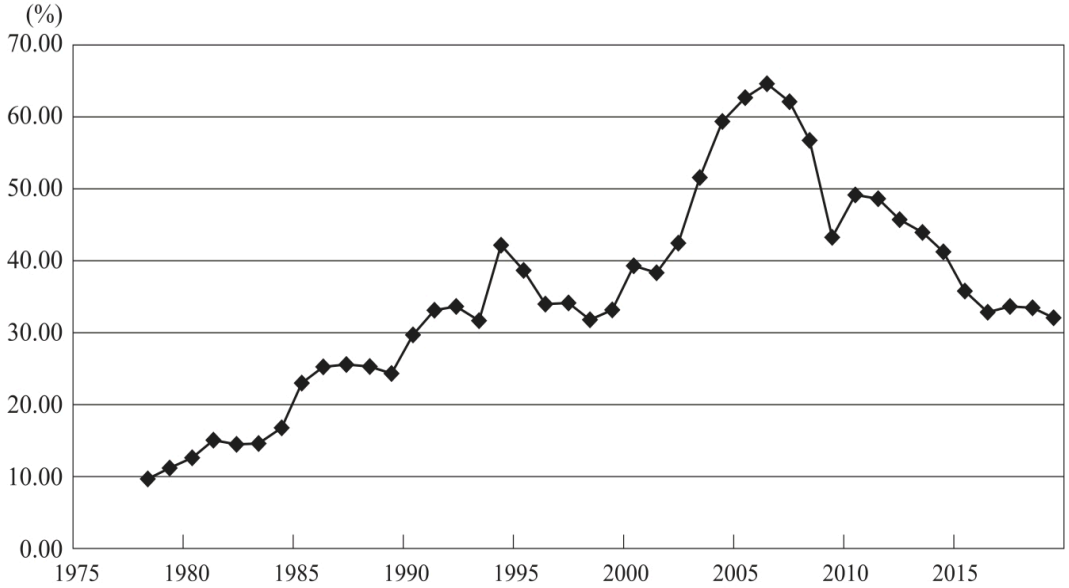



Figure 1-12 Ratio of merchandise trade to GDP in China, 1978-2019

Source: Author's composition based on data from the website: http://data.stats.gov.cn/easyquery.htm?cn=C01

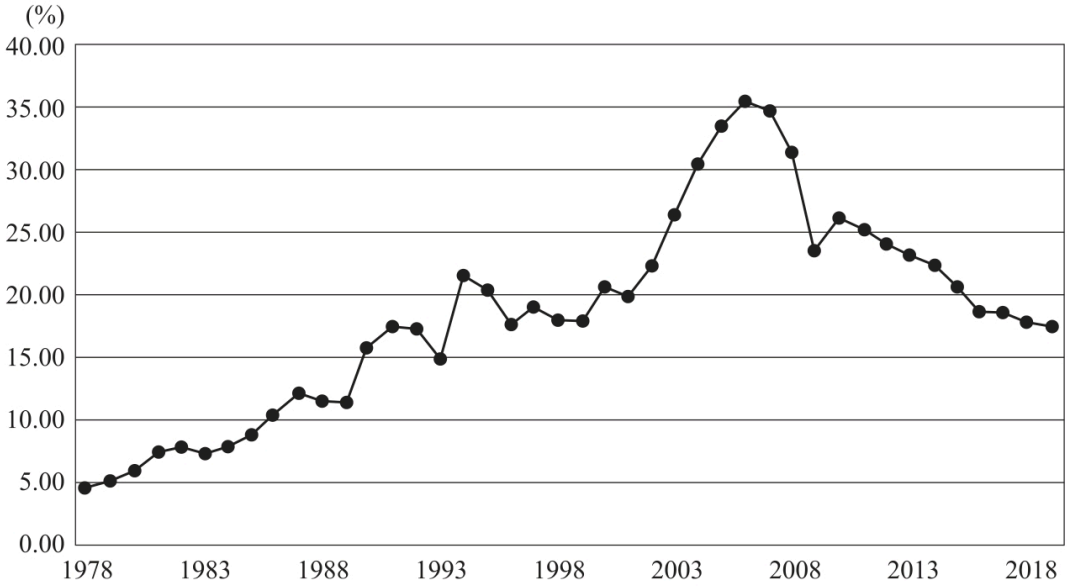


Figure 1-13　Ratio of exports to GDP in China during 1978-2019

Source: Author's composition based on the data from the website: http://data.stats.gov.cn/easyquery.htm?cn=C01

## 8.Trade in value-added （增加值贸易）[14]

Trade in value-added (TiVA) is a statistical method used to estimate the sources of value added when producing goods and services for export and import."Trade in value-added"(TiVA) traces the value added by each industry and country in the production chain to the final export, and allocates the value added to these source industries and countries.TiVA recognizes that exports in today's globalized economy rely on global value chains (GVCs), which use intermediate items imported from various industries in a number of countries.

Traditional trade statistics record gross flows of goods and services every single time they cross a border.This creates a"double counting" or"multiple counting" problem.For instance,a traded intermediate item used as an input for an export may be counted several times in trade figures.The TiVA approach avoids this double counting issue by accounting for the net trade flow between countries.

For example, a cellphone manufactured in China and exported from that nation may need several components such as memory chips, touch screen and camera from companies located in Korea, Taiwan Province of China and the U.S.These companies would in turn need intermediate inputs such as electronic components and integrated circuits imported from other nations or regions to produce the cellphone components that will be exported to the Chinese manufacturer.The TiVA method would allocate the value added by each of these companies involved in the manufacture of the final export, the cellphone in this instance.

The TiVA approach can unearth value-added figures that are quite startling.For example,since Apple's ubiquitous iPhone is manufactured in China, it would be logical to assume that every iPhone exported from China earns t

hat nation a handsome profit.But that's hardly the case.An analysis in 2010 revealed that while the iPhone 4 cost $187.5 at the factory gate in China, K orea contributed $80.05 worth of components, the U.S.$22.88, Taiwan Prov ince of China $20.75 and Germany $16.08.China's contribution in assembli ng the final product was just $6.50, or only about 3.5％ of the total cost.

According to the OECD and the WTO, the new perspective provided b y measuring TiVA may impact policy choices in a number of areas, includin g global trade imbalances, market access and trade disputes, trade and empl oyment, and export competitiveness.

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[1]See comparative advantage theory in Chapter 2.

[2]Unless specified otherwise, international trade discussed in this textbook refers to international tra de in merchandise.

[3]As of Jan.16， 2017， the WTO has 164 members， accounting for nearly 96％ of the global eco nomy and 98％ of world Trade.For details about WTO， see Chapter 10.

[4]For details， see http：//unstats.un.org/unsd/cr/registry/regcst.asp？Cl=28.

[5]n.e.s.stands for not elsewhere specified.

[6]The Uruguay Round was the 8th round of multilateral trade negotiations （MTN） conducted with in the framework of the General Agreement on Tariffs and Trade （GATT）， spanning from 1986 t o 1994 and embracing 110 countries as"contracting parties".The Round transformed the GATT into t he World Trade Organization.For more details， see Chapter 10.

[7]For more information about"free on board", see Chapter 11.

[8]For more information about"cost, insurance and freight", see Chapter 11.

[9]World energy prices dropped by 45％ in 2015.

[10]Source: http://stats.oecd.org/glossary/detail.asp?ID=2810.

[11]Source: http://stats.oecd.org/glossary/detail.asp?ID=5547.

[12]Customs warehouses are also known as bonded warehouses （保税仓库）， which are utilized for storing goods until duties are paid or goods are otherwise properly released.Payment of customs d uties is deferred until the goods enter the customs territory of a country.The goods are not subject to d uties if re-shipped to foreign points.For more information about bonded warehouse， see Chapter 7.

[13]Free trade zones are areas within a country （a seaport， airport， warehouse or any designated area） but regarded as being outside its customs territory.Importers may therefore bring goods of for eign origin into such an area without paying customs duties and taxes，pending （直到） their even

tual processing， transshipment or re-exportation.For more information about free trade zones， see Chapter 7.

[14]Source： http：//www.investopedia.com/terms/t/trade-value-added-tiva.asp.

# Chapter 2　Classical Trade Theories

Learning Objectives

In this chapter, you will learn:

- Development of Mercantilism thought
- David Hume's price-specie-flow mechanism
- Theory of absolute advantage
- Theory of comparative advantage

This chapter provides a path through centuries of thought on why and how trade across borders occurs.Although theories and theorists come and go with time， a few basic questions have dominated this intellectual adventure （开拓）： Why do countries trade？ What are the gains from trade？ What is the role of international trade？ What is the role of trade policy？ Do the elements that give rise to （产生，导致） the competitiveness of a firm， an industry， or a country as a whole， arise from （产生于） some inherent endowment （内在禀赋） of the country itself， or do they change with time and circumstance？

Some of the early ideas are found in the writings of the Mercantilist school of thought（重商主义学派）.Later， these ideas were challenged by different views of trade offered by David Hume （大卫·休谟）， Adam Smith （亚当·斯密） and David Ricardo （大卫·李嘉图）.

This chapter firstly discusses the Mercantilism thoughts and economic policies pursued（实行的） by mercantilists.Then it presents two challenges to the Mercantilist thought， David Hume's price-specie-flow mechanism （价格—货币—流动机制） and the theory of absolute advantage （绝对优势理论）.Finally it concentrates on the theory of comparative advantage （比较优势理论） which develops from the theory of absolute advantage.

# 2.1 Mercantilism

Mercantilism refers to the school of economic thought that came into existence （建立）in Europe during the period from 1500 to 1750.It cannot be classified as a formal school of thought， but rather as a collection of similar attitudes toward domestic economic activity[1].Most of the European economists who wrote between 1500 and 1750 are today generally considered as mercantilists.Many of these ideas not only were spawned （引起） by events of the time but also influenced history through their impact on government policies.Indeed，Mercantilism is often referred to as （被称作是） the political economy of state building.

## 1.The development of mercantilist thought

The following are two major events that contributed to the development of Mercantilist thought.

(1) Geographical explorations

The geographical explorations in the late 15th century provided new opportunities for trade and broadened the scope of international relations.The colonial systems （殖民体系） of the European nation-states[2] （民族国家） were established.

As early as 1500， the benefits of trade were clearly established in Europe as nation-states expanded their influence across the globe in the creation of colonial systems.To maintain and expand their control over these colonial possessions （领地）， the European nations needed fleets （船队）， armies， food， and all other resources they could muster （集中）.They needed wealth.Trade was therefore conducted （经营） in a fashion （方式） that would fill the governments' coffers （金库）， their treasuries （国库）， at the minimum expense （以最小代价） to themselves and to the detriment （损害） of their captive （受控制的） trade partners.Although colonialism normally associated with （同……相连） the e

xploitation （剥削） of those captive societies， it went hand in hand with the evolving exchange of goods among the European countries themselves.

（2） The collapse （瓦解） of feudal （封建的） society and the rise of the merchant class

Feudal society was a state of autarky （自给自足）， a society that did not trade because all of its needs were met internally （内部地）.The feudal estate was self-sufficient.Needs literally were those of food and shelter （住房）， and all available human labor was devoted to the task of fulfilling those basic needs.As merchants began meeting in the marketplace， as travelers began exchanging goods from faraway places at the water's edge， the attractiveness of trade became evident.

In addition to the above two events， the upsurge （增长） in population， the impact of the Renaissance on culture （文艺复兴）， the discovery of precious metals in the New world，changing religious views on profits and accumulation （积累）， and the rise of nation-states also contributed to the development of Mercantilist thought.

## 2.The mercantilist economic system

1） Central to mercantilist thinking was the view that national wealth was reflected in a country's holding of precious （贵重的） metals （gold and silver）.Mercantilism identified （认为……等同于） strength with the accumulation of specie （硬币）.

2） One of the most important pillars （核心） of Mercantilist thought was the static （静态的）view of world resources.Thus economic activity in this setting （环境） can be viewed as a zero-sum game （零和博弈） in which one country's economic gain was at the expense of another[3].

3) Mercantilism mixed exchange through trade with accumulation of wealth.It stressed the need to maintain an excess of exports over imports, i.e.a favorable balance of trade,because an excess of exports would help to earn gold.

## 3.Economic policies pursued by the mercantilists

The following are economic policies advocated by the mercantilists:

1) Government controlled the use and exchange of precious metals.

2) Government prohibited the export of gold, silver, and other precious metals by individuals.Rulers let specie leave the country only out of necessi ty.

3） Individuals caught smuggling （走私） specie were subject to （常遭受） swift punishment，often death.

4） Government gave exclusive （独家的） trading rights for certain routes or areas to specific companies.Trade monopolies （垄断） fostered （促进） the generation （产生） of higher profits through the exercise of monopoly.Profits contributed both directly and indirectly to a positive trade balance and to the wealth of the rulers who shared the profits of this activit y.The Hudson Bay Company and the Dutch East India Trading Company ar e familiar examples of trade monopolies， some of which continued well in to the nineteenth century.

5） Exports were subsidized （补贴） and quotas （配额） and high tariffs were placed （征收）on imports of consumption goods.Tariffs on i mports of raw materials that could be transformed （变换） by domestic la bor into the exportables were， however， low or nonexistent，since the r aw material imports could be“worked up” （加工） domestically and expo rted as high value manufactured goods.Trade was fostered （促进） with t he colonies， which were seen as low cost sources of raw materials and agr icultural products and as potential markets for exports of manufactures from the parent country （母国）.

## 4.Discussions

While the mercantilists’ doctrines （学说） seem naive today， they undoubtedly seemed logical （合乎常理的） in the period from 1500 to 17

50.Frequent warfare （战事） lent （增添）credibility （可信性） to maintaining a powerful army and merchant marine （商船队）.The legitimization （合法性） and growing importance of saving by the merchant class could easily be extended to behavior by the state， making the accumulation of precious metals seem equally reasonable.

By the late 18th century， ideas concerning international trade began to change when early classical writers such as David Hume， Adam Smith and David Ricardo challenged the basic tenets （信条） of mercantilism.David Hume argued （认为） that given （假若） sufficient time，there was an automatic trade balance adjustment.Adam Smith’s proposition （主张） that， with trade， two countries could benefit by specializing in goods in which they were absolutely more efficient was critical to the movement from protectionism to free trade.This movement was given even more impetus （推动） by the work （著作） of David Ricardo， The Principles of Political Economy and Taxation （1817）， which stressed that the potential gains from international trade were not confined （受限制的） to absolute advantage.

# 2.2 David Hume’s Challenge to Mercantilism

## 1.Assumptions of price-specie-flow mechanism

The price-specie-flow mechanism rests （依托） on the following assumptions （假设条件）：

1） Formal link between money and prices， i.e.$M_S V=PY$ （quantity theory of money），where： $M_S$=the supply of money； V=the velocity （速度） of money （fixed by tradition）； P=the price level； Y=the level of real output （产量） （fixed， full employment）.

2） Demand for traded goods is price elastic （有弹性的）， which means the ratio of the percent change in demand to the percent change in price is greater than one.

3) Perfect competition in both product and factor markets in order to establish the necessary link between price behavior and wage behavior.

4） A gold standard （金本位） exists.A gold standard is a system in which gold is the official means （工具） of international payments and each nation’s currency is in the form of gold itself or of paper currency fully convertible （可兑换的） into gold.In other words， all currencies are pegged （钉住） to gold and hence to each other.

## 2.The price-specie-flow mechanism

The price-specie-flow mechanism is a logical argument by David Hume against the mercantilist idea that a nation should strive for （力求） a positive balance of trade， or net exports.

Hume argued that when a country with a gold standard had a positive balance of trade，gold would flow into the country in the amount that the value of exports exceeds the value of imports.Conversely （反之）， when such a country had a negative balance of trade， gold would flow out of the country in the amount that the value of imports exceeds the value of exports. Consequently， in the absence of any offsetting （冲销） actions by the central bank on the quantity of money in circulation （流通）， called sterilization （冲销）， the money supply would rise in a country with a positive balance of trade and fall in a country with a negative balance of trade.Using a theory called the quantity theory of money that money supply has a direct，positive relationship with the price level， Hume argued that in countries where the quantity of money increases， prices of products would tend to （往往） rise and in countries where the money supply decreases， prices of products would tend to fall.

The higher prices would， in the countries with a positive balance of trade， cause exports to decrease and imports to increase， which will alter

（改变） the balance of trade.Inversely （反之）， in countries with a negative balance of trade， the lower prices would cause exports to increase and imports to decrease， which will heighten （提高） the balance of trade.These adjustments in the balance of trade will continue until the balance of trade equals zero in all countries.Table 2-1 illustrates an automatic trade balance adjustment for Italy and Spain.

Table 2-1 An automatic trade balance adjustment (given sufficient time)

| | Italy (Trade Surplus)<br>Exports>Imports | Spain (Trade Deficit)<br>Exports< Imports |
|---|---|---|
| Step 1 | Net inflow of specie | Net outflow of specie |
| Step 2 | Increase in the money supply | Decrease in the money supply |
| Step 3 | Increase in prices and wages | Decrease in prices and wages |
| Step 4 | Increase in imports and decrease in exports | Increase in exports and decrease in imports |
| Until | Exports = Imports | Exports = Imports |

## 2.3 Adam Smith's Theory of Absolute Advantage

Generally considered as the father of economics， the UK economist Adam Smith published The Wealth of Nations （《国富论》） in 1776 in London.In this book， Smith attempted to explain the process by which markets and production actually operate in society.His studies led him to a number of striking results.Smith's two main areas of contribution， absolute advantage and the division of labor， were fundamental to trade theory.

Production, the creation of a product for exchange, always requires the use of society's primary element of value and human labor.Smith noted that some countries, owing to the skills of their workers or the quality of their natural resources, could produce the same products as others with fewer labor hours.He termed this efficiency"absolute advantage".

# 1.Assumptions of Adam Smith's theory of absolute advantage

1) There are only two countries and two products in the world.

2） Each country has a fixed endowment of resources， and all units of each particular resource are identical （完全相同的）.

3） The factors of production are completely mobile between alternative uses （不同的用途） within a country.This assumption implies that the prices of factors of production also are the same among these alternative uses.

4） The factors of production are completely immobile externally （对外）， that is， they do not move between countries.Therefore， factor prices may be different between countries prior to （在……之前） trade.

5） A labor theory of value is employed （采用） in the model.Thus， the value of a commodity is based solely on its relative labor content.From a production standpoint， this implies that （i） no other inputs are in the production process， or （ii） any other inputs are measured in terms of the labor embodied （包含于） in their production， or （iii） the other inputs/labor ratio is the same in all industries.In simple terms （简而言之）， this assumption means that a good embodying two hours of labor is twice as expensive as a good using only one hour.

6) The level of technology is fixed for both countries, although the technology can differ between them.

7） Costs of production are constant （常量）.Thus， the hours of labor per unit of production of a good do not change， regardless of （无论） the quantity produced.This means that the supply curve for any good is horizontal （水平的）.

8) There is full employment.

9） The economy is characterized by perfect competition.No single consumer or producer is large enough to influence the market； hence， all are price takers （接受者）.All participants have full access to （完全可以得到） market information， there is free entry to and exit from an industry， and all prices equal the marginal cost of production （边际生产成本）.

10) There are no government imposed obstacles to economic activity.

11) Internal and external transportation costs are zero.

## 2.Challenge to Mercantilism

The theory of absolute advantage held that

1） A nation’s wealth was reflected in its productive capacity （生产力）.Smith perceived（认为） that a nation’s wealth was reflected in its productive capacity （i.e.its ability to produce final goods and services）， not in its holdings of precious metals.Attention thus turned from acquiring species to enlarging the production of goods and services.

2） Specialization （分工） would generate （产生） productivity gains.Self-interest （自利）would lead individuals to specialize in and exchange goods and services based on their own special abilities.The natural tendency“to truck （易货）， barter （易货）， and exchange” goods and services would generate productivity gains through the increased division and specialization of labor.Smith applied his ideas about economic activity within a country to specialization and exchange between countries.He concluded that a country should specialize in and export those commodities it produced more efficiently because the absolute labor required per unit was less than that of the prospective （潜在的） trading partner.

3） Free environment should be stressed.Smith believed that growth in productive capacity was fostered best in an environment where people were free to pursue （追求） their own interests.He stressed that a government policy of laissez faire （自由主义） （allowing individuals to pursue their

own activities within the bounds of law and order and respect for property rights） would best provide the environment for increasing a nation's wealth. The proper role of government was to see that （确保） the market was free to function in an unconstrained （不受约束的） manner by removing the barriers to effective operation of the"invisible hand" of the market.Self-interest was the catalyst （催化剂） and competition was the automatic regulation （调整） mechanism.Smith saw little need for government control of the economy.In The Wealth of Nations， Smith explained not only the critical role the market played in the accumulation of a nation's wealth but also the nature of the social order that it achieved and helped to maintain.

## 3.Example

We here use an example to illustrate Smith's argument.Consider the two-country， twocommodity framework in Table 2-2.Assume that a labor theory of value is employed， meaning that goods exchange for each other at home in proportion to the relative labor time embodied in them.In this situation， with a labor theory of value， 1 barrel of wine will exchange for 4 yards of cloth in Britain （or 1C for 1/4 W）； on the other hand， 1 barrel of wine exchange for 3/2 yards of cloth in Portugal （or 1C for 2/3 W）.Britain has an absolute advantage in the production of cloth and Portugal has an absolute advantage in the production of wine because less labor time is required to produce cloth in Britain and wine in Portugal.According to Smith，there is a basis for trade because both nations are clearly better off （更好） specializing in their low cost commodity and importing the commodity that can be produced more cheaply abroad.

Table 2-2 Labor requirements and absolute advantage in Britain and Portugal

| | Cloth | Wine | Price ratio in autarky |
|---|---|---|---|
| Britain | 1 hr./yd. | 4 hrs./bbl. | 1W: 4C (or 1C: 1/4 W) |
| Portugal | 2 hrs./yd. | 3 hrs./bbl. | 1W: 3/2 C (or 1C: 2/3 W) |

For the purpose of illustrating the gains from trade, assume that the tw o countries, rather than producing each good for themselves, exchange good s at a rate of 1 barrel of wine for 3 yards of cloth.For Britain this means obt aining wine in Portugal for only 3 yards of cloth per barrel instead of 4 yard s at home.Similarly, Portugal benefits from acquiring cloth for a cost of onl y 1/3 barrel of wine instead of 2/3 barrel of wine at home.

It is important to note that gains from trade can occur over a wide rang e of barter prices.Smith's argument was especially significant at the time be cause it indicated that both countries could benefit from trade and that trade was not a zero-sum game as the mercantilists had believed.The fact that trad e was mutually beneficial and was a positive sum game （正和博弈）， i. e.， all players can receive a positive payoff （收益） in the game， was a powerful argument for expanding trade and reducing many trade controls th at characterized the Mercantilist period.

Smith saw the source of these absolute advantages as the unique set of natural resources（including climate） that characterized a particular natio n.He did， however， acknowledge that certain advantages could be acquir ed through the accumulation， transfer， and adaptation of skills and techn ology.Although Smith's ideas were crucial for the early development of Cla ssical thought and for altering the view of the potential gains from internati onal trade， it was David Ricardo who expanded upon Smith's concepts an d demonstrated that the potential gains from trade were far greater than thos e Adam Smith had envisioned （设想的） in his concept of absolute advan tage.

# 2.4 David Ricardo's Theory of Comparat ive Advantage

## 1.The concept of comparative advantage

Although Smith's work was instrumental （起作用的） in the development of economic theories about trade and production， it did not answer a question like if a country did not possess absolute advantage in any product， could it （or would it） trade？ David Ricardo， in his 1819 work entitled On the Principles of Political Economy and Taxation （政治经济学及赋税原理）， sought to take the basic ideas set down by Smith a few steps further.

The assumptions of the theory of comparative advantage are completely the same as that of the theory of absolute advantage except that there is relative technology difference instead of absolute difference in the two countries.

The theory of comparative advantage states that each country would benefit if it specializes completely in the production of the product in which it possesses comparative advantage and trades for the other.

Then what is comparative advantage? And how do we know whether a country has comparative advantage in producing a particular product? Comparative advantage is the ability of a country to produce a particular good at a lower relative cost than another country.

The comparative advantage in producing a particular product can be determined by relative labor productivity, relative cost or opportunity cost.

1) Determined by relative labor productivity

Relative labor productivity is the ratio of labor productivity of one particular product to another.It can be represented by the following formula （公式）：

$$\text{Relative labor productivity of Product A (to Product B)} = \frac{\text{Labor productivity of Product A } (Q_A/L)}{\text{Labor productivity of Product B } (Q_B/L)}$$

If the relative labor productivity of Product A (to B) in a country is higher than in another country, then the country has a comparative advantage in Product A.Otherwise, it has a comparative disadvantage in Product A.

2) Determined by relative cost

Relative cost is the ratio of the amount of input for producing one unit of a particular product to the amount of input for producing one unit of anot her product.

$$\text{Relative cost of Product A (to Product B)} = \frac{\text{Amount of input for prducing one unit of Product A } (a_{LA})}{\text{Amount of input for producing one unit of Product B } (a_{LB})}$$

If the relative cost of Product A (to B) in a country is lower than in ano ther country, then the country has a comparative advantage in Product A.Ot herwise, it has a comparative disadvantage in Product A.

3) Determined by opportunity cost

Opportunity cost is the decreased quantity of another product given up for producing one more unit of a particular product.

$$\text{Opportunity cost of Product A} = \frac{\text{Decreased quantity of Product B } (\Delta Q_B)}{\text{Increased quantity of Product A } (\Delta Q_A)}$$

If the opportunity cost of Product A in a country is lower than in anoth er country, then the country has a comparative advantage in Product A.Othe rwise, it has a comparative disadvantage in Product A.

## 2.Example

To fully understand the theory of comparative advantage, consider the following example:

There are two countries， Britain and Portugal， producing two kinds of goods， cloth and wine， using labor as the sole input in production.The labor requirements for per unit of production are given in Table 2-3.In this e xample， Portugal has an absolute advantage in the production of both com

modities.From Adam Smith's perspective （观点）， there is no basis for t rade between these countries because Portugal is more efficient in the produ ction of both goods.Britain has an absolute disadvantage in both goods.

Table 2-3 Labor requirements and absolute advantage in Britain and Portugal prior to divisio n of labor

| | Wine | Cloth | Price ratio in autarky |
|---|---|---|---|
| Portugal | 80 hrs./bbl. | 90 hrs./yd. | 1W:8/9 C (1C:9/8W) |
| Britain | 120 hrs./bbl. | 100 hrs./yd. | 1W:6/5C (1C:5/6W) |

Table 2-4 shows: (a) The relative labor productivity of wine (to cloth) i n Portugal is higher than in Britain while the relative labor productivity of c loth (to wine) in Britain is higher than in Portugal; (b) The relative cost of w ine to cloth in Portugal is lower than in Britain while the relative cost of clot h to wine in Britain is lower than in Portugal; (c) The opportunity cost of wi ne in Portugal is lower than in Britain while the opportunity cost of cloth in Britain is lower than in Portugal.

Table 2-4 Comparative advantage determined by relative labor productivity,relative cost and opportunity cost

| | Wine (to cloth) | | Wine | Cloth (to wine) | | Cloth |
|---|---|---|---|---|---|---|
| | Relative labor productivity | Relative cost | Opportunity cost | Relative labor productivity | Relative cost | Opportunity cost |
| Portugal | 9/8 | 8/9 | 8/9 | 8/9 | 9/8 | 9/8 |
| Britain | 5/6 | 6/5 | 6/5 | 6/5 | 5/6 | 5/6 |
| Portugal has a comparative advantage in wine and Britain has a comparative advantage in cloth. | | | | | | |

In other words, Portugal is relatively more efficient and has a comparat ive advantage in the production of wine and Britain is relatively more effici ent and has a comparative advantage in the production of cloth.

Ricardo's theory of comparative advantage holds that the relative cost differences arising from technology differences give rise to trade.A country

can benefit from export if only it has a comparative advantage in the production of the exporting product.A country may have no absolute advantage in all products.However, it surely has a comparative advantage in a particular product.Therefore, any country will have a product to export and gain from international trade.

To see this, consider the autarky (pre-trade) price ratios.Within Britain, 1 barrel of wine should exchange for 6/5C yards of cloth, while within Portugal, 1 barrel of wine would exchange for only 8/9 yard of cloth.Thus, Portugal stands to gain if it can specialize in wine and acquire cloth from Britain at a ratio of 1 barrel: 6/5 yards.Similarly, Britain would benefit by specializing in cloth production and exporting cloth to Portugal, where it could receive 9/8 barrels of wine per yard of cloth instead of 5/6 barrel per yard at home.Even though trade is unrealistically restricted to two goods in this basic analysis, similar potential gains also occur in more comprehensive analysis. The main point is that the basis for and the gains from trade rest on comparative, not absolute advantage.

There are two ways to illustrate the gains from trade: one is in terms of labor time saved,the other is to state that more goods can be obtained for the same amount of labor time than is possible in autarky.

1) In terms of labor time saved

Assume that the terms-of-trade （贸易条件） ratio was 1W：1C.At these terms， consider the gain for Britain.With trade， Britain could devote 100 hours of labor to producing cloth，its comparative advantage good，and get 1C.This 1C could then be exchanged with Portugal for 1W.Thus，100 hours of labor in Britain have indirectly produced 1 unit of wine.If Britain had chosen to produce 1W at home directly， the cost involved would have been 120 hours of labor.However， trade saves Britain 20 hours of labor for each unit of its imported good.

There is also obviously a gain for Portugal in terms of labor time saved.Portugal can take 80 hours of labor to produce 1 unit of wine.With this 1W, Portugal can obtain 1 unit of cloth through trade.Direct production of 1C in Portugal would have required 90 hours of labor, and trade has enabled th

e country to gain or save 10 hours of labor per unit of its imported good.Th us, unlike the zero-sum game of the Mercantilists, international trade is a po sitive sum game.

2) In terms of more goods obtained

With trade, more goods can be obtained for the same amount of labor t ime than is possible in autarky (see Table 2-5 and Table 2-6).Portugal would gain 1.125 barrels more of wine and Britain would gain 0.2 yard more of cl oth.

Table 2-5 Wine and cloth obtained by Portugal and Britain after division of labor

| | Wine | Cloth |
|---|---|---|
| Portugal | (80 hrs+90 hrs.)/80 = 2.125 bbl. | |
| Britain | | (100 hrs + 120 hrs.)/100 =2.2 yds. |

Table 2-6 More wine and cloth obtained by Portugal and Britain after trading at 1W: 1C

| | Wine | Cloth |
|---|---|---|
| Portugal | 1.125 bbls. | 1 yd. |
| Britain | 1 bbl. | 1.2 yds. |

## 3.Analysis of the theory of comparative advantage by using modern tools

The theory of comparative advantage can be illustrated by using figure s （图表） and curves.In the analysis of general equilibrium （一般均衡）， we use the production possibility curve （生产可能性曲线） to de pict （描述） the supply and community indifference curve （社会无差异曲线） to depict the demand.

(1) Tools to be used

1) Production possibility curve

Production possibility curve, also called production possibility frontier (PPF) or transformation curve, is a graph that shows the different rates of pr oduction of two goods that a country can efficiently produce with limited pr oductive resources.It reflects all the combinations of products that a country can produce given its resources are fully utilized.For example, in Figure 2-1, point E represents the combination of $0X_1$ of good X and $0Y_1$ of good Y a nd point F represents the combination of $0X_2$ of good X and $0Y_2$ of good Y t hat the country can produce when its resources are fully utilized.Point C ind icates that the country's resources are not fully utilized and point D indicate s that the resources of the country are not enough to produce at this point.A straight line of slope represents the opportunity costs of production are the s ame at the various levels of production.It indicates that the relative costs of product X and Y do not change as the economy shifts its production from al l X or Y, or anywhere in between.Since Ricardo's theory of comparative ad vantage assumed that labor was the only production input and the productiv ity was fixed, the opportunity costs of production were therefore fixed.The PPF of each country was a straight line.

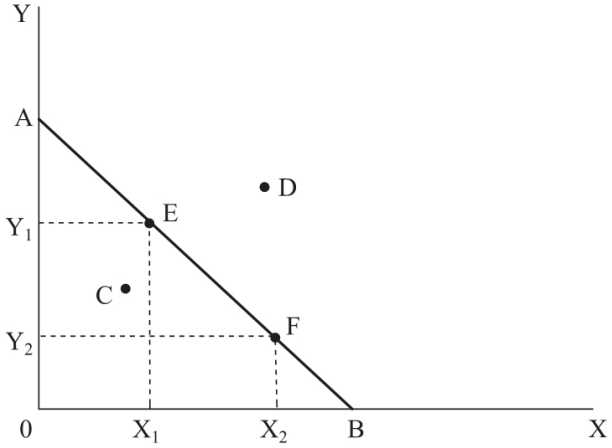



Figure 2-1 Production possibility curve

The slope （斜率） of line AB in Figure 2-2（a） is smaller than the slope of line AB in Figure 2-2（b）， indicating that the opportunity costs of good X in Country I are smaller than in Country II and Country I has a c omparative advantage in good X while County II has a comparative advanta ge in good Y.

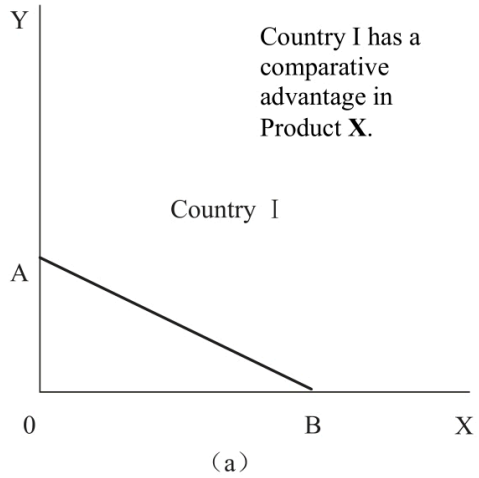



Figure 2-2 (a)　Production possibility curve of Country I

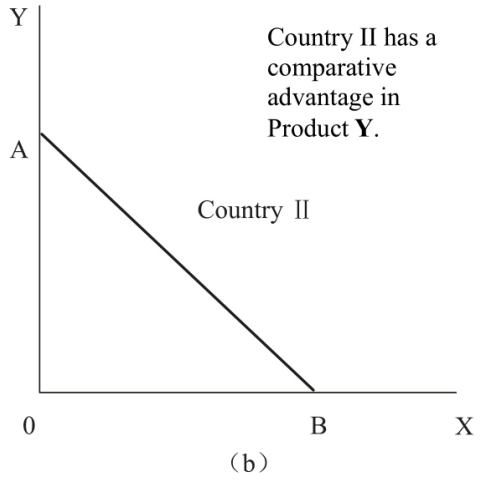



Figure 2-2 (b)　Production possibility curve of Country II

2) Community indifference curves

A community indifference curve is an illustration of various combinations of two commodities that yield the same level of well-being （福利） for the community （or country） as a whole.As shown in Figure 2-3， the combination of $0X_1$ of good X and $0Y_1$ of good Y （at point A）yields the same level of well-being as the combination of $0X_2$ of good X and $0Y_2$ of good Y （at point B）.And curves $CIC_2$ and $CIC_3$ represent successively （逐次） higher levels of well-being.The（negative of the） slope at any point on an indifference curve is called the marginal rate of substitution （MRS=

$MU_X/MU_Y$）（边际替代率）.MRS of X for Y in consumption refers to th e amount of Y that a nation could give up for one extra unit of X and still re main on the same indifference curve.The indifference curve is down-slopin g and convex（凸出的） to the origin（圆点）， meaning a diminishing （递减的） MRS.The diminishing MRS or absolute slope of an indifferenc e curve is a reflection or the fact that the more of X and the less of Y a natio n consumes.

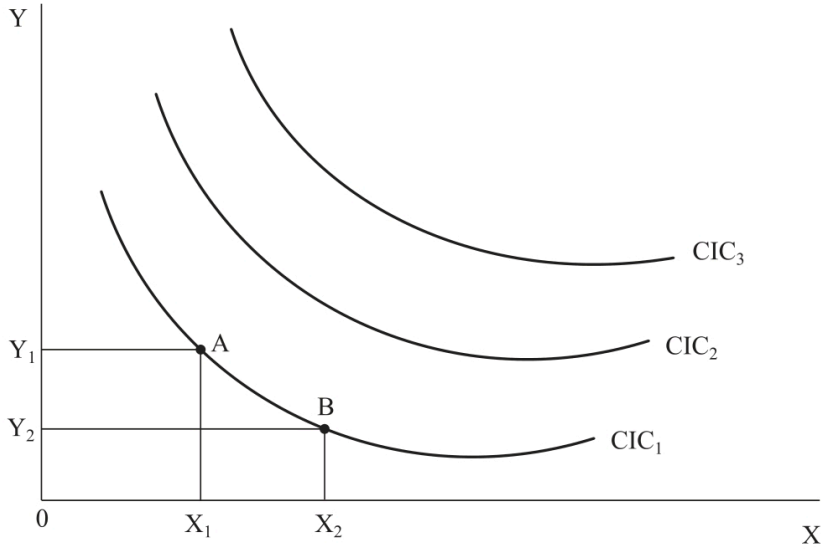



Figure 2-3 Community indifference curves

（2） Equilibrium analysis（均衡分析）

1） General equilibrium in autarky（自给自足经济下的一般均衡）

General equilibrium refers to the equality of supply and demand in all markets of an economy simultaneously.The number of markets does not hav e to be large.The simplest Ricardian model has markets only for two goods and one factor， labor， but this is a general equilibrium model.General eq uilibrium contrasts with partial equilibrium（局部均衡） which is the equ ality of supply and demand in only a subset of an economy's markets—usua lly just one—taking variables（变量） from other markets as given.

In autarky， a country achieves general equilibrium at the point where its community indifference curve is tangent（相切的） to the slope（斜坡，斜率） of its PPF.The slope of the PPF is also called the marginal rate

of transformation （MRT）（边际交换率）.It is the rate at which a produ cer is able to substitute a small amount of one input-variable for a small am ount of another.This rate indicates the opportunity cost of a unit of each co mmodity in terms of another.It is also known that the slope of the PPF is eq ual to the relative marginal costs.So at the equilibrium point， where （$P_X$/ $P_Y$）=（$MC_X$ / $MC_Y$），producers would have no incentives to change the production pattern unless relative price ratio changes.We also introduce the indifference curve that is tangent to the PPF.So we have the condition：

$$MRT=(MC_X/MC_Y)=(P_X/P_Y)=(MU_X/MU_Y)=MRS$$

Consider Figure 2-4(a) and Figure 2-4(b).Country I has the same oppor tunity costs of production and so does Country II.Figure 2-4(a) shows that t he autarky equilibrium for Country I is at point A when the relative price of good X to good Y is $P_{X/Y}$ while Figure 2-4 (b) shows that the autarky equili brium for Country II is at point A′when the relative price of good X to good Y is $P'_{X/Y}$.As $P_{X/Y}$ is smaller than $P'_{X/Y}$, Country I has therefore a comparati ve advantage in good X while Country II has a comparative advantage in go od Y.According to the theory of comparative advantage, Country I should s pecialize in the production of good X and trade for good Y with Country II and Country II should specialize in the production of good Y and trade for g ood X with Country I.

In autarky, for Country I the equilibrium point is point A, at which the gains of Country I are $0X_1$ of good X and $0Y_1$ of good Y.For Country II, the equilibrium point is point A′, at which the gains of Country II are $0'X'_1$ of g ood X and $0'Y'_1$ of good Y.

2） Introduction （引入） of trade

With trade, at the world exchange ratio of good X to good Y $P_W$ (The world exchange ratio $P_W$ must lie between the two internal price ratios bein g flatter than the autarky price line in Country II and steeper than the autark y price line in Country I, $P_{X/Y} < P_W < P'_{X/Y}$.At this new relative price, the

equilibrium point for Country I moves from A to E and at this point Country I gains $X_1X_2$ more of good X and $Y_1Y_2$ more of product Y [see Figure 2-4 (a)].Similarly, the gains with trade for Country II are $X'_1X'_2$ more of good X and $Y'Y'_2$ more of product Y [see Figure 2-4(b)].

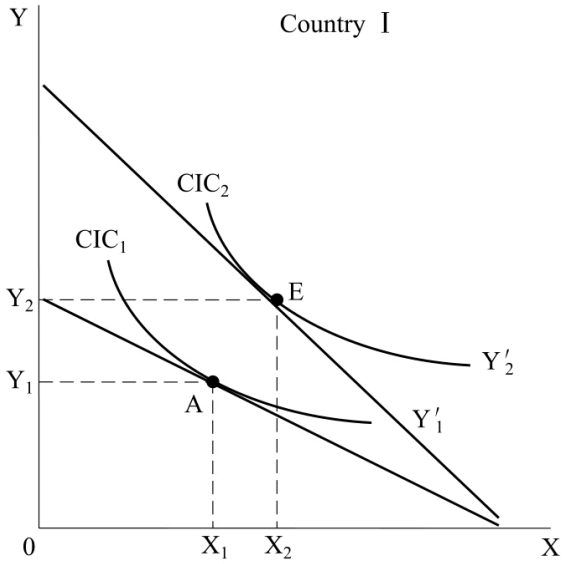



Figure 2-4 (a) Equilibrium points and gains in autarky and with trade for Country I when op portunity costs of production are the same.

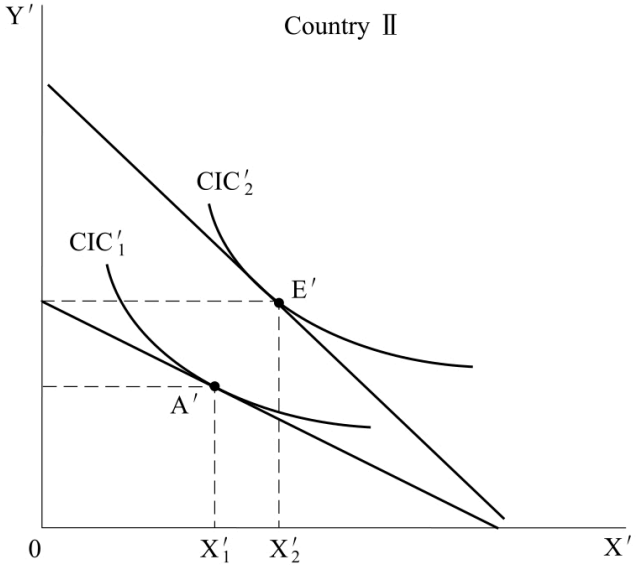



Figure 2-4 (b) Equilibrium points and gains in autarky and with trade for Country II when op portunity costs of production are the same.

[1]The bulk （大部分） of what is commonly called“mercantilist literature” appeared in the 1620s in Great Britain.Smith saw English merchant Thomas Mun （1571-1641） as a major creator of the mercantile system.Perhaps the last major mercantilist work was James Steuart’s Principles of Political Economy published in 1767.

[2]The state is a political and geopolitical entity （地缘政治实体）； the nation is a cultural and/or ethnic entity （民族实体）.The term“nation-state” implies that the two geographically coincide， and this distinguishes the nation state from the other types of state.

[3]Poker is a zero-sum game where one person’s winnings are matched by the losses of the other players.

# Chapter 3　Neoclassical Trade Theories

Learning Objectives

In this chapter, you will learn:

- Gains from trade in neoclassical trade theory
- Reciprocal demand theory
- Factor endowment theory
- Leontief Paradox

The classical trade theory is limited in their analysis by the labor theory of value and the assumption of constant costs.The neoclassical trade theory provides tools of analysis and studies the impact of trade in a more rigorous （缜密的） and less restrictive manner.It extends the simple trade model to the more realistic case of increasing opportunity costs and factors of production besides labor.

In this chapter， we first discuss the gains from trade in neoclassical trade theory by using the tools of analysis of increasing opportunity costs and general equilibrium.Based on these tools， we then introduce the reciprocal demand theory which illustrates how the trade terms in international trade are determined and the factor endowment theory developed （阐释） by the Swedish economists Eli Heckscher （伊莱·赫克歇尔） and Bertil Ohlin （贝蒂·俄林）.Finally we discuss the Leontief paradox （里昂惕夫悖论） which finds that the country with the world's highest capital per worker has a lower ratio of capital to labor in exports than in imports.

# 3.1 Gains from Trade in Neoclassical Trade Theory

## 1.Increasing opportunity costs on the PPF

With increasing opportunity costs， the shape of the PPF is concave （凹的） to the origin or bowed （如弓的） out [see Figure 3-1（a） and Figure 3-1（b）].The reasons for increasing opportunity costs are：（1） Resources or factors of production are not homogeneous；（2） Resources or factors of production are not used in the same fixed proportion or intensity in the production of all commodities.

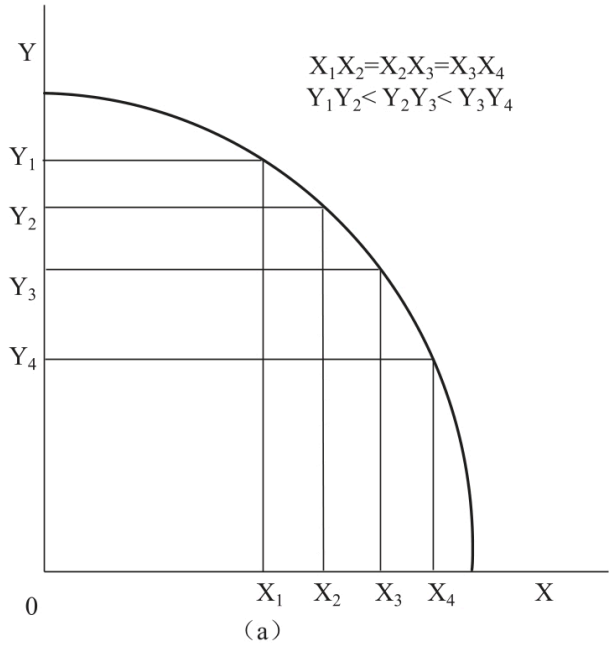



Figure 3-1 (a)　Increasing opportunity costs on the PPF

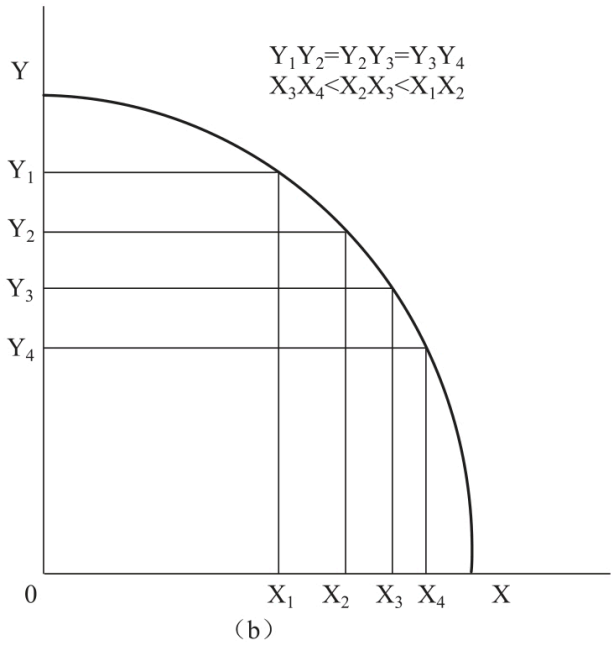



Figure 3-1 (b)　Increasing opportunity costs on the PPF

As shown in Figure 3-2(a) and Figure 3-2(b), Country I and Country II have different PPFs.The difference in the PPFs of the two countries is due t o the fact that the two countries have different factor endowments or resour ces at their disposal and/or use different technologies in production.The PP F of Country I demonstrates a technology that is relatively more efficient in the production of X while the PPF of Country II demonstrates a technology more efficient in the production of Y.

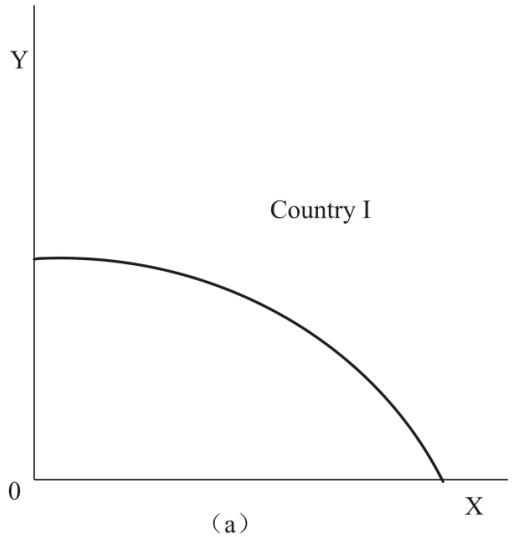



Figure 3-2(a)　Country I's PPF

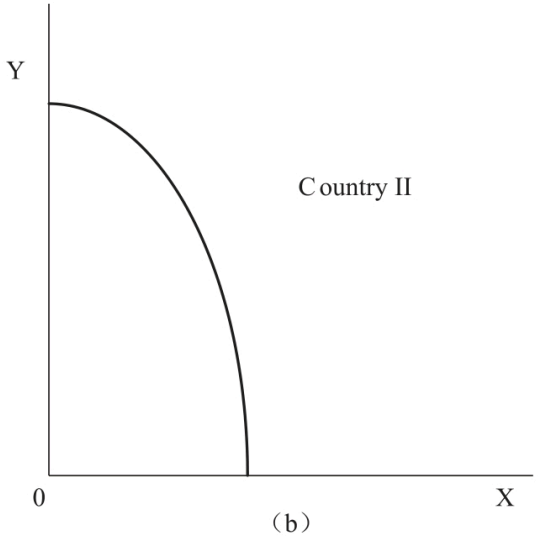



Figure 3-2(b)　Country II's PPF

## 2.General equilibrium and gains in autarky

In Figure 3-3(a) and Figure 3-3(b), the equilibrium points in autarky for Country I and Country II are point A and point A′ when the relative prices of good X to good Y ($P_X/P_Y$) are $P_{X/Y}$ and $P'_{X/Y}$ respectively.In autarky, at the equilibrium point A, the gains of Country I are $0X_1$ of good X and $0Y_1$ of product Y [see Figure 3-3(a)].Similarly at the equilibrium point A′,the gains of Country II are $0X'_1$ of good X and $0Y'_1$ of product Y [see Figure 3-3(b)].

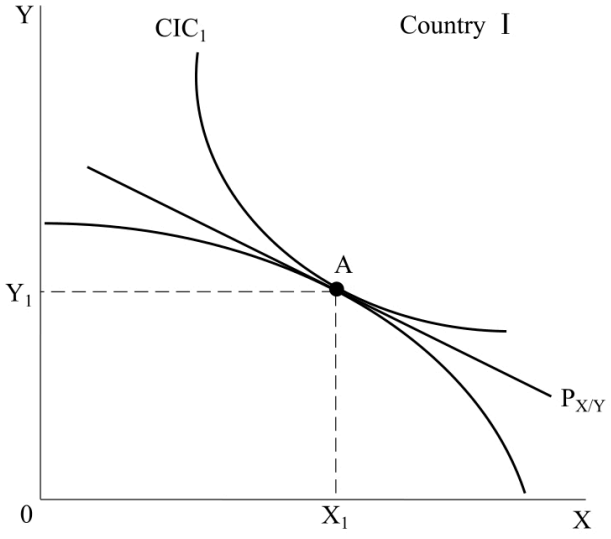


Figure 3-3 (a)　The equilibrium point in autarky for Country I is at point A when

$P_X/P_Y=P_A$

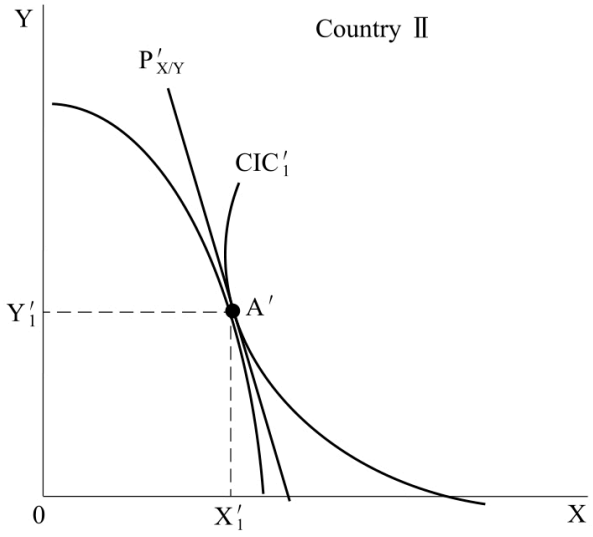



Figure 3-3 (b)　The equilibrium point in autarky for Country II is at point A′when

$\mathbf{P'_X/P_Y=P'_{A'}}$

I is at point A when $P_X/P_Y=P_A$

# 3.General equilibrium and gains after the introduction of international trade

Since $P_{X/Y}$ is smaller than$P'_{X/Y}$, i.e.the relative prices of good X to good Y in Country I is smaller than in Country II, namely, $(P_X/P_Y)_I<(P_X/P_Y)_{II}$, Country I has a comparative advantage in good X while Country II has a comparative advantage in good Y.According to the theory of comparative advantage, Country I should specialize in the production of good X and trade for good Y with Country II while Country II should specialize in the production of good Y and trade for good X with Country I.

With trade, at the world exchange ratio of good X to good Y $P_W$ (The world exchange ratio $P_W$ must lie between the two internal price ratios being flatter than the autarky price line in Country II and steeper than the autark

y price line in Country I, $P_{X/Y} < P_W < P'_{X/Y}$.At this new relative price, the eq uilibrium point for Country I moves from A to E and at this point Country I gains $X_1X_2$ more of good X and $Y_1Y_2$ more of good Y [see Figure 3-4(a)].Si milarly, the gains with trade for Country II are $X'_1X'_2$ more of good X and $Y'Y'_2$ more of product Y [see Figure 3-4(b)].

Gains from trade are composed of two parts: One is consumption gain which is the gain from exchange without changes in production.The other is production gain which is the gain from specialization.Take Country I as an example.The community indifference curve changes from $CIC_1$ to $CIC_2$ wh en exchange ratio changes from $P_{X/Y}$ in autarky to $P_W$ with trade and to $CIC_3$ when production point changes from point E to E′ (see Figure 3-5).

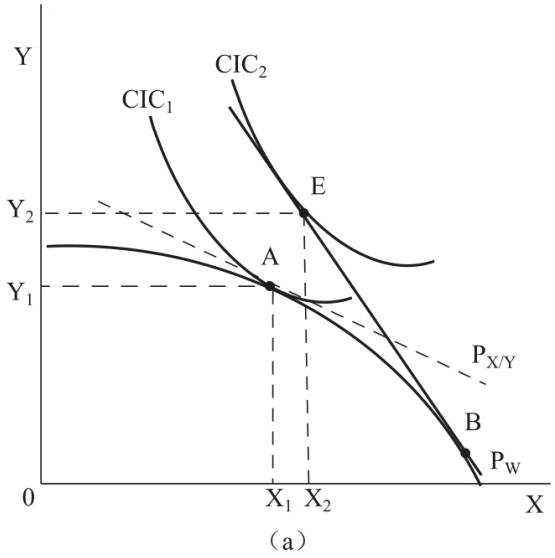



Figure 3-4 (a)　Equilibrium points and gains in autarky and with trade for Country I when op portunity costs of production are increasing

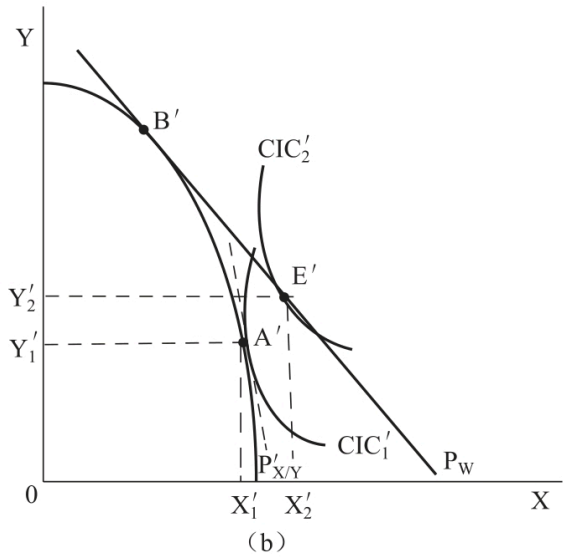



Figure 3-4 (b)　Equilibrium points and gains in autarky and with trade for Country II when op portunity costs of production are increasing

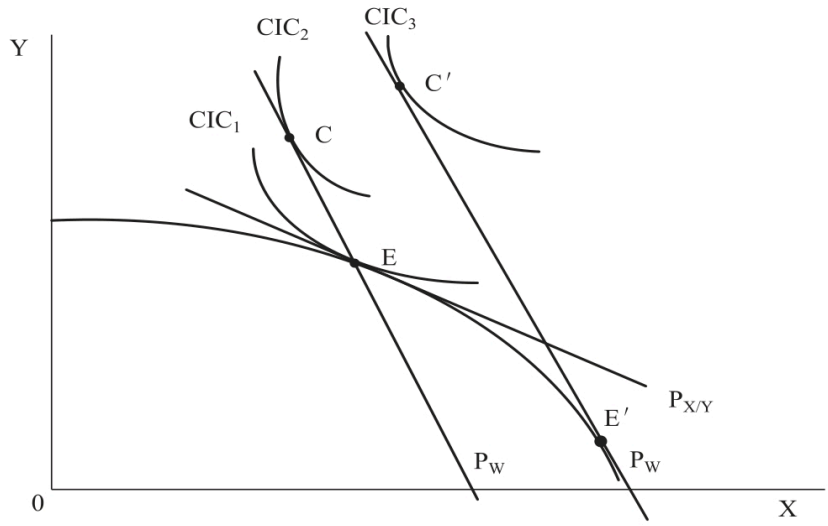



Figure 3-5　Two parts of gains from trade: gains from consumption and gains from specializat ion

# 3.2　Reciprocal Demand Theory

In our previous discussions in Chapter 2 and the above section， worl d prices after trade began were assumed to be at a certain level.For exampl e， in the Ricardo model we assumed that 1 barrel of wine would exchange

for 1 yard of cloth in international trade.Similarly， in the above section，a given $P_X/P_Y$ or $P_W$ was drawn in the PPF—indifference curve diagram， and no attention was paid to the reason for this price ratio.In this section， we explore how these international prices are determined.The important analytical concept employed is known as the offer curve （提供曲线）.We first introduce the concept of offer curve and then demonstrate how equilibrium prices are attained in international trade.

## 1.A country's offer curve

A country's offer curve， or reciprocal demand curve （相互需求曲线）， indicates the quantity of imports and exports the country is willing to buy and sell on world markets at all possible relative prices.It shows the country's willingness to trade at various possible terms of trade.The offer curve really is a combination of the demand for imports and the supply of exports.It was first verbalized （描述） by John Stuart Mill （约翰·斯图尔特·密尔）， and then put into graphic（图表的） form by Alfred Marshall （阿尔弗雷德·马歇尔） and F.Y.Edgworth （埃奇沃思）.

Figure 3-6(a) shows that under free trade, the country is producing $0X_2$ of good X and $0Y_2$ of good Y (at point B).Consumption is $0X_1$ of good X and $0Y_1$ of good Y (at point A).$X_1X_2$ is the amount of good X the country is exporting and $Y_1Y_2$ is the amount of good Y the country is importing.Trade triangle ABC reflects the trade pattern, with line CB representing the exports and line AC representing the imports the country is willing to undertake at the terms of $(P_X/P_Y)_1$.

In Figure 3-6(b), the world price line is steeper than that in Figure 3-6(a), the country's production and consumption are correspondingly adjusted.Since the relative price of X in Figure 3-6(b) is greater than that in Figure 3-6(a), producers have responded to the relatively higher price of X by increasing their production of X and decreasing their production of Y(production point has moved from point B to B′).Production now takes place at B′, with

$0X_4$ of good X and $0Y_4$ of good Y being produced.At prices $(P_X/P_Y)_2$ consu mption takes place at point A′ with $0X_3$ of good X and $0Y_3$ of good Y consu med.Exports and imports of this country are now $X_3X_4$ of good X and $Y_3Y_4$ of good Y respectively.Trade triangle A′ B′ C′ represents the volume of trad e.

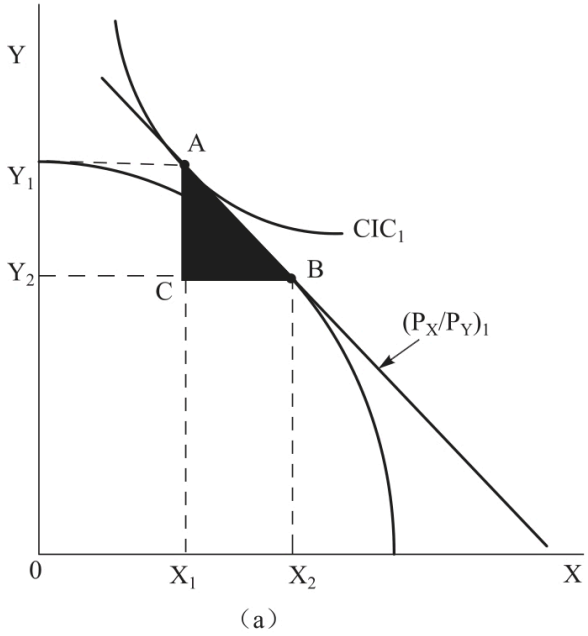



Figure 3-6 (a)　Trade triangle at a possible terms of trade of $(P_X/P_Y)_1$

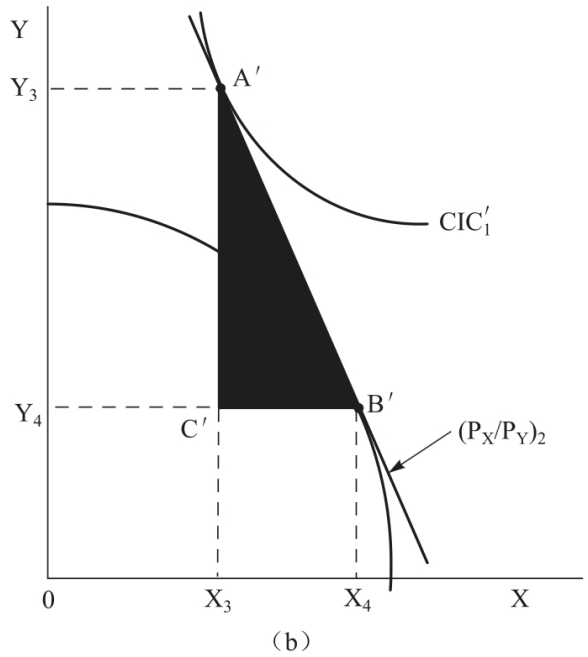



Figure 3-6 (b)　Trade triangle at a possible terms of trade of $(P_X/P_Y)_2$

The offer curve diagram （图） takes the information from Figure 3-6（a） and Figure 3-6（b）and plots （绘制） it onto a new curve （see Figure 3-7）.The figure presents the quantities of exports and imports at different sets of prices.Quantity of export $0X_5$ corresponds to quantity of exports of $X_1X_2$ in Figure 3-6（a） and $0X_6$ in Figure 3-7 equals the quantity of $X_3X_4$ in Figure 3-6（b）.The higher relative price ratio （$P_X/P_Y$） is represented by a steeper price line in Figure 3-7 and means greater quantities of good X are exported.

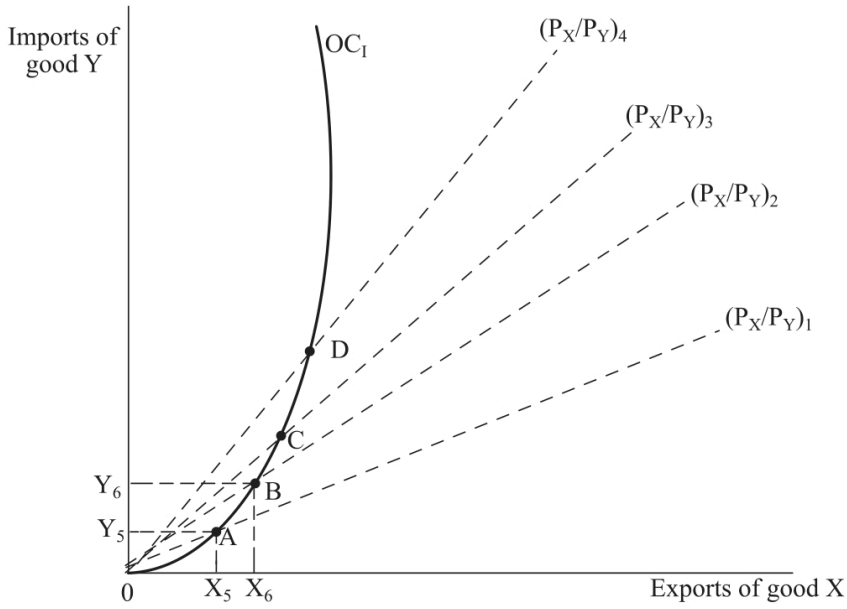



Figure 3-7 Alternative terms of trade and export-import combination on the offer curve of Country I

The construction of the offer curve is completed by connecting all possible points at which a country is willing to trade, with the resulting curve labelled $OC_I$ representing the offer curve of Country I[1].

The most useful feature of the offer curve diagram is that it can bring two trading countries together in one diagram.To accomplish this， the offer curve of Country I's trading partner， Country II， needs to be developed（建立）.The trade triangles for Country II are plotted in the same way as those for Country I.The only difference is that Country II exports good Y and imports good X.Country II's offer curve appears as $OC_{II}$ in Figure 3-8.It represents the quantity of good X it is willing to import and the quantity of good Y it is willing to export on world markets at various possible terms of trade.

## 2.Trading equilibrium

Figure 3-8 shows the trading equilibrium （贸易均衡） and the equilibrium terms of trade when Country I's and Country II's offer curves are bro

ught together in one figure.The horizontal axis indicates exports of good X f or Country I and imports of good X for Country II.Similarly， the vertical a xis indicates exports of good Y for Country II and imports of good Y for Co untry I.

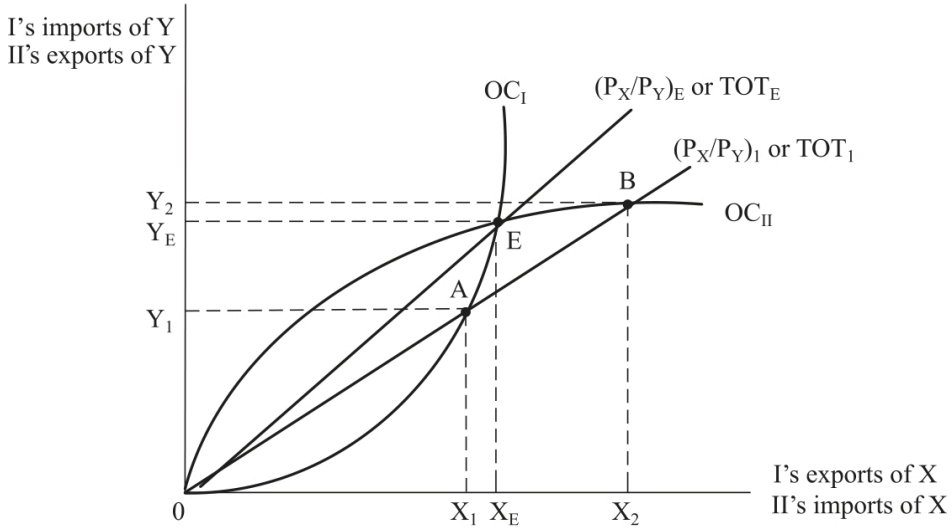



Figure 3-8 Trading equilibrium between Country I and Country II

At point A when the relative price ratio is $(P_X/P_Y)_1$, the quantity of goo d X Country I is willing to export is $0X_1$ which is less than $0X_2$, the quantity of good X which Country II is willing to import and the quantity of good Y Country I is willing to import is $OY_{1,}$ less than the quantity of good Y which Country II is willing to export.That is to say, the demand for good X exceed s the supply of good X and the supply of good Y exceeds the demand for go od Y, so the world relative price ratio of $P_X/P_Y$ will go up.

When the world relative price ratio increases to （$P_X/P_Y$）$_E$， the expo rts of good X by Country I equals exactly the imports of good X by Country II and the exports of good Y by Country II equals exactly the imports of goo d Y by Country I.Thus， relative price ratio（$P_X/P_Y$）$_E$ is market-clearing （市场出清） price ratio， since the demand for and supply of good X on the world market are equal， as are the demand for and supply of good Y.

## 3.Measurement of terms of trade

The relative price ratio $P_X/P_Y$ is called the commodity terms of trade of Country I, price terms of trade or net barter terms of trade of Country I, usually simplified as TOT.

For any particular country, its TOT is defined as the price of its exports divided by the price of its imports.Thus, in our previous example, the TOT for Country I would be $P_X/P_Y$ while for Country II it would be $P_Y/P_X$.The economic interpretation of the terms of trade is that, as the price of exports rises relative to the price of imports, each unit of a country's exports is able to purchase a larger quantity of imports.

Since a country exports and imports many goods， a price index for a given year must therefore be calculated.A price index is a weighted average of the prices of many goods，calculated for comparison with a base year.A base year for the export price （$P_X$） and import price （$P_Y$） indexes must be chosen.The base-year price indexes are usually set at values of 100，and other years can be compared with them.Thus the terms of trade of a particular country in a given year is the ratio of the country's export price index to its import price index in the given year （usually multiplied by 100 to compare with the TOT in the base year）.If the figure is greater than 100， it means comparing with the base year， the terms of trade in the given year is improved or each unit of the country's exports in the given year can exchange for more units of imports than in the base year.If the figure is less than 100， the terms of trade is then deteriorated （恶化）.The commodity terms of trade indicates the quantity of foreign goods and services （imports） that a country can purchase from the proceeds （收益） of the sale of its goods and services （exports） of a given quantity.

Take China as an example.Use 1994 as the base year in calculating the terms of trade for China, thus both China's $P_X$ and $P_M$ in that year were 100. Then we consider the year 2002.Suppose the price index for China's exports in 2002 was 89 (that is, export prices were 11 percent (11=100−89) below

the base-year prices) and the price index for China's imports was 141 (that is, import prices were 41 percent (41=141−100) over the base-year values).The terms of trade for China in 2002 would be calculated as follows: TOT=($P_X/P_M$)×100=(89/141) ×100=63.12.The figure 63.12 means that each unit of China's exports in 2002 exchanged for 36.88 percent fewer units of imports than in the base year.

There is another terms-of-trade measure which is income terms of trade[2].Income terms of trade is the ratio of the value of exports to the price index of imports， that is， $TOT_{IN}$=（$P_X$×$Q_X$）/$P_M$， where $Q_X$ is the quantity index of exports.A rise in $TOT_{IN}$ indicates that the country's export earnings now permit the country to purchase a greater quantity of imports.The commodity terms of trade and the income terms of trade do not have to move in the same direction over time， because a decline in $P_X/P_M$ could be more offset by a rise in the quantity of exports （$Q_X$）.It is also true that a decline in the commodity terms of trade for a country can be reinforced （加剧） by a decline in the quantity of exports.Still consider the above example，suppose China's quantity index of exports in 2002 was 198.Then the income terms of trade for China in 2002 was： （$P_X$×$Q_X$）/$P_M$=（89×198）/141=124.98 （＞100）， indicating that the income terms of trade of China in 2002 was improved compared with that in the base year.

There has been concern about the deterioration （恶化） of terms of trade of developing countries.Studies published in 1950 by the Argentine economist Raul Prebisch and the British economist Hans Singer suggested that there is a tendency for the prices of agricultural products to fall relative to the prices of manufactured goods； turning the terms of trade against the developing countries.Their findings have been confirmed by a number of subsequent studies， although it has been suggested that the effect may be due to quality bias （偏差） in the index numbers used or to the possession of market power by manufacturers.The Prebisch/Singer findings remain controversial （有争议的）， but they were used at the time and have been used subsequently to suggest that the developing countries should erect barriers a

gainst manufactured imports in order to nurture （培育） their own“infant industries”（幼稚产业） and so reduce their need to export agricultural pr oducts.

## 3.3 Factor Endowment Theory

Trade theory changed drastically （大大地） in the first half of the tw entieth century.The theory developed by the Swedish economist Eli Hecksc her （1879-1952） and later expanded by his former graduate student Berti l Ohlin[3]（1899-1979） formed the major theory of international trade that is still widely accepted today， factor endowment theory （要素禀赋论）. Factor endowment theory， also termed factor proportions theory （要素比例论） or Heckscher-Ohlin theorem， was based on a more modern con cept of production， one that raised capital to the same level of importance with labor.

### 1.Factor intensity in production

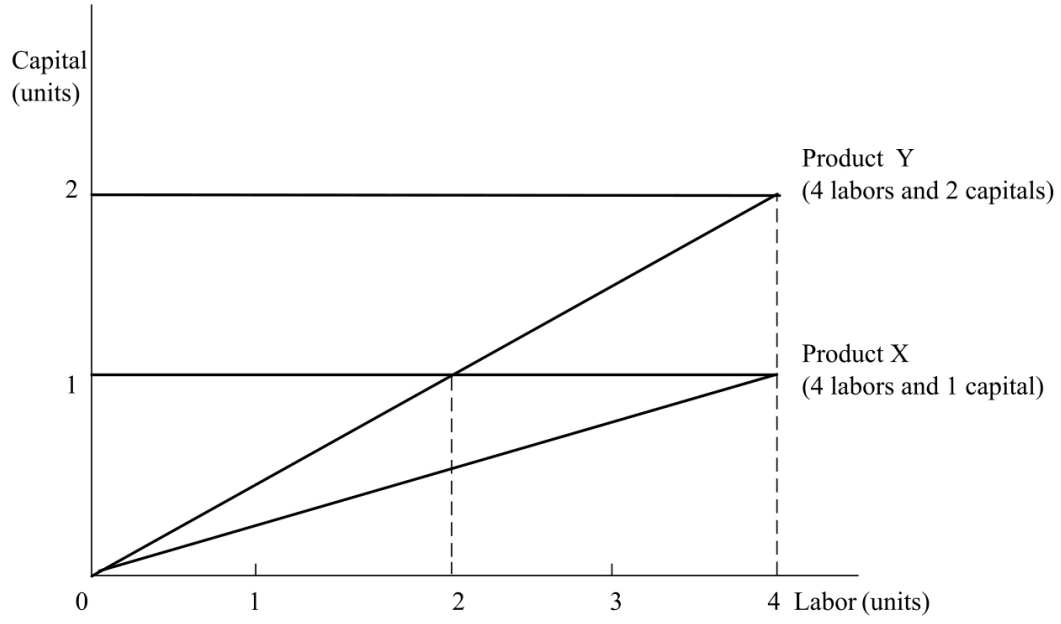



Figure 3-9 Description of Good X and Good Y by their factor proportions

The Heckscher-Ohlin theory considered two factors of production， labor and capital.Technology determines the way they combine to form a product.Different products require different proportions of the two factors of production.Figure 3-9 illustrates what it means to describe a product by its factor proportions.The production of one unit of product X requires 4 units of labor and 1 unit of capital.At the same time， to produce 1 unit of good Y requires 4 units of labor and 2 units of capital.Product X therefore requires more units of labor per unit of capital （4 to 1） relative to Y （4 to 2）.X is therefore classified as a relatively labor intensive product， and Y is relatively capital intensive.These factor intensities （要素密集度） or proportions are truly relative and are determined only on the basis of what product X requires relative to product Y and not to the specific numbers of labor to capital.

A commodity is said to be factor A intensive whenever the ratio of factor A to a second factor B is larger when compared with a similar ratio of factor usage of a second commodity.For example, steel is said to be capital intensive compared with cloth if the K/L ratio in steel production is larger than the K/L ratio in cloth production.

It is easy to see how the factor proportions of production differ substantially across goods.For example, the manufacturing of leather footwear is still a relatively labor intensive process, even with the most sophisticated leather treatment and patterning machinery.Other goods, such as computer memory chips, however, although requiring some highly skilled labor, require massive quantities of capital for production.These large capital requirements include the enormous sums needed for research and development and the manufacturing facilities needed for clean production to ensure the extremely high quality demanded in the industry.

According to factor proportions theory, factor intensities depend on the state of technology and the current method of manufacturing a product.The theory assumed that the same technology of production would be used for the same goods in all countries.It is not,therefore, differences in the efficiency of production that will determine trade between countries as it did in classical theory.Classical theory implicitly assumed that technology or the produ

ctivity of labor is different across countries.Otherwise, there would be no logical explanation as to why one country requires more units of labor to produce a unit of output than another country.Factor proportions theory assumes no such productivity differences.

## 2.Factor endowments, factor prices, and comparative advantage

If there is no difference in technology or productivity of factor across the countries, what then determines comparative advantage in production and export?

The answer is that factor prices determine cost differences.And these prices are determined by the endowments of labor and capital the country possesses.The theory assumes that labor and capital are immobile, meaning they cannot move across country borders.Therefore, the country's endowment determines the relative costs of labor and capital as compared to other countries.It is important to understand that the phrase"different factor endowments" refers to different relative factor endowments, not different absolute amounts.

Crucial to the H-O analysis is that factor proportions are different between the two countries.Relative factor abundance may be defined in two ways: the physical definition and the price definition.Physical definition explains factor abundance in terms of the physical units of two factors, for example, labor and capital, available in each of the two countries.Country I would be the capital abundant country if its ratio of capital to labor exceeded the ratio of capital to labor in Country II $[(K/L)_I > (K/L)_{II}]$.It must be stressed that the relative amount of the factors is critical, not country size.A small country with fewer absolute units of physical capital than a larger country could still be the capital abundant country as long as the amount of capital relative to labor was greater than the same ratio in larger country.Finally, in the two countries, two factors case, if Country I is capital abundant, then country II must be the labor abundant country.

The price definition relies on the relative prices of capital and labor to determine the type of factor abundance characterizing the two countries.According to this definition, Country I would be the capital abundant country as long as $(r/w)_I < (r/w)_{II}$; that is the ratio of the price or rental rate of capital (r) to the price of labor (w) in Country I is less than that in Country II.

## 3.Assumptions of the factor proportions theory

1) Two countries, two products, and two factors of production whose initial levels are fixed and assumed to be relatively different for each country.

2) The two commodities have different factor intensities, and the respective commodity factor intensities are the same for all factor price ratios.

3) Technology is identical in both countries, that is, production functions are the same in both countries.The H-O model is a long run model.Ohlin argued that"the physical conditions of production are everywhere the same." Some countries may be slow to adopt new technology.With the development of modern telecommunications, information travels fast.There is a result of declining transportation and communication costs.

4） Perfect competition prevails in both product and factor markets.This assumption rules out （把……排除在外） monopolistic （垄断的） and oligopolistic （寡头垄断的） market structures.It also rules out price and wage rigidities.In a perfectly competitive market， all buyers and sellers are price takers， i.e.， each one is too small to exert （施加） market power and influence market prices.All factors are fully employed.

5) Factors are perfectly mobile within each country but are immobile between countries.Like Ricardo, H-O model draws a sharp distinction between domestic and external factor mobility.The maximum degree of factor mobility is permitted between industries within the same country(domestic factor mobility).However, neither capital nor labor can cross national borders(international factor immobility).Domestic factor mobility ensures that workers move from a low wage region to a high wage region, and capital moves fr

om a low interest region to a high interest region.The net effect is that all fa ctor prices are the same within a country.International factor immobility im plies that Mexican workers are not allowed to work in or migrate to the US.

6) There are no transportation costs.Transportation costs are assumed t o be zero.In reality, transportation costs are a significant portion of the mark eting costs of most traded goods, especially in agricultural products.Howev er, this is not a bad assumption, because transportation costs inhibit and red uce trade volume; it does not reverse the trade pattern between the countrie s.

7） There are no impediments （障碍）， such as tariffs， quotas， voluntary export restraints， and exchange control in restricting the movem ent of goods between countries or interfering with the market determination of prices.

8) Production is characterized by constant returns to scale for both com modities in both countries.Constant returns to scale means that a proportion ate increase in all inputs increases the output by the same percentage.Specif ically, constant returns to scale means: If Y=F (L,K), then Y′=F (2L, 2K)=2 Y.

Among these assumptions, the two that are especially critical to the He ckscher-Ohlin explanation of the emergence and structure of trade are assu mption 1) that factor endowments are different in each country and assumpt ion 2) that commodities are always intensive in a given factor regardless of relative factor prices.

## 4.The Heckscher-Ohlin theorem

The Heckscher-Ohlin theorem can be stated as: A country will export t he commodity that uses relatively intensively its relatively abundant factor of production, and will import the good that uses relatively intensively its re latively scarce factor of production.To put it simply,a capital abundant count ry will export capital intensive good, while a labor abundant country will ex port labor intensive good.

For example, a country such as China possesses a relatively large endowment of labor and a relatively smaller endowment of capital.At the same time, Japan is a relatively capital abundant country, with a relatively smaller endowment of labor.China possesses relatively cheaper labor and should therefore specialize in the production and export of labor-intensive products (such as good X in Figure 3-9).Japan possesses relatively cheap capital and should specialize in the production and export of capital intensive products (such as good Y in the Figure 3-9).Comparative advantage is derived not from the productivity of a country, but from the relative abundance of its factors of production.

As shown in Figure 3-10(a), the two different shaped PPFs of Country I and Country II are now combined with the same set of tastes and preferences, two different sets of relative prices emerge in autarky.The relative price of X to Y is lower in Country I than that in Country II, i.e.$P_{X/Y} < P'_{X/Y}$.At the autarky price of $P_{X/Y}$, Country I will produce and consume at A and at the autarky price of$P'_{X/Y}$, Country II will produce and consume at A′.Since relative prices are different in autarky, there is a basis for trade.As shown in Figure 3-10(b), with international terms of trade $P_E$ which lies between $P_{X/Y}$ and $P'_{X/Y}$Country I will expand its production of X to B and Country II will expand its production of Y to B′.Since demand is identical in the two countries, both will choose to consume at the point of tangency between the terms of trade and the highest possible indifference curve at E (E′ ).The trade triangles for Country I and Country II are ΔBCE and ΔB′C′E′ respectively.

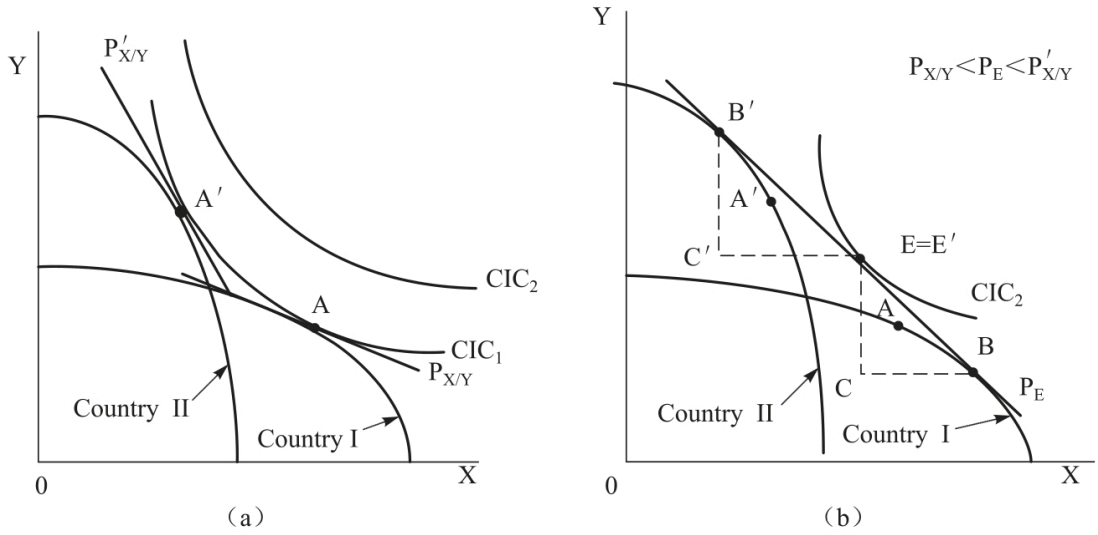



Figure 3-10　Gains from trade in two countries with identical technology and demand but diff erent relative factor endowments

# 5.An example to illustrate H-O theorem

As shown in Table 3-1, there are two kinds of products (steel and clot h) and two countries(Japan and China).

Table 3-1　A numerical example illustrating the H-O theorem

| Requirements of labor and capital in the production of steel and cloth | | |
|---|---|---|
| | Steel | Cloth |
| Labor | 1 | 2 |
| Capital | 4 | 0.02 |
| Note: Steel is relatively capital intensive and cloth is relatively labor intensive. | | |

| Different prices of labor and capital in Japan and China | | |
|---|---|---|
| | Japan | China |
| Labor | $10 | $4 |
| Capital | $ 5 | $7 |
| Note: Japan is relatively capital abundant and China is relatively labor abundant. | | |

| Different prices of steel and cloth in Japan and China | | |
|---|---|---|
| | Japan | China |
| Steel | $10×1+$5×4 =$30 | $ 4×1+$7×4 =$32 |
| Cloth | $10×2+ $5×0.02 =$20.1 | $ 4×2+$7×0.02=$ 8.14 |
| Note: Steel is cheaper in Japan than in China while cloth is cheaper in China than in Japan. | | |

1) Consider the two products: steel and cloth.One unit of steel requires 1 labor and 4 capitals to produce; and one unit of cloth requires 2 labors and 0.02 capital to produce.Since$(K/L)_{Steel}$ is greater than $(K/L)_{Cloth}$ (i.e.4/1＞ 0.0 2/2), steel is therefore relatively capital intensive while cloth is relatively la bor intensive.

2) Consider the relative prices of capital to cloth in both Japan and Chi na.The unit prices of labor and capital in Japan are $10 and $5 respectively, while in China, they are $4 and $7 respectively.Therefore the relative price of capital to labor in Japan (5/10) is smaller than that in China (7/4), i.e., $(r/w)_J$＞$(r/w)_C$.In other worlds, Japan is relatively capital abundant and China i s relatively labor abundant.

3) Consider the price of each product in each country.The price ($30) of steel in Japan is cheaper than that ($32) in China whereas the price ($8.14) of cloth in China is cheaper than that ($20.1) in Japan.

## 6.The factor price equalization theorem

The discussion of H-O demonstrated that the convergence （趋同） of product prices takes place as the price of the product using the relatively abundant factor increases and the price of the product using the country's scarce factor prices falls.This change in final product prices has implications for the price of factors in both of the participating countries.

Let us still consider two countries producing cloth and steel, with cloth the labor intensive good and steel the capital intensive good.Japan is the capital abundant country and China the labor abundant country.

With trade, the price of steel rises and the price of cloth falls in Japan. This indicates that producers in Japan will produce more steel and less cloth.Under perfect competition, production will shift along the PPF toward more output of steel and less of cloth.For this to happen,resource must be shifted from cloth production to steel.In China, similar adjustment takes place.

The movement of Japan's production from labor intensive good cloth to capital intensive good steel will lead to the expansion of steel production, and result in an increase in overall demand for capital because steel is capital intensive relative to cloth.At the same time, the reduction in cloth production will lead to a decline in the overall demand for cloth and will result in a decline in the overall demand for labor because cloth is labor intensive product.These shifts will result in an increase in the price of capital and a decrease in the price of labor.In China, similar adjustment takes place.(See Table 3-2)

Table 3-2　Change of prices of factors in capital abundant country

| | |
|---|---|
| Price of steel ↑ | Price of cloth ↓ |
| Output of steel ↑ | Output of cloth ↓ |
| Demand for capital ↑ | Demand for labor ↓ |
| Price of capital ↑ | Price of labor ↓ |

Combining the general equilibrium results of Japan and China reveals an interesting result.Prior to trade, $(w/r)_{Japan}$ is greater than $(w/r)_{China}$.However, with trade the factor price ratio in Japan falls while that in China rises.Trade will expand until both countries face the same set of relative factor prices.This result is what is known as the factor price equalization theorem.

However， in the real world， differences in factor prices do exist.This can be explained in part by the fact that the assumptions underlying the factor-endowment theory are not completely borne out （证实） in the real world.For example， to the extent that different countries use different technologies or that markets are not perfectly competitive， factor prices may only partially equalize.Transportation costs and trade barriers may prevent product prices from becoming equal.Such market imperfections reduce the volume of trade， limiting the extent to which commodity prices and factor prices can become equal.

## 7.The Stolper-Samuelson theorem

The Stolper-Samuelson theorem was developed by Wolfgang Stolper and Paul Samuelson in 1941 and explains the H-O model regarding the income distribution effects of trade.The theorem argues that with full employment before and after trade takes place, the increase in the price of abundant factor and the fall in the price of the scarce factor because of trade imply that the owners of the abundant factor will find their real incomes rising and the owners of the scarce factor will find their real income falling.Given these conclusions, it is not surprising that owners of the relatively abundant resources tend to be“free trader” while owners of relatively scarce resources tend to favor trade restrictions.

# 3.4 The Leontief Paradox—An Empirical Test of the Factor Proportions Theory

It had widely been recognized that the United States was a relatively capital abundant and labor scarce country.According to the factor-endowment theory, the United States should export capital intensive goods and import labor intensive goods.In 1954, Wassily Leontief conducted the first major test of the H-O theorem by analyzing the labor and capital content of all U.S. merchandise imports and exports.The result of the test was surprising that the world's largest trader, the United States, did not trade according to the Heckscher-Ohlin Pattern.

## 1.The Leontief Paradox

Leontief made use of his own invention—an input-output analysis.Input-output analysis is a technique of decomposing （分解） a product into the values and quantities of the labor，capital， and other potential factors employed in the product's manufacture.Leontief then used this methodology to analyze the labor and capital content of all U.S.merchandise imports and exports.The hypothesis was relatively straightforward： U.S.exports should be relatively capital intensive （use more units of capital relative to labor） than U.S.imports.Leontief's results were， however， a bit of a shock.Leontief found that the products that U.S.firms exported were relatively more labor intensive than the products the United States imported.It seemed that if the factor proportions theory were true， the United States is a relatively labor abundant country！ Alternatively， the theory could be wrong.Neither interpretation of the results was acceptable to many in the field of international trade.

The Leontief test produced the surprising result that the capital per worker embodied in U.S.exports was less than the capital per worker embodied in U.S.imports.The result reflects the relative factor intensities of the individual industries.Table 3-3 lists, from 167 industrial categories, the 10 largest

net export and import categories (where exports exceeded imports and impo rts exceeded exports, respectively, by the greatest dollar amounts)per $1 mil lion of total exports and competitive imports, respectively, in Leontief's dat a for the 1947 test year.Also listed are the capital/labor ratios for each of the industries in dollars of capital required per person-year of labor.These K/L r atios are total or direct-plus-indirect factor requirements.

Table 3-3 Leading net export and net import industries and capital/labor ratios, 1947

(Unit: $)

| Net exporters | K/L | Net importers | K/L |
|---|---|---|---|
| Wholesale trade | 7,638 | Agriculture and fisheries | 29,689 |
| Motor vehicles | 10,447 | Paper and paper board mills | 11,123 |
| Grain mill products | 20,752 | Rubber | 17,848 |
| Textile mill products, spinning, weaving, and dyeing | 10,738 | Pulp mills | 12,180 |
| Railroad transportation | 21,022 | Food products: canning, preserving, and freezing | 15,635 |
| Ocean transportation | 15,945 | Other nonferrous mining (i.e., not copper, lead, zinc, bauxite) | 16,205 |
| Steelworks and rolling mills | 15,273 | Crude petroleum and natural gas | 29,508 |
| Coal mining | 8,491 | Furs (hunting and trapping) | 14,259 |
| Special industrial machinery | 10,439 | Primary copper | 20,080 |
| Petroleum products | 27,139 | Other primary metals (i.e., not lead, zinc, copper, or aluminum) | 16,344 |

Source: Derived from data in W.W.Leontief,"Domestic Production and Foreign Trade: The Am erican Capital Position Re-examined", in Jagdish Bhagwati, ed., International Trade: Selected Readings, Table 2,PP102-121.

Looking at the table, it is evident that seven of the ten net import indus tries have larger K/L ratios than their corresponding net export industries.Al so, the average K/L ratio of the 10 net importers is $18,287 per worker, whil e the average K/L ratio for the 10 net exporters is $14,788 per worker.

Thus， the seemingly commonsense notion that a country abundant in capital would export capital intensive goods and import labor intensive goo

ds was seriously called into question.The doubt cast on the widely accepted H-O theorem by this study became known as the Leontief Paradox （里昂惕夫之谜）.

## 2.Suggested explanations for the Leontief Paradox and related theories

A variety of explanations and continuing studies have attempted to solve what has become known as the Leontief Paradox.At first, it was thought to have been simply a result of the specific year (1947) of the data.However, the same results were found with different years and data sets.

1) Different skill levels of labor (this study attempted to separate labor factors into skilled labor and unskilled labor)

In this explanation of the Leontief Paradox, the basic point is that the use of“labor” as a factor of production may involve a category that is too aggregative, since there are many different kinds and qualities of labor.A test involving this approach was conducted by Donald Keesing (1966).Keesing divided labor into eight different categories.For example, category I(scientists and engineers) was regarded as the most skilled labor, while category II (technicians and draftsmen) was regarded as the second most skilled.This list continued through category VIII (unskilled and semiskilled workers).Keesing then compared U.S.labor requirements in export and import competing industries with those of 13 another countries for 1962.He found that U.S.exports embodied a higher proportion of category I workers and a lower proportion of category VIII workers than the exports of other countries.Similarly, on the import side, the United States used the smallest fraction of category I workers and the largest fraction of category VIII workers.This type of test suggests that the Leontief Paradox may have occurred because a two factor test was employed instead of a test with a larger number of factors (with each skill category of labor regarded as a distinct factor of production).Perhaps the United States is skilled labor abundant (as well as capital abundant) and unskilled labor scarce in its factor endowments.If so, the U.S.trade pattern c

onformed to H-O because the United States was exporting goods that were r elatively intensive in skilled labor and importing goods that were relatively intensive in unskilled labor.

2） Demand reversal （逆转）

Each country's tastes and preferences are not identical （完全同样的）， which could cause it to value the products in very different ways.De mand patterns differ， e.g.Demand in Country I （capital abundant countr y） is so oriented toward steel that the relative pre-trade price of steel is gre ater than that in Country II （labor abundant country）.Consequently， （$P_S/P_C$）$_I$ ＜ （$P_S/P_C$）$_{II}$，Country I exports cloth.

3) Factor-intensity reversal

Factor-intensity reversal occurs when a good is produced in one countr y by relatively capital-intensive methods, but is produced in another country by relatively labor-intensive methods.The reversal suggests that, although U.S.imports might have been produced labor-intensively overseas, the prod uction process of these goods in the United States was relatively capital-inte nsive.U.S.import goods (toys) were labor-intensive overseas and capital-int ensive in the U.S.The trading partners were conforming to H-O when they e xported the goods.The validity of this explanation for the occurrence of the Leontief paradox is also an empirical question.

4) U.S.tariff structure

In the U.S., labors are more protectionists (according to the Stopler-Sa muelson theorem).U.S.trade barriers tend to hit hardest the imports of relati vely labor-intensive goods.

In a 1971 study， estimated K/L ratio U.S.imports would be about 5％ lower if this effect was incorporated （包含）.

5) The role of natural resources

Two-factor test is too restrictive.Many of the"capital intensive product s" such as petroleum products, coal products, iron and steel were really"nat ural resource intensive products".James Hartigan confirmed: A paradox exis

ted in general, but not when natural resource-intensive industries were delet ed.Robert Baldwin found: only reduced the paradox,but not eliminated it.Th erefore, there is uncertainty.

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[1]A full discussion of the exact shape of this offer curve can be found in Dennis R.Appleyard and Al fred J.Field, International Economics (China Machine Press, 2002.1, PP106-111).

[2]Other terms-of-trade measures include single factor terms of trade and double factor terms of trad e.A fuller discussion of these two terms of trade can be found in Dennis R.Appleyard and Alfred J.Fie ld， International Economics （China Machine Press，2002.1， PP112-113）.

[3]Berti Ohlin was not only a professor of economics at Stockholm， but also a major political figur e in Sweden.He served in Riksdag （Swedish Parliament）， as the head of liberal party for almost a 1/4 of a century.He was Minister of Trade during World War II.In 1979 Ohlin was awarded a Nobel prize jointly with James Meade for his work in international trade theory.

# Chapter 4　Post-Hecksher-Ohlin Theories of Trade

Learning Objectives

In this chapter, you will learn:

- Product cycle theory
- Linder theory
- Intra-industry trade theory

H-O theory states that comparative advantage is based on two countries being abundant in different factors， implying that most trade should be between countries with different factor abundances.H-O theory also states that countries should specialize in， and export，goods that intensively use their abundant factor in production.However， in fact， trade patterns are not so clear-cut （清晰的）.For example， most Mexican exports are not clothing， fruits and vegetables.They are electrical machinery and equipment， vehicles， nuclear reactors， boilers and similar items.There is obviously a need for trade theory besides H-O.These theories either examine trade flows that are counter to the H-O theory， or provide different explanations for trade flows by relaxing several assumptions as employed in the theories presented earlier， such as differences in technology across countries， an active role for demand conditions， economic of scale and imperfect competition.It is important to recognize that there is no model of trade that explains all international trade.Each model provides some understanding of underlying （根本的） economic forces， and consequences to trade， and to economic choices.

This chapter reviews several of the more recent theories on the causes and consequences of international trade, including the product life cycle the

ory and the Linder theory.It also goes into the discussion of intra-industry trade—a prominent feature in international trade of manufactures.

# 4.1 The Product Cycle Theory

## 1.The imitation lag hypothesis

The imitation lag hypothesis （模仿滞后假设） in international trade theory was formally introduced in 1961 by Michael V.Posner.This theory is discussed here only to the extent that it paves the way for a better known theory—the product cycle theory （PCT） （产品生命周期理论）.

The imitation lag hypothesis relaxes the assumption in the H-O analysis that the same technology is always available everywhere （at the same time）.It assumes that the same technology is not available in all countries and that there is a delay in the transmission of diffusion （普及） of technology from one country to another.Consider countries I and II.Suppose that a new product appears in Country I due to successful efforts of research and development teams.According to the imitation lag theory， this new product will not be produced immediately by firms in Country II.The imitation lag refers to the period of time between when the product is produced at home （Country I） and when it is produced in Country II.The imitation lag includes a learning period during which the firms in Country II must acquire technology and know-how （技术诀窍） in order to produce the product.In addition， it takes time to purchase inputs， install equipment， process the inputs， and bring the finished product to market， and so on.In this approach， a second adjustment lag is the demand lag， which is the period of time between when the product is sold in Country I and when it is demanded by consumers in Country II.This demand lag also can be expressed in a number of months， say， 3 months.

A key feature in the Posner theory is the comparison between the length of the imitation lag and the length of the demand lag.For example, a new product is introduced in Country I.For 3 months, people in Country II do no

t demand it because they have no information about it,or they do not know whether it is good, or they have loyalty to the existing consumption bundle, etc.After 3 months, Country II demands it.After 8 months from the start, Co untry II can produce it, i.e., the imitation lag is 8 months and the net lag is 5 months which is 8 months less 3 months of demand lag.During this 5-mont h period, Country I will export the product to Country II (see Figure 4-1).Af ter this period, since firms in Country II are also producing and supplying th e product, the demand for Country I's product diminishes.

Thus the imitation lag hypothesis implies: 1) New goods create opport unity for trade.How can a country become a continually successful exporte r? By continually innovating;2) The shorter the demand lag, the faster a goo d can be exported; 3) The longer the imitation lag, the longer a good can be exported; 4) It is the net lag that determines the period of export for a good. That is why trade focuses on new products.

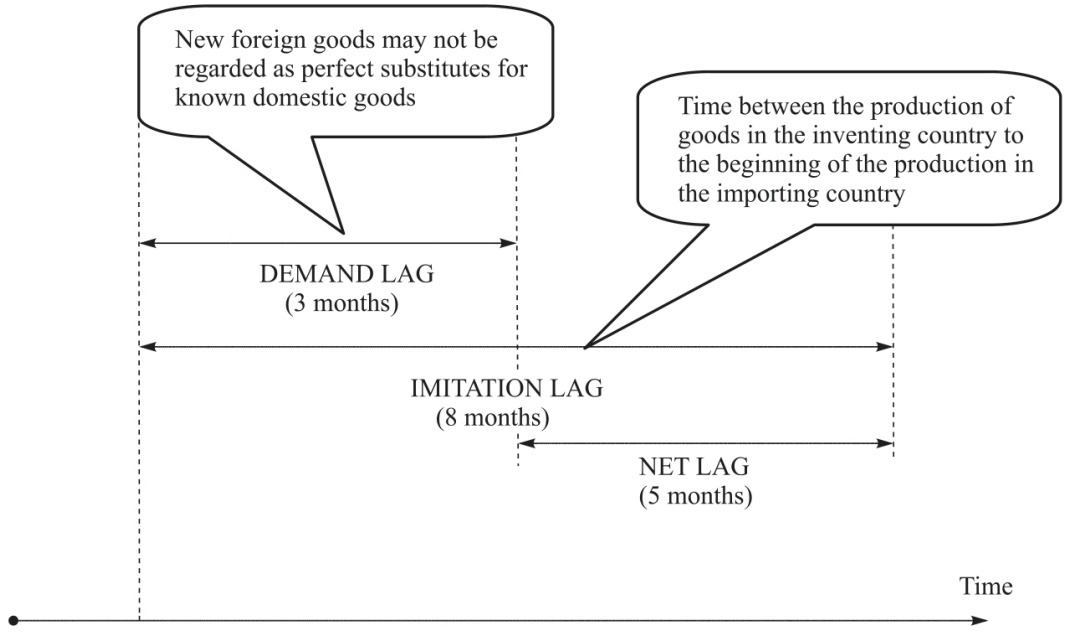



Figure 4-1 Imitation lag hypothesis

## 2.The product cycle theory

The product cycle theory[1] addresses （设法解决） the pattern of trade based on the life cycle of products.It is built upon the imitation lag hypothesis， but is further developed.This theory was developed in 1966 by Raymond Vernon.

The PCT is concerned with the life cycle of a typical“new product” and its impact on international trade.Vernon developed the theory in response to the failure of the United States—the main country to do so—to conform empirically （以经验为主地） to the H-O model.Vernon emphasized manufactured goods， and the theory begins with development of a new product in the United States.The new product will have two principal characteristics： （a） it will cater （适合） to high income demands because the United States is a high-income country；and （b） it promises， in its production process， to be labor-saving and capital-using in nature.

The reason for the potential labor-saving nature of the production process is that the United States is widely regarded as a labor scarce country.Thus, technological change will emphasize production processes with the potential to conserve this scarce factor of production.The PCT divides the life cycle of this new product into three stages.In the first stage, the new product stage, the product is produced and consumed only in the United States.Firms produce in the United States because that is where demand is located, and these firms wish to stay close to the market to detect consumer response to the product.The characteristics of the product and the production process are in a state of change during this stage as firms seek to familiarize themselves with the product and the market.No international trade takes place.

The second stage of the life cycle is called the maturing product stage.In this stage， some general standards for the product and its characteristics begin to emerge， and mass （大批量）production techniques start to be adopted.With more standardization in the production process，economies of scale start to be realized.This feature contrasts （对比） with H-O and Ricardo，whose theories assumed constant returns to scale.In addition， foreign consumers learn of the product and start to demand it， but it is associated particularly with other developed countries，since the product is catering to high income demands.This rise in foreign demand （assisted by econo

mies of scale） leads to a trade pattern whereby the United States exports th e product to other high income countries （principally in Western Europ e）.Other developments also occur in the maturing product stage.

Once U.S.firms are selling to Europe， they may begin to spread their production to other countries for the purpose of having better access to mar kets， better feedback from the consumers as well as reducing transportatio n and production costs.If this is done， exports from the U.S.start to fall.Fo r example， with a plant in France， not only France but other European c ountries can be supplied from the French facility （工厂） rather than from the U.S.plant.Thus， an initial export surge by the United States is followed by a fall in U.S.exports and a likely fall in U.S.production of the good.This relocation of production aspect of the PCT is a useful step because it recogn izes—in contrast to H-O and Ricardo—that capital and management are not immobile internationally.This feature also is consistent with the very large a mount of direct investment by U.S.firms in Western Europe during the 1960 s and 1970s and， in 1980s and 1990s， by Japanese firms in rapidly growi ng countries （such as China， and the Republic of Korea）.

Vernon also suggested that， in this maturing product stage， the prod uct might now begin to flow from Western Europe to the United States beca use， with capital more mobile internationally than labor， the price of cap ital across countries was unlikely to diverge （偏离）as much as the price of labor.With relative commodity prices thus heavily influenced by labor co sts， and with labor costs lower in Europe than in the United States， Euro pe might be able to undersell the United States in this product.However， t he United States is not yet an importer.

The final stage is the standardized product stage.By this time in the pro duct’s life cycle,knowledge of the technology is widespread, and the produc tion is moved to where it is the cheapest.Vernon hypothesized that producti on may shift to the developing countries.Labor costs again play an importan t role, and the developed countries are busy introducing other products.Thu s, the trade pattern is that the United States and other developed countries m ay import the product from the developing countries.The United States is no

w the net importer of the product.Figure 4-2 summarizes the production, co nsumption, and trade pattern for the originating country, the United States.

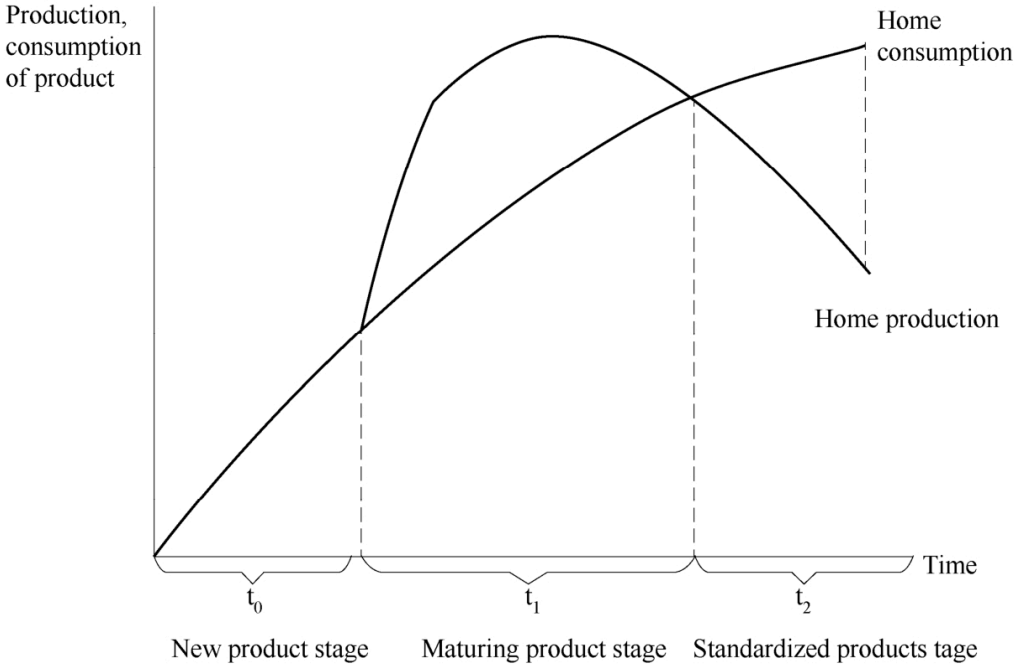



Figure 4-2 Pattern of trade for home invention under product cycle theory

In summary， the PCT postulates （假定） a dynamic （动态的） c omparative advantage because the country source of exports shifts througho ut the life cycle of the product.The innovating country is the first exporter， then other developed countries produce and export the product and developi ng countries are the exporters of standard products.This dynamic comparati ve advantage， together with factor mobility and economies of scale， ma kes the product cycle theory an appealing alternative （替换物） to the H-O model.

However, the PCT has limited applicability.It represents an attempt to explain trade in manufactured products that require some degree of technica l sophistication in their invention,design, and development.In some cases, th e theory seems to fit the facts.For instance, color television was invented in the United States, and in the early days of the product, the United States pro duced and exported this good.Then, over time, the production of color telev

isions has shifted almost entirely to countries and regions such as Japan, Tai wan Province of China, Korea,and elsewhere.

For other sophisticated products, such as computers and aircraft, the m odel seems to do less well.The United States, which took the lead in the dev elopment of these goods, still retains substantial comparative advantage des pite the fact that each is now a relatively mature product.These examples po int to the fundamental weakness of the product life cycle model—its inabilit y to generalize its predictions about the timing of changes in the location of comparative advantage.

In his later work, Vernon (1979) suggested that the power of the produ ct hypothesis has been changing.Two reasons account for the change: one, a n increase in the geographical reach of many of enterprises that are involve d in the introduction of new products, as a consequence of their establishme nt of many overseas subsidiaries; and two, a change in the national markets of the advanced industrialized countries, which has reduced some of the diff erences that has previously existed between such markets.

In industries such as electronics and chemicals, innovating firms that a re limited to their own markets are no longer very common.Instead, firms w ith highly developed multinational networks introduce the new products sim ultaneously in the Triad—the United States, Europe,and Japan—and in som e less developed countries.With a multinational network, U.S.firms also feel at ease in foreign production.The interval of time between the introduction of any new product in the United States and its first production in a foreign location has thus been rapidly shrinking.

The product cycle hypothesis has strong predictive power in the first t wo or three decades after World War II, especially in explaining the compos ition of U.S.trade and in projecting the likely patterns of direct foreign inves tment by U.S.firms.However, as certain conditions of that period are now g one, the predictive power of the hypothesis is weakened.

## 4.2 The Linder Theory

The Linder Theory is also known as the theory of demand preference （偏好） similarity（or income trade theory）.This theory was proposed by the Swedish economist Staffan Linder in 1961.The Linder Theory is a dramatic departure （与……背离） from the H-O model because it is almost exclusively demand oriented.H-O centers on expected trade patterns when countries have different capacities for production， but similar tastes.H-O does explain trade patterns to some extent， but in its purest form， H-O would lead to the conclusion that developed countries are more likely to trade with developing countries （who have very different endowments） rather than with each other.

The Linder Theory focused not on the production or supply side， but instead on the preference of consumers， the demand side.Linder acknowledged that in natural resource based industries， trade was indeed determined by relative costs of production and factor endowments.This was consistent with the previous factor proportions theory.However， Linder argued， trade in manufactured goods was dictated （决定） not by cost concerns but rather by the similarity in product demands across countries.Linder’s theory was a significant departure from previous theories.

## 1.Assumptions of the Linder Theory

The Linder Theory was based on two assumptions:

1） Consumers’ tastes depend on per capita （人均） income level.As income， or more precisely per capita income， rises， the complexity and quality level of the products demanded by the country’s residents also rise.The total range of product sophistication （混合，复杂）demanded by a country residents is largely determined by its level of income；

2） The entrepreneurs directing the firms that produce society’s needs are more knowledgeable about their own domestic market than about foreign markets.An entrepreneur could not be expected to effectively service a foreign market that is significantly different from the domestic market because competitiveness comes from experience.A logical pattern would be for an e

ntrepreneur to gain success and market share at home first， then expand to foreign market that are similar in their demands or tastes.In other words， international trade is a by-product （副产品） of the home market's production and consumption pattern.International trade in manufactured goods would then be influenced by similarity of demands.The countries that would see the most intensive trade are those with similar per capita income levels for they would possess a greater likelihood of overlapping （重叠） product demands.

## 2.Trade comes in the overlapping ranges of product sophistication

So where does trade come in? According to Linder, the overlapping ranges of product sophistication represent the products that entrepreneurs would know well from their home markets and could therefore potentially export and compete in foreign markets.

For example, the United States and Canada have almost parallel sophistication ranges,implying they would have a lot of common ground and overlapping product ranges for intensive international trade and competition.They are quite similar in their per capita income levels.However, Mexico and the United States, or Mexico and Canada, would not.Mexico has a significantly different product sophistication range as a result of a different per capita income level.The conclusion drawn from Linder's theory of demand preference similarity is strikingly different from the traditional cost oriented trade theory preceding it.First, the most intensive trade, according to Linder, would exist between countries of the same income or industrialization levels, not dissimilar levels as often concluded from previous theories.Second, the theory implied that a large part of international trade would consist of the exchange of similar or slightly differentiated goods.

In Figure 4-3, let goods produced (and consumed) by Country I be ordered according to quality: A, B, C, D, E—A lowest, E highest.Let Country II have income distribution that fits demand for goods C, D, E, F and G.The

n, trade would occur in goods C, D and E, where both countries have a dem and for the good.We would therefore expect most trade to be intra-industry t rade (countries should both import and export the same goods).Let Country III have income such that it produces goods E, F, G, H, and I.Country III wi ll trade goods E, F, G with Country II, but only good E with Country I.Ther efore, countries will trade together more,if they have similar per capita inco mes and most trade will be intra-industry trade.But with this theory, we can not predict the pattern of trade (which country will export more/less of whic h good).

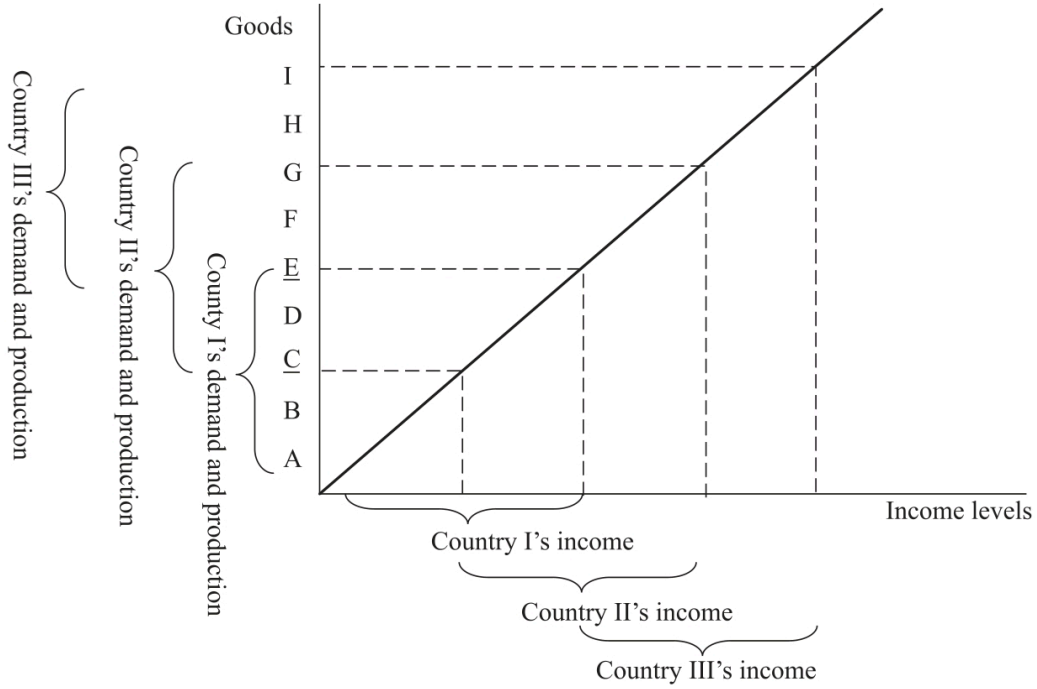



Figure 4-3 Overlapping demands in the Linder Model

However， there is a problem with the second assumption of the Lind er theory.In today's global economy， the home-oriented myopic （近视的） view of the managers is less appealing because firms often target the g lobal market rather than domestic markets.For example，artificial Christma s trees are exported by non-Christian countries such as China， where the market for the product is small， to Christian countries such as the United States.Other counter-examples include OEM[2] manufacturing and internatio

nal subcontracting[3] （分包）， which are popular in many less developed countries.These are not for the domestic market， but for exports.

## 4.3 Intra-Industry Trade Theory

International trade is traditionally thought to consist of each country exporting the goods most suited to its factor endowment， technology， and climate while importing the goods least suited for its national characteristics.Such trade is called inter-industry trade （IIT） because countries export and import the products of different industries.But the top exports and imports of most industrial countries are actually similar items， such as passenger cars，electrical generators， or valves （电子管） and transistors.

Intra-industry trade （产业内贸易） refers to the exchange of products belonging to the same industry.This type of trade occurs when a country's exports and imports are in the same product classification categories.For example， Europe exported 2.6 million motor vehicles in 2002， and imported 2.2 million of them.Japan exported 4.7 million vehicles in 2002 （1 million of which went to Europe， and 2 million to North America）， and imported 0.3 million.These exchanges represent simultaneous （同时发生的） imports and exports of varieties of the same product.

Why do countries at the same time import and export the products of the same industry,or import and export the same kinds of goods? The traditional model of David Ricardo and the Heckscher-Ohlin model used the idea of comparative advantage as an explanation of why countries trade.However, many economists have made the point of claiming that these models provide no explanation towards intra-industry trade as under their assumptions countries with identical factor endowments would not trade and produce goods domestically.Hence, over the past three decades as intra-industry trade has developed many economists have looked at other explanations.

### 1.Explanations of intra-industry trade

(1) Economies of scale[4]

The most comprehensive and widely accepted explanation， at least within economic theory， is that of Paul Krugman[5]'s New Trade Theory.Krugman argues that economies specialize to take advantage of increasing returns， not following differences in regional endowments （as contended by neoclassical theory）.In particular， trade allows countries to specialize in a limited variety of production and thus reap （获得） the advantages of increasing returns （i.e.， economies of scale）， but without reducing the variety of goods available for consumption.

（2） Product differentiation （差异化）

This explanation of intra-industry trade was outlined earlier and mainly elaborated horizontal intra-industry trade.Briefly, many varieties of a product exist because producers attempt to distinguish their products in the minds of consumers in order to achieve brand loyalty or consumers exploit their taste for variety by consuming a set of differentiated products displaying similar qualities and carrying the same price.Differentiated products include clothing, wines, electronics, autos and others.Each variety requires a fixed production cost, which gives rise to decreasing average production costs.Therefore, each variety is produced in a different country.

(3) Interaction of factor endowments and product variety

According to Nigel Grimwade，“An explanation cannot be found within the framework of classical or neo-classical trade theory.The latter predicts only inter-industry specialization and trade”.However， this is far from the case.Another explanation by Flavey & Kierzkowski（1987） tried to get rid of the idea that all products are produced under identical technical conditions.Their model showed that on the demand side goods are distinguished by the perceived quality of that good and high quality varieties are exported by capital-abundant countries and low quality varieties are exported by labor-abundant countries.Thus H-O theory can， in this framework， yield （产生） intra-industry trade.

（4） Degree of product aggregation （聚合）

One attempt to explain IIT was made by Finger （1975）， who thou ght that occurrence of intra-industry trade was“unremarkable” as existing cl assifications place goods of heterogeneous（异质的） factor endowments i n a single industry.If the classification is broad （for instance，beverage an d tobacco are classified into the same category）， there will be greater int ra-industry trade than would be the case if a narrower classification is exam ined.However， evidence shows that even when industries are disaggregate d to extremely fine levels， intra-industry trade still occurs， so this argum ent can be ignored.

## 2.Measurement of intra-industry trade

(1) Measurement of intra-industry trade for a particular industry

Intra-industry trade is difficult to measure statistically because regardin g products or industries as“the same” is partly a matter of definition and cla ssification.For a very simple example， it could be argued that although a BMW and a Ford are both motor cars， and although a Budweiser （百威 啤酒） and a Heineken （喜力啤酒） are both beers， they are really all different products.Various indexes of intra-industry trade have been create d， including the Grubel-Lloyd index， the Balassa index， the Aquino in dex， the Bergstrand index and the Glesjer index， among which Grubel-L loyd index is commonly used by being based on commodity group transacti ons.Thus， for any particular product class i， an index of the extent of intr a-industry trade in the product class is given by the following ratio：

$$IIT_i = 1 - \frac{|X_i - M_i|}{X_i + M} \qquad (1)$$

Where $X_i$ is the value of exports of industry i and $M_i$ is the value of im ports of industry i.

If there is no trade overlap in industry i， so that either $X_i$ or $M_i$ is positive， but not both，the value of the index is equal to zero.For instance， if $X_i > 0$ and $M_i=0$， the index is zero.By the same token （同样地）， if $M_i > 0$ and $X_i=0$， the index is also equal to zero.By contrast， if there is complete trade overlap， so that $X_i=M_i$， the index is equal to 1 （or 100 if the index is expressed as a percentage by multiplying by 100）.

This measure of IIT is best illustrated by the following example.Suppose that County A has only four categories of traded goods and that exports and imports of each category are as follows:

| Good | Exports ($) | Imports ($) |
|---|---|---|
| Fruit | 65 | 54 |
| Toy | 56 | 680 |
| Car | 700 | 200 |
| Movie | 300 | 97 |

The indexes of intra-industry of the four categories of the traded goods are:

$$\mathrm{IIT_f} = 1 - \frac{|65-54|}{65+54} = 1 - \frac{11}{119} = 0.907\,6$$

$$\mathrm{IIT_t} = 1 - \frac{|56-680|}{56+680} = 1 - \frac{624}{736} = 0.152\,2$$

$$\mathrm{IT_c} = 1 - \frac{|700-200|}{700+200} = 1 - \frac{500}{900} = 0.444\,4$$

$$\mathrm{IT_m} = 1 - \frac{|300-97|}{300+97} = 1 - \frac{203}{397} = 0.488\,7$$

(2) Measurement of intra-industry trade for a country as a whole

Given that intra-industry trade takes place within a commodity category, how can it be measured for a country as a whole? The measure has been

developed as follows:

$$IIT_i = 1 - \frac{\sum |(X_i / X) - (M_i / M)|}{\sum (X_i / X) + (M_i / M)} \quad (2)$$

In this formula， $X_i$ and $M_i$represent exports and imports of each category respectively.$X_i/X$（or $M_i/M$） is the percentage of the country's total exports （or imports） in category i and $|(X_i / X) - (M_i / M)|$ indicates the absolute value of the difference between the share of exports and imports in the category. （$X_i$ /X）+ （M $_i$+ M）indicates the sum of the export and import shares in the category.The ∑ sign means that we are summing over all the commodity categories， and the denominator （分母） must have a value of 2 because 100 percent of exports are being added to 100 percent of imports.

The following is an example:

| Good | Exports ($) | Imports ($) |
|---|---|---|
| A | 400 | 100 |
| B | 100 | 300 |
| C | 200 | 200 |
| Total | 700 | 600 |

$$\begin{aligned} IIT &= 1 - \frac{|400/700 - 100/600| + |100/700 - 300/600| + |200/700 - 200/600|}{(400/700 + 100/600) + (100/700 + 300/600) + (200/700 + 200/600)} \\ &= 1 - \frac{|0.571 - 0.167| + |0.143 - 0.5| + |0.286 - 0.333|}{(0.571 + 0.167) + (0.143 + 0.5) + (0.286 + 0.333)} \\ &= 0.596 \end{aligned}$$

[1]There are differences between Vernon's concept of the product cycle and marketers' perception of the product life cycle.Vernon's model is a production oriented， macro level empirical explanation of shifting trade patterns while the marketers'perception of product life cycle is a market oriented， mic

ro level explanation of the life cycle of products in international markets.It claims that products， lik e living organisms， go through stages of birth， development， growth， maturity， decline and d emise.To be meaningful， the product life cycle concept has to be used in conjunction with its count erpart， market evolution that is comprised of various stages of market development.

[2]OEM stands for Original Equipment Manufacturer referring a company which produces products t hat are marketed under the brand of a different company.

[3]Subcontracting means performing a specific task as part of the overall project.

[4]Economies of scale in this model are external economies pertaining to the industry level, not the fi rm level.As the industry grows, individual firms experience cost reduction per unit of output because, for example, the industry growth is attracting a pool of qualified labor.A more common view of econ omies of scale consists of internal economies of scale, whereby growth of an individual firm causes c ost reductions because more advanced and/or larger equipment can be used or because greater special ization of labor within the firm can take place.

[5]Paul Robin Krugman （born on February 28， 1953） is an American economist， columnist an d author.He is Professor of Economics and International Affairs at the Woodrow Wilson School of Pu blic and International Affairs， Princeton University，Centenary Professor at the London School of Economics， and an op-ed columnist for The New York Times.In 2008， Krugman won the Nobel Memorial Prize in Economics for his contributions to New Trade Theory and New Economic Geogra phy.He was voted sixth in Prospect Magazine’s 2005 global poll of the world’s top 100 intellectuals.

# Chapter 5 Import Protection Policy: Tariffs

Learning Objectives

In this chapter, you will learn:

- Types of import tariffs
- Effects of import tariffs
- Measurement of import tariffs

According to the law of comparative advantage, world resources can b e most effectively used through specialization and trade.Full specialization i s only possible when completely free trade is permitted.Unfortunately, ever y country in the world has trade barriers which are designed to protect its ec onomy against international market forces.These restrictions may be divide d into tariff barriers and non-tariff barriers.

Tariff barriers are the most common forms of trade restrictions.A tariff is a tax, or duty,levied on a commodity when it crosses the boundary of a cu stoms area.Tariffs may be levied on commodities leaving an area (export du ties) or on merchandise entering an area (import duties).Import duties are m ore common than export duties because most nations are anxious to expand exports and increase foreign exchange earnings.The purpose of an import d uty is to increase the price of goods to make domestic goods more competiti ve or to raise tax revenues for a government.Duties may also be used to pun ish exporters or countries for unfair trade practices.

This chapter first introduces the different types of import tariffs.Then it makes analysis on the effects of import tariffs on welfare.Finally it discusse s the measurement of import tariffs.

# 5.1 Types of Import Tariffs

Import tariffs take many different forms.

## 1.In terms of the means of collection

In terms of the means of collection， import tariffs can take the forms of specific duty （从量税）， ad valorem duty （从价税）， mixed or compound duty （混合税） and alternative duty （选择税）.

(1) Specific duty

A specific duty is a tariff levied as a fixed charge for each unit of imported goods, for example, US$1 per kilogram of sugar.Tax authorities can collect specific tariffs with ease because they need to know only the physical quantity of imports coming into the country, not the monetary value.

However， the specific duty has a fundamental disadvantage as it does not vary （改变） with the price of the good.These tariffs are vulnerable （脆弱的） to changes in the market or inflation unless updated periodically.For example， if the import price from the foreign producers is $5 and the tariff is $1 per unit， this is equivalent to a 20 percent tariff.However， if inflation occurs and the price of the import rises to $10， the specific duty is now only 10 percent of the value of the import.Domestic producers could rightly （无疑地） feel that this tariff is not doing the job of protection （after inflation） that it used to do.The inflation that took place during and after World War II and again in dramatic form in the late 1970s and early 1980s led countries to turn away from specific tariffs， but they still exist on many goods.

(2) Ad valorem duty

The ad valorem duty makes it possible for domestic producers to overcome the loss of protective value that the specific duty was subject to during inflation.The ad valorem duty is a duty levied as a constant percentage of the value of imported goods.For example, 25％ tariff on the imported cars.Th

us, if the ad valorem duty rate is 10 percent, an imported good with a world price of $10 will have a $1 tax added as the import duty; if the price rises to $20 because of inflation, the import levy rises to $2.

Although the ad valorem duty preserves the protective value of the trade interference for home producers as prices increase， there are difficulties with this tariff instrument as when the international price of a good falls， so does the tariff， and domestic industries become more vulnerable to competition.Conversely， when the price of a good rises on the international market， so does the tariff， but a country is often less interested in protection when the price is higher.They also face the problem of inappropriate transfer pricing[1] （转移定价） where a company declares a value for goods being traded differs from the market price， aimed at reducing overall taxes due.Nevertheless， ad valorem duties have come into widespread use.

(3) Mixed or compound duty

A mixed or compound duty is a combination of specific duty and ad valorem duty.The sum of these customs duties is referred to as a mixed or compound duty.An example will assist in understanding: Country A assesses a compound duty on imports of car batteries.The duty consists of 10％ of the value plus $1.00 per battery.A shipment of 100 batteries valued at$2,000 would be assessed at a $300 compound duty (10％ of $2,000 + $1.00×100=$300).

(4) Alternative duty

When both the rate of a specific duty and an ad valorem duty are stipulated for a particular item, the customs would impose duties by adopting either of these two duties.

## 2.In terms of the different tariff rates applied

In terms of the different tariff rates applied， import duties can take the forms of preferential duty （特惠税）， generalized preferential duty （普惠税）， MFNT duty （最惠国税）and general duty （普通税）.

(1) Preferential duty

Preferential duty is a tariff levied against imports from a country that is being given favored treatment, as in a preferential trading arrangement.

A historical example of this phenomenon was commonwealth （英联邦） or imperial preference， whereby Great Britain levied a lower rate if the goods were coming into Britain from a country that was a member of the British Commonwealth， such as Australia， Canada，or India.As independence arrived for most of these areas and membership in the Common Market expanded to include Britain and other nations， the European Union negotiated a series of preferential trade agreements with certain developing nations in Africa， the Caribbean and the Pacific （ACP）.In the December of 1989， the Fourth Lomé Convention（洛美协定） was signed between the twelve members of the European Community and 68 ACP countries concerning industrial products， as well as a number of agriculture tariff preferences.

(2) Generalized preferential duty

This is a duty extended （给予） under the General System of Preferences（GSP普惠制）.The GSP was established in the early 1970s and intended to give preferential tariff treatment to developing countries until their exporters are able to compete on world markets with normal，non-preferential tariffs.Under the system， developed countries （“donor countries” 给惠国）allow duty free or low-duty entry to imports from selected developing countries （“receiving countries” or“beneficiaries” 受惠国） up to a certain limit or quota.The tariff is a unilateral grant of tariff concessions， i.e.developing countries are not required to extend reciprocal tariff reductions[2]. （They must， however， meet certain conditions.）

The GSP is implemented through GSP schemes of the donor countries. While the GSP schemes vary from country to country, they mainly cover the following scope:

1） Country eligibility （合格） criteria （a selected list of countries）： Under the GSP schemes，the countries must be eligible and be a desi

gnated beneficiary country.For example， in the first GSP scheme of the U nited States， members of OPEC and countries dominated by international communism were excluded.In Japan’s fourth GSP scheme （the scheme fro m April 2001 to March 2011）， 155 beneficiaries， including 141 develo ping countries and 14 territories are included.

2） Product eligibility criteria （a selected list of products）： The se cond requirement to receive GSP is that the article or product must be consi dered as an eligible article.For example，under the first GSP scheme of the United States， there were some 3，000 articles that have been designated as eligible.However， there are certain articles that can never receive duty f ree treatment because they are excluded as being“import sensitive” items.T hese include textile and apparel （服装） articles； watches； certain elec tronic articles； certain steel articles； certain footwear articles； and certa in glass products.Considering the number of items that are already on GSP and the number of items that are excluded because of import sensitivity， it is fair to say that each year it becomes increasingly difficult to add new item s to GSP.Products are added each year in what is called the product review. Products are also removed during this period.Generally， the criterion for r emoval is whether the product has become import sensitive.

3) Competitive need criterion: Unlike the general process of adding an d removing a product from GSP, which usually affects the product from all countries involved, competitive need decision focuses on individual countri es.For example, if a product that is imported from any country exceeds 5 0％ of the total quantity of U.S.imports from all countries, it will be remove d just in the following year, and just for that country.Similarly, products ma y also be removed from any country if total imports from that country excee d a certain value.This dollar value figure changes each year and it is tied to t he GNP.The EU, Japan and Australia take other similar measures like prior l imitation to protect their domestic production and market.

4) Graduation policy: A product or all products could be removed from the GSP for one particular country if it was found that this country is suffici ently competitive in a product or all products in the world market.

This policy was first adopted by the United States in 1981.After the first five years of operation of America's GSP program, they found that too great a percentage of the GSP benefits was going to a smaller group of advanced developing countries and that a program was needed to"graduate" the more advanced countries from the programs at least as to products in which they had become competitive in the U.S.market.On Jan.1, 1995, the EU also adopted the policy.Late in 1988, President Reagan"graduated" Hong Kong Special Administrative Region of China, Korea, Taiwan Province of China and Singapore entirely from the GSP program.Previously, goods from these countries and regions had amounted to about 60％ of all duty free GSP imports.Thereafter, goods from Mexico accounted for 25％ of all such imports until 1994 when NAFTA removed Mexico from the list of GSP beneficiaries.In 1997, President Clinton graduated Malaysia from the GSP program.

Previously， the addition of products was also generally on a non-discriminatory （非歧视的） basis so that if a product was added for one country， it was added for any GSP country.Under graduation， products could be excluded for countries whose product had reached a sufficiently high level of competitiveness.

5） Rules of origin （原产地规则）： Rules of origin are the criteria needed to determine the national source of a product.The purpose of GSP is to help the LDCs to expand their export.The rules of origin are to ensure that only the goods from the beneficiary countries receive the preference.The rules of origin require that an article must be imported directly from the beneficiary country and substantial transformation， which means the cost or value of the material and direct processing operations performed in the beneficiary country equal to a certain amount of the value of the finished article.An article cannot receive the preference unless it satisfies the rules of origin and qualifies as being from the beneficiary developing country.

（a） Rule of direct consignment （直运规则）： The article must be shipped directly from the beneficiary country to the importing country.If， however， due to geographic or shipment reasons， shipment via the third country or territory has to be made， the article must be under the custody

（监管） of customs， and relevant certifications of transit must be provid ed.

（b） Substantial transformation （实质性变化）：The simplest situ ation is that none of the materials incorporated into the finished eligible arti cle were imported into the LDC.In other words， when a product is wholly obtained and produced in a single country， it is relatively easy to determin e its origin.

Difficulties arise when a product is manufactured， assembled， or m ade from materials originating in other countries.In the latter case， substan tial transformation is required.However， the standard of substantial transf ormation varies from country to country.In the United States， 35％ value added is required.In the EU and Japan， however， a specified change in t ariff heading （税目） is required.

(c) GSP origin certificate：GSP-covered imports must be accompanie d by a Certificate of Origin issued by one of the following certifying bodies: the exporting country’s customs agency; another authoritative government a gency; or the Chamber of Commerce or other similar bodies.

Box 5-1

Effectiveness of GSP in the European Union (EU)

The EU implements general GSP in ten-year cycles, with the current o ne adopted in 2004 and set to last from 2006 to 2015.It is reviewed approxi mately every 3 years.Preferential treatment was given to 179 countries or te rritories for 7,000 products, among which 3,750 were“sensitive” products th at received reductions in tariffs and 3,250 were“non-sensitive”that received duty free access.

One can note that based on this statistic alone， over half of GSP eligi ble products in the EU were considered sensitive and faced some level of pr otectionist taxation at the border，albeit （尽管） at lower rates than woul d be normally imposed.Still， these can range from very low to very high t ariffs.For example， in 2001， fresh cut flowers faced an MFN rate of 15-

17％and a GSP tariff rate of 15％.Lower rates do not necessarily indicate lo w overall rates.

According to the 2004“Least Developed Countries Report” issued by UNCTAD, the utilization rate of GSP for imports destined for the EU never reached 50％ between the years 1994-2001.It peaked in 1995 at 48％ and hi t a low of 26.2％ in 1998.

Besides the low rate of GSP use， the effectiveness of GSP is limited by non-tariff barriers that the EU imposes on imports.Agriculture is a major sticking point （障碍） between less developed countries and advanced in dustrialized countries.Although LDCs have the comparative advantage in a griculture， they are unable to maximize this feature of their economies bec ause the subsidies provided by the Common Agricultural Policy （CAP） o f the EU cuts away at their competitive edge by lowering production costs.

Tariff escalation also reduces the effectiveness of GSP.Tariff escalation occurs when the tariff charged for a product increases the further it is proces sed before entering the importing country.In the early 2000s, cocoa and coff ee were subject to GSP tariffs between 9％ and 12％.Unprocessed products, on the other hand, were duty-free.Clothing and textiles, other sensitive indu stries, are still highly protected by tariff escalation.Cotton seeds and waste a re duty free,but yarn and cloth face single-digit taxes while tariffs on clothin g can reach the double-digits.It protects domestic industries, prevents devel oping countries from building up their exports and processing sector and li mits their economies to providing raw materials and commodities.

In order to benefit from GSP, LDCs must comply with Rules of Origin to prevent the movement of products to other countries in search of lower ta riffs before reaching their final destinations.Rules of Origin require (a) good s to originate from the beneficiary country, (b) goods to be directly transport ed from the beneficiary country to the EU, and (c) submission of valid proo f of origin.These requirements vary dramatically based on the individual pr oduct and fulfilling them can be costly.Should exporters fail to provide the proof demanded, they must pay the normal import duties.It is possible that

paying normal duties may be more cost-effective than using GSP and compl ying with its complicated Rules of Origin.

Source: Josephine Nguyen, The Generalized System of Preferences, htt p://internationalecon.com/ students/JNguyen.pdf.

(3) MFN duty

MFN duty is a duty for nations entitled to most-favored-nation treatme nt or trading status.When one country grants“most-favored-nation” treatme nt， it is agreeing to accord （给予） products imported from that country the most favorable treatment or the lowest tariff rates that is to similar prod ucts imported from its other MFN trading partners.

The term of most-favored-nation treatment is misleading because it im plies that a country is getting special, favored treatment over all other count ries.However, the term means the opposite—it represents an element of non discrimination in tariff policy.

Most-favored-nation treatment is a commitment that a country will ext end to another country the lowest tariff rates it applies to any third country. A nation entering into a tariff treaty that includes the MFN treatment is requ ired to extend to all signatories （签约国） any tariff concessions （优惠） granted to any participating members.The purpose of such a treaty pro vision is to simplify tariff bargaining and increase the likelihood of tariff re duction.All members of WTO are entitled （有资格的） to MFN treatmen t.Suppose that the United States and India conclude a bilateral tariff negotiat ion whereby India reduces its tariffs on U.S.computers and the U.S.reduces its tariffs on Indian clothing.MFNT states that any third country with which the United States has an MFN agreement （such as China） will get the sa me tariff reduction on clothing from the United States that India received.Fu rther， China will， if it has an MFN agreement with India， also get the s ame tariff reduction from India on computers（if China exported any comp uters to India） that the United States received.These reductions for China occur even though China itself did not take part in the bilateral （双边的） tariff negotiations.In effect （实际上）， MFNT has been a hallmark （特

征） of post-World War II multilateral tariff negotiations under the auspices （支持） of the GATT.

(4) General duty

General duty is a non-MFNT tariff, applied to countries without MFN T agreement.

A country's tariff schedule （or customs tariff） （关税税则） is a lis t of all its import and export duties.The schedule may have one or more col umns.In a single column schedule， the tariff is the same for a specific prod uct regardless of the country of origin.A multicolumn schedule discriminate s among export countries， with lower rates applying to countries with whi ch tariff treaties have been negotiated.The advantage of the multicolumn tar iff is its flexibility for tariff bargaining.

## 3.In terms of special purposes for collection

In terms of special purposes for collection， import duties can take the forms of countervailing duty （反补贴税） and antidumping duty （反倾销税）.

(1) Countervailing duty

A countervailing duty （CVDs） is a tariff designed to"counter" the ef fects of the foreign export subsidy.Countervailing duties are imposed （征收） when a foreign country subsidizes its exports， hurting domestic prod ucers in the importing country.

According to World Trade Organization rules， a country can launch （发起） its own investigation and decide to charge extra duties， provide d such additional duties are in accordance with the GATT Article VI and the GATT"Agreement on Subsidies and Countervailing Duties".Since countries can rule domestically whether domestic industries are in danger and whethe r foreign countries subsidize the products， the institutional process surrou nding the investigation and determinations has significant impacts beyond t he countervailing duties.

Countervailing duties in the U.S.are assessed by the International Trade Administration of the U.S.Department of Commerce which determines whether imports in question are being subsidized and， if so， by how much.If there is a determination that causing material injury to the competing domestic industry， the Department of Commerce will instruct the U.S.Customs Service to levy （征收） duties in the amount equivalent to subsidy margins.Petitions （申请） for remedies may be filed （提出） by domestic manufacturers or unions within the domestic industry， however the law requires that the petitioners represent at least 25％ of the domestic production of the goods for which competition is causing material injury.

(2) Anti-dumping duty

Dumping is a situation of international price discrimination, where the price of a product when sold in the importing country is less than the price of that product in the market of the exporting country.An anti-dumping duty is a duty to imports to offset the effects of dumping.

Article VI of GATT 1994 explicitly （明确地） authorizes the imposition of a specific anti-dumping duty on imports.The Agreement on Implementation of Article VI of GATT 1994，commonly known as the Anti-Dumping Agreement， provides further elaboration （详尽阐述）on the basic principle set forth in Article VI of GATT 1994， to govern the investigation， determination， and application of anti-dumping duties.Under Article VI of GATT 1994 and the Anti-Dumping （ADP） Agreement， WTO Members can impose anti-dumping measures， if WTO Member can confirm：（a） that dumping is occurring，（b） that the domestic industry producing the like product is suffering material injury or threat of material injury， and （c） that there is a causal （因果） link between the two.

According to the definition of ADP Agreement， a product is dumped if its“export price”is less than“normal value” （NV）.The NV is the foreign home market price of a“foreign like（相同的） product” sold in the ordinary course of trade （i.e.not to a related party or below cost）for consumption in the exporting country.If home market sales are incomparable because such sales are few， nonexistent， or at below cost prices， alternative

methods are to be used.One is NV in a third country price， the other alternative method is constructed （推算的） normal value，a value based on cost of production， selling， general and administrative expenses， and profits.In a particular situation of economies where the government has a complete or substantially complete monopoly （垄断） of its trade and where all domestic prices are fixed by the state，GATT 1994 and the Agreement recognize that a strict comparison with home market prices may not be appropriate.Importing countries have thus exercised （行使） significant discretion（自由决定权） in the calculation of normal value of products exported from non-market economies.

An investigation to determine the existence， degree and effect of an alleged （所谓的）dumping may be initiated （发起） （a）“upon a written application by or on behalf of the affected domestic industry”， （b）“in special circumstances” by governmental authorities of the affected state， or （c） by an application made by authorities of an affected third country.In any of these cases， the application must disclose evidence showing （a） dumping， （b） material injury or threat of injury to， or material retardation to the establishment of， a domestic industry， and （c） a causal link between the dumped imports and the alleged injury.

The authorities carrying out an investigation must give all interested parties a notice of the investigation， an opportunity to present written evidence， and the opportunity to examine and rebut （驳回） adverse （不利的） evidence.Even so， the investigation is to be carried out expeditiously （迅速地）， and the procedure that allows interested parties to participate may not be used by the parties as a means of delaying the investigation， from reaching a preliminary or final decision， or from applying provisional or final antidumping measures.

Provisional （暂时的） measures （that is， the imposition of a provisional antidumping duty or the deposit of a security equal to a provisionally estimated antidumping duty） may be imposed after an investigation has been initiated.Final antidumping duties may be imposed at the discretion of the authorities concerned upon the completion of an investigation and a fina

l determination that dumping， injury， and a causal link between them exi st.

In response to alleged dumping, the United States follows a specified p rocedure (similar procedures exist in other countries that belong to the WT O).(a) Upon receipt of a petition from a domestic import competing firm or industry, the Department of Commerce determines from price and cost data (which may be difficult to obtain) whether dumping is occurring.If so,then (b) the U.S.International Trade Commission, an independent federal agency, determines from a study of the recent history of the industry whether this du mping has been an important source of injury to the industry.If so, then (c) a ntidumping duties are imposed on the imported goods.The size of the duties is designed to offset the extent of the dumping.

According to the WTO statistics, the People's Republic of China has b een the number one target of antidumping actions filed by WTO members.F rom Jan., 1, 1995 to June 30, 2016, the total number of antidumping actions initiated by reporting WTO members was 5132, among which 1170 were ag ainst China, amounting to 22.80％ of the total.The major WTO members fil ing antidumping actions are shown in Table 5-1.

Table 5-1 Antidumping initiations against China by major reporting members(01/01/1995-3 0/06/2016)

| | | | |
|---|---|---|---|
| India | 193 | Australia | 49 |
| the United States | 140 | Colombia | 46 |
| European Union | 128 | South Africa | 39 |
| Argentina | 97 | Canada | 38 |
| Brazil | 92 | Korea, Republic of | 28 |
| Turkey | 76 | Peru | 22 |
| Mexico | 51 | Pakistan | 22 |

Source: https://www.wto.org/english/tratop_e/adp_e/adp_e.htm
https://www.wto.org/english/tratop_e/adp_e/AD_InitiationsRepMemVsExpCty.pdf.

One reason for this special status is that China was one of the world's l owest cost producers at that time.Because of the cost structure of its industri es and economy, as well as the fact that it manufactured products at the low end of the quality scale, and was able to sell a wide range of products at low er prices than most competitors.Furthermore, because it was classified as a non-market economy, special rules must be used to determine the cost of pr oduction.

Box 5-2

An Antidumping Action Initiated by the U.S.Commerce Department against the PRC

The Commerce Department launched an antidumping investigation of the Chinese persulfate （过硫酸盐） industry as the result of a petition file d in July， 1996 by FMC Corporation of Chicago.Based on an examination of the evidence， it found that there was a reasonable indication that an ind ustry in the United States was threatened with material injury by reason of i mports from China （USITC 1996b： v）.

Since China is classified as a nonmarket economy， a surrogate （替代） country was chosen in order to determine equivalent costs.The petitio ner chose India to value factors of production， in this case， since India is the only persulfate producer among surrogate countries that the Commerce Department typically uses for the PRC.Based on comparisons of export pric es with the normal values the petitioner constructed from factors of producti on， dumping margins were determined to range from 15.87％ to 182.37％ （USITC 1996b： A-6）.The final determination found that Chinese persu lfates were being， or were likely to be， sold in the United States for less than fair value （USITC 1997c： A-5）.Dumping margins in the final dete rmination ranged from 40.97％ to 134％ （USITC 1997c： A-18）.

Source: Robert W.McGee, Yeomin Yoon, Antidumping and the Peopl e's Republic of China: Five Case Studies, Working Paper 98.2 May 1998.

Box 5-3

China's Market Economy Status after 2016?

Over the last years, most WTO Members have categorized China as a Non-Market Economy (“NME”) during antidumping investigations (“AD in vestigations”).For this reason,China and Chinese companies have been subj ect to methodologies that deviate from the strict comparison with domestic prices or costs required by the GATT 1994 and the Antidumping Agreement (“ADA”).Inevitably, China’s categorization as a NME has soundly affected Chinese industries due to the imposition of high antidumping duties during AD investigations.

This differential treatment is based on paragraph 15(a) of China’s Acce ssion Protocol,which allows importing Members to use an alternative metho dology when Chinese producers cannot clearly show that market economy c onditions prevail in the industry in question.However, paragraph (d) of Arti cle 15 contains an expiration clause stating that the provisions of subparagra ph 15(a)(ii) will expire 15 years after the date of China’s accession, namely after December 11 of 2016.

Market Economy Status and Non-Market Economy Status

Pursuant to the provisions set forth in Article VI of the GATT 1994 an d the ADA,dumping occurs when products of one country are introduced int o the market of another country at a value lower than the normal value of th e products in the market of origin, and causes or threats to cause material inj ury to an established industry or materially delays the establishment of a do mestic industry of like products.In such circumstances, the importing countr y is authorized to levy on the dumped product an antidumping duty up to th e margin of dumping (the normal value minus the export price).

According to subparagraph 1 of Article VI, the general rule is that nor mal value is the comparable price, in the“ordinary course of trade, for the li ke product when destined for consumption in the exporting country”.The co mparability in the“ordinary course of trade”requires that both countries hav e ME.Therefore, when an importing country initiates an antidumping invest igation over an exporting Member with MES, it is obliged to use domestic p rices or costs when determining the normal value of the products.

Nevertheless, for NME exporters, as it is the case of Chinese companies, the general rule may not be applied as it is deemed that domestic prices are largely determined by the State,and not by the market.Thus, for WTO Members who are subject to a specific provision in a WTO Accession Protocol, the importing Member may adopt an alternative methodology instead, such as the use of surrogate prices in a third ME country (analogous third country methodology).

In this regard, Section 15 of China's Accession Protocol established a NME clause providing that, if Chinese producers under investigation can clearly demonstrate that market economy conditions prevail in the industry producing the like product with regard to the manufacture, production and sale of that product, the importing WTO Member shall use Chinese prices or costs for the industry under investigation in determining price comparability [Section 15(a)(i)].However, if producers under investigation cannot clearly demonstrate that market economy conditions prevail, the importing WTO Member may use a methodology that is not based on a strict comparison with domestic prices or costs in China, such as the analogous third country methodology [Section 15(a)(ii)].

This NME clause is critical to Chinese domestic industries since exporters have suffered significant financial losses due to the implementation of alternative methodologies used to calculate antidumping duties.

For instance, we draw attention to the U.S antidumping cases against color televisions originating in China and Malaysia in 2004.In these cases, the U.S.Commerce Department initiated AD investigations against televisions manufactured in China and Malaysia which were essentially identical and used the same internationally available parts and components.In spite of this fact, the U.S.found no dumping in the proceeding against Malaysia, but found dumping margins of up to 78％ in the proceeding against Chinese producers.This discrepancy occurred mainly because the U.S.Commerce Department treated China as a NME in the investigation and used India as a surrogate country when determining the normal value of the products.

It is important to recall that China has been the principal target in AD investigations over the last years.According to the WTO Antidumping Statistics, between January 1, 1995 and June 30, 2014, 1022 AD investigations were initiated against China, 185 against Japan, 181 against India and 119 against Malaysia.73％ of the initiated investigations were successful in levying antidumping duties to Chinese producers.While 69％, 57％, and 56％ of the investigations against ME such as Japan, India and Malaysia were successful.

Expiration of the NME clause

According to paragraph 15(d) of China's Accession Protocol, the NME clause [Section 15(a)(ii)] will expire on December 11, 2016.As from that date, importing Members will be obliged to treat China the same as other Members during AD investigations, since there will be no longer a legal basis in the Accession Protocol to treat China as a NME.

This means that the importing country will have to calculate the normal value of Chinese product according to the general rule embedded in subparagraph 1 of Article VI, and use domestic prices and costs in China to perform the comparison.

Nonetheless, a methodology not based on a strict comparison with domestic prices or costs in China is still applicable according to the Ad Note to Art.VI.1 GATT 1994 (the"Ad Note").The Ad Note recognizes that, in the cases of imports from countries where the State has a complete or substantially complete monopoly of trade and where all domestic prices are fixed by the State, importing Members may determine that a comparison with domestic prices may not be appropriate due to special difficulties in determining price comparability.

However, the application of the Ad Note requires the investigating authority to demonstrate that the exporting State monopolizes trade and sets all domestic prices.Thus, if importing Members continue to apply alternative methodologies based on the categorization of China as a NME after 2016, without invoking the Ad Note, the affected producers may resort to the WTO d

ispute settlement system and request the restoration of their rights to the use of domestic prices or costs.

Implementation issues

While a significant share of China's economy is thought to be driven b y market forces,allegedly the Chinese government continues to play a major role in economic decision-making,possibly distorting trade and investment f lows.

According to the U.S.-China Economic and Security Review Commiss ion, the Chinese government maintains policies to bolster domestic enterpri ses such as subsidies, tax breaks,preferential loans, trade barriers, foreign di rect investment restrictions, discriminatory regulations and standards, expor t restrictions on raw materials (such as rare earths), technology transfer requ irements imposed on foreign firms, public procurement rules that give prefe rences to domestic firms, and weak enforcement of Intellectual Property Ri ghts laws ("IPR").Furthermore, the Chinese government has taken quick ste ps to take full control of industries such as, autos, aviation, banking, coal, c onstruction, environmental technology, information technology, insurance, media, metals (such as steel), oil and gas, power, railways, shipping,telecom munications, and tobacco.

Recently, U.S.policy makers and stakeholders have expressed their con cern for these issues, as well as for the widespread cyber economic espiona ge against U.S.firms by Chinese government entities, the increasing pressur e over foreign-invested firms to transfer technology in exchange for market access, and China's inconsistent record on implementing its WTO obligatio ns.

These control-based policies have placed China's recognition as a ME on 2016 in the tightrope.For instance, the EU and U.S.have expressed their reluctance to treat China as a ME until it demonstrates that it operates under market policies.In fact, in 2012, President Obama created a new Trade Enfo rcement Unit"charged with investigating unfair trade practices in countries l ike China."

Currently, the U.S-China Strategic and Economic Dialogue is explorin g the possibility of cooperating to enable the U.S.to treat China as a market economy, and treat certain Chinese firms as market-oriented industries, for t he purpose of U.S.trade remedy laws.

Thus, it is still not clear whether in practice China will start to enjoy M ES for the purpose of AD investigations, along with the expiry of the NME clause in December 11, 2016.

Source: China's Market Economy Status after 2016? posted on Februar y 26, 2015 by Jose Francisco Mafla

http://www.worldservicesgroup.com/blog/practice/post/Chinas-Market -Economy-Status-after-.aspx.

# 5.2 The Effects of Import Tariffs

## 1.Concepts of consumer surplus and producer sur plus

An import tariff raises the price of a good in the importing country, so we expect the effects of import tariffs is to hurt consumers and benefit prod ucers there.We use the concepts of consumer surplus and producer surplus t o measure these effects.In addition, the tariff revenue the government gains from a tariff is also taken into account.

1) Consumer surplus: Consumer surplus measures the amount that a co nsumer gains from a purchase by the difference in the price he pays from th e price he would have been willing to pay.The price he would have been wil ling to pay is determined by a demand(willingness to buy) curve.When the price increases, the quantity demanded decreases as well as the consumer su rplus (see Figure 5-1).

2) Producer surplus: Producer surplus measures the amount that a prod ucer gains from a sale by the difference in the price he receives from the pri

ce he would have been willing to sell at.The price he would have been willi ng to sell at is determined by a supply (willingness to sell) curve.When pric e increases, the quantity supply increases as well as the producer surplus (se e Figure 5-2).

## 2.The welfare effects of import tariffs

1) The welfare effects of an import tariff in a small country

When a country is“small”, it has no effect on the foreign (world) price of a good,because its demand for the good is an insignificant part of world d emand.Therefore, the foreign price will not fall, but will remain at $P_w$.The p rice in the domestic market, however,will rise to $P_d=P_w + t$.

The rise of the price of a good in the importing country because of a ta riff makes its consumer surplus decrease (makes its consumers worse off) a nd makes its producer surplus increase (makes its producers better off).Als o, government revenue will increase.

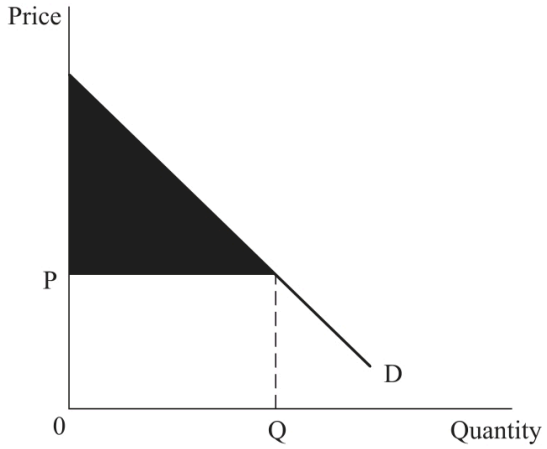



Figure 5-1 Geometry （几何图形） consumer surplus（Consumer surplus equals the area u nder the demand curve and above the price）

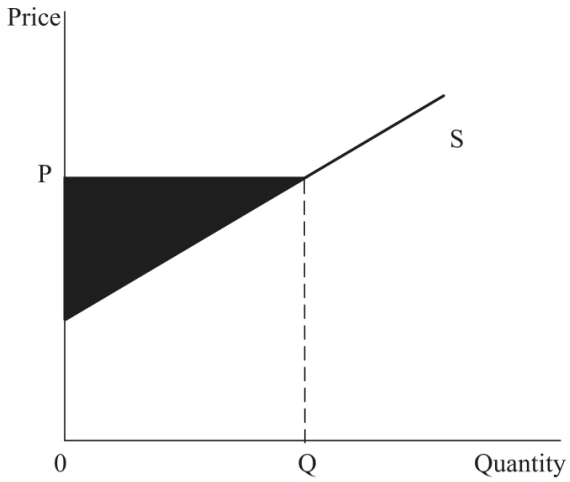



Figure 5-2 Geometry producer surplus(Producer surplus equals the area above the supply curve and under the price)

In Figure 5-3， the area of rectangular （直角梯形）“a+b+c+d” represents the consumer loss which is the consumer surplus when there is no tariff minus the consumer surplus when a tariff is put in place and the area“a” represents the producer gains which is the producer surplus when there is no tariff minus the producer surplus when a tariff is in place.The area“c” represents the tariff revenue collected by the importing country.Thus the net welfare effects of the tariff is a deadweight loss （净损失） which is represented by the sum of area“b” and“c”.

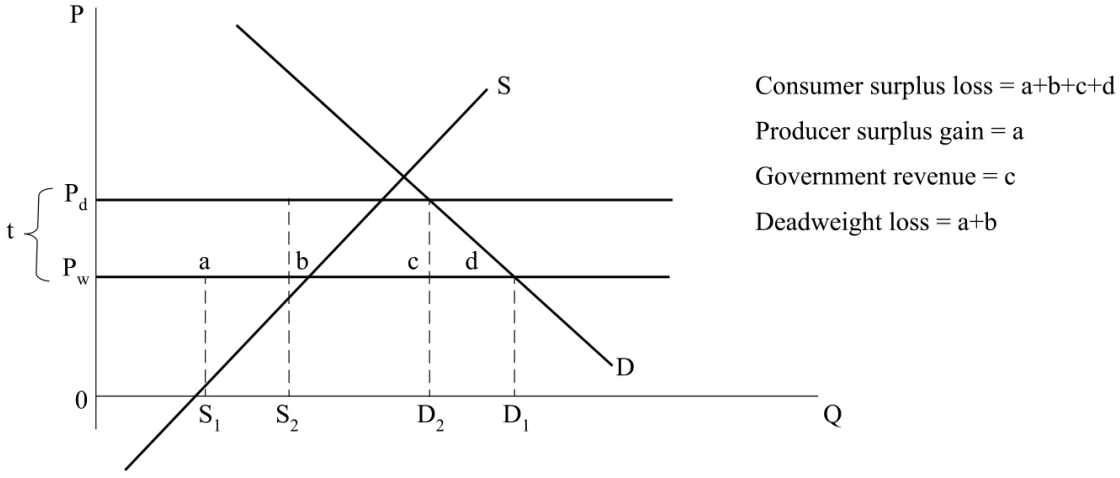



Figure 5-3 The welfare effects of an import tariff in a small country

2) The effects of an import tariff in a large country

For a“large” country whose trade （and changes in its trade） can have an impact on international product prices， the welfare effects of a tariff is ambiguous （不明确的）.In Figure 5-4， the area of“g” represents the terms of trade gain which increases because the tariff lowers foreign export （domestic import） price to $P'_w$.The area of （c+g） represents government revenue from the tariff which equals the tariff rate times the quantities of imports.Part of government revenue （the area of“g”） represents the terms of trade gain and part of the value（the area of“c”） lost consumer surplus.Thus， the government gains at the expense of foreign producers and home consumers.The welfare effects of an import tariff in a large country is the area of （g-b-d）.If the area of （g-b-d） is positive， then the country gains from the tariff imposition.Otherwise， it has a deadweight loses.Thus， the welfare effects are not clear.

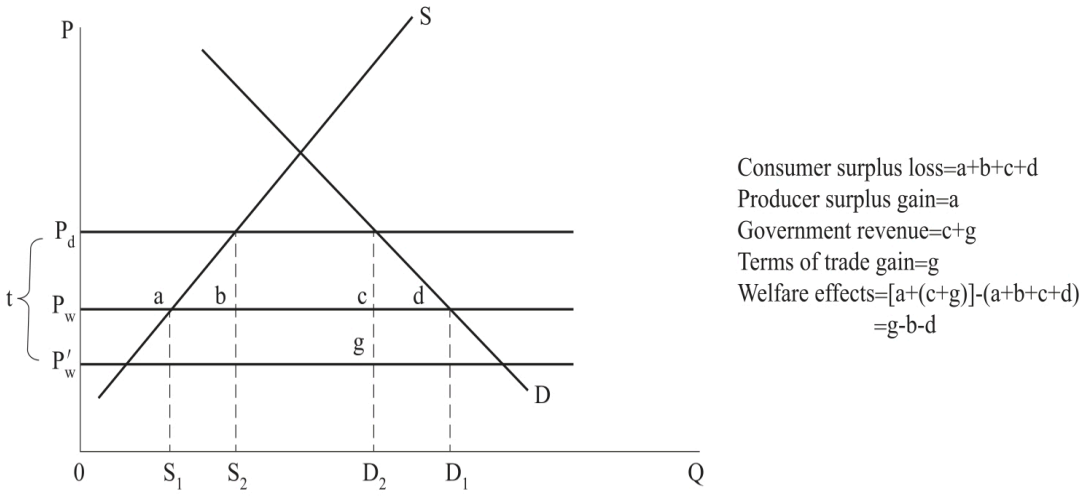



Figure 5-4 The welfare effects of an import tariff in a“large” country

# 5.3 Measurement of Import Tariffs

## 1.The“height” of import tariffs

All countries have a large number of different tariff rates on imported goods.How do we determine the average tariff rate from this great variety?

One measure of a country's average tariff rate is the unweighted-average （未加权平均）tariff rate.Suppose that we have only three imported goods with the following tariff rates：product A， 15 percent； product B， 20 percent； and product C， 25 percent.The unweightedaverage of these rates is

$$\frac{15\% + 20\% + 25\%}{3} = 20\%$$

The problem with this technique is that it does not take into account the relative importance of the imports： if the country imports mostly goods A， this unweighted average would tend to overstate （夸大） the height of the country's average tariff.The alternative technique is to calculate a weighted-average （加权平均） tariff rate.Each product's tariff rate is weighted by the importance of the goods in the total bundle of imports.Using the tariff rates from the unweighted case， suppose that the country imports $800，000 worth of product A，$500，000 worth of product B， and $200，000 worth of product C.The weighted-average tariff rate is

$$\begin{aligned}&\frac{(15\%)(\$800{,}000) + (20\%)(\$500{,}000) + (25\%)(\$200{,}000)}{\$80{,}000 + \$500{,}000 + \$200{,}000}\\ &= \frac{\$120{,}000 + \$100{,}000 + \$50{,}000}{\$1{,}500{,}000}\\ &= 18\%\end{aligned}$$

The weighted rate of 18 percent is lower than the unweighted rate of 20 percent，indicating that relatively more low tariff imports than high tariff imports are coming into the country.Nevertheless， the weighted-average tariff rate has a disadvantage related to the law（规律） of demand.Assuming demand elasticity is similar across all goods； purchases of goods with relatively high tariffs tend to decline because of the imposition of the tariffs，while those of goods with relatively low tariffs tend to decline to a lesser degree.Thus， the tariff rates themselves change the import bundle， giving greater weight to low tariff goods.The weighted-average tariff rate is therefor

e biased （偏向） downward.The weighting problem can be illustrated in a n extreme form with prohibitive （禁止性的） tariffs.A prohibitive tariff h as a rate that is so high that it keeps imports from coming into the country.I n the above example， a prohibitive tariff would exist if item D has a tariff r ate of 200 percent， but there are zero imports of D because of this rate.The weighted-average tariff rate for the country could still be 18 percent， beca use the 200 percent tariff has zero weight.In the extreme， a country that i mports a few goods with zero tariffs but has prohibitive tariffs on all other p otential imports will have a weighted-average tariff rate of 0 percent， and t he country would look like a free trade country！

In practice, the unweighted-average tariff rate may be as useful as the weighted-average rate.A way to avoid some of the bias of the weighted aver age rate is to calculate it by using weights of the goods in world trade, not t he particular country’s trade.This procedure reduces the bias associated wit h using the importing country’s own weights, because the world weights are less influenced by the importing country’s tariff schedule.

## 2.Nominal versus effective tariff rates

In recent decades, many concerns have been centered on the choice of the appropriate tariff rate when evaluating the impacts of tariffs.This issue i nvolves the distinction between the nominal tariff rate on a good and the eff ective tariff rate, more commonly known as the effective rate of protection (ERP).

(1) Nominal tariff rate

The nominal tariff rate is the tariff rate in the tariff schedule.It is the si mplest way to estimate the nominal rate of protection of an industry, if tariff s are the only barrier that restricts imports and applied to all imports without exception.

In reality there are other barriers restricting imports such as quantitativ e restrictions， import approval system， safety standards， hygienic （卫 生的） standards and so on.Also， the government may exempt or rebate t

ariffs when imports are used for some special purposes such as production o f exports， research and development.Hence， the rates in the tariff schedu le are more often than not a poor indicator of the nominal rate of protection. It would be ideal if domestic prices and import prices were known， as the domestic price would bear all effects of tariff and non-tariff measures of pro tection.Of course， the information is not readily available but has to be col lected through survey， and the survey is not always accurate.

Given the above considerations, two alternatives are suggested.One is t he actual tariff rate which may be obtained by dividing the tariff revenue on an import good by the value of imports, the other is the tariff equivalent, the ratio of domestic price to import price less one.It may be expressed as NRP = $(P_d / P_i) - 1$ or NRP = $(P_d - P_i)/P_i$ , where $P_d$ is the do mestic market price of a good and $P_i$ is the import price of a good.

(2) Effective tariff rate (ERP)

NPR is not a good indicator of how much the domestic producers are p rotected by a tariff that gives rise to the NPR.For domestic producers, of gre ater interest than the price rise is the rise in value added.A better indicator o f the protection accorded to the domestic producers is the effective tariff rat e.Effective tariff rate is also called effective rate of protection which is the r ate by which the value added increases after the imposition of tariffs.

Economists employing the nominal rate are concerned about the extent to which the price of the goods to domestic consumers is raised by the exist ence of the tariff.However,economists are concerned, when using ERP, abo ut the extent to which“value added” in the domestic import competing indus try is altered by the existence of the whole tariff structure(that is, the tariff r ate not only on the final goods but also on the intermediate goods that go int o making the final goods).The ERP can be illustrated with a numerical exa mple.

Consider a situation in which good F is the final good and goods A and B are intermediate inputs used in making F.Assume that A and B are the onl y intermediate inputs and that 1 unit each of A and B is used in producing 1

unit of final good F.Goods A and B can be imported goods or domestic goo ds that compete with imports and thus have their prices influenced by the ta riffs on the competing imports.

Suppose that, under free trade, the price of the final product ($P_F$) is \$1, 000 and the prices of the inputs are $P_A$=\$400 and $P_B$=\$300.In this free trade situation, the value added is\$1,000−(\$400+\$300)=\$300.Now consider a situ ation where protective tariffs exist; a prime mark next to a price (P) indicate s a tariff protected price.Suppose that the tariff rate ($t_F$) on the final product i s 15 percent and that the tariff on input A ($t_A$) is 8 percent and on input B (t $_B$) is 5 percent.If we assume that the country is a small country—remember, it takes world price as given and cannot influence them—then the domestic prices of the goods with the tariffs in place are

$$P'_{F'} = \$1{,}000 + 0.15(\$1{,}000) = \$1{,}000 + \$150 = \$1{,}150$$
$$P'_A = \$400 + 0.08(\$400) = \$400 + \$32 = \$432$$
$$P'_B = \$300 + 0.05(\$300) = \$300 + \$15 = \$315$$

The value added in industry F under protection is \$1,150−(\$432+\$315) =\$403.The industry has experienced an increase in its value added because of the tariffs, and therefore the factors of production (land, labor, and capita l) working in industry F are able to receive higher returns than under free tr ade.There is thus an economic incentive for factors of production in other in dustries to move into industry F.Since the effective rate of protection is the percent change in the value added when moving from free trade to protectio n, the ERP in this example is

$$\frac{VA' - VA}{VA} = \frac{\$403 - \$300}{\$300} = 34.33\%$$

Where VA′ is the value added under protection, VA is the value added with free trade.

Thus, the factors of production in industry F have benefited from the ta riffs, although consumers have lost.A more common formula for calculating the ERP for industry j utilizing inputs designated as i is

$$\text{ERP} = \frac{t_j - \sum_i a_{ij} t_i}{1 - \sum_i a_{ij}}$$

where $a_{ij}$ represents the free trade value of input i as a percentage of the free trade value of the final good j, $t_j$ and $t_i$ represent the tariff rates on the fi nal good and on any input i,respectively, and the $\sum_i$ sign means that we are s umming over all inputs.In the example, the $a_{ij}$ for input A is \$400/\$1,000 or 0.40, and the value of the $a_{ij}$ for input B is \$300/\$1,000 or 0.30.The ERP in t he example is the same as in the calculation above:

$$\text{ERP}_F = \frac{0.15 - [(0.40)(0.08) + (0.30)(0.05)]}{1 - (0.40 + 0.30)} = 34.33\%$$

This second method of calculating the ERP has the advantage of illustr ating three general rules about the relationship between nominal rates and ef fective rate of protection.These rules are (a) if the nominal tariff rate on the final goods is higher than the weighted-average nominal tariff rate in the inp uts, then the ERP will be higher than the nominal rate on the final goods; (b) if the nominal tariff rate on the final goods is lower than the weighted-av erage nominal tariff rate on the inputs, then the ERP will be lower than the nominal rate on the final goods; and (c) if the nominal tariff rate on the final goods is equal to the weighted-average nominal tariff rate on the inputs, the n the ERP will be equal to the nominal rate on the final goods.

Rule （a） incorporates an escalated （逐步升级的） tariff structure and reflects the situation in most countries.It means that nominal tariff rates on imports of manufactured goods are higher than nominal tariff rates on int ermediate inputs and raw materials.This situation has particular relevance （关联） to trade between developed countries and developing countries.Si

nce the developed countries have escalated tariff structures with correspond ingly （相对地）heavier protection for manufactured goods industries than for intermediate goods and raw materials industries.A final note on the“nom inal” versus“effective” tariff distinction is that an industry does not always have an ERP higher than its nominal rate.Further， an ERP can be negativ e， meaning that the tariffs on inputs are considerably higher than the tariff on the final goods.Thus， the structure of tariffs in this latter situation work s to drive factors of production out of the industry rather than draw resource s in.In overview， the nominal tariff rate is useful for assessing the price im pact of tariffs on consumers.For producers， however， the effective rate i s more useful because factors tend to flow toward industries with relatively higher ERPs.In the assessment of development prospects and economic pla nning in the developing countries， a strong case can be made for ERPs as analytical tools， even more than nominal rates of protection.

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[1]Transfer pricing refers to the pricing of contributions （assets， tangible and intangible， service s， and funds） transferred within an organization.For example， goods from the production divisio n may be sold to the marketing division， or goods from a parent company may be sold to a foreign subsidiary.Since the prices are set within an organization （i.e.controlled）， the typical market mec hanisms that establish prices for such transactions between third parties may not apply.The choice of the transfer price will affect the allocation of the total profit among the parts of the company.This is a major concern for fiscal authorities who worry that multi-national entities may set transfer prices on c ross-border transactions to reduce taxable profits in their jurisdiction.

[2]The preferential and unilateral nature of GSP is a departure from the nondiscriminatory， or most-favored-nation treatment（MFNT） principles that have guided post-World War II multilateral tariff reductions under the General Agreement on Tariffs and Trade （GATT）.The GATT provides that tra de must be conducted on a basis.Generally， members of the World Trade Organization must extend any tariff concessions to all trading partners.Tariff reductions under the GATT have also been based o n reciprocity： tariff concessions from each member country are reciprocated by concessions from ot hers.Since 1971， however，a GATT waiver has allowed the industrial countries to extend preferent ial tariff treatment for developing countries.For more details about MFNT， see Chapter 10.

# Chapter 6 Import Protection Policy: Non-tariff Barriers

Learning Objectives

In this chapter, you will learn:

- Different forms of non-tariff barriers
- Effects of non-tariff barriers

Historically, nations sought to protect domestic industries from foreign competition by levying tariffs on goods imported from other nations.Since t he 1970s, the global trend has been toward free trade among nations.Becaus e of this, tariffs around the world have fallen dramatically.However, a variet y of non-tariff barriers have increased, as industries around the world contin ue to seek protection from foreign competitors.

Non-tariff barriers here refer to a range of actions， other than tariff s， that governments apply to restrict imported goods.Often bureaucratic in nature， the intention of non-tariff barriers is to raise the prices of imported products to make them less attractive to consumers，or to restrict their avai lability in favor of domestically produced versions of the same goods.Altho ugh most non-tariff barriers violate （违反） World Trade Organization rul es， their use is increasing.

This chapter first introduces the major forms of non-tariff barriers and then analyzes the effects of some of them.

## 6.1 Forms of Non-tariff Barriers

Non-tariff barriers take various forms and may fall into one of the six b road categories： 1） Quantity control measures； 2） Price control meas

ures； 3） Para-tariff （准关税） measures； 4） Finance measures； 5） Anti-competitive measures； 6） Miscellaneous （各种不同的） measures.

# 1.Quantity control measures

Quantity control measures are aimed at restraining （控制） the quantity of goods that can be imported， regardless of whether they come from different sources or one specific supplier.These measures can take the form of restrictive licensing， fixing of a pre-determined quota， or through prohibitions.These measures include：

1） Non-automatic license： This license is an import license which is not granted automatically.The license may either be issued on a discretionary （任意的） basis or may require specific criteria to be met before it is granted.

2) Quota: Quota is government-imposed restriction on quantity, or sometimes on total value.It involves restricting the importation of specified products through the setting of a maximum quantity or value of goods authorized for import.The limit may be expressed in terms of weight (so many tons of grain), value (no more than $1,000,000 in value of goods),units (no more than 1,000 trucks of a certain type), or more recently in terms of a percentage of final value (no more than 50％ of the final value of goods may come from outside the country).Quotas may take the following forms:

（a） Absolute quota： Absolute quota is an import quota that allows a limited quantity of specified merchandise into a country.It means that when the imports of a specific commodity during a given period reach the quotas， no import would be allowed.Absolute quotas can be either global quotas or country quotas.（i） Global quotas （unallocated quotas）： Global quotas are quotas established on the basis of the total quantity or value of imports of specific products， which are filled on a first-come， first-served basis， without reference to countries of origin.（ii） Country quotas （allocated quotas）： These are quotas of imports reserved for a specific countr

y.The importer is usually required to submit certificates of origin.The allocation of quotas is based on the political or economic relations between the importing and exporting countries.They may be imposed unilaterally （单方面地）， as in the case of sugar imports into the United States.They can also be negotiated on a so-called voluntary basis， as in the case of Japanese automobile imports into the United States during the early 1980s.

（b） Tariff rate quota： Tariff rate quota is the import quota that allows a limited quantity of specified merchandise into a country at a reduced duty rate during a specified period.This is a system of multiple tariff rates applicable to a same product.The lower tariff rates apply up to a quota of imports， and the higher rates are charged on imports which exceed the quota amount.Quota may be defined in terms of quantity or value.For example， if the tariff on tires was 5％ for the first 100，000 imported， it might move to 10％ for any additional importation of tires.Such a quota discourages （阻碍） importers from bringing large quantities of a particular item into the country.Tariff rate quotas may also be on a country basis or on global basis.

The import quota is in contrast to the tariff, which specifies an amount or percentage of tax but then lets the market determine the quantity to be imported with the tariff in existence.Quotas are more certain and precise as trade restraint than are tariffs.An import duty that is not prohibitive will reduce imports, but it does not impose an absolute limit on imported goods.A quota system limits with certainty the extent of foreign competition in the domestic market.

Quotas provide greater flexibility in bargaining and administration.In the importing countries， quotas usually require a licensing system and an agency to distribute the quota shares to domestic importers.Where the total quota is small relative to the total domestic market， domestic prices are likely to be higher than the price of imports.Quota recipients，therefore， will gain windfall profits （横财）.Government could capture the windfall profits by auctioning （拍卖） off the licenses to the higher bidder.The more general practice， however， is for the profits to go to private parties.Thus inequities and corruption （腐败） may occur in the allocation of quotas.

3) Quantitative safeguard measures: These measures are adopted when the government of the importing country wishes to prevent or remedy serio us injuries from a sudden increase of imports, or to facilitate adjustment and have effect on quantitative restrictions.

4) Prohibition: Prohibition includes total prohibition, a prohibition wit hout any conditions or qualifications and other prohibitions for special reas ons.

5)“Voluntary” export restraints (VERs):“Voluntary” export restraints ar e arrangements made by government or industry of an exporting country t o“voluntarily” limit exports in order to avoid imposition of mandatory restri ctions by the importing country.

As the GATT generally disallows the use of quotas， member states b egin to employ“voluntary” export restraints （VERs） as a legally distinct but functionally identical mechanism to create a quantitative barrier to impo rts.The legalistic difference between a quota and a VER is that the former is imposed by the state that wants to shield （保护） its domestic producers f rom foreign competitors.By contrast， VER is imposed by a state on its ho me firms’ exports，an export restraint that is not in truth“voluntary”.Instea d， it results from diplomatic pressure from abroad by those who are prohi bited by the GATT treaty from using a quota.

Two of the most widely publicized VERs exist in automobile trade an d， in both cases， it is the Japanese government that has“voluntarily” limi ted the exports of its home firms.The first of these dates back to 1981， wh en Tokyo yielded to （屈服于） pressure from Washington by setting a lev el of 1.68 million units on annual Japanese car exports to the USA （then a bout 21 percent of the US market）.Although that VER was scheduled to e xpire after 36 months， it has subsequently been renewed （延长期限） o n a continuing basis and is still in effect with only negligible quantitative ad justments in subsequent years.The second VER in autos is the 1992 agreem ent by which the Japanese agreed to restrict auto exports to 11 percent of th e European Union market for the duration of the 1990s.In both instances， t hese VERs have led Japanese automakers to circumvent （绕过） the trade

barrier by direct foreign investment in overseas“transplants （迁移）” where vehicles are assembled within the protected North American and European markets.More to the point （更重要的是）， these VERs resulted from diplomatic pressure on the Japanese government to rein （严格控制） in their highly successful auto firms.

## 2.Price control measures

Price control measures are implemented to control the prices of imported articles in order to： support the domestic price of certain products when the import price of these goods is lower； establish the domestic price of certain products because of price fluctuation in domestic markets， or price instability in a foreign market； and counteract （抵消） the damage resulting from the occurrence of“unfair” foreign trade practices.Measures intended to control the prices of imported articles consist of

1） Administrative pricing： By administrative price fixing， the authorities of the importing country take into account the domestic prices of the producer or consumer； establish floor （最低） and ceiling （最高） price limits； or revert to determined international market values.There may be different price fixing methods， such as minimum import prices or prices set according to a reference.

2) Variable charges: Variable charges are taxes or levies aimed at bringing the market prices of imported agricultural and food products in line with the prices of corresponding domestic products, such as variable levies (also called flexible import fees), the rate of which varies inversely with the price of imports.

3） Antidumping or countervailing measures： These measures are to offset the effect of dumping or subsidies.They can take the form of price undertakings （承诺） to increase the export price which may be offered by exporters and to avoid the imposition of antidumping duties.Under WTO rules， prices can be negotiated for this purpose， but only after the dumping has been proved.

## 3.Para-tariff measures

Other measures that increase the cost of imports in a manner similar to tariff measures， i.e.by fixed percentage or a fixed amount， calculated res pectively on the basis of the value or the quantity， are known as para-tariff measures.Four groups are distinguished： customs surcharges；additional t axes and charges； internal taxes and charges levied on imports； and decr eed （法定的） custom valuation.

1） Customs surcharges： Customs surcharges， which are also calle d surtax or additional duty， is an ad hoc （临时性的） trade policy instru ment to raise fiscal （财政的） revenues or to protect domestic industries.

2） Additional taxes and charges： Additional taxes and charges are le vied on imported goods in addition to customs duties and surcharges and ha ve no internal （内部的） equivalent，and comprise various taxes and fee s.The category of additional charges includes the tax on foreign exchange tr ansactions， stamp tax， import license fee， consular invoice fee， statis tical tax， tax on transport facilities and charges for sensitive product categ ories.

3） Internal taxes and charges levied on imports： The internal taxes a nd charges include general sales tax， excise taxes （消费税） imposed on selected types of imports， usually of a luxurious or non-essential nature， taxes and charges for sensitive product categories.

4） Decreed （法定的） customs valuation： Customs valuation is a customs procedure applied to determine the customs value of imported goo ds.If the rate of duty is ad valorem， the customs value is essential to deter mine the duty to be paid on an imported good.Some countries raise the cust oms value to limit the importation of foreign goods.For example， America n customs authority levied import duties on some products based on Americ an Selling Price （ASP） System，by which certain products are valued fo r tariff purpose at the level of the domestically produced articles with which they compete.In practice， the ASP has led to protection equal to more than a 100％ rate of duty， although generally it is applied to less than one perc

ent of total United States imports.This system was not abolished until the co nclusion of Tokyo Round Valuation Code[1].

## 4.Finance measures

These are measures which are intended to regulate the access to and co st of foreign exchange for imports and define the terms of payment.They m ay increase import costs in the same manner as tariff measures.

1） Advance payment requirements： Advance payment requirements related to the value of the import transaction and/or import taxes， are mad e at the time an application is lodged （提出）， or when an import licens e is issued.These payment requirements can consist： Advance import depo sits which require the importer to deposit a percentage of the value of the i mport transaction before receiving the goods.No interest is paid on these de posits.

2) Multiple exchange rates: Multiple exchange rates mean varying exc hange rates for imports, depending on the product category.Usually, the offi cial rate is reserved for essential commodities while the other goods must b e paid at commercial rates or occasionally by buying foreign exchange thro ugh auctions.

3) Restrictive official foreign exchange allocation: These restrictions ar e usually executed by the central bank in the form of permits, visas, authori zations, etc., and are intended to control import flows.

4) Prohibition of foreign exchange allocation: No official foreign exch ange allocations are available to pay for imports.

5) Bank authorization: A special authorization needs to be obtained fro m the central bank.

6） Surrender （上缴） requirement： This requirement relates to the surrender of foreign exchange earnings to the central bank.

## 5.Anti-competitive measures

Anti-competitive measures refer to measures to grant exclusive or special preferences or privileges （特权） to one or more limited group of economic operators， for social， fiscal，economic or political reasons.

1) Single channel for imports: The requirement that all imports, or imports of selected commodities, have to be channeled through state-owned agencies or state-controlled enterprises.The private sector is sometimes also granted exclusive import rights.

2) Compulsory national service: Compulsory national service consists of governmentbacked exclusive rights of national insurance and shipping companies on all or a specified share of imports.

## 6.Miscellaneous measures

1) To subsidize import-competing industries

National governments sometimes grant subsidies to domestic industries which are competing with foreign industries.To subsidize import-competing industries refers to, in this instance, a supplemental financial support provided by government to domestic industries.Such devices are an indirect form of protection.By providing domestic industries a cost advantage, a subsidy allows them to market their products at prices lower than warranted by their actual cost or profit considerations.The agricultural industry is commonly subsidized, both in the United States and in other countries including Japan and the EU.

2) Government procurement policy

Government procurements are among the largest customers in the world.According to an estimation of OECD made in 2002， for all levels of government， total expenditure was 19.96 percent of GDP for OECD members， valued at US$4，733 billion.For non-OECD countries，total government procurement accounts for 14.48 percent of GDP， valued at US$826 bil

lion.Most nations require their own government agencies to give some prefe rences to domestically made products.The laws may apply to goods purchas ed by defense-related （与国防相关的）agencies or by the military.Other l aws might require that the purchased product contain proportion of domesti cally made component parts or materials.

In the United States, the U.S.Buy American Act as well as state and loc al Buy American laws allow preferences for the purchase of domestic good s.The federal government is required to buy domestic products unless such purchases are not in the public interest or the costs are unreasonable.The U. S.Department of Defense must purchase domestic products unless those pro ducts are more than 50 percent more expensive than competing foreign goo ds.Japan has come under criticism for its discriminative procurement rules. For the company that is considering bidding on a foreign government procu rement contract, knowledge of the specific rules applicable to the bid is esse ntial.

3) Administrative classification

Because tariffs on goods coming into a country differ by type， the act ual tax charged bans vary according to the category into which a good is cla ssified.There is some leeway （灵活性）for customs officials.For exampl e， in August 1980， the U.S.Customs Service raised the tariff rate on imp orted light trucks by simply shifting categories.Before then， the tariff rate for the unassembled trucks was 4 percent as they were classified as truck pa rts.However， the Customs Service ruled that the imports were not“parts” b ut vehicle itself.The applicable duty to the vehicle was 25 percent.Arbitrary classification decision clearly can influence the size of trade[2].

4) Technical measures

Technical measures include sanitary and phytosanitary （植物检疫的） standards （SPS）and technical barriers to trade （TBT）.Since the early 1990s， many governments have increased their use of SPS and TBT. SPS and TBT are designed to protect human life or health， or animal life o r health （sanitary regulation）， plant health （phytosanitary regulatio

n），environment and wildlife， human safety and national security， etc. Examples of SPS and TBT are：

（a） Labelling （标签）， marking （标记） and packing requirements： Labelling requirements regulate the kind， color and size of printing on consumer packages and labels， etc.Marking requirements define the information that the transport/distribution packing of goods should carry.Packing requirements regulate the mode in which goods must be or cannot be packed and the packing materials to be used.

（b） Traceability （溯源性） requirements： Traceability is the disclosure of information regarding the origin of live animals and animal products as well as for agricultural products，including product processing history， and the distribution and location of the product after delivery.It aims to track through all phases of production and distribution.

（c） Tolerance （公差） limits for residues （残留物） of or contamination （致污物） by certain substances in foods and feeds： The limits include Maximum Residue Limits （MRL） for toxic（有毒的） and other harmful substances and contaminants that enter the product during the production and/or distribution processes and restricted use of certain substances in foods and feeds， restriction on the use of certain substances as ingredients （原料）.

（d） Hygienic requirement： Restrictions to avoid contamination by microorganisms （微生物） and parasites （寄生虫） in foods and feeds that cover production， manufacturing， transport and storage conditions.

（e） Restriction/prohibition in case of outbreak （暴发） of infectious （有传染的） diseases，including measures to protect animals， humans and plants from any infectious/contagious （有传染性的） diseases.

（f） Quarantine （检疫） requirement： Requirement to quarantine imports for a certain period.It is not a prohibitive measure.Quarantine supposes （包含） also quarantine fees，inspection fees， veterinary （医家畜的） fees， fumigation （熏蒸） etc.

Available estimates indicated that at least 10 percent of export losses f or developing countries as a group resulted from SPS/TBT measures.These measures severely restricted trade， in many cases totally blocking exports. Control measures such as those in the area of SPS， meant to protect huma ns， animals and plants， often exceed multilaterally accepted norms（标准）.Thus， there have been instances of some developing countries' consi gnments of prawns and frozen seafood being rejected by certain developed countries， which insisted on a zero bacteria （细菌） count instead of a minimum acceptable level， as per international standards.It is noteworthy （值得注意的） that prawns and seafood products exported by the same c ompanies have encountered no such problems in some other developed cou ntry markets.

Technical barriers to trade （TBT） have also arisen when standard s， regulations and assessment systems intended to ensure safety are not ap plied uniformly.Experience has shown that duplication of testing procedures that do not add value to a product adds to the cost of compliance.Several re gulations in developed countries apply stringent （严格的） rules on food quality， packing and labelling.Exports of poultry products， for exampl e， have been particularly affected by such sanitary regulations， which en compass （涉及） rules pertaining （与……有关系的） to equipment an d methods used in the processing and packing of the product.Obtaining appr ovals is a lengthy （漫长的） process that involves substantial documentat ion and tedious（冗长的） bureaucratic （官僚的） procedures.It has tak en some developing countries' exporters of meat products two years to get a pproval.However， NTBs are encountered not only in developed country m arkets but also in developing countries.

According to an International Trade Center study, many developing co untries and LDCs appear to be the most exposed to NTBs.The six most freq uently reported NTBs surveyed in developing countries were: 1) Technical measures (TBT and SPS); 2) Customs rules and procedures; 3) Competition -related restrictions on market access ("entry barriers"); 4) Import licensing; 5) Subsidies; and 6) Trade defense instruments (AD, CVD and safeguards).

Table 6-1 Forms of non-tariff barriers to trade

| | |
|---|---|
| Quantity Control Measures | Non-Automatic License |
| | Quotas |
| | Quantitative Safeguard Measures |
| | Prohibitions |
| | “Voluntary” Export Restraint |
| Price Control Measures | Administrative Pricing |
| | Variable Charges |
| | Antidumping or Countervailing Measures |
| Para-Tariff Measures | Customs Surcharges |
| | Additional Taxes and Charges |
| | Internal Taxes and Charges Levied on Imports |
| | Decreed Customs Valuations |
| Finance Measures | Advance Payment Requirement |
| | Multiple Exchange Rates |
| | Restrictive Official Foreign Exchange Allocation |
| | Prohibition of Foreign Exchange Allocation |
| | Bank Authorization |
| | Surrender Requirement |
| Anti-Competitive Measures | Single Channel for Imports |
| | Compulsory National Service |
| Miscellaneous Measures | Subsidies to Import-Competing Industries |
| | Government Procurement Policy |
| | Administrative Classification |
| | Technical Measures |

## 6.2 Effects of Non-tariff Barriers

Although identification and analyses of non-tariff barriers have significantly evolved （演变）， understanding their nature， extent and trade effects remains a challenge for analysts and policymakers.Why and how are particular measures used？ What are their economic effects on importing countries？ Here we analyze the effects of two commonly employed non-tariff measures： an import quota and a subsidy to an import-competing industry.

# 1.The effects of an import quota

As you recall, a quota operates by limiting the physical amount of the good imported.This reduces the quantity available to consumers, which in turn leads to the increase of the domestic price.The domestic price continues to rise until the quantity supplied domestically at the higher price plus the amount of the import allowed under the quota exactly equals the reduced quantity demanded.The quota thus restricts quantity supplied, causing price to adjust,in contrast to a tariff, which induces a quantity adjustment by fixing a higher domestic price.The market effects in the two cases are exactly the same.

Return to Figure 5-3 in Chapter 5.The tariff imposed by a small importing country caused the domestic price to rise from $P_w$ to $P_d$ and the quantity of imports to decline from($S_1D_1$) to ($S_2D_2$), as domestic quantity supplied increased and domestic quantity demanded decreased.The imposition of a quota of $S_2D_2$ units would have produced the very same result!With imports restricted to $S_2D_2$ units, the domestic price will rise and continue to rise until the combination of domestic quantity supplied and the quota-restricted imports equal quantity demanded.Thus, every quota has an equivalent tariff that produces the same market result, just as every tariff has an equivalent quota.[3]

Since the price and quantity adjustments are the same under both instruments， the changes in producer surplus， consumer surplus， and the consequent welfare loss are also the same.However， the welfare implications are not.The government revenue effect is， however，not the same.With a

tariff， the government receives revenue equal to the amount of the tariff ti mes the quantity of imports.But under quota no such tax is collected.In effe ct， the product（乘积） of the difference between the domestic price and the world price of the imported good times the quantity of imports is an quo ta rent， which is the economic rent[4] received by the holder of the right （or license） to import under a quota.

Then， to whom may the economic quota rent accrue （获利）？ Th e home government captures the entire quota rent if it sells the licenses und er an auction quota system （which must take place in a competitive enviro nment） to those who wish to import the good at a price equal to the differe nce between the world price and the higher （quota-distorted） domestic pr ice.This generates government revenue equal to that achieved with the equi valent tariff.However， in such case， administrative costs become additio nal deadweight losses.Domestic importers will receive the rent if they obtai n the import licenses freely from the government and the foreign suppliers d o not organize to raise the export price.Foreign suppliers receive the quota r ent if they behave in a non-competitive， monopolistic manner.It is also po ssible that the foreign government receives the quota rent if it steps in and d evises a scheme for allocating the supply of exports.For example， the fore ign government sells export licenses at a price equal to the difference betwe en the world price and the domestic price in the quota-imposing country.

As shown in Figure 6-1, the welfare effects of an import quota are: The producer surplus gain is represented by the area of“a”, the consumer surplus loss is represented by the area of“a+b+c+d”.The area of“c” represents the e conomic rent.Thus the net welfare of an import quota is represented by the s ummation of area of“b” and“d”.

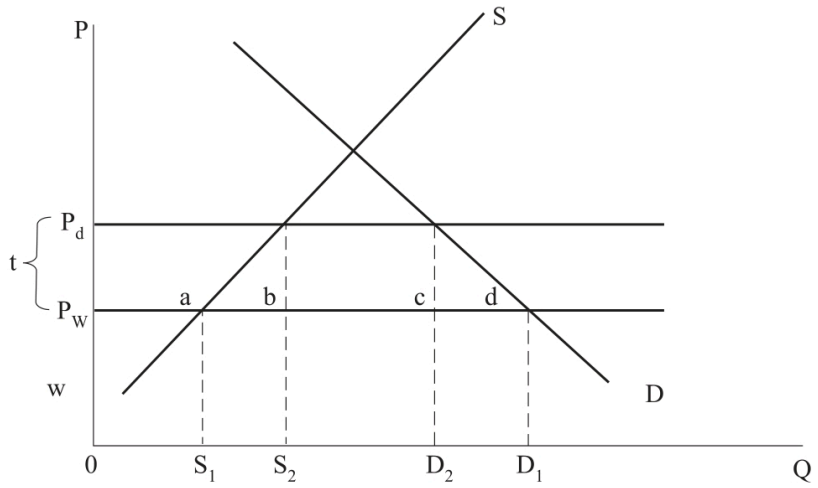



Figure 6-1 The welfare effects of an import quota in a small country

## 2.The effects of a subsidy to an import-competing industry

Figure 6-2 illustrates the welfare effects of a production subsidy grante d to an importcompeting industry.Suppose the government grants home pro ducers a production subsidy of t per unit.The subsidy has the effect of shifti ng supply curve S down vertically by t to S′.Domestic production expands f rom $S_1$ to $S_2$.At the output of $S_2$, the net price to the home producers is $P_d$ (w hich is called“producer price”)—the sum of the price paid by the consumer ($P_w$) plus the subsidy (t).Note, however, that there is no change in the domes tic market price;it remains equal to the world price in the case of a domestic producer subsidy.Thus there is no loss in consumer surplus and no deadwei ght loss for consumers.To the home government, the total cost of protecting its producers equals the amount of the subsidy times the amount of domesti c output ($S_2$), represented by the area“a+b”.Where does this subsidy revenu e go? Part of it is redistributed to the more efficient home producers in the f orm of producer surplus.This amount is represented by area“a” in the figur e.There is also a protective effect, whereby much costly domestic output is allowed to be sold in the market as a result of the subsidy.This is represente

d by the triangle“b” in the figure.To the importing country as a whole, the p rotective effect represents a deadweight loss of welfare.

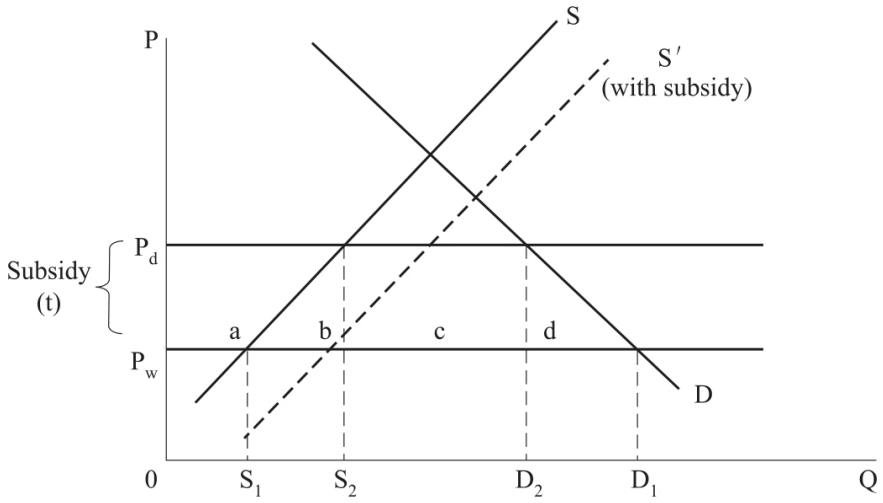



Figure 6-2　The welfare effects of a subsidy to an import-competing industry

From a welfare standpoint, the production subsidy certainly is more att ractive than a tariff or quota.A subsidy tends to yield the same result for do mestic producers as does an equivalent tariff or quota, but at a lower cost in terms of national welfare.If the consumers are also the taxpayers, the cost of the subsidy (area“a+b”) is less than the loss in consumer surplus (area“a+b+ c+d”) that results from either a tariff or a quota.

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[1]Tokyo Round Valuation Code is a code of conduct negotiated during the Tokyo Round to establish a uniform， fair and predictable international system for the valuation of goods for customs purpose s， and to preclude （阻止） the use of arbitrary national valuation systems as non-tariff barriers to trade.Also known as the GATT Valuation Code， the code establishes the“transaction value”—or the price actually paid or payable for imported goods plus certain permitted additional costs—as the prim ary method of valuation by customs officials and specifies a hierarchy of other methods to be employ ed when the transaction value cannot be used.The code also contains technical provisions intended to ensure equitable currency conversion，rapid clearance of goods when there are delays in determinin g the value of imported goods， domestic appeal rights， and publication of laws and regulations aff ecting customs valuation.

[2]Cited from Dennis R.Appleyard， Alfred J.Field， Jr.， International Economics， P246， publi shed by China Machine Press， 4th edition.

[3]This is not true over time after any initial equivalence.For example, if home consumer demand ris es, no larger quantity of imports can come into the country with the quota (assuming no change in the size of the quota), but a tariff permits more imports as the demand curve shifts out.

[4]Economic rent is the premium that the owner of a resource receives over and above its opportunity cost.

# Chapter 7 Export Promotion and Other Policies

Learning Objectives

In this chapter, you will learn:

- Effects of export subsidies and production subsidies
- Other export promotion policies
- Objectives and effects of export restrictions
- Objectives of import promotion policies
- Factors that influence the effects of trade sanctions

While governments tend to restrict imports by imposing tariffs or by taking various forms of non-tariff measures, they usually adopt many policies to promote exports.Governments may also promote imports and restrict exports for some particular objectives.

This chapter first makes in-depth analysis on two primary export promotion policies:export subsidies and production subsidies, and then introduces some other export promotion polices.After that, it explains why countries sometimes restrict exports and promote imports.Finally, trade sanctions are discussed.

## 7.1 Export Subsidy and Production Subsidy

### 1.Export subsidy and its effects

(1) Direct export subsidy and indirect export subsidy

An export subsidy （补贴） is a payment by the government to encourage the export of specified products.Export subsidy can either be a direct subsidy or an indirect subsidy.

Direct subsidy includes price subsidy and income subsidy.Price subsidy is a direct payment made against the export value or quantum.For example, a subsidy of $1 is paid for each $100 worth of exports.Payment for the difference between the domestic price and the international market price of an export is another example of price subsidy.Income subsidy is,however, the payment for export losses.

Indirect subsidy is intended to encourage a nation's exports by reducing the price paid by foreigners.It includes special tax exemptions such as export tax rebate and the provision of capital at favored rates, etc.For example, since 1985, China has adopted tax rebates for exporting enterprises.The central government pays back a certain proportion of the consumption taxes and value added tax (VAT) to the enterprises after they pay taxes for exported goods.In 1994, in order to stimulate exports, China established the Export-Import Bank of China (China Eximbank) to provide export seller's credit (to Chinese exporters) and export buyer's credit (to foreign importers) at rates lower than commercial rates.

(2) The effects of an export subsidy

The effects of an export subsidy in a small country differ from that of a large country.Figure 7-1 depicts the case of an export subsidy imposed by a small country.When there is no subsidy, the domestic supply and demand are $S_1$ and $D_1$ respectively, and the export is $X_1$.With an export subsidy being in place, firms receive a per-unit payment only when they export the good.Thus, domestic suppliers are given the incentive to shift sales from the domestic to foreign markets to receive the government subsidy.And they will sell to their own home market only if they receive a price equal to the revenue per unit, i.e.the world price plus the subsidy ($P_w$+s).The final result is that the export subsidy reduces the quantity sold in the domestic market, increases t

he price in the domestic market to where it equals the world price plus the s ubsidy ($P_w$+s), and increases the quantity supplied by producers as they resp ond to the higher price, leading finally to increased exports $X_2$.

The rise of domestic price will obviously lead to a decrease of consum er surplus which is(a+b) and an increase of producer surplus by (a+b+c), res ulted from consumer surplus (a +b)and part of government subsidy c.The to tal government subsidy is, however, (b+c+d).So the net welfare of an export subsidy is a deadweight loss of (b+d).

Figure 7-2 depicts the effects of an export subsidy“t” granted by a larg e country.The increase of exports by large country has an impact on world p rice, making it drop to $P'_w$.The effects are as follows: consumer surplus loss (a+b), producer surplus gain (a+b+c),government subsidy (e+b+f+c+g+d).T hus the whole welfare effect is a deadweight loss of(e+b+ f+g+d).

Since (e+b) is equivalent to b in the small country setting and (g+d) is equivalent to d in the small country setting, the actual deadweight loss of th e large country is greater than that of the small country.Therefore, export su bsidy might be an unwise policy for a country which has already large share in the world market.

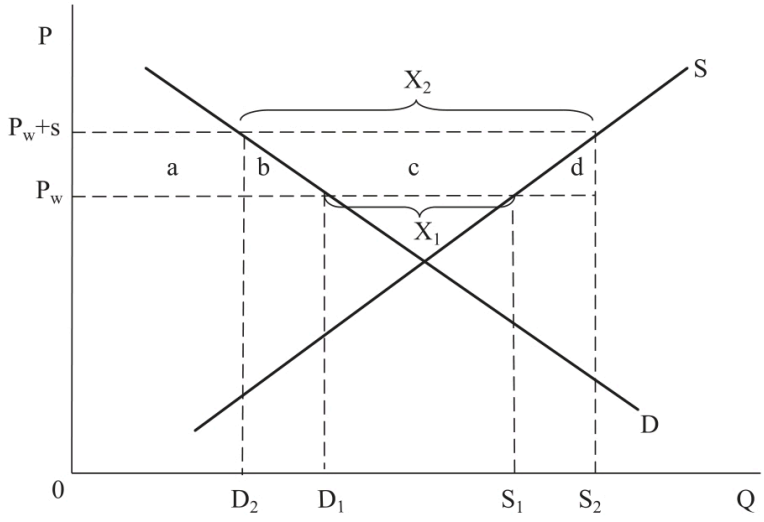



Figure 7-1 Effects of an export subsidy in a small country

When an export subsidy“s” is put in place in a small country, the world price is not impacted.But the domestic price increases by“s” dollar.The consumer surplus is reduced by (a+b), producer surplus is increased by (a+b+c+d) and government subsidy is(b+c+d).The whole welfare effect is a deadweight loss of (b+d).

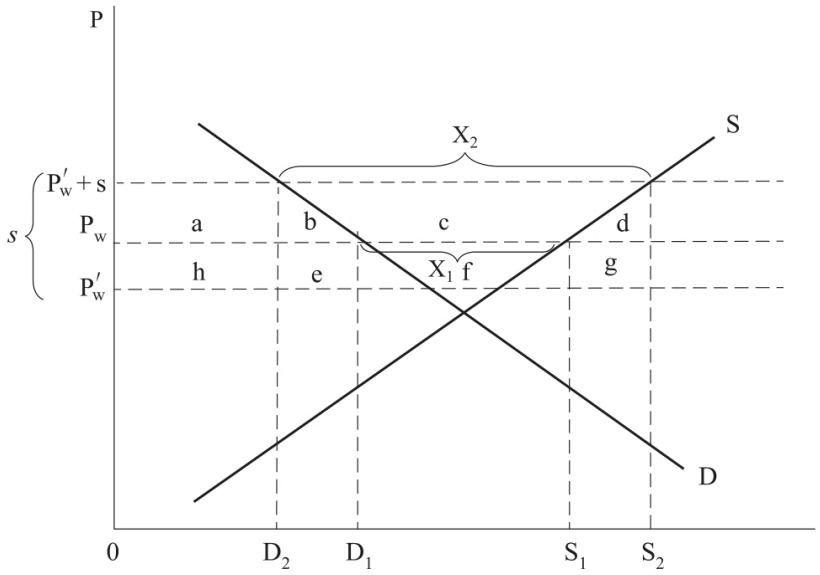



Figure 7-2 Effects of an export subsidy in a large country

When there is an export subsidy“s” in a large country, the world price drops to $P'_w$ and the domestic price rises to $P'_w$ +s.

The consumer surplus is reduced by (a+b), the producer surplus is increased by (a+b+c) and government subsidy is (e+b+f+c+g+d).The whole welfare effect is a deadweight loss of (e+b+f+g+d).

## 2.Production subsidy and its effects

A production subsidy is a payment made by a government to firms in a particular industry based on the output or production.The subsidy can be specified either as an ad valorem subsidy (% of the value of production) or as a specific subsidy (dollar payment per unit of output).Production subsidy is different from export subsidy in that it provides a payment based on all production regardless of where it is sold.The export subsidy, on the other hand, only offers a payment to the quantity or value that is actually exported.Production subsidies include direct modes such as direct payment to a firm, tax rebate, and indirect modes like offering land or office at favorable rates or ev

en free, discount for electricity and communication fees and favorable conditions for bank loans, etc.

Production subsidies are generally used for two main reasons.First， subsidies provide a way of raising the incomes of producers in a particular industry.This is in part why many countries apply production subsidies on agricultural commodities： because it raises the incomes of farmers.The second reason to use production subsidies is to stimulate output of a particular good.This may be done because the product is assumed to be critical for national security.This argument is sometimes used to justify （对……作出解释） subsidies to agricultural goods， as well as steel， motor vehicles and many other commodities.Countries might also wish to subsidize certain industries if it is believed that the industries are important in stimulating growth of the economy.This is the reason many companies receive research and development subsidies.Although R&D subsidies are not strictly production subsidies， they can have similar effects.

Figure 7-3 depicts how a production subsidy promotes exports in a small country.Curves S and D represent the supply curve and demand curve of Country A respectively.Under free trade, the supply and demand of the country are $S_1$ and $D_1$ respectively, and total export is $X_1$.Assume now the government offers a production subsidy“s” dollars.This means the government will pay“s” dollars for every unit the domestic firm produces, regardless of where the product is sold.

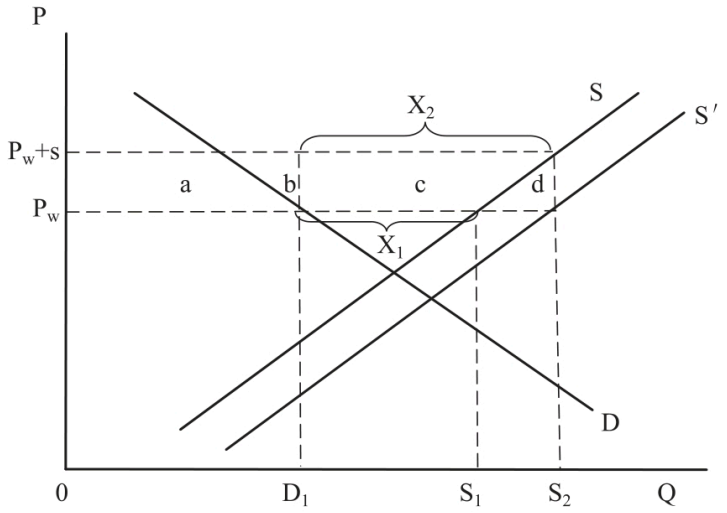



Figure 7-3 Effects of a production subsidy in a small country

When a production subsidy“s” is put in place in a small country, the world price is not impacte d.The consumer surplus does not change, the producer surplus is increased by (a+b+c) and the government subsidy is (a+b+c+d).The whole welfare effects are a deadweight loss of (d).

The subsidy effectively raises the price that the producer receives for e ach unit of the good produced and sold (we’ll call this the producer price), which is equivalent to (as good as)a“s” dollars reduction in production cost. The supply curve shifts down vertically“s”dollars.If the world price does no t change, the supply will be $S_2$.The domestic price charged by the producer will still be $P_w$, i.e.the subsidy will not have an effect upon the domestic pri ce that consumers pay.In other words, the subsidy will cause the producer p rice to rise above the price paid by consumers (called the consumer price).T he new producer price is labeled $P_w$+s in the diagram, while the consumer p rice, remains equal to the free trade price $P_w$ and the demand remains equal to the free trade quantity $D_1$.Thus the production subsidy expands exports fr om $X_1$ $X_2$.

Since the price paid by the consumers remains equal to the free trade p rice $P_w$, there is no consumer surplus loss.The producer surplus increases by (a+b+c).The government expenditure of subsidy is (a+b+c+d).The net welfa re effect is a deadweight loss of d.From the perspective of the whole social

welfare, production subsidy is better than export subsidy.But production sub sidy requires more expenditure by the government than export subsidy.

Box 7-1

The EU's Agricultural Export Subsidies

Under the Common Agricultural Policy (CAP) of the EU, the EU spen ds 43 billion euros a year to its farmers in agricultural export subsidies and price supports.These market distortions encourage and result in overproduct ion in the EU and the subsequent dumping of surplus agricultural products on the world market.For example, the EU is one of the largest exporters of milk and milk products because it spends 16 billion euros of its annual budg et on its dairy program.The average EU cow is said to receive a $2.20 daily subsidy, more than the daily wage of 20 percent of the world's population.

Export subsidies allow producers to sell at below cost， often undercu tting local farmers and crushing markets in places such as Kenya， India an d Jamaica.The same applies to the production of sugar.In 2002， the cost of production in the EU was two to three times that of South Africa but subsidi es lowered this cost for European farmers to only one-third of that of South African producers.According to the Wall Street Journal， the resulting over production and dumping significantly lowered world sugar prices by 2 0%， reduced the income of South African farmers by one-third， and cost the country 100 million euros in potential exports.This chronic （长期的） oversupply of agricultural products from the EU depresses world prices and limits market access.

Source: Josephine Nguyen, The Generalized System of Preferences, http://i nternational.com/ students/ JNguyen.pdf.

## 7.2 Other Export Promotion Policies

In addition to the policies discussed above, several other export policie s are also commonly adopted in most countries.These include: 1) Devaluati

on of home currency; 2) Commodity dumping; 3) Special trade zones; 4) E xport promotion programs.

## 1.Devaluation of home currency

Devaluation of home currency is an official lowering of the value of a country's currency.For a currency to be devalued means that the issuing gov ernment has mandated that the price of the currency (in foreign dollars) is lo wer than it was before.For example: if the Chinese government changes the exchange rate from RMB680=USD100 to RMB780=USD100, then the Ren minbi has been devalued.

Generally, a stronger home currency would make home exports more e xpensive in other countries, and it would reduce the cost of home imports.S o a stronger home currency would benefit home importers and the producer s and final consumers who need import commodities.A weaker home curren cy would ease exporters and related producers and make home products mo re competitive because they are cheaper for foreigners.

However， whether the policy of devaluation of home currency can be successful depends on two conditions： 1） The goods exported has big ex port price elasticity； 2） Trading partners do not retaliate （报复）.

## 2.Commodity dumping

As previously noted， commodity dumping is an international price di scrimination which takes place when a producer sells a commodity abroad a t a price lower than that charged in his domestic market.In general three typ es of dumping can be distinguished：sporadic （偶发性的）， predatory （掠夺性的）， and persistent （持续性的）.

1) Sporadic dumping: Sporadic dumping means a firm sells a temporar y surplus of its production at whatever price it is able to get (i.e.possibly bel ow the production cost).As the name suggests, sporadic dumping occasional ly occurs, when a producer who happens to have unsold stocks (e.g.because

of bad production planning or unforeseen changes in demand) and wants to get rid of them without spoiling the domestic market, selling them abroad at reduced prices.

2） Predatory dumping： Predatory dumping takes place when a firm sells at low price in order to eliminate competition and eventually to reap （获得） monopolist profits.Of course this firm will also suffer losses but —if he is successful—can raise the price to monopoly level， once competi tors leave the market.This type of dumping is therefore， only temporary.

Naturally predatory dumping is difficult， if not impossible to achieve if the market is perfectly competitive.Even under oligopolistic situations， i t may be difficult to deter （制止）entry.Only if there are significant barrie rs to entry （perhaps by the government） is this remotely possible.

3） Persistent dumping： Persistent dumping means a firm who enjoy s domestic monopolistic power exploits （利用） the possibility of price di scrimination between domestic and foreign markets in order to maximize pr ofits.

Consider the case of a domestic seller that enjoys market power as a re sult of barriers that restrict competition at home.Suppose this firm sells in fo reign markets that are highly competitive.This means the domestic consume rs response to a change in price is less than that abroad; the home demand is less elastic than the foreign demand.A profit-maximizing firm would benefi t from international price discrimination, charging a higher price at home, w here competition is weak and demand is less elastic, and a lower price for th e same product in foreign markets to meet competition.This practice results in increased revenues and profits as compared to what would occur in the a bsence of price discrimination.Price discrimination is viable only if there ar e no ways for consumers in the high-price market to buy the product from t he low-price market, and if policymakers in the importing country do not i mpose antidumping duties.

For example, the Japanese producer of telephones is a monopolist who uses price discrimination to maximize profits in the two markets.The firm c harges a higher price in the Japanese market where the demand curve is less

elastic.In the more elastic (more competitive)U.S.market, the firm charges a lower price for its exported product.

In the home market in Japan, consumers see fewer substitutes.The prof it-maximizing price (when marginal cost equals marginal revenue) is at $60 in Japan.At a price of $60 Japanese consumers buy 100 telephones.The prof it the firm earns in Japanese market is the shaded rectangle in Figure 7-4 (a).In the more elastic (more competitive) U.S.market, the firm charges a lo wer price of $25 for its exported product.At a price of $25 American consu mers buy 150 telephones.The profit the firm earns in the U.S.market is the s haded rectangle in Figure 7-4 (b).Total profits are the sum of the two shaded rectangles.

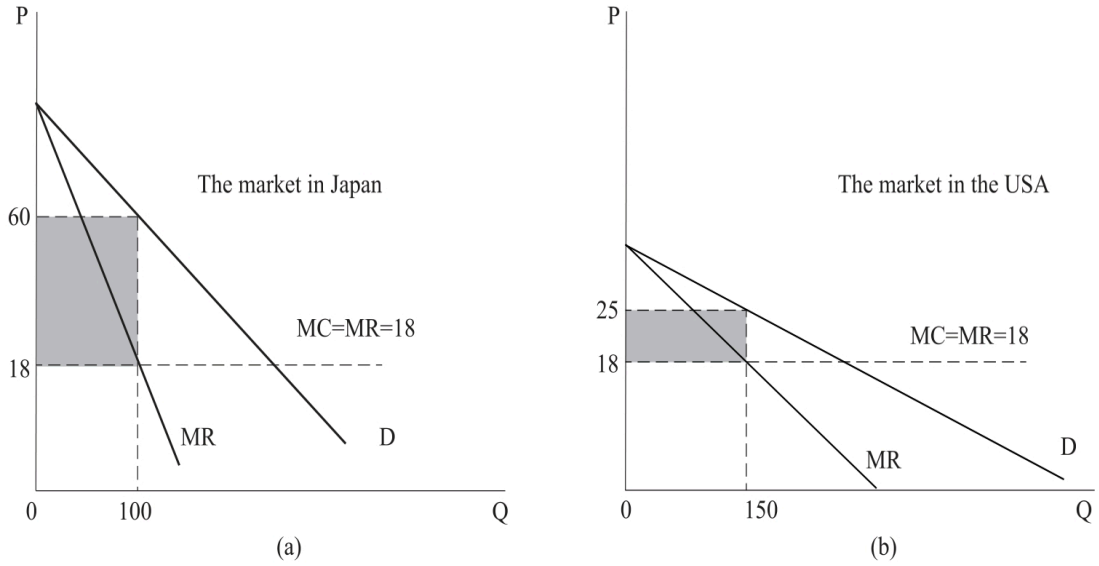



Figure 7-4 Persistent dumping

## 3.Bonded warehouse

Bonded warehouse （保税仓库） refers to the warehouses that are est ablished upon approval of the customs for exclusive keeping of bonded goo ds and other goods that have not gone through customs clearance[1].

Before the establishment of bonded warehouses， payment of duties o n imported goods had to be made at the time of importation， or a bond wit

h security for future payment given to the revenue authorities.The inconveni ences of this system were many： it was not always possible for the import er to find sureties （担保）， and he had often to make an immediate sale of the goods， in order to raise （筹募） the duty， frequently selling whe n the market was depressed （不景气的） and prices low.The duty， havi ng to be paid in a lump sum （一次付清），raised the price of the goods b y the amount of the interest on the capital required to pay the duty， etc.

The common practice of storing goods in bonded warehouses has seve ral advantages.First of all， and most important， the importers can store t heir goods without having to pay the immediate （直接的） duties on the m.Moreover， if the importer sells the products for re-export，they do not have to pay any duties at all.By placing the goods in a bonded warehouse th at has adequate insurance， the value of the goods will be covered should t hey get damaged or destroyed while in storage.This covers such events as fi res， flooding， or other means.If the products are damaged or destroye d， then the importer does not have to pay custom duties.Custom duties are not cheap， especially on imported shipments of large quantities.By having bonded warehouses， it frees up cash flow for importers.They can also take their time to market their goods properly to get the best price possible.

Bonded warehouses are subject to specific laws which vary from count ry to country and state to state.These laws cover who can use bonded wareh ouses and what kind of goods can be stored there.Specific ports may also ha ve their own set of regulations that bonded warehouse operators need to abi de by.This may include proof of insurance, adequate security systems, safet y measures for fire prevention.

In China， the goods stored in a bonded warehouse may go through si mple processing，such as packing， grading and classification， adding sh ipping marks， dismantling （拆卸）， and assembling （组装）， et c.， but no substantial processing may go through.Without the approval of t he customs office， the goods stored in a bonded warehouse may not be sol d， transferred，mortgaged （抵押）， pledged （典当）， kept as lien [2] （留置）， used for any other purpose or disposed of （被处理） other wise.

# 4.Special trade zone

Special trade zone, also called bonded area or free trade area.It is an area where foreign goods may be held or processed and then re-exported without incurring duties.The zones can be found at major ports of entry and also at inland locations near major production facilities.

Special trade zones are designed to exclude the impact of duties.This is done by exempting （使免除） merchandise in the special trade zone from duty payment.The international firm can therefore import merchandise， store it in the special trade zone， and process， alter， test，or demonstrate it—without paying duties.If the merchandise is subsequently shipped abroad（that is re-exported）， no duty payments are ever due （应支付的）. Duty payments become due only if the merchandise is shipped into the country from the special trade zone.

The advantages of the existence of trade zones can be quite useful to the international firm.For example， in particular country， the benefits derived （得到） from lower labor costs may be offset （抵消） by high duties and tariffs.As a result， location of manufacturing and storage facilities in that country may prove uneconomical.

Trade zones can also be useful as transshipment points to reduce logistics （物流） cost and redesign marketing approaches.For example， an American company was shipping small quantities of car alarms from a contract manufacturer in China’s Taiwan directly to distributors in Chile.The shipments were costly and the marketing strategy of requiring high minimum orders stopped distributors from buying.The firm resolved the dilemma （困境） by using a Miami trade zone to ship the alarms from Taiwan Province of China and consolidate （合并）the goods with other shipments to Chile. The savings in freight costs allowed the Chilean distributors to order whatever quantity they wanted and allowed the company to quote lower prices.As a result， sales improved markedly （显著地）.

All parties to the arrangement benefit from special trade zones.The government maintaining the trade zones achieves increased employment and in

vestment.The firm using the trade zones obtains a spearhead （先锋） in th e foreign market without incurring （承担） all of costs customarily （通常） associated with such an activity.As a result， goods can be reassembl ed， and large shipments can be broken down into smaller units.Also， go ods can be repackaged when packing weight becomes part of the duty asses sment.Finally， goods can be given domestic“made in” status if assembled in the special trade zones.

In addition to special trade zones， governments also have established export processing zones and special economic areas.The common dimensio ns （特点） for all the zones are that special rules apply to them when com pared with other regions of the country， and the purpose of these special r ules lies in the government’s desire to stimulate the economy， particularly the export side of international trade.

Export processing zones usually provide tax and duty free treatment fo r production facilities whose output is destined abroad.China has used trade zones very successfully for its own economic development.Through the cre ation of special economic zones， which are exempt from tariffs and enjoy substantial tax incentives （鼓励）， and low prices for land and labor， t he government has attracted many foreign investors bringing in billions of d ollars.The investors have brought new equipment， technology， and man agerial know-how and have substantially increased the local economic pros perity （繁荣）.

Box 7-2

Special Economic Zones in the People’s Republic of China

Between 1980 and 1984 China established special economic zones (SE Zs) in Shantou,Shenzhen, Zhuhai in Guangdong Province, Xiamen in Fujia n Province and designated the entire island province of Hainan a special eco nomic zone.

In 1984, China opened 14 other coastal cities to overseas investment (l isted north to south): Dalian, Qinhuangdao, Tianjin, Yantai, Qingdao, Liany ungang, Nantong, Shanghai,Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhanji ang, and Beihai.

Then, beginning in 1985, the central government expanded the coastal area by establishing the following open economic zones (listed north to sout h): Liaodong Peninsula,Hebei Province (which surrounds Beijing and Tianji n), Shandong Peninsula, Yangtze River Delta Xiamen-Zhangzhou-Quanzho u Triangle in southern Fujian Province, Pearl River Delta,and Guangxi.

In 1990, the Chinese government decided to open the Pudong New Zo ne in Shanghai to overseas investment, as well as more cities in the Yangzi River Valley.

Since 1992, the State Council has opened a number of border cities an d all the capital cities of inland provinces and autonomous regions.

In addition, 15 free-trade zones, 32 state-level economic and technolog ical development zones, and 53 new and high-tech industrial development z ones have been established in large and medium-sized cities.As a result, a m ultilevel diversified pattern of opening and integrating coastal areas with riv er, border, and inland areas has been formed in China.

## 5.Export promotion programs

Government-supported national export promotion programs are comm on around the world.The range of export promotion activities offered by dif ferent governments reflects the imagination of the operatives designing and delivering these programs.Activities include organizing trade exhibitions, ar ranging group visits overseas, delivering market information to firms, provi ding contact details of potential customers, agents or distributors, conductin g“how to export” workshops, preparing publications on exporting and mark ets, allocating operatives to assist particular firms develop export plans.

Box 7-3

The U.S.Export Promotion Program

A major actor in fostering U.S.exports is the Trade Promotion Coordin ating （协调）Committee （TPCC）.Created in 1993 to develop and coor dinate U.S.export promotion programs， the TPCC has an annual budget in

excess of $2 billion.It works one-on-one with U.S.exporters requesting government assistance in bidding competitions.TPCC tracks （跟踪） projects worldwide， provides counseling （咨询服务）， and coordinates advocacy （支持） ranging from trade missions to visits， telephone calls， and letters from U.S.officials.

As one might imagine， direct monetary support is popular with U.S.exporters.Examples of grants and subsidies for exporters include the Market Access Program（MAP） and the Export Enhancement Program （EEP） of the U.S.Department of Agriculture.The MAP， established in 1990， has an annual budget of $100 million and provides partial defrayment （支付） of the costs of market building and product promotion overseas.The EEP， which was established in 1985 and is budgeted to receive $500 million in 1998， pays cash bonuses （奖金） to exporters of certain U.S.agricultural commodities.

In addition， the U.S.Export-Import Bank plays a role in Washington’s support of U.S.transnational corporations （TNCs 跨国公司） by providing direct loans and loan guarantees for up to 85％ of the export value of U.S.goods and services.This financing goes to foreign buyers of U.S.exports and is intended to help U.S.companies win sales.The U.S.Trade and Development Agency signs agreements with host country agencies to provide U.S.government funding for feasibility （可行性） studies of major development projects in sectors such as telecommunications and energy.In all， more than 20 federal agencies collect information about foreign markets.The one-stop source for much of the data is the National Trade Data Bank （NTDB）， which is updated monthly.

The Commerce Department has established U.S.Commercial Centers in China,Indonesia, and Brazil to provide one-on-one business counseling and export assistance to U.S.companies.The Commerce Department also offers a fee-based research service that provides firms with specific information on marketing their individual products in selected countries.

The Trade Promotion Coordinating Committee （TPCC） is charged with （承担） providing a unifying interagency framework to coordinate

U.S.export promotion activities and develop a government-wide strategic pl an.TPCC member agencies provide a wide range of export promotion activi ties， including the Department of Commerce’s advice and advocacy to bus inesses during the export process， the Department of Agriculture’s financi ng for promotional activities， and the Export-Import Bank’s （Ex-Im） lo an guarantees for foreign buyers of U.S.exports.

Source: Janice C.Shields, Export Promotion Programs, Foreign Policy In Focus, Interhemispheric Resource Center and Institute for Policy Studies, V olume 2, Number 34 May 1997.http://www.fpif.org/briefs/vol2/v2n34exp.ht ml.

Box 7-4

China’s Export Promotion Strategy

Since 1978， China has introduced （采取） a variety of policies to s timulate exports，including repeated devaluation of renminbi， tax rebate s， fiscal subsidies， preferential access to credit， low-priced energy and raw materials， and direct rewards.Export growth had become a fixed conc ept in official documents.The Eighth Five-year Plan proposed a“machinery export promotion” strategy， designed to improve product quality and adju st the export structure towards one more reliant on higher value-added man ufactured goods， in particular machinery，electrical， high-tech product s.The government set up the National Foreign Trade Development Fund and contributed RMB60 million each year to subsidize upgrading in order to fac ilitate exports of machinery.

On February 1999， the government initiated“marching out” （“走出去”） strategy，encouraging domestic enterprises to set up overseas R.&D. institutions and invest overseas.Part of the strategy was aimed explicitly at building multinational companies that could compete in world markets with the leading corporations of the advanced industrialized countries.Soon after that， the State Economic and Trade Commission （SETC） promulgated （颁布） the“List of Famous Brands and Supported Export Products”， co vering twenty-nine kinds of products， mainly in the categories of domesti c appliances and textiles， which were considered to enjoy comparative ad

vantage in the world market.The facilitates included：priority access to allo cations from the Foreign Trade Development Fund and import quotas as we ll as subsidies for technical upgrading， including reducing or eliminating t he tax or tariff on imports essential for export activities； priority in approv al for exports including customs procedures and for business trips.The tax r ebate rate for textiles， certain light manufactured products and domestic a ppliances was increased from 9 percent to 11 percent in 1998.

Source: Lin Liu, China's Industrial Policies and the Global Industrial Revol ution, the Case of the Domestic Appliance Industry, first published by Routl edge, 2005, P28-29.

Box 7-5

Export Tax Rebate: A Trade Policy Tool for Promoting Exports

Export tax rebates are an important trade policy tool for promoting exp orts.They entail（必然伴有） the refund （退还） of value-added tax and consumption tax already paid on exported goods during production， circul ation （流通） and sales.The aim is to let the exported goods enter the inte rnational markets at tax-excluded prices without being subject to double tax ation， so as to promote export trade.Export tax rebates are allowed by the rules of the World Trade Organization and are commonly adopted by many countries.

China began implementing export tax rebate policy in 1985.In its 1994 tax system reform， the zero tax rate policy for exported goods has been de clared.China's Provisional （暂行的） Statute （条例） for Value-added Tax also stipulates a zero tax rate for exported goods； its Provisional Statu te for Consumption Tax stipulates a consumption tax exemption for taxable consumer goods designated for export.The Chinese government also drafted relevant provisions and measures， including the Regulations Governing E xport Tax Rebates （Exemption）， which specifies the refund or exempti on of value-added tax and consumption tax for exported goods.Presently the export tax rebate in China applies mainly to the refund of value-added tax （VAT） and consumption tax already levied during the domestic producti on or sales of exported goods.

In light of （根据） the fact that the consumption tax applies to only a few consumer goods，the export tax rebate predominantly （占主导地位地） covers VAT paid.Value-added tax in China is levied by three categories： a 17％ basic rate applied to general goods， processing and repair service； a lower 13％ rate applied to farm produce， feeds， chemical fertilizers，medication， household water consumption， printed books， and newspapers； and a 0％ rate applied to exported goods.Moreover， China adopts the production-type VAT， where VAT in relation to fixed assets purchased for the production of the exported goods is not deductible（可扣除的）.Thus the prices of exported goods actually contain tax levied.

China’s export tax rebate system is defective （有缺陷的） to some extent.Some unlawful enterprises bilk （蒙骗） the government out of rebate money with fake （假的） VAT invoices，while law-abiding enterprises are faced with convoluted （复杂的） tax rebate procedures or have to wait for the refund for a considerable period of time due to the tax rebate quota.

China’s export tax rebate system has not stayed steady since 1994.The rebate amount has been rising continuously as exports grow.In the span from 1985 to 2002， the rebate amount rose 69 times from 1.795 billion RMB to 125.8 billion RMB.The central government slashed （削减） the rebate rates a couple of times， for example， in 1995， 1996 and 2004， to alleviate （减轻） its fiscal burden.In some other years， prompted （导致） by the macroeconomic situation， the government raised the rebate rates to encourage exports， as in the case of 1997， 1998， and 1999.

During 1997， when the Asian financial crisis broke out， China was faced with steep challenges in exports.The simplest and most direct measure to boost exports is to depreciate the country’s currency.But renminbi depreciation at that juncture （关键时刻） would have produced a serious impact on the world economy， and China reiterated （重申） on many occasions its resolve not to depreciate its currency.Faced with the dilemma of declining export competitiveness and the inability to depreciate the renminbi，raising the export tax rebate rate became the best alternative to China at that time.Thus from 1997 on， China lifted the rebate rates several times and implemented a four-tiered rebate system from July 1， 1999 （17％， 1

5%， 13%， and 5%） with an average rate of 15% in the hopes of boosti ng exports and easing the pressure of renminbi depreciation.

In October 2003， however， the Chinese government implemented a n average 3%reduction of export tax rebate rates， from 15.11% to 12.1 1%， and further announced that a five-rate system， i.e.， 17%， 1 3%， 11%， 8%， and 5%， would be implemented starting in 2004.Th e rates of 5% and 13% applied to farm produce remained unchanged， whi le the rate for farm produce that were deep processed， such as wheat powd er and corn powder was raised from 5% to 13%.The rate for some mechani cal and electrical products， apparel and cotton textile products dropped fro m 17% to 13%.The rebate for some natural resource products，e.g.， crud e oil and log was cancelled， and the rebate rate for some other natural reso urces fell from 8% to 5%.Export goods affected most in this latest round of export tax rebate reform are the home appliance， mechanical/electrical， and cotton textile sectors.Furthermore， the rebate is split （分摊） betwe en the central and local governments in the ratio of 75% to 25%.This new measure aims to alleviate the fiscal burden of the central government and th e renminbi appreciation pressure.

Source: Chien-Hsun CHEN, Chao-Cheng MAI, Hui-Chuan YU,“The effect of export tax rebates on export performance: Theory and evidence from Chi na”, China Economic Review 17 (2006), pp226-235.

# 7.3 Export Restrictions and Import Pro motion Policies

## 1.Export restrictions policies

Export restrictions, or restrictions on exportation, are limitations on the quantity of goods exported to a specific country or countries by a governme nt.

An export restriction may be imposed： 1） To prevent a shortage of goods in the domestic market because it is more profitable to export； 2） To manage the effect on the domestic market of the importing country， which may otherwise impose antidumping duties on the imported goods； 3） As part of foreign policy， for example as a component of trade sanctions； 4） To limit or restrict arms or dual-use items that may be used in nuclear proliferation （扩散）， terrorism，nuclear， chemical or biological warfare； 5） To limit or restrict trade to embargoed （被禁运的）nations. Many countries employ export taxes and quotas to restrict exports.

(1) The effects of an export tax

An export tax is a tax collected on exported goods.As with import tariffs, export taxes can be set on a specific or an ad valorem basis.For example, in December 1995, the EU imposed a $32 per ton export tax on wheat.Brazil imposed a 40％ export tax on sugar in 1996.

The effects of an export tax by a small exporting country is demonstrated in Figure 7-5.With the imposition of the export tax t dollars, the producers in the exporting country will only get ($P_w$−t)dollars per unit when he exports at the world price of $P_w$ (also domestic price).The producers are induced to lower their domestic price and sell more at home to avoid paying the tax. This will take place until the difference between the price of the good in the domestic market and the world price is equal to the export tax.As a result of the tax, exports decline from $X_1$ to $X_2$ due to both the increased local consumption and the reduced quantity supplied of the export good.

The effects of an export tax are: consumer surplus increased by (a); government revenue increased by (c); producer surplus decreased by (a+b+c+d).Thus the whole welfare effect is a deadweight loss of (b+d).

If the exporting country is a large country, what are the effects? Since this is a large-country setting, the reduced supply of exports on the world market results in an increase in the international price.Thus, the export price for the exporting country rises, the terms of trade of the country improves.Other effects to the country are the same as in the setting of a small country.Thu

s a large country suffers less net welfare loss than a small country when the same export duty is imposed in the two countries.If the gains from the impr ovement of terms of trade exceed the loss resulted from price distortion, the whole welfare effect might be positive.

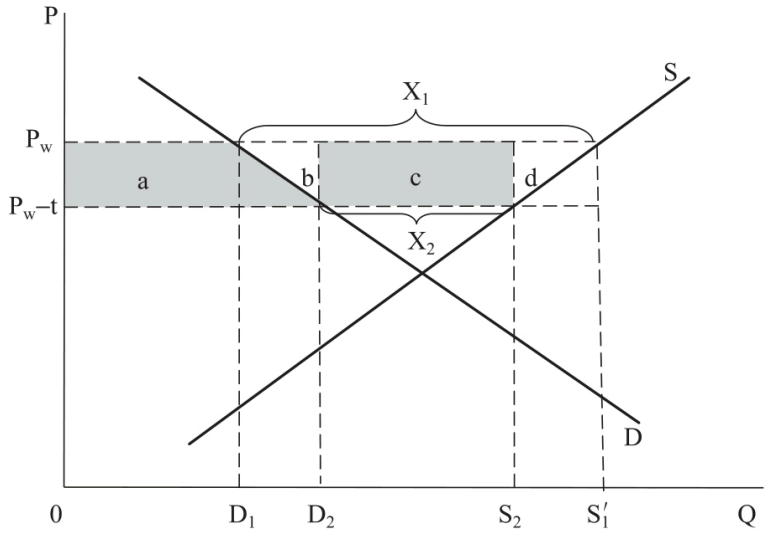



Figure 7-5 The effects of an export tax in a small country

With the imposition of an export tax“t” dollars, a producer in the exporting country will get on ly ($P_w-t$) dollars per unit when he exports at the world price of $P_w$.Thus he would prefer to sell in the home market, which will lead to an increase in supply and a drop in the home market pri ce.

(2) The effects of an export quota

We now turn to the policy of an export quota in a small country.The ca se is depicted in Figure 7-6.Suppose the export quota $X_2$ equals the actual q uantity exported when an export tax“t” is in place.When the world price is $P_w$， the quantity that the home producers are willing to supply is $S_1$， whi ch is greater than the domestic demand $D_1$ plus the restricted quantity of exp orts $X_2$.The domestic price will then drop.The effects of an export quota are similar to those of an export tax.The difference is， with the import quot a， no government revenue is necessarily collected.The recipient （接受方） of the quota rent is unclear.

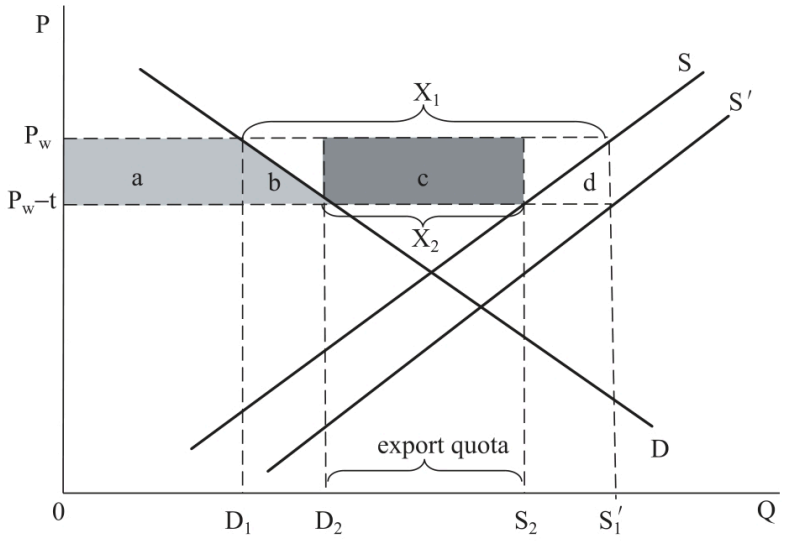



Figure 7-6 The effects of an export quota in a small country

With the imposition of an export quota of $X_2$, the effects are similar to those of an export tax.The difference is, with the import quota,no government revenue is necessarily collected.The recipient of the quota rent is unclear.

## 2.Import promotion policies

Sometimes governments also adopt policies to promote imports of particular products.The objectives of import promotion include： 1） For the benefit of home consumers.When domestic supply is insufficient while the import price is on the high side， the importation of life necessities like food， meat salt etc.are encouraged； 2） To protect domestic scarce natural resources， especially those non-reproductive resources with strategic significances as petroleum； 3） To promote the development of particular home industries.For this purpose， the importation of parts， components and raw materials which are vital （极重要的） to these industries but not available at home are encouraged.

The measures taken involve import subsidies, consumption subsidies on imported products and production tax on the import-competing industries.

In contrast to the effect of an import duty, the effect of an import subsidy is: domestic price decreases, producer surplus decreases, consumer surpl

us increases, government expenditure increases, social welfare as a whole d ecreases.

# 7.4 Trade Sanctions

## 1.Introduction to trade sanctions

Trade sanctions are government-mandated restrictive measures relating to trade policy.The restriction can be on imports and/or exports， and it can be an entire ban on trade （trade embargo） or be limited to particular prod ucts.In most cases， embargoes are implemented against countries whose c onduct has been condemned （谴责） by the international community.The purpose can be to isolate （孤立） the target country， pressure its govern ment and cause it to reverse （取消） a specific policy.Sanctions can be de clared either by one country or by a group of countries.

The usage of trade sanctions are increasing and becoming a useful tool to create pressure instead of violence or disturbances （骚乱）.Trade sancti ons have been a prominent （突出的）part of American statecraft （治国本领） since World War II， and increasingly so since the end of the Cold War.It is estimated that during 1950s-1990s， approximately 100 sanctions had been imposed， among which about 70 were imposed by the USA.

There is a debate going on about the effectiveness of trade sanctions.S ome authors in the subject are negative and some are positive towards the ef fects of sanctions.

It was found that sanctions achieve their objectives in fewer than 20 pe rcent of cases.For example， the Nuclear Proliferation Prevention Act of 19 94 failed to deter （阻止） India and Pakistan from testing nuclear weapon in May 1998.Sanctions have utterly （完全地） failed to change the nature or basic behavior of governments in Cuba， Burma， Iran， Nigeria， Yu goslavia，and a number of other target countries.

Box 7-6

## COCOM—A Multilateral Export Control Organization

COCOM is an acronym （首字母略缩词） for Coordinating Committee for Multilateral Export Controls （多边出口限制统筹委员会）.COCOM was established in 1947， during the Cold War， to put an embargo on COMECON （Council for Mutual Economic Assistance） （经济互动委员会） which was an economic organization of communist states countries.

It had 17 member states: Australia, Belgium, Canada, Denmark, France, Germany,Greece, Italy, Japan, Luxembourg, Netherlands, Norway, Portugal, Spain, Turkey, the United Kingdom and the United States.In addition, there were a number of cooperating countries,such as Austria, Finland, Ireland, New Zealand, Sweden and Switzerland.

It was revealed （显示） in 1987 that Japan's Toshiba Machine Company had supplied eight computer-guided propeller （螺旋桨） milling machines （铣床） to the Soviet Union between 1982 and 1984， an action that violated the COCOM regulations.It was argued in the United States that this technology greatly improved the ability of Soviet submarines （潜艇） to evade detection， leading to a significant cost for the United States to improve its own technology once more.In 1988， Congress moved to sanction Toshiba and bar imports into the United States of Toshiba products.

COCOM ceased to function on March 31， 1994， and the then-current control list of embargoed goods was retained （保持） by the member nations until the successor （接替者）， the Wassenaar Arrangement （瓦森纳安排） was established on May 12， 1996， in the Dutch town of Wassenaar， near The Hague.

Box 7-7

### Do Trade Sanctions Work?

The U.S.often uses its economic power to influence other countries, sometimes by severely limiting trade.“Sanctions are usually imposed to try to cause change, but they can have unintended results,” says Steven Schrage of the nonpartisan Center for Strategic and International Studies.“Comprehen

sive sanctions—which ban most trade and services between the U.S.and oth er nations—cost our economy $12 billion yearly."

Here are the four countries that have endured the most extensive U.S.tr ade sanctions.

| COUNTRY | IMPOSED BECAUSE | EFFECTS |
|---|---|---|
| Cuba | The U.S. hoped that major sanctions, begun in 1962, would cripple Fidel Castro's Communist regime and bring democracy. | Cuba has struggled economically, but the government—now under Raul Castro—has stayed in power. Former President Obama has called for "a new chapter" in U.S.-Cuba relations, which may lead to an end to sanctions. |
| Sudan | Sudan's sponsorship of terrorism led to initial sanctions in 1997. New restrictions were imposed in 2007 due to mass killings in Darfur. | Sudan's government remains unchanged and has made little effort to stop the Darfur genocide. Still, as a result of U.S. sanctions, the country has lost investors from other countries, including Britain and Germany. |
| Burma (Myanmar) | Sanctions followed a military crackdown in 1988 and were tightened in 2007, when generals brutally repressed protesters. | As Former Secretary of State Hillary Clinton recently conceded, the military government has not altered its strong-arm tactics. Clinton says the U.S. is looking for other ways to influence Burma's leaders. |
| Iran | Radicals seized 66 U.S. hostages in 1979. Sanctions were later tightened because of Iran's nuclear program and terrorist ties. | Iran's capacity to export oil has been harmed, because it can't buy U.S. technology. It's also thought that Iran's many plane crashes—hundreds of people have died in them—are due to its inability to buy parts from the U.S. |

Source: http://www.parade.com/news/intelligence-report/archieve/do-trade-sanction-work.html.

## 2.Effectiveness of trade sanctions

The historical record of trade sanctions provides some insight （了解） into the factors that govern their effectiveness.Among the most import ant determinants （决定因素） of the success of trade sanctions are：

1) The number of nations imposing sanctions.

Although unilateral （单边的） sanctions may have some success in achieving intended results， it helps if sanctions are imposed by a large number of nations.For example， although the United States is by far the world's largest economy， its global economic leverage （力量） is limited.The United States accounts for only 13 percent of the world's merchandise exports and 16 percent of its imports.If Washington seeks to punish another country by unilaterally， other global suppliers stand ready to fill the gap.Besides，multilateral sanctions generally result in greater economic pressure on the target nation than unilateral sanctions.Multilateral measures also increase the probability of success by demonstrating that more than one nation disagrees with the target nation's behavior， thus enhancing the political legitimacy （合法性） of the effort.

2) The degree to which the target nation has economic and political ties to the imposing nation(s).

Sanctions tend to be more effective if the target nation had substantial economic and political relationships with the imposing nation（s） before the sanctions were imposed.Then the potential costs to the target nation are very high if it does not comply （符合） with the wishes of the imposing nation（s）.For example， the Western sanctions against South Africa during the 1980s helped convince the government to reform its apartheid （种族隔离） system， in part because South Africa conducted four-fifths of its trade with six Western industrial nations and obtained almost all of its capital from the west.

3) The extent of political opposition within the target nation.

If there is substantial domestic opposition in the target nation, trade sanctions can lead powerful business interests to pressure the government to conform to the imposing nation's wishes.

4) Cultural ties between the imposing nation(s) and the target nation.

When the people of the target nation have strong cultural ties to the imposing nation（s），they are likely to identify （支持） with the imposing nation's objectives， thus enhancing the effectiveness of sanctions.

[1]This definition is adaped from the Provisions of the Customs of the People's Republic of China on the Administration of Bonded Warehouses and the Goods Stored Therein， Article 2， implemented as of February 1st， 2004.

[2]In law， a lien is a form of security interest granted over an item of property to secure the paymen t of a debt or performance of some other obligation.

# Chapter 8　Arguments Against Free Trade

Learning Objectives

In this chapter, you will learn:

- Traditional arguments against free trade
- New protectionism
- Political economy of trade policy

For hundreds of years, at least since Adam Smith's publication of The Wealth of Nations,the majority of economists have been strong supporters of free trade among nations.Paul Krugman once wrote that if there were an Economist's Creed it would surely contain the affirmation,"I advocate free trade."

The original arguments for free trade began to supplant （取代） mercantilist views in the early to mid-18th century.Many of these original ideas were based on simple exchange or production models that suggested free trade would be in everyone's best interest and surely in the national interest.During the 19th and 20th centuries， however， a series of objections were raised suggesting that free trade was not in everyone's interest and perhaps was not even in the national interest.The most prominent of these arguments include： infant （幼稚的） industry argument， terms of trade argument， balance of trade argument， tariff to reduce aggregate unemployment， fair competition argument， national security argument， and more recently，strategic trade policy arguments.

This chapter starts with discussing several arguments for protection covering both the traditional arguments and new protectionism and then addresses the question of how the setting of trade policy is influenced by institutions and the political process.

# 8.1 Traditional Arguments against Free Trade

## 1.Infant industry argument

Infant industry argument refers to an argument in favor of protecting th e domestic backdated （落后的） industries through government backin g， help， and intervention （干预）.Economists generally agree that this argument for protection is valid from the standpoint of enhancing the welfar e （福利） of the world as a whole.The infant industry argument holds that the home country industry which is getting a“late start” may possess a long run comparative advantage if protection could temporarily be given to the i ndustry.It goes that internal and external economies of scale will be realize d.The internal economies of scale means that the producers in the home cou ntry will be moving down their downward-sloping long-run average cost cu rves by producing a larger volume of output.The economies could be extern al to the firm but internal to the industry， in which case greater industry o utput would reduce costs for the individual firm due， for instance， to the attraction of a pool of skilled labor to an area.In any event， per-unit costs eventually fall to such an extent that the industry in the home country beco mes an exporter of the good.At this point， protection can be removed and the government would allow the industry to be subjected to international co mpetition to fend for （保护） itself.

The main motive behind Infant industry argument is to create a level pl aying field （公平的竞争环境） between a backdated industry and a highl y advanced industry producing similar commodities.This argument has bee n observed to be followed more often by the developing or the under-develo ped countries which possess comparatively backdated and traditional indust ries.In such cases， if these industries are subjected to the international mar kets， then their products would not be able to compete with the price and probably quality offered by the highly mechanized and advanced industries producing the same output and probably better quality too.Keeping all these

aspects and factors into mind， two economists named Hamilton and List p roposed the“Infant Industry Argument”.They argued that in such uneven pla ying fields， the domestic， traditional， and backward industry would re quire government protection and backing either through tariff protection on a temporary basis or forwarding subsidy towards these industries.

Infant industry argument is applied on economies for the sake of corre cting the distortions （扭曲） of short lived nature.According to this argum ent， the government protection to the industry holds good for a certain per iod of time and after that the market force is allowed to be in existence.

However, there are two problems that come up with this argument:

1） The identification （确定） of infant industry.Infant industry argu ment requires extra funds to be allocated by the government on a primary b asis.But the justification of this initial greater cost allocation by the govern ment remains valid only when the national income of the economy is higher than the non-protection phase.So the industries that are likely to become lo w-cost producers should be identified.If an industry protected by this argum ent is not a true infant， then the country may be saddled with （使负担） permanent protection of a high-cost industry and less resource use.Westphal pointed out that the initial costs in terms of domestic resources for infant in dustry protection in developing countries might be twice the amount of fore ign exchange saved or earned by protection.

2） The form of protection.Another problem that comes up with the ar gument is whether the tariff or another form of protection is the relevant pol icy.For example， a case might be made， for attaining both internal and e xternal economies， that a subsidy to the industry by the home country gov ernment is superior to （优于） a tariff.A subsidy has a lower welfare cost to the country than a tariff[1].A subsidy also comes up for reevaluation every year when a government authorizes expenditure， so its benefits and costs are analyzed more frequently than is possible with a tariff， which is in pla ce in the schedules and does not need to be brought up for annual review.M ore fundamentally， however， the economist says entrepreneurs （企业家）in a market economy presumably （很可能） know that internal econ

omies of scale could be realized from expansion and would undertake expansion on their own.Then why the industry needs protection？If this process does not get under way on its own， capital markets are probably operating in allocating funds.Therefore， the policy should center around taking measures to improve the operation of capital markets， perhaps through deregulation （解除管制）or government guarantees for the loans.

## 2.Terms of trade argument

The terms of trade argument comes directly out of cost-benefit analysis.For a large country that is able to affect the prices of foreign exporters， a tariff lowers the price of imports.When a country imposes a tariff， foreign exporters have greater difficulty in selling their products.As their exports decline， they may cut prices in order to keep their sales from falling drastically （大幅度地）.Consequently， the world price of the imported good will fall and $P_X/P_M$ will rise.Thus a terms of trade benefit is generated.We emphasize that only a large country can employ the terms of trade argument with any success because the tariff-imposing country must be able to influence its terms of trade.Remember that a small country by definition cannot influence its terms of trade.

The terms of trade argument is not yet complete， however.What has not been taken into account in a welfare sense is that the quantity of imports has fallen with the imposition of the tariff.This quantity reduction， other things being equal， reduces the level of home country’s welfare because the country’s consumption of low-cost imports， for which home production is at a comparative disadvantage， has been reduced.In sum， the country gains because of a lower world price of the imported good but loses because of a smaller import quantity of that good.This additional consideration of forgone （放弃的） quantities is brought into the analysis through the concept of the optimum （最优的） tariff rate.The optimum tariff rate is the rate that maximizes the country’s welfare.Conceptually， it is the tariff rate at which the positive difference between the gain from better prices and the loss from reduced quantity of imports is at a maximum.

Figure 8-1 shows that at small tariff rates, a large country's welfare is higher than with free trade.As the tariff rate is increased, however, the costs eventually begin to grow more rapidly than the benefits and the curve relating national welfare to the tariff rate turns down.A tariff rate that completely prohibits trade ($t_p$ in Figure 8-1) leaves the country worse off than with free trade; further increases in the tariff rate beyond $t_p$ have no effect, so the curve flattens out.

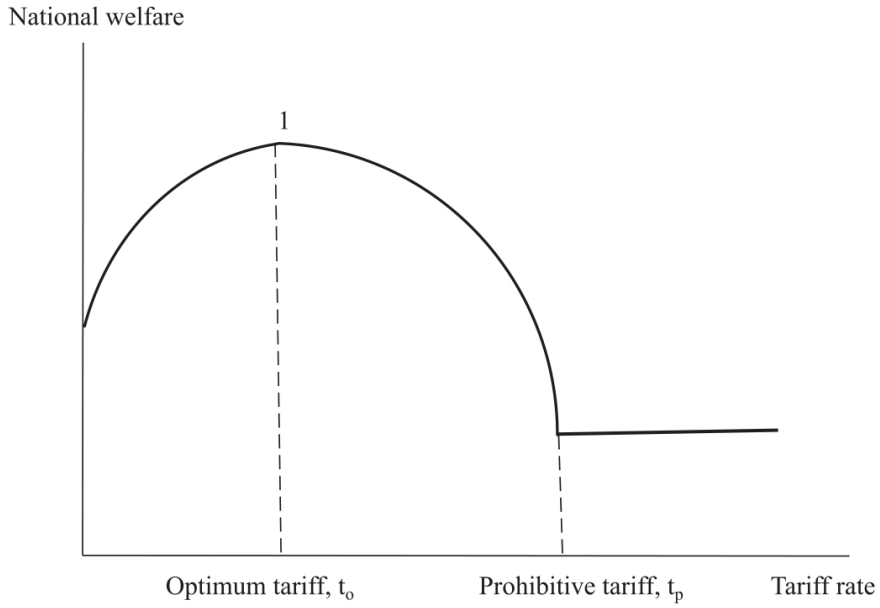



Figure 8-1 The optimum tariff

At point 1 on the curve in Figure 8-1, corresponding to the optimum tariff $t_0$, national welfare is maximized.The optimum tariff rate is always positive but less than the prohibitive rate ($t_p$) that would eliminate all imports.

Another problem with the terms of trade argument is that it is a beggar-my-neighbor （损人利己） argument because the welfare of the partner country falls.Since the partner country is injured by the tariff， it will likely retaliate with a tariff of its own.In that event （如果那样的话）， both countries will end up with （以……告终） reduced welfare compared with their situation under free trade.If continual retaliation occurs， neither country may end up with terms of trade better than during the initial free trade.

## 3.Balance of trade argument

The argument for a tariff to improve the balance of trade claims that th e imposition of the tariff will reduce imports.Assuming that exports are not affected, the obvious result is that the balance of trade improves, since the b alance of trade (the difference between the value of exports and the value of imports) becomes less negative (i.e.the trade deficit is reduced) or a deficit t urns into a surplus.

Theoretically, this argument has no problem, since it is rational that les s imports will save foreign exchange and will in turn reduce trade deficit or increase trade surplus.But one essential problem ignored by this argument is that international trade is a two-way international exchange of goods.The i mposition of a tariff by the home country may result in:1) Retaliation by tra ding partners.As we all know, if trading partners take the action of retaliatio n, the exports of the home country will be reduced.2) The reduced ability of foreign countries to buy the home country's products due to a reduction in t heir national income.Thus the balance of trade might not be improved and t he use of a tariff is no guarantee that the balance of trade will improve.Furth ermore, the price paid by the home consumers as well as export industries might be rather great.

Then， are there any other approaches rather than protection to impro ve balance of trade？The answer is definite.As we know， when trade defi cit exists， it means we are spending beyond our means （收入）.Thus tra de deficit can be reduced or eliminated by increasing means，reducing spe nding， or undertaking some combination of the two.Policies such as raisin g the productivity of export industry and exploring more export potentials a re more proactive （积极主动的） and less costly methods to accomplish t he particular objective.

## 4.Tariff to reduce aggregate unemployment argum ent

The argument for a tariff to reduce aggregate unemployment holds that the imposition of a tariff will result in a shift in demand by domestic consumers from foreign goods to home-produced goods, with this increase in demand, home industries will expand their output and, in the process, will hire more labor and thus contribute to the reduction of unemployment in the country.The new labor hired will also be earning spendable income and, by the familiar Keynesian multiplier process, other industries will then expand and add new jobs.

The issue of jobs has been a dominant factor in motivating government to levy trade restrictions on imported goods.It is sometimes said that an economy with substantial unemployment， such as EU in the 1990s and early 2000s provides an exception to the case of free trade.During periods of economic recession， workers are especially eager to point out that cheap foreign goods undercut （削弱） domestic production， resulting in a loss of domestic jobs to foreign labor.

This view, however, also fails to acknowledge the dual nature of international trade.Changes in a nation’s imports of goods and services are closely related to changes in its exports.Suppose that tariffs or import quotas cut the imports of Japanese cars, China’s textiles and US computers.Surely, the argument maintains, this will create more employment in local industries producing similar products.The answer is that it will—initially.But the Japanese,Chinese and Americans can buy from the EU only if they earn euros by selling things to the EU.The decline in their sales of cars, textiles and computers will decrease the purchases of Spanish vegetables, French wine, and holidays in Greece.Jobs will be lost in EU export industries, and gained in those industries that formerly faced competition from imports.The likely long-term effect is that overall employment will not be increased but merely redistributed among industries.

## 5.Fair competition argument

Fairness in trade is another reason given for protectionism.The argument claims that foreign governments play by a different set of rules than the h

ome government， giving foreign firms unfair competitive advantages.It co ntends （主张） that import restriction should be enacted （制定） to offs et these foreign advantages， thus creating a level playing field on which al l producers can compete on equal terms.The protection provided by the ho me country is to accomplish the following objectives.

(1) To offset foreign dumping

As previously noted， to the economist， dumping occurs when a fir m sells its product at a lower price in the export market than in the home co untry market.The argument for protection is that dumping by foreign firms i nto the home country is in some sense unfair and constitutes （构成） a thr eat to domestic producers because of the low import price；therefore， this unfair behavior should be prevented through the imposition of a tariff， tha t is， an antidumping duty.

(2) To offset a foreign subsidy

This argument goes that foreign government subsidy awarded to a fore ign import supplier constitutes unfair trade and disturbs the“level playing fi eld” in international trade.It assumes that foreign firms are able to outcomp ete home firms in the latter’s market because of an artificial advantage that t he foreign firms enjoy by virtue of （利用） government subsidies.And it c laims that subsidy generates a distortion from the free-trade allocation of res ources when the foreign country does not have a comparative advantage in t his goods.An imposition of tariff can offset the distortion and aid the restora tion of the trade pattern to a more efficient one.

There are some other trade fairness arguments， like argument which alleges that foreign firms are not subject to the same government regulation s regarding pollution control and worker safety as the importing country an d it is especially true in many developing countries where environmental la ws and enforcement have been lax （宽松的）.Moreover， foreign firms may not have to comply with employment regulations such as minimum wa ges and overtime pay （加班费）.

## 6.National security argument

One of the oldest and most common arguments supporting protection i s the so-called“national security argument” or“national defense argument”. This argument assumes that an industry is vital to a country’s security and it is necessary to protect certain industries with a tariff， to assure continued domestic production in the event of a war.If， during normal times，free tr ade is permitted in the product of this industry， imports may capture the li on’s share （最大的一份） of the market and either drive domestic produc ers away from the industry or reduce the size of the industry.If a cutoff occu rs due to the disruption of normal trade patterns， the country is left withou t adequate supplies of the product and national security is threatened.To pre vent this threat from becoming a reality in the future， the industry must be protected now.With tariff protection， the industry will thrive （兴盛）， and national security will not be undermined （被损害） should disruption occur.

Many products have been identified as being sufficiently important to warrant （保证）protection for this reason.Perhaps the most common indu stry identified is agriculture.Simply consider the problems that would arise i f a nation did not have an adequate food supply at a time when it was at war with the outside world.Low food stocks may induce severe hardships and e ven famine （饥荒）.A simple solution to avoid this potential problem is to maintain a sufficiently high tariff in order to keep cheap foreign goods ou t， and in turn， maintain production of the domestic goods.

Similar problems may arise in many other industries.Consider the pote ntial problems for a country’s national security if it could not produce an ad equate amount of steel, aluminum,ships, tanks, planes, fuel, etc.in the event of a war.The products that could be added to this list are enormous.Indeed, at one time or another, in most country’s histories, almost every product ima ginable has been argued as important from a national security perspective, a nd thus is deserving of protection.For example, the U.S.watch industry succ essfully obtained protection using this argument.

## 8.2 New Protectionism

New protectionism， also called strategic trade policy theories， emerged in the 1970s.Comparing with the traditional protectionism， the new protectionism has two distinguished features： 1） It acknowledges that the market of industrial products is imperfect.The varieties of products make it possible for any firms in any countries to obtain monopoly forces to some extent； 2） It also acknowledges that the production of many industrial products enjoy economies of scale.In respond to these two new recognitions， the protection policy has two new bases： 1） To impose tariffs to extract （获得） the foreign monopoly profits； 2） To help home firms to acquire more market shares so that they can realize economies of scale in production and thus obtain competition advantages in the market.

## 1.Tariff to extract foreign monopoly profit

Consider a domestic market supplied by a foreign monopoly firm.The domestic market consists of many consumers who demand the product but has no domestic producers of the product.All supply of the product comes from a single foreign firm.To make this an international trade story we simply assume the monopoly supplier happens to be a foreign firm.

Figure 8-2 illustrates the basic analysis.The linear （直的） demand curve D represents domestic consumer demand for the foreign monopoly firm’s product.Since the firm faces a downward-sloping demand curve （unlike the case in perfect competition， where the demand curve facing an individual firm is horizontal）， marginal revenue （MR） is less than price.For the sake of simplicity， let the flat MC line represent a constant marginal cost in production for the foreign monopolist （i.e.each additional unit of output is produced at the same cost as previous units） and that there are no fixed costs and no transportation costs.With free trade， the firm will set MR equal to MC in order to maximize profit， and the quantity sold to the home country will be $0Q_1$.The price charged will be $0P_1$ and the monopolist’s profit is the difference between total revenue and total cost， which is the rectangle $C_1P_1RF$.

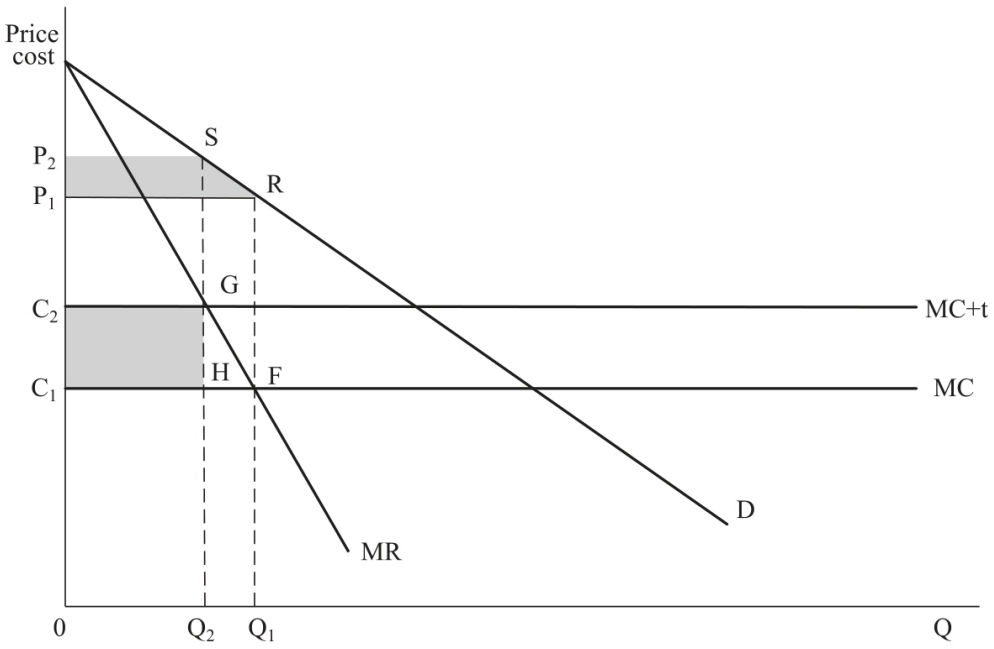



Figure 8-2 A tariff to extract foreign monopoly profit for the importing country

Now suppose that the home country wishes to obtain some of the monopoly profit，which means the national welfare can be improved although it is often at the expense of （在损害……情况下） foreign countries.In this example we shall consider the welfare effects of a specific tariff set equal to t.The tariff will raise the cost of supplying the product to the domestic market by exactly the amount of the tariff.The marginal cost curve will then move upward by the amount of the tariff to MC+t.So profit maximization now equates marginal revenue with“new” marginal cost MC+t.Quantity produced for the home country drops to $0Q_2$ and the monopolist will raise its price to $0P_2$.Note that the price rises by less than the amount of the tariff.

To consider the welfare change of the tariff-imposing country, examine the profit change of the monopoly firm.After the imposition of the tariff, the profit is rectangular $C_2P_2SG$.The area $C_1C_2GH$ represents the tariff revenue of the home country, which is the former profit transferred from the monopolist.To assess the net gain for the home country, we must take the change of the consumer surplus into account.The consumer surplus reduced by the area of $P_1P_2SR$ because of an increase in the price.Thus if area $C_1C_2GH$ is gre

ater than area $P_1P_2SR$,then the net gain for the home country is positive, whi ch means that the home country has succeeded in enhancing its welfare at th e expense of the foreign producer.

## 2.Export subsidy in duopoly

Since the international market has the nature of imperfect competition and economies of scale exist， the market share is becoming especially sig nificant for all firms.The competition in the market is a game between mark et competitors.The one who occupies the market can obtain abnormal profi t.The new protectionism alleges that government should support home firm s to win international competition through subsidies and the profit acquired by home firms after they win will exceed the government subsidies.The ana lysis assumes a duopoly （双寡头）context of a home firm and a foreign fi rm.

The firms are competing for sales in the market of a third country.And it also assumes that they do not sell any output in their own domestic marke t.To illustrate that the use of a subsidy can enhance exports, economists ofte n take Boeing and Airbus as an example.In the real world, they are the two major aircraft producers.

Now consider both Boeing and Airbus contemplate （仔细考虑） pro duction for China of a particular type of aircraft with substantial economies of scale.Table 8-1 shows a“payoff matrix[2] （收益矩阵）” for the four pos sible situations.The upper-left portion indicates that， if both firms produce this aircraft， each will lose $5 million because the market is not large enou gh for both of them to produce the good economically.The upper-right porti on of the diagram indicates production by Boeing and no production by Air bus would yield $100 million profit for Boeing while Aircraft would earn n o profit.The lower-left part of the matrix（矩阵） is opposite to the upper-r ight part， with producing firm Airbus obtaining $100 million profit and no n-producing firm Boeing receiving no profit.Finally， if neither firm produ

ces the aircraft， profits are zero for each firm， as shown in the lower-rig ht portion of the matrix.

In Table 8-1, the“game” has two outcomes: If Boeing takes the lead in entering China’s market, Airbus only has two choices: produce but suffer lo ss and not produce and no loss.The rational choice is surely not produce (th e upper-right portion); on the other hand, if Aircraft enters the market first, t here are also two choices for Boeing and the outcome is to give up the mark et (the lower-left portion).

Table 8-1 Hypothetical payoff matrix for Boeing and Airbus

Unit: million dollars

| | | Airbus | |
|---|---|---|---|
| Boeing | | produces | does not produce |
| | produces | (–5, –5) | (100, 0) |
| | does not produce | (0, 100) | (0, 0) |

However, suppose that the European governments announce that they will grant $10 million subsidy to Airbus if it produces for Chinese market. With this commitment, the payoff matrix now appears as shown in Table 8-2.The upper-left and lower-left portions of the matrix reflect the $10 million subsidy to Airbus.If only Airbus produces and Boeing doesn’t produce,then the total profit of Airbus will reach $110 million.Even if both Airbus and Bo eing produce,Airbus can still make a profit of $5 million.Since no subsidy i s granted to Boeing, there is no change in its profits and losses.

Table 8-2 Hypothetical payoff matrix for Boeing and Airbus when Airbus receives $10 milli on subsidies from the government

Unit: million dollars

| | | Airbus | |
|---|---|---|---|
| Boeing | | produces | does not produce |
| | produces | (–5, 5) | (100, 0) |
| | does not produce | (0, 110) | (0, 0) |

Under the new circumstance, Airbus will make profit if only it produce s no matter Boeing produces or does not produce.There are only two choice s for Boeing: one is not to produce and let Aircraft produce alone, and then Boeing will neither gain nor lose.The other choice insisting on produce, but Airbus would not make concession.The result is that both firms produce an d bear a loss of $5 million.As such, there is no possibility for Boeing to obta in any profit.The rational choice of Boeing would be to give up competitio n.The outcome is that Aircraft monopolies the market and obtains $110 mill ion (the equilibrium outcome of the game is the lower-left portion).To Airbu s and the European governments, this outcome is surely attracting: The gov ernments' subsidy of $10 million generates $110 million profit and the net p rofit is $100 million.

Of course there is no guarantee that the foreign government will not ret aliate with its own subsidy.In the above example, suppose the government o f the United States also grants $10 million subsidy to Boeing and the outco me is that both firms will produce as shown in Table 8-3.Although both Boe ing and Airbus can make profits with the subsidies, the expenditures by the governments outweigh the profits obtained by the firms.Thus it is a deadwei ght loss for the world as a whole.

Table 8-3 Hypothetical payoff matrix for Boeing and Airbus when each company receives $1 0 million subsidies

Unit: million dollars

| Boeing | | Airbus | |
|---|---|---|---|
| | | produces | does not produce |
| | produces | (5, 5) | (110, 0) |
| | does not produce | (0, 110) | (0, 0) |

## 8.3 The Political Economy of Trade Polic y

As we have noted in the previous two sections, in reality there are many different arguments for trade protection, but why do nearly all governments choose some apparently inefficient protectionist policies or how is a trade policy determined? In recent decades, an impressive theoretical and empirical literature on the“political economy of trade policy” has attempted to answer this question.

The primary explanation is that sub-optimal policies are chosen because policies aren’t set by those who seek to maximize economic efficiency.Rather， they are set in political contexts where the objectives of the policy-makers are different from that of aggregate welfare maximization.This“endogenous （内生的）” trade policy determination， which takes into explicit account the political circumstances under which policy is set， forms the core of the political economy of trade policy.In their analysis， economists have built up several political models.

## 1.Median voter model

The median voter model （中点选民模型）， also known as median voter theory or median voter theorem， is a famous voting model positing （假定） that in a majority election： 1） There are two competing political parties； 2） The objective of each party is to get elected by majority vote.Then what policies will the parties promise to follow？ The answer is that both parties will commit to the policy position preferred by the median voter， the voter in the middle of distribution （分布） on the single dimension （维度）.

Consider the following simple example.Suppose the single dimension is defined only by a tariff rate policy and that voters can be ranked according to whether they desire high or low tariff rates.Figure 8-3 shows that in the dimension there are 9 voters who are lined up in order of the tariff rate they prefer.No.1 prefers 1％ tariff rate， No.2 prefers 2％， on the analogy （类推）of this， No.9 prefers 9％.Then No.5 who is in the middle of the dimension is the median voter.Now suppose there are two political parties： the Democratic and the Republic， both parties wish to get support from the m

ajority voters.In the process of determining the trade policy， if the tariff ra tes chosen by the Democratic and the Republic are 7% and 6% respectivel y， then No.7， No.8 and No.9 who are in favor of higher tariff will suppo rt the Democratic while No.1 to No.6 who are in favor of lower tariff will s upport the Republic.Although the tariffs preferred by No.1-5 are not adopte d， compared with the 7% tariff offered by the Democratic，the tariff prop osed by the Republic is nevertheless closer to theirs.If a third Party， say Pr ogress Party， proposes the policy of 5% tariff rate， then No.1 to No.5 wi ll turn to support the Progress Party.And the Republic will have only one su pporter， No.6.

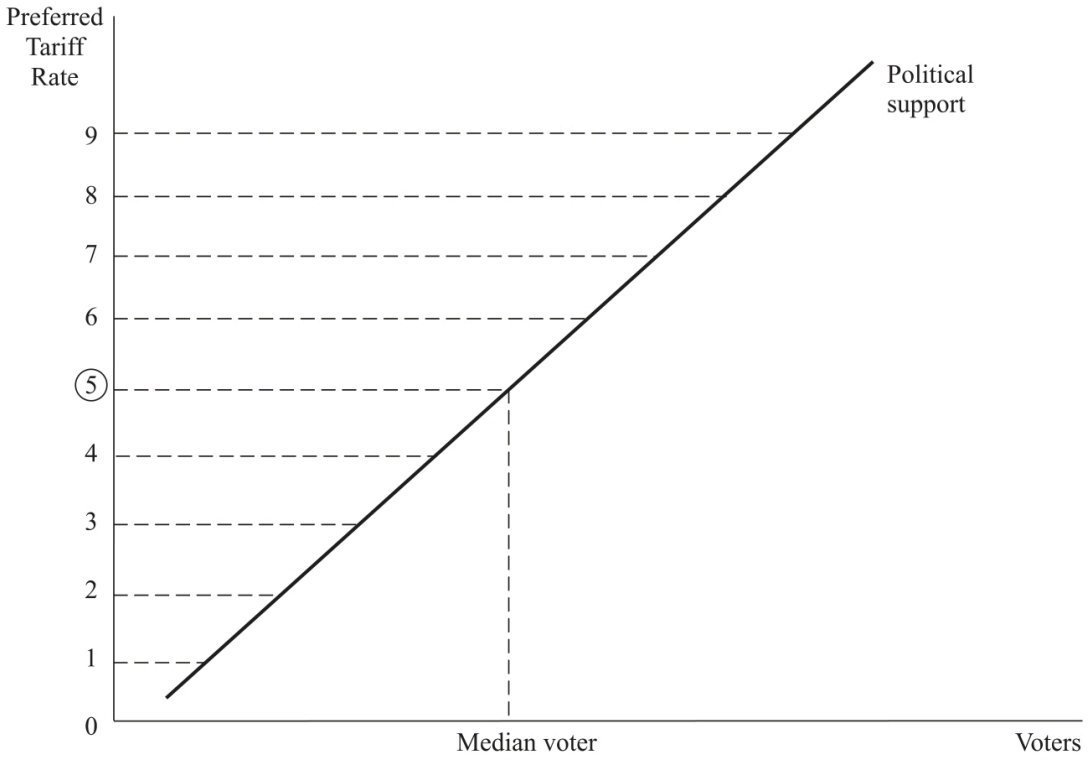



Figure 8-3 An example of median voter model

This political competition drives both parties to propose tariffs close to 5%， the tariff preferred by the median voter.Thus， the median voter theo rem implies that a two-party democracy should enact trade policy based on how many voters it pleases.A policy that inflicts （使承受） large losses o n a few people （import-competing producers） but benefits a large numbe

r of people （consumers） should be enacted into law.But trade policy does n’t seem to follow this prediction.

## 2.Collective action theory

The median voter model seems logical theoretically.But when we revie w the practice of trade policy making in democratic countries, it is not hard to find that in many cases, the minority is protected.For example, in the U. S., Europe and Japan, farmers make up a small fraction of the electorate but receive generous subsidies and trade protection.

Mancur Olson developed a theory of collective action （集体行动理论）[3].The theory challenged wisdom （正确的判断） in his day that：1） If anyone in a group has interests in common， then they will act colle ctively to achieve them； and 2） In a democracy， the greatest concern is that the majority will tyrannize （横行霸道） and exploit （剥削） the mi nority.

The collective action theory argues that individuals in any group attem pting collective action will have incentives to“free ride”（搭便车） on the efforts of others if the group is working to provide public goods[4].Individua ls will not“free ride” in groups which provide benefits only to active partici pants.Hence， without selective incentives to motivate （激发）participati on， collective action is unlikely to occur even when large groups of people with common interests exist.

The theory also notes that large groups will face relatively high costs w hen attempting to organize for collective action while small groups will face relatively low costs.Furthermore,individuals in large groups will gain relativ ely less per capita of successful collective action;individuals in small group s will gain relatively more per capita through successful collective action.H ence, in the absence of collective incentives, the incentive for group action diminishes as group size increases, so that large groups are less able to act i n their common interests than small ones.

The conclusion of the theory is that not only will collective action by l arge groups be difficult to achieve even when they have interests in commo n, but situations could also occur where the minority (bound together by co ncentrated selective incentives) can dominate the majority.Narrow special i nterests are often more politically powerful because they are easier to organ ize and the benefits of membership exceed the cost of participation.

## 3.Contribution in political campaigns

While politicians may win elections partly because they advocate popu lar policies as implied by the median voter theorem, they also require funds to run campaigns.These funds may especially come from groups who do no t have a collective action problem and are willing to advocate a special inter est policy.

Trade policy making is often influenced by supporters of each political party since the ultimate objective of the policy is to safeguard its political p ower.

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[1]For more details， see Chapter 7.

[2]Payoff matrix： Decision analysis tool that summarizes pros and cons of a decision in a tabular fo rm.It lists payoffs （negative or positive returns） associated with all possible combinations of altern ative actions （under the decision maker’s control） and external conditions （not under the decisio n maker’s control）.Also called payoff table.

[3]Mancur Olson， The Logic of Collective Action， Harvard University Press， 1965.

[4]Public goods are goods which are non-excludable （i.e.one person cannot reasonably prevent anot her from consuming the good）and non-rival （one person’s consumption of the good does not affec t another’s， nor vice-versa）.

# Chapter 9　Regional Economic Integration

Learning Objectives

In this chapter, you will learn:

- Types of economic integration among countries
- Costs and benefits of integrative arrangements
- Development of economic integration in Europe
- Development of economic integration in north America and Asia

In our previous discussions of trade policy， we generally conducted the analysis in a framework whereby a country was raising or lowering trade barriers against all trading partners simultaneously and uniformly.Increasingly， however， much international trade is taking place in a context where countries accord differential treatment to their trading partners.This treatment usually occurs by way of economic integration （一体化）， where countries join together to create a larger economic unit with special relationships among members.

In this chapter, we start with an explanation of several different types of economic integration, and then examine both the static and dynamic effects of economic integration.Given the EU is the most well-known integration unit, we explore its origination, development and institutions.Since NAFTA is becoming prominent in public, we discuss it in the second part of Section 3.Economic integration in Asia is discussed by exploring APEC and ASEAN in the third part of Section 3.In addition, a brief introduction is made to the TPP (Trans-Pacific Partnership Agreement), a trade agreement discussed between the United States and 11 nations.

# 9.1 Types of Regional Economic Integration

Regional economic integration （区域经济一体化） is a process in which states enter into a regional agreement in order to enhance regional economic cooperation through regional institutions and rules.Regional economic integration can be viewed in terms of a hierarchy（层次体系） of arrangements which extend from the preferential （优惠的） tariff agreement to the free trade area， the customs union （关税同盟）， the common market and， in the extreme case， the economic union.The latter is now frequently described as economic and monetary union.

## 1.Preferential tariff arrangement

Preferential tariff arrangement is the least restrictive and loosest form of economic integration among countries.In such an arrangement， the countries involved reduce but do not undertake to eliminate totally their import tariffs （customs duties） on the trade in goods flowing between them； meanwhile， they retain （保留） tariff protection on goods entering their economies from outside.

## 2.Free trade area

The second level of economic integration is free trade area.A free trade area is a group of countries that eliminate all tariffs on trade with each other but retain autonomy （自主权） in determining their tariffs with nonmembers.

This scheme is usually assumed to apply to all products， but sometimes a free trade area is formed only for certain classes of goods and services. An agriculture free trade area， for example， implies the absence of restrictions on the trade of agricultural products only.The most notable feature of

a free trade area is that each country continues to set its own policies in relation to nonmembers.In other words， each member is free to set any tariffs， quotas， or other restrictions that it chooses for trade with countries outside the free trade area.Among such free trade areas the most notable are the European Free Trade Area[1] （EFTA） and the North American Free Trade Agreement （NAFTA）.

## 3.Customs union

The third level of economic integration is a customs union.In this stage, like members of a free trade area, members of a customs union dismantle barriers to trade in goods and services among themselves.In addition, however, the customs union establishes a common trade policy with respect to nonmembers.Typically, this takes the form of a common external tariff, whereby imports from nonmembers are subject to the same tariff when sold to any member country.Arrangements of this kind are clearly discriminatory, since they represent free trade within the bloc but discrimination against the rest of the world.

## 4.Common market

The fourth level of economic integration is referred to as a common market.Like the customs union， a common market has no barriers to trade among members and has a common external trade policy.In addition， however， factors of production are also mobile among members.Factors of production include labor， capital， and technology.Thus restrictions on immigration， emigration， and cross-border investment are abolished.An individual can offer himself for employment in any member state of the common market；capital can flow to where it can earn the highest remuneration （酬金）； business （企业） can set up subsidiaries， branches， etc.in any of the participating states.

The free movement of labor and capital between members represents a higher level of economic integration and, at the same time, a further reducti on in national control of the individual economy.The importance of factor mobility for economic growth cannot be overstated.When factors of product ion are freely mobile, then capital, labor, and technology may be employed i n their most productive uses.The Treaties of Rome in 1957 established a co mmon market within the European Community (EC), which officially bega n on January 1,1958, and which became the EU on November 1, 1993.

## 5.Economic union

The highest form of economic integration is an economic union.An ec onomic union is now frequently described as economic and monetary unio n.The“economic” aspect of economic union refers to the existence of a com mon market.The“monetary” aspect relates to the associated monetary and fi scal arrangements， and may involve the introduction of a common currenc y together with highly unified fiscal arrangements.In effect， the Member S tates become mere regions of the larger economic area.Clearly， the format ion of an economic union requires nations to surrender （放弃） a large me asure （程度） of their national sovereignty （国家主权）.

It is important to emphasize that actual integration exercises （应用） may not fit neatly into any of the aforementioned scenarios.Thus， as we h ave seen， a customs union involves a Common External Tariff combined with the total elimination of internal tariffs.However，the parties to an inte gration arrangement may reduce the internal barriers only partially， in whi ch case the resulting arrangement is， in effect， a partial customs union.It is equally essential to recognize that， while integration arrangements may be overall in character，they may also be only partial in coverage.For exam ple， the European Coal and Steel Community related purely to free trade b etween the partners in respect of iron， steel and coal.

Table 9-1　Types of regional economic integration

| | free movement of goods | common trade policy | free movement of production factors | harmonization and unification of economic policies |
|---|---|---|---|---|
| Preferential Tariff Arrangement | × | × | × | × |
| Free Trade Area | √ | × | × | × |
| Customs Union | √ | √ | × | × |
| Common Market | √ | √ | √ | × |
| Customs Union | √ | √ | √ | √ |

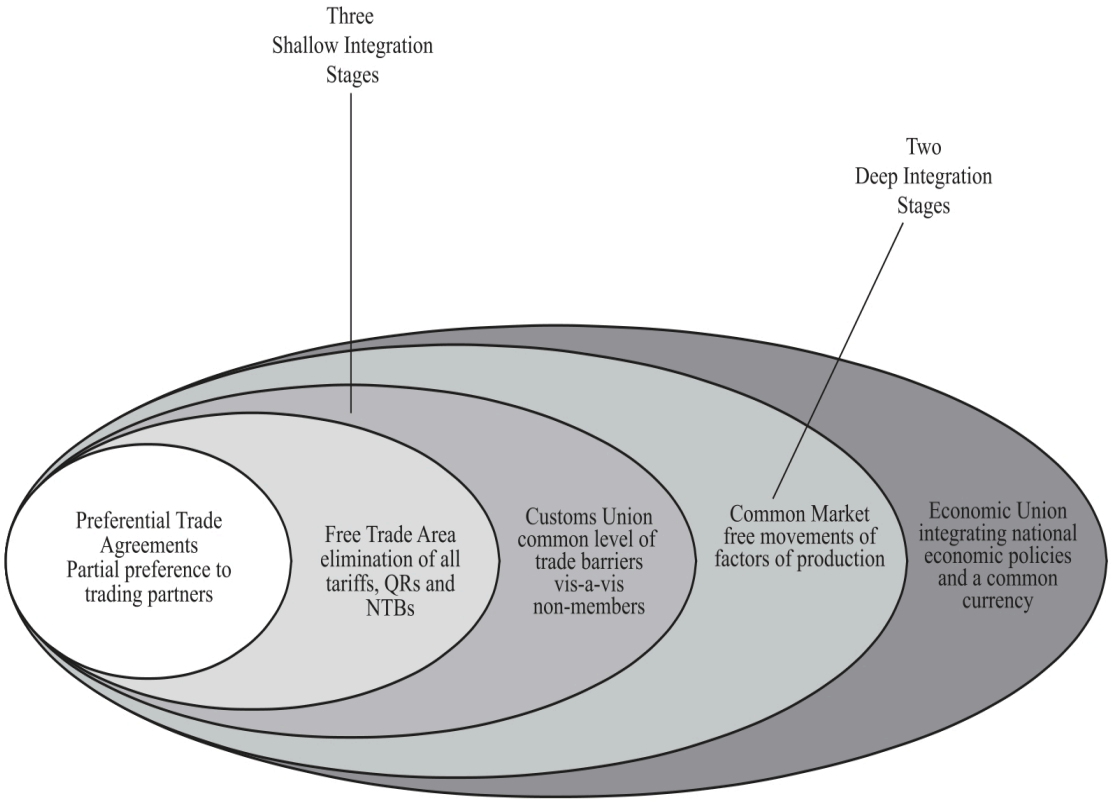



Figure 9-1 Types (levels) of regional economic integration

# 9.2 The Static and Dynamic Effects of Regional Economic Integration

# 1.Static effects of regional economic integration

Static effects of regional economic integration are the effects that occur directly on the formation of the integration project.Economist Jacob Viner（1950） first formalized the static effects of economic integration.Chapter 2 illustrates that the classical theory of trade predicts a win-win result for countries participating in free trade.The question is whether similar benefits accrue （产生） when free trade is limited to one group of countries.

The case examined by Viner was the customs union.The conclusion of Viner's analysis was that either negative or positive effects may result when a group of countries trade freely among themselves but maintain common barriers to trade with nonmembers.While integration represents a movement to free trade on the part of member countries， at the same time it can lead to the diversion （转移） of trade from a lower-cost nonmember source （which still faces the external tariffs of the group） to a member country source （which no longer faces any tariffs）.These two static effects of economic integration are called trade creation and trade diversion which were coined （造词） by Viner in 1950.

(1) Trade creation

In general, trade creation means that economic integration creates trade that would not have existed otherwise.As a result, supply occurs from a more efficient producer of the product.In all cases, trade creation will raise a country's national welfare.

Suppose, for example, that in the US domestic bicycles are sold at US $70, while China sells bicycles for US$50, Mexico sells them for US$60, and both face a US tariff of more than US$20 per bicycle, say US$30.Under this circumstance, no trade on bicycles takes place between the United States and China, or between the United States and Mexico.If tariffs are eliminated on Mexican goods, U.S.consumers will shift their purchases from domestic to Mexican bicycles.The result is that Americans will purchase from a lower-cost source.

(2) Trade diversion

In general, trade diversion means that economic integration diverts tra de, away from a more efficient supplier outside the economic integration un it, towards a less efficient supplier within the economic integration unit.

Suppose, another similar example, that the US domestic bicycles are s old at US$70,China sells bicycles for US$50, Mexico sells them for US$60, and both face a US tariff of less than US$20 per bicycle, say US$15.The Un ited States will import from China at a price of US$65.If tariffs are eliminat ed on Mexican goods, U.S.consumers will shift their purchases from Chines e to Mexican bicycles.The result is that Americans will purchase from a hig her-cost source.

(3) Administrative saving

Economic integration can lead to administrative saving by eliminating the need for government officials to monitor the goods and services that cro ss the borders.Providing around-the-clock （昼夜不停的） customs surveil lance （监管） at all possible crossover points can be costly.

(4) Collective terms of trade improving

As previously stated， changes in the terms of trade are generally mea sured by comparing changes in the ratio of export prices to import prices.Th e terms of trade are considered to have improved when a given volume of e xports can be exchanged for a larger volume of imports.The economic size of the union may permit it to improve its collective （集体的） terms of tra de vis-à-vis （相对于） the rest of the world compared with the average te rms previously obtained by individual member countries.

When a small country imposes a tariff on imports, the price of the goo ds will typically rise because sellers will increase prices to cover the cost of the tariff.This increase in price, in turn, will result in lower demand for the i mported goods.If a bloc of countries imposes the tariff, however, the fall in demand for the imported goods will be substantial.The exporting country m ay then be forced to reduce the price of the goods.The possibility of lower p rices for imports results from the greater market power of the bloc relative t o that of a single country.The result may then be an improvement in the trad e position of the bloc countries.

(5) Greater bargaining power

The member countries will have greater bargaining power in trade negotiations with the rest of the world than they would have had negotiated on their own.

## 2.Dynamic effects of regional economic integration

In addition to the static effects of economic integration， it is likely that the economic structure and performance of participating members may evolve （逐步发展） differently if they had not integrated economically.The factors that cause this to come about are dynamic effects of economic integration.

(1) Increase competition and economies of scale

Integration increases market size and therefore may result in a lower degree of monopoly in the production of certain goods and services.This is because a larger market will tend to increase a number of competing firms，resulting in greater efficiency and lower prices for consumers.Moreover， less energetic and productive economies may be spurred （被刺激） into action by competition from the more industrious bloc members.Many industries， such as steel and automobiles， require large scale production in order to obtain economies of scale in production.Therefore， certain industries may simply not be economically viable in smaller，trade protected countries. However， the formation of a trading bloc enlarges the market so that large scale production is justified.The lower per unit costs resulting from scale economies may then be obtained.These lower production costs resulting from greater production for an enlarged market are called internal economies of scale.

In a common market, external economies of scale may also be present. Because a common market allows factors of production to flow freely across borders, the firm may now have access to cheaper capital, more highly ski

lled labor, or superior technology.These factors will improve the quality of t he firm's product or service or will lower costs or both.

(2) Stimulate greater investment in the member countries

It is also possible that integration will stimulate greater investment in t he member countries from both internal and foreign sources.For example, massive U.S.investment occurred in the EC in the 1960s.

# 9.3 Economic Integration in Europe, Nor th America and Asia

## 1.Economic integration in Europe

(1) The origination and development of the EU

After the end of World War II， moves towards European integration were seen by many as an escape from the extreme forms of nationalism （民族主义） which had devastated （使震惊）the continent.The first ste p in this regional cooperative effort was the establishment of the Organizati on for European Economic Cooperation （OEEC） in 1948 to administer Marshall Plan aid[2]from the United States.Although the objective of the OE EC was limited to economic reconstruction （恢复） following the war， i ts success set the stage for more ambitious integration programs.In 1952， six European countries （West Germany， France， Italy， Belgium，the Netherlands， and Luxembourg） joined in establishing the European Coal and Steel Community （ECSC）[3].The objective of the ECSC was the for mation of a common market in coal and steel for member countries.These b asic industries were rapidly revitalized （恢复生机）into competitive and efficient producers.Following the formation of a common market for coal a nd steel， the same six countries agreed， in 1957， to form the European Economic Community （EEC） under the Treaty of Rome， expanding th e scope of the common market to all industrial and agricultural commoditie

s， thus setting in motion （启动） the extraordinary process of economic integration and political unification among European states.

During the early years of the EEC, a huge economic boom, led by a dy namic West Germany, created much greater prosperity in Western Europe a nd drove forward the liberalization of the EEC economy.In 1967, ECSC and EEC as well as the European Atomic Energy Community (EAEC) were mer ged to form the European Community (EC) and the Merger Treaty created a single set of institutions for the three communities.The early years of the EE C were principally focused upon developing the customs union.In 1968, EC countries stopped charging custom duties when they traded with each other.

In 1973， the Community enlarged to include Denmark， Ireland and the United Kingdom.Norway had negotiated to join at the same time but No rwegian voters rejected membership in a referendum （全民公决） so Nor way remained outside.In 1979 the first direct， democratic elections to the European Parliament were held.Greece joined in 1981， and Spain and Port ugal in 1986.In 1985， the Schengen[4] Agreement （申根协定） led the w ay toward the creation of open borders without passport controls between m ost member states and some non-member states.In 1986， the European fla g began to be used by the Community and the Single European Act （SE A） was signed.The Single European Act was the first major attempt made by member states to amend the arrangements made under the Treaty of Ro me.Although the European Community had been in operation for nearly thir ty years， it had not achieved its aim of a genuine common market.The SE A's main effect was to set a deadline for the creation of a full single market by 1992.It also created deeper integration by making it easier to pass law s，strengthening the EU Parliament and laying the basis for a European for eign policy.In these ways it took the process of European integration to a ne w level， laying the groundwork for the rapid changes of the 1990s and 20 00s.

In 1990， after the fall of the Iron Curtain[5]， the former East German y became part of the Community as part of a newly united Germany.With e nlargement toward Eastern and Central Europe on the agenda， the Copenh

agen criteria for candidate members to join the European Union were agreed.The European Union was formally established when the Maastricht Treaty（马斯特里赫特条约） came into force on 1 November 1993， and in 1995 Austria， Sweden and Finland joined the newly established EU.The Maastricht Treaty amended the provisions of the Treaty of Rome while hugely advancing the agenda set out under the Single European Act（1986） for deepening European Political Union （EPU）.It created a new model for the Community based around three“pillars” which， broadly speaking， covered economic relations，foreign affairs and home affairs.It also officially created the European Union （EU）， which became the title to cover all the functions of the much-expanded European governmental structure.It set in train （准备妥当） the process of Economic and Monetary Union （EMU），which would lead to the creation of the Euro.

In 2002， euro notes and coins replaced national currencies in 12 of the member states.Since then， the eurozone has increased to encompass （包括） sixteen countries， with Slovakia joining the euro zone on 1 January 2009.In 2004， the EU saw its biggest enlargement to date when Malta， Cyprus， Slovenia， Estonia， Latvia， Lithuania， Poland， the Czech Republic，Slovakia， and Hungary joined the Union.On 1 January 2007， Romania and Bulgaria became the EU’s newest members and Slovenia adopted the euro.In December of that year， European leaders signed the Lisbon Treaty which was intended to replace the earlier， failed European Constitution， which never came into force after being rejected by French and Dutch voters.The treaty entered into force on 1 December 2009.On 17 July 2009， Iceland formally applied for joining EU.

Table 9-2　EU enlargement

| Year | Members |
|---|---|
| 1957: establishment | West Germany, France, Italy, Belgium, the Netherlands, and Luxembourg |
| 1973: 1st enlargement | Denmark, Ireland and the United Kingdom |
| 1981: 2nd enlargement | Greece |
| 1986: 3rd enlargement | Spain and Portugal |
| 1995: 4th enlargement | Austria, Sweden and Finland |
| 2004: 5th enlargement | Malta, Cyprus, Slovenia, Estonia, Latvia, Lithuania, Poland, the Czech Republic, Slovakia, and Hungary |
| 2007: 6th enlargement | Romania and Bulgaria |

Table 9-3 Origination and development of EU

| Year | Treaty or Organization | Objectives or Achievements |
|---|---|---|
| 1948 | The Organization for European Economic Cooperation (OEEC) | ➢ Administer Marshall Plan aid from the United States |
| 1952 | The European Coal and Steel Community (ECSC) | ➢ Form a common market in coal and steel for member countries |
| 1958 | The European Economic Community (EEC) | ➢ Expand the scope of the common market to all industrial and agricultural commodities |
| 1967 | ECSC, EEC and EACC merged to form the EC (the Merger Treaty ) | ➢ Create a single set of institutions for the three communities |
| 1985 | The Schengen Agreement | ➢ Lead the way toward the creation of open borders without passport controls between most member states and some non-member states. |
| 1986 | The Single European Act (SEA) | ➢ Amend the Treaty of Rome<br>➢ Set a deadline for the creation of a full single market by 1992<br>➢ Create deeper integration |

to be continued

continued

| Year | Treaty or Organization | Objectives or Achievements |
|---|---|---|
| 1993 | The Maastricht Treaty | ➢ Amend the Treaty of Rome<br>➢ Advance the agenda for deepening European Political Union (EPU)<br>➢ Create a new model for the Community based around three "pillars" covering economic relations, foreign affairs and home affairs, officially created the European Union (EU)<br>➢ Set in train the process of Economic and Monetary Union (EMU) |
| 2007 | The Lisbon Treaty | ➢ Intend to replace the earlier, failed European Constitution<br>➢ Entered into force on 1 December 2009<br>➢ Amend the Treaty on European Union (TEU, *Maastricht*; 1992) and the Treaty establishing the European Community (TEC, *Rome*; 1957). In this process, the TEC was renamed to Treaty on the Functioning of the European Union (TFEU). |

（2） Brexit （英国脱欧）： The British leaving the EU

The United Kingdom's withdrawal from the European Union is widely known as Brexit（a word merging the words Britain and exit）.Following a referendum （公投） held on 23 June 2016 in which 52％ of votes cast were in favor of leaving the EU， the UK government intends to invoke Art icle 50 of the Treaty on European Union， the formal procedure for withdra wing，by the end of March 2017.This， within the treaty terms， would p ut the UK on a course to leave the EU by March 2019.Prime Minister There sa May， elected by the ruling Conservative Party in the wake of the refere ndum， has promised a bill to repeal the European Communities Act 1972 and to incorporate existing EU laws into UK domestic law.The terms of wit hdrawal have not yet been negotiated； in the meantime， the UK remains a full member of the European Union.

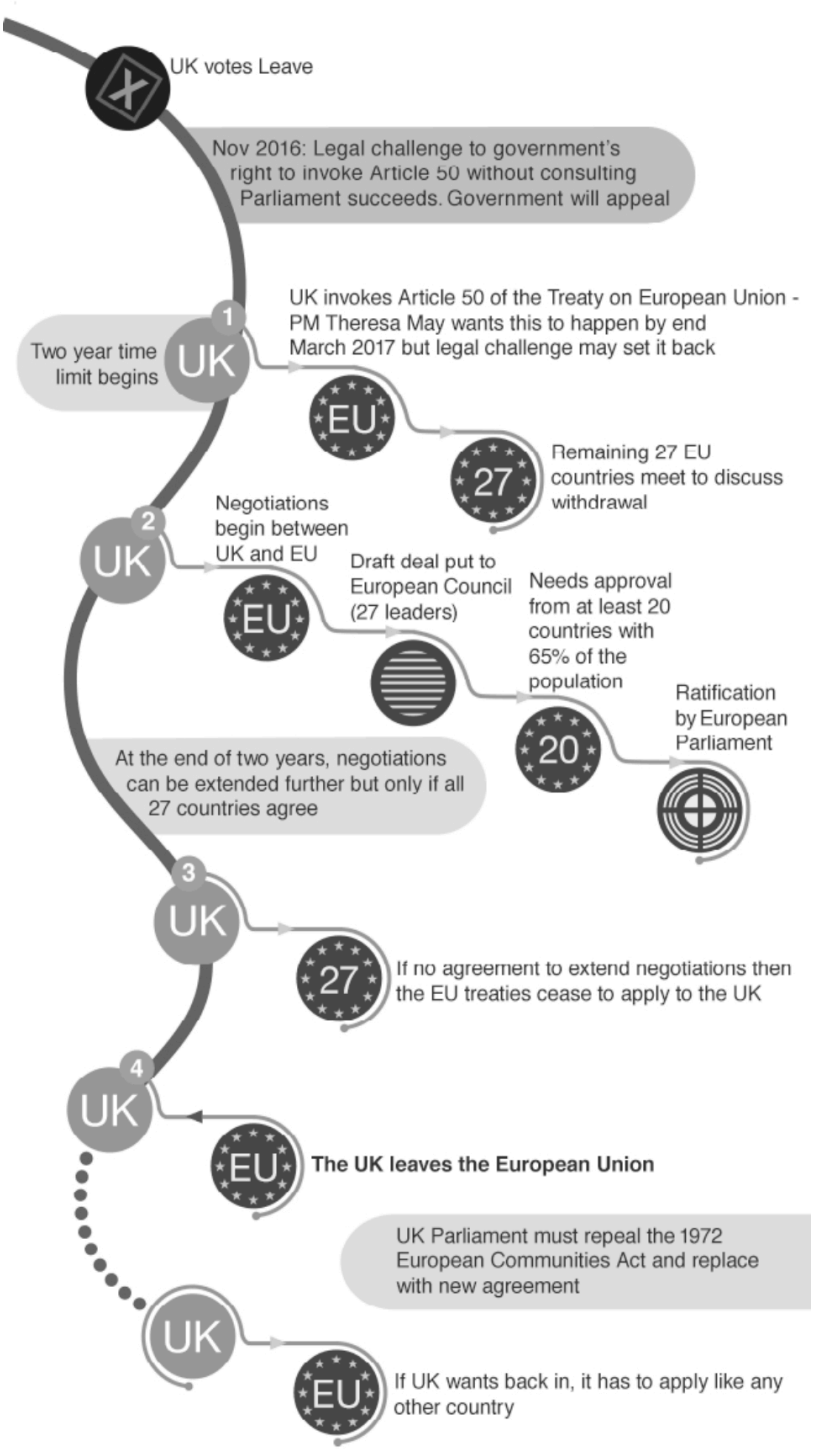
Those campaigning for Britain to leave the EU （退出派） argued tha t Britain was being held back by the EU which had imposed too many rules on business and charged billions of pounds a year in membership fees for lit tle in return.They also cited sovereignty and democracy， and they wanted Britain to take back full control of its borders and reduce the number of peo

ple coming here to live and/or work.They also objected to the idea of“ever c loser union” between EU member states and what they see as moves toward s the creation of a“United States of Europe”.

Those campaigning for Britain to stay in the EU （留下派） said it ge ts a big boost from membership—it makes selling things to other EU countr ies easier and， they argued， the flow of immigrants， most of whom are young and keen to work， fuels economic growth and helps pay for public services.They also said Britain’s status in the world would be damaged by l eaving the EU.

BOX 9-1

Steps to UK Leaving the EU




Source: Alex Hunt & Brian, 2017.Brexit: All you need to know about the UK leaving the EU. Wheelerhttp://www.bbc.com/news/uk-politics-32810887.

A report by Tim Oliver of the German Institute for International and Security Affairs argues a UK withdrawal“has the potential to fundamentally change the EU and European integration.On the one hand， a withdrawal could tip （倾覆） the EU towards protectionism，exacerbate （加剧） existing divisions， or unleash （放纵） centrifugal （离心的） forces leading to the EU’s unravelling （拆散）.Alternatively （或者）， the EU could free itself of its most awkward（难对付的） member， making the EU easier to lead and more effective”.Some authors also highlight the qualitative change in the nature of the EU membership after Brexit：“What the UK case has clearly shown in our view is that for the Union to be sustainable， membership needs to entail （需要，包括） constant caretaking as far as individual members’ contributions to the common good are concerned， with both rights and obligations”.

After the December 2019 election, the British Parliament finally ratified the withdrawal agreement.The UK left the EU at the end of 31 January 2020 CET (11 p.m.GMT).During the transition, the UK remained subject to EU law and remained part of the EU customs union and single market.

(3) EU institutions and other bodies

The EU is not a federation like the United States.Nor is it simply an organization for co-operation between governments， like the United Nations.It is， in fact， unique.The countries that make up the EU （its“member states”） remain independent sovereign nations but they pool （共用） their sovereignty in order to gain a strength and world influence none of them could have on their own.Pooling sovereignty means， in practice， that the member states delegate（授权） some of their decision-making powers to shared institutions they have created， so that decisions on specific matters of joint interest can be made democratically at European level.

The EU’s decision-making process in general and the co-decision procedure in particular involve three main institutions: the European Parliament (EP), which represents the EU’s citizens and is directly elected by them; the Council of the European Union, which represents the individual member sta

tes; the European Commission, which seeks to uphold the interests of the U nion as a whole.

This“institutional triangle” produces the policies and laws that apply th roughout the EU.In principle， it is the Commission that proposes new law s， but it is the Parliament and Council that adopt them.The Commission a nd the member states then implement them， and the Commission ensures t hat the laws are properly taken on board （接受；完全理解）.

Two other institutions have a vital part to play: the Court of Justice uph olds the rule of European law, and the Court of Auditors checks the financin g of the Union’s activities.

The powers and responsibilities of these institutions are laid down in th e Treaties， which are the foundation of everything the EU does.They also l ay down the rules and procedures that the EU institutions must follow.The Treaties are agreed by the presidents and/or prime ministers of all the EU co untries， and ratified （批准） by their parliaments.In addition to its instit utions， the EU has a number of other bodies that play specialized roles.

## 2.Economic integration in North America

Although EU is undoubtedly the most successfully and well-known int egrative efforts，integration efforts in North America， although about 15 years old， have gained momentum （势头） and attention.

(1) The origination of NAFTA

Negotiations on North American Free Trade Agreement (NAFTA) beg an in 1991.The agreement was signed in August, 1992 and took effect on Ja nuary 1, 1994.Upon entering into force in January 1994, NAFTA represente d a $6 trillion economy with a population of 372 million (the world’s largest free market).In 2008, the NAFTA area grew to US$17 trillion economy wit h a population of 444.1 million.This agreement is between the United States and its first and third largest trading partners, Canada and Mexico.The pact

marked a bold departure: never before have industrialized countries created such a massive free trade area with a developing country.

Of course， North America economic integration was long under way before NAFTA—building on the 1965 Canada-United States Automotive A greement （commonly known as the 1965 Auto Pact）， initiation of the Mexican maquiladora （组装工厂） program of 1965， Mexican economi c reforms from the mid-1980s， accession to the GATT in 1986， and the Canada-U.S.Free Trade Agreement （CUSFTA[6]） in 1989.For many deca des before 1990s， the United States accounted for the predominant share o f trade and foreign direct investment in both Canada and Mexico.

For the United States， NAFTA was an economic opportunity to capit alize （充分利用） on a growing export to the south.At the same time， N AFTA was seen as a way to deepen the democratic processes in Mexico.In a ddition， US officials hoped the regional talks would spur（鼓励） progre ss on the slow-paced Uruguay Round of multilateral negotiations.The USA also recognized that the imports from Mexico would likely include higher U S content than competing imports from Asia， providing an additional bene fit.

For Mexico， NAFTA represented a way to lock in the reforms of aper tura （开口）， or“market opening”.Mexico needed more rapid growth to provide new opportunities for its young， expanding population.

For Canada， the objectives were less ambitious.Canadian officials su spected that a new agreement with Mexico would erode （损害） the hard-fought gains of the CUSFTA， which had come into force only in 1989.Ho wever， as it became clear in September 1990 that the United States and M exico were going to move ahead with or without Canada， the Canadian go vernment decided that it had more to gain by joining the negotiation than by staying on the sideline （在局外）.Involvement allowed the government to minimize the risks to Canada of the US-Mexico free trade and offered an op portunity to extract new commercial concessions from the United States.

(2) The objectives of NAFTA

The objectives of NAFTA are to: 1) eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties; 2) promote conditions of fair competition in the free trade area; 3) increase substantially investment opportunities in the territories of the Parties; 4) provide adequate and effective protection and enforcement of intellectual property rights in each Party's territory; 5) create effective procedures for the implementation and application of this Agreement, for its joint administration and for the resolution of disputes; and 6) establish a framework for further trilateral, regional and multilateral cooperation to expand and enhance the benefits of this Agreement.

(3) The main contents of NAFTA

NAFTA is a complex and lengthy document that includes eight sections， 22 chapters， and some 2，000 pages.Some of the most important provisions are highlighted （强调） below：

1) Market access for goods

■ The elimination of duties on thousands of goods crossing borders within North America.

■ Phased-in （逐步实施） tariff reductions—now complete—and special rules for agricultural，automotive， and textile and apparel products.

■ Important rights for NAFTA services providers and users across a broad spectrum of sectors.

■ Special commitments regarding telecommunications and financial services.

■ Formal dispute resolution processes that help resolve differences that arise in the interpretation or application of NAFTA's rules.

2) Protection for foreign investment

■ Commitment to treat each other' s investors and their investments in the territory of the host NAFTA country no less favorably than their own domestic investors.

■ Commitment to provide NAFTA investors with the best treatment gi ven to foreign investors from beyond North America.

■ A transparent and binding dispute resolution mechanism specially de signed to deal with investment.

3) Protection for intellectual property

Adequate and effective protection and enforcement of a broad range of intellectual property rights (including through patents, trademarks, copyrigh ts, and industrial designs),while ensuring that the measures that enforce thes e rights do not become barriers to legitimate trade themselves.

4) Easier access for business travelers

Easier access for business professionals in hundreds of different profes sions so that they can travel for business throughout the continent.

5) Access to government procurement

Access to government procurement opportunities at the federal levels i n Canada, Mexico,and the United States.

6) Rules of origin

NAFTA rules of origin are used to determine whether a good is eligible for preferential treatment under NAFTA.At various times since NAFTA ca me into effect, the partners have implemented measures to liberalize or expa nd the list of products that qualify for preferential treatment.Since 2005, for example, the NAFTA partners have implemented two sets of changes to ma ke it easier for traders to qualify for duty-free treatment under NAFTA.

The NAFTA partners also negotiated two side agreements: the North A merican Agreement on Environmental Cooperation and the North American Agreement on Labor Cooperation.

(4) The impact of NAFTA

At the time of its ratification， NAFTA was hailed （称颂） by some and derided （讥笑） by others.Even after more than a decade of hindsight

（事后认识） and data， the political debate over NAFTA remains confused and divisive （引起分歧的）.

Since NAFTA came into effect, merchandise trade among the NAFTA partners has more than tripled, reaching US$946.1 billion in 2008.Over that period, Canada-U.S.trade has nearly tripled, while trade between Mexico and the U.S.has more than quadrupled.The North American economy has more than doubled in size.The combined gross domestic product(GDP) for Canada, the United States, and Mexico surpassed US$17 trillion in 2008, up from US$7.6 trillion in 1993.In 2008, Canada and the United States' inward foreign direct investment stocks from NAFTA partner countries reached US$469.8 billion.Meanwhile,Mexico has become one of the largest recipients of foreign direct investment among emerging markets, and received US$156 billion from its NAFTA partners between 1993 and 2008.(For more impacts of NAFTA, see Box 9-1)

Box 9-2

The Impact of NAFTA on Mexico's Employment,Productivity and Wages

A study made by The Carnegie Endowment for International Peace[7] presented the following results about the change in employment, productivity and wages, etc.

1） Employment： NAFTA has produced a disappointingly small net gain in jobs in Mexico.Jobs created in export manufacturing have barely kept pace with jobs lost in agriculture due to imports.Mexican agriculture has been a net loser in trade with the United States， and employment in the sector has declined sharply.U.S.exports of subsidized crops， such as corn， have depressed agricultural prices in Mexico.NAFTA's net effect on jobs in the United States has been minuscule （极小的）， given the size of the U.S.economy and the importance of other trading partners.For Canada， NAFTA's predecessor， CUFTA took effect in 1989 and at first led to substantial net job losses in Canada's traded sectors.After about five years， the losses stopped and export manufacturing began to grow again.A decade after the enactment of CUFTA， manufacturing employment recovered to the le

vels seen before the trade pact and has continued to grow modestly since th en.

2) Productivity: Productivity has increased in all three countries over t he last decade.

NAFTA and CUFTA likely played a significant role in the observed pr oductivity growth in Mexico and Canada， because both countries cut tariff s deeply and were thereby exposed to （面对） competition from their gian t neighbor.In the United States， NAFTA probably has played a small or ne gligible role in productivity growth for two reasons： U.S.tariffs were alrea dy low before NAFTA and trade with the rest of the world plays a much lar ger role.The desirable growth in productivity may have had the unwanted si de effect of reducing the rate of job growth， since fewer new jobs were cre ated as workers already on payrolls produced more.

3） Wages： Real wages for most Mexicans today are lower than whe n NAFTA took effect.This stunning （令人震惊的） setback in wages is m ainly attributable to the peso crisis of 1994-1995.However， during the NA FTA period， productivity growth has not translated into wage growth， as it did in earlier periods in Mexico.Mexican wages are also diverging from， rather than converging with， U.S.wages.Since the net impact of NAFTA o n U.S.employment is small， the impact on overall wages is also minor.But a widening gap between the wages of skilled and unskilled workers is partly attributable to trade， and NAFTA as a factor in U.S.trade is thus likely to a ccount for a portion of the observed growth in wage inequality.

Source: http://www.carnegieendowment.org/files/nafta1.pdf Adapted from Nafta’s Promise and Reality, Lessons from Mexico from the Hemisphere.

(5) Renegotiation of NAFTA

Under the leadership of President Donald J.Trump, the United States re negotiated the North American Free Trade Agreement, replacing it with an updated and rebalanced agreement that works much better for North Americ a—the United States-Mexico-Canada Agreement(USMCA), which entered i nto force on July 1, 2020.The USMCA is a mutually beneficial win for Nort h American workers, farmers, ranchers, and businesses.The Agreement is cr

eating more balanced, reciprocal trade supporting high-paying jobs for Ame ricans and the growth of North American economy.

Agreement highlights include:

● Creating a more level playing field for American workers, including improved rules of origin for automobiles, trucks, other products, and discipl ines on currency manipulation.

● Benefiting American farmers, ranchers, and agribusinesses by moder nizing and strengthening food and agriculture trade in North America.

● Supporting a 21st Century economy through new protections for U. S.intellectual property, and ensuring opportunities for trade in U.S.services.

● New chapters covering Digital Trade, Anticorruption, and Good Reg ulatory Practices,as well as a chapter devoted to ensuring that Small and Me dium Sized Enterprises benefit from the Agreement.

## 3.Economic Integration in Asia and Asia-Pacific re gion

（1） ASEAN （Association of Southeast Asian Nations） （东南亚国家联盟）

The Association of Southeast Asian Nations （ASEAN） was establis hed on 8 August 1967 in Bangkok （曼谷） by the five original member co untries， namely， Indonesia， Malaysia， the Philippines， Singapore， and Thailand.Brunei Darussalam （文莱） joined on 8 January 1984， Viet nam on 28 July 1995， Laos and Myanmar （缅甸） on 23 July 1997， an d Cambodia on 30 April 1999.

As of 2006, the ASEAN region has a population of about 560 million, a total area of 4.5 million square kilometers, a combined gross domestic pro duct of almost US$ 1,100 billion,and a total trade of about US$1,400 billio n.

The aims and purposes of the Association are: 1) To accelerate economic growth, social progress and cultural development in the region and 2) To promote regional peace and stability through abiding respect for justice and the rule of law in the relationship among countries in the region and adherence to the principles of the United Nations Charter.

The ASEAN Vision 2020， adopted by the ASEAN Leaders on the 30th Anniversary of ASEAN， agreed on a shared vision of ASEAN as a concert （一致） of Southeast Asian nations，outward looking， living in peace， stability and prosperity， bonded together in partnership in dynamic development and in a community of caring societies.

In 2003, the ASEAN Leaders resolved that an ASEAN Community shall be established comprising three pillars, namely, ASEAN Security Community, ASEAN Economic Community and ASEAN Socio-Cultural Community.

Building on the Joint Statement on East Asia Cooperation of 1999, cooperation between the Southeast and Northeast Asian countries has accelerated with the holding of an annual summit among the leaders of ASEAN, China, Japan, and the Republic of Korea (ROK) within the ASEAN Plus Three process.

ASEAN Plus Three relations continue to expand and deepen in the areas of security dialogue and cooperation, transnational crime, trade and investment, environment, finance and monetary, agriculture and forestry, energy, tourism, health, labour, culture and the arts, science and technology, information and communication technology, social welfare and development,youth, and rural development and poverty eradication.There are now thirteen ministerial-level meetings under the ASEAN Plus Three process.Bilateral trading arrangements have been or are being forged between ASEAN Member Countries and China, Japan, and the ROK.These arrangements will serve as the building blocks of an East Asian Free Trade Area as a long term goal.

In November 2000， China first proposed the idea of China-ASEAN Free Trade Area（CAFTA）， a free trade area among ten member states of the Association of Southeast Asian Nations （ASEAN） and the People’s

Republic of China.The initial framework agreement was signed on 4 November 2002 in Phnom Penh （金边）， Cambodia， with the intent on establishing a free trade area among the eleven nations by 2010.The free trade area came into effect on 1 January 2010.The China-ASEAN Free Trade Area is the largest free trade area in terms of population （about 1.7 billion） and the third largest free trade area in terms of trade volume（about 4.5 trillion U.S.dollars） after the European Economic Area and the North American Free Trade Area.

China-ASEAN trade grew by 24.2 percent annually from 2003 to 2008.Bilateral trade hit 231 billion U.S.dollars in 2008, up from 78.2 billion U.S.dollars in 2003 and 6.3 billion U.S.dollars in 1991.China is currently the third largest trade partner of ASEAN; ASEAN is the fourth largest trade partner of China.

In the CAFTA， the average tariff on goods from the ASEAN countries to China is cut down to 0.1 percent from 9.8 percent.The five original ASEAN members， Indonesia， Malaysia，the Philippines， Singapore and Thailand， will slash （削减） the average tariff on Chinese goods from 12.8 percent to 0.6 percent.By 2015， the policy of zero-tariff rate for 90 percent of traded goods is expected to extend between China and the four new ASEAN members， Cambodia，Laos， Myanmar and Vietnam.

（2） APEC （Asia-Pacific Economic Cooperation） （亚太经济合作组织）

Asia-Pacific Economic Cooperation, or APEC, is the premier forum for facilitating economic growth, cooperation, trade and investment in the Asia-Pacific region.It has 21 members—referred to as“Member Economies”—which account for approximately 40.5％[8]of the world’s population, approximately 54.2％ of world GDP and about 43.7％[9]of world trade.

1) The origin of APEC

The idea of APEC was firstly publicly broached （提出讨论） by former Prime Minister of Australia， Mr.Bob Hawke in January 1989.Later that year， 12 Asia-Pacific economies met in Canberra， Australia to establis

h APEC.The founding members were： Australia， Brunei Darussalam， Canada， Indonesia， Japan， Korea， Malaysia， New Zealand， the P hilippines，Singapore， Thailand and the United States.China， Hong Ko ng Special Administrative Region of China and Taiwan Province of China j oined in 1991.Mexico and Papua New Guinea followed in 1993.Chile acced ed in 1994.And in 1998， Peru， Russia and Viet Nam joined，taking the full membership to 21.

Between 1989 and 1992， APEC met as an informal senior official an d ministerial level dialogue.In 1993， former United States President， Mr. Bill Clinton， established the practice of an annual APEC Economic Leade rs' Meeting.A moratorium （暂停） on new membership stands until the e nd of 2010， at which point APEC member economies will consider wheth er or not to lift the moratorium.

2) The operation of APEC

APEC operates as a cooperative, multilateral economic and trade foru m.It is the only inter-governmental grouping in the world operating on the b asis of non-binding commitments,open dialogue and equal respect for the vi ews of all participants.Unlike the WTO or other multilateral trade bodies, A PEC has no treaty obligations required of its participants.Decisions made wi thin APEC are reached by consensus and commitments are undertaken on a voluntary basis.APEC achieves its goals by promoting dialogue and arrivin g at decisions on a consensus basis, giving equal weight to the views of all members.

Every year one of the 21 APEC Member Economies plays host to APE C meetings and serves as the APEC Chair.The APEC host economy is respo nsible for chairing the annual Economic Leaders' Meeting, selected Ministe rial Meetings, Senior Officials Meetings, the APEC Business Advisory Cou ncil and the APEC Study Centres Consortium.Until 2009, the host has also f illed the Executive Director position at the APEC Secretariat.From 2010, th e appointment will be made on a fixed-term basis (3 years) and will be open to candidates from all Member Economies.

APEC activities are centrally funded by small annual contributions fro m APEC Member Economies—since 1999 these have totaled US$3.3 millio n each year.From 2009 onwards， members' contribution will increase by 3 0％ to a total of US$5 million.These contributions are used to fund a Secret ariat in Singapore and various projects which support APEC's economic an d trade goals.APEC Member Economies also provide considerable resource s to assist the operation of APEC.These include the secondment （借调） o f professional staff to the Secretariat； the hosting of meetings； and partia l or full funding of some projects.

3) The major achievements and benefits of APEC

APEC works in three broad areas: Trade and Investment Liberalizatio n, Business Facilitation, Economic and Technical Cooperation.APEC's wor k under these three main pillars of activity has helped drive the economic gr owth and improve employment opportunities and standards of living for the citizens of the region.

(a) Trade and investment liberalization: Trade and investment liberaliz ation reduces and eventually eliminates tariff and non-tariff barriers to trade and investment.It focuses on opening markets to increase trade and investm ent among economies, resulting in economic growth for APEC Member Ec onomies and increased standards of living for all.When APEC was establish ed in 1989, average trade barriers in the region stood at 16.9％; by 2004 bar riers had been reduced by approximately 70％ to 5.5％.[10]As a consequenc e, intra-APEC merchandise trade (exports and imports) has grown from US $1.7 trillion in 1989 to US$8.44 trillion in 2007—an average increase of 8. 5％ per year; and merchandise trade within the region accounted for 67％ o f APEC's total merchandise trade in 2007.[11] Similarly, trade with the rest of the world has increased from US$3 trillion in 1989 to US$15 trillion in 200 7, an average increase of 8.3％ per year.Trade in the rest of the world has in creased at 7.6％ over the same period.Over 30 bilateral free trade agreemen ts (FTAs) have been concluded between APEC Member Economies.

（b） Business facilitation： Business facilitation focuses on reducing the costs of business transactions， improving access to trade information a

nd aligning （使……一致） policy and business strategies to facilitate gro wth， and free and open trade.APEC’s Structural Reform agenda addresses this area.As a result of the APEC Trade Facilitation Action Plan （TFAP I），the cost of business transactions across the region was reduced by 5％ between 2002 and 2006.A second trade facilitation action plan （TFAP I I）， aims at reducing transaction costs by a further 5％ between 2007 and 2010.APEC initiatives that help facilitate trade include： The introduction of electronic/paperless systems by all member economies， covering the pa yment of duties， and customs and trade-related document processing.

(c) Economic and technical cooperation: APEC’s Economic and Techn ical Cooperation(ECOTECH) activities are designed to build capacity and s kills in APEC Member Economies at both the individual and institutional le vel, to enable them to participate more fully in the regional economy and th e liberalization process.Since APEC first began to undertake capacity buildi ng work in 1993, more than 1200 projects have been initiated; and in 2008, APEC was implementing a total of 212 capacity building projects with a tot al value of US$13.5m.A particular focus has been reducing the digital divid e between developed and developing economies.

The outcomes of these three areas enable APEC Member Economies t o strengthen their economies by pooling resources within the region and ach ieving efficiencies.Tangible benefits are also delivered to consumers in the APEC region through increased training and employment opportunities, gre ater choices in the marketplace, cheaper goods and services and improved a ccess to international markets.

Since APEC’s inception （开始） in 1989， the Asia-Pacific region h as consistently been the most economically dynamic region in the world.AP EC’s total trade has grown 395％，significantly outpacing the rest of the w orld.In the same period， GDP （in purchasing power parity terms） in the APEC region has tripled， while GDP in the rest of the world has less than doubled.

（3） TPP （Trans-Pacific Partnership） Agreement （跨太平洋伙伴协定）

The Trans-Pacific Partnership (TPP) or Trans Pacific Partnership Agre ement (TPPA) is a trade agreement among twelve of the Pacific Rim countri es—notably not including China.The finalized proposal was signed on 4 Fe bruary 2016 in Auckland, New Zealand, concluding seven years of negotiati ons.It is currently awaiting ratification to enter into force.The 30 chapters of the agreement aim to“promote economic growth; support the creation and r etention of jobs; enhance innovation, productivity and competitiveness; rais e living standards;reduce poverty in the signatories’ countries; and promote transparency, good governance, and enhanced labor and environmental prot ections.”

The TPP offers its signatories the potential to benefit from the large siz e of the markets covered by the agreement and to increase their share of wo rld trade.In 2014, the signatories accounted for 36 percent of the world’s G DP, or US$ 28 trillion, and encompassed a population of 810 million.The U nited States is the largest market in terms of GDP and population, representi ng 62 percent of the TPP’s GDP and 40 percent of the population covered b y the TPP.

The TPP began as an expansion of the Trans-Pacific Strategic Economi c Partnership Agreement (TPSEP or P4) signed by Brunei, Chile, New Zeal and, and Singapore in 2005.Beginning in 2008, additional countries joined t he discussion for a broader agreement:Australia, Canada, Japan, Malaysia, Mexico, Peru, United States, and Vietnam, bringing the total number of cou ntries participating in the negotiations to twelve (all are members of the AP EC).Current trade agreements between participating countries, such as the North American Free Trade Agreement, will be reduced to those provisions that do not conflict with the TPP or provide greater trade liberalization than the TPP.The United States government considers the TPP a companion agre ement to the proposed Transatlantic Trade and Investment Partnership(TTI P), a broadly similar agreement between the U.S.and the European Union.

Participating nations aimed at completing negotiations in 2012, but the process was prolonged by disagreements over contentious issues, including agriculture, intellectual property, and services and investments.They finally reached agreement on 5 October 2015.A version of the treaty text“Subject t

o Legal Review (...) for Accuracy, Clarity and Consistency”was made publi c on 5 November 2015, the same day President Obama notified Congress he intended to sign it.On November 11, 2016, it was reported that, due to Dona ld Trump’s election to President, the White House would not pursue passing the agreement.On 20 November 2016, Singapore declared that they will am end legislation to bring the TPP into effect.

Some analysts have even suggested that the U.S.may be trying to use t he TPP as a means to undermine China’s growing economic might in the re gion.Many believe that other members of the APEC bloc may also join the agreement in the coming years, making it an even more important pact.Unf ortunately, On Jan., 23, 2017, President Donald Trump who took office on 1 9 Nov., 2016 officially withdrew the United States from the Trans-Pacific P artnership (TPP) trade deal.During his campaign for the presidency, Trump said some trade deals with other countries cost America jobs.He said they le ad employers to move operations outside the United States to save on labor costs.The United States negotiated the TPP during the administration of for mer President Barack Obama.But the U.S.Congress never approved the trad e deal.

（4） RCEP Agreement （Regional Comprehensive Economic Partne rship Agreement， 区域全面经济伙伴关系协定）

Unifying the preexisting bilateral agreements between the 10-member ASEAN and five of its major trade partners (Australia, China, Japan, New Zealand, Korea), the RCEP was signed on 15 November 2020 at a virtual A SEAN Summit hosted by Vietnam, and will take effect 60 days after it has b een ratified by at least six ASEAN and three non-ASEAN signatories.The R CEP is arguably the largest free trade agreement in history.

Together, the RCEP participating countries account for about 30％ of t he global GDP and 30％ of the world population.The objective of the RCE P Agreement is to establish a modern,comprehensive, high-quality, and mut ually beneficial economic partnership that will facilitate the expansion of re gional trade and investment and contribute to global economic growth and d evelopment.Accordingly, it will bring about market and employment opport

unities to businesses and people in the region.The RCEP Agreement will wo rk alongside and support an open, inclusive, and rules-based multilateral tra ding system.

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[1]Under the leadership of the UK， Austria， Denmark， Norway， Portugal， Sweden and Switz erland formed the European Free Trade Area （EFTA） in 1960， with the aim of removing trading barriers among the member countries but retaining national autonomy with regard to economic polici es， and without contemplating （考虑接受） a political union.

[2]A four-year program proposed by U.S.Secretary of state， George C.Marshall， on June 5， 19 47， and instituted at the Paris Economic Conference in July 1947 to provide foreign assistance to se venteen western and southern European nations during World War II reconstruction.Implemented by t he Economic Cooperation Administration， it was created to restore economic stability in Europe an d to facilitate foreign trade， and it dispensed （分类） over $13 billion between 1948 and 1951.It was also designed to contain Soviet and communist expansionism.It was a predecessor of NATO and the Atlantic alliance.The USSR declined to participate in the program and subsequently established th e Cominform （the Communist Information Bureau） to oppose the Marshall Plan.

[3]Coal and steel production was essential for the reconstruction of countries in Europe after the seco nd World War and this sector of the national economy had been important for warfare in the first and second World Wars.Therefore， France had originally maintained its occupation of the Saarland with its steel companies after the founding of the Federal Republic of Germany （West Germany） in 194 9.By transferring national powers over the coal and steel production to a newly created ECSC Comm ission， the member states of the ECSC were able to provide for greater transparency and trust amon g themselves.

[4]Schengen is a small wine-making village and commune （最小行政区） in far south-eastern Lux embourg， near the point where the borders of Germany， France， and Luxembourg meet.

[5]“Iron Curtain” is a term used to describe the boundary that separated the Warsaw Pact countries fr om the NATO countries from about 1945 until the end of the Cold War in 1991.The Iron Curtain was both a physical and an ideological division that represented the way Europe was viewed after World War II.

[6]The CUSFTA included a schedule for the elimination of all tariffs on trade between Canada and th e United States by January 1，1998.It established a mutually beneficial framework for the fair and pr edictable treatment of investors.It also included rules governing trade in services.

[7]The Carnegie Endowment for International Peace is a foreign-policy think tank based in Washingt on， D.C.The organization describes itself as being dedicated to advancing cooperation between nati ons and promoting active international engagement by the United States.Founded in 1910 by Andrew Carnegie, its work is not formally associated with any political party.

[8]Sources: The APEC Region Trade and Investment 2008.

[9]Sources: The APEC Region Trade and Investment 2008, World Trade [Trade in goods and services (exports + imports)].

[10]Source: APEC (2005), A Mid-Term Stocktake of the Bogor Goals.

[11]Source: The Department of Trade and Foreign Affairs (2008), The APEC Region Trade and Inves tment 2008, Australia.

# Chapter 10　GATT and WTO

Learning Objectives

In this chapter, you will learn:

- History of GATT and WTO
- Basic principles, structure and agreements of WTO
- Issues concerning China's accession to WTO

Since its establishment in 1948， GATT had become an ongoing （不断发展的）organization that sponsored （发起） regular negotiations of easing （放松） trade restrictions in all of the participating countries.GATT helped establish a strong and prosperous multilateral trading system that became more and more liberal.But by the 1980s the system needed a thorough overhaul （革新）.This led to the Uruguay Round， and ultimately to the WTO.

This chapter starts with the origination of GATT and the achievements of the Uruguay Round, GATT's last round of negotiation.Then it makes an in-depth analysis of the basic principles and some agreements of WTO.Finally, the long negotiation of China's accession to WTO as well as China's main commitments in WTO is reviewed.The impact of China's accession to WTO is also studied.

## 10.1　GATT

### 1.The origination of the GATT

From 1948 to 1994， the General Agreement on Tariffs and Trade （GATT） provided the rules for much of world trade and presided （主持） o

ver periods that saw some of the highest growth rates in international comm erce.It seemed well-established， but throughout those 47 years， it was a provisional agreement and organization.

The original intention was to create a third institution to handle the tra de side of international economic cooperation， joining the two“Bretton W oods”[1]（布雷顿森林）institutions， the World Bank and the Internationa l Monetary Fund.Over 50 countries participated in negotiations to create an International Trade Organization （ITO） as a specialized agency of the U nited Nations.The draft ITO Charter was ambitious （雄心勃勃的）.It exte nded beyond world trade disciplines （规则）， to include rules on emplo yment，commodity agreements， restrictive business practices， internati onal investment， and services.The aim was to create the ITO at a UN Conf erence on Trade and Employment in Havana，Cuba in 1947.

Meanwhile， 15 countries had begun talks in December 1945 to reduc e and bind customs tariffs.With the Second World War only recently ende d， they wanted to give an early boost to trade liberalization， and to begin to correct the legacy （遗留问题） of protectionist measures which remain ed in place from the early 1930s.

This first round of negotiations resulted in a package of trade rules and 45，000 tariff concessions affecting $10 billion of trade， about one fifth o f the world’s total.The group had expanded to 23 by the time the deal was si gned on 30 October 1947.The tariff concessions came into effect by 30 June 1948 through a“Protocol of Provisional Application”（临时适用议定书）.So the new General Agreement on Tariffs and Trade was born， with 23 founding members （officially“contracting parties”）.

The 23 members were also part of the larger group negotiating the ITO Charter.One of the provisions of GATT says that they should accept some o f the trade rules of the draft.This，they believed， should be done swiftly a nd“provisionally” in order to protect the value of the tariff concessions they had negotiated.They spelt out （阐述了） how they envisaged （设想） t he relationship between GATT and the ITO Charter， but they also allowed for the possibility that the ITO might not be created.They were right.

The Havana conference began on 21 November 1947， less than a mo nth after GATT was signed.The ITO Charter was finally agreed in Havana i n March 1948， but ratification （正式批准） in some national legislature s （立法机关） proved impossible.The most serious opposition was in the US Congress， even though the US government had been one of the drivin g forces.In 1950， the United States government announced that it would n ot seek Congressional ratification of the Havana Charter， and the ITO was effectively dead.So， the GATT became the only multilateral instrument go verning international trade from 1948 until the WTO was established in 199 5.

## 2.The GATT’s activities: eight trade negotiatio n“Rounds”

Throughout its 47 year history， the GATT provided the structure for a global process of steady trade liberalization through eight“rounds” of mult ilateral trade negotiations sponsored by its Contracting Parties， covering p rogressively （日益增加地） larger volumes of international trade.

(1) The first five rounds of trade negotiations

From 1947 to 1961， five GATT rounds of trade negotiations were hel d， in which the participating countries hammered out （阐明） mutually acceptable reductions of various barriers.1） The first round was held in Ge neva in 1947.The General Agreement on Tariffs and Trade （GATT） was signed by twenty three nations.The Agreement contained tariff concessions agreed to during the first multilateral trade negotiations and a set of rules de signed to prevent these concessions from being frustrated （挫败） by restr ictive trade measures；2）The second round was held in 1949， from Apri l to August at Annecy， France.Thirteen contracting parties exchanged som e 5，000 tariff concessions； 3） The third round was held in Torquay fro m September 1950 to April 1951.Thirty-eight contracting parties exchanged some 8，700 tariff concessions in the English town， yielding （带来） ta riff reductions of about 25 percent in relation to the 1948 level； 4） The f

ourth round was completed in May， 1956 in Geneva.The round produced some US$2.5 billion worth of tariff reductions.These tariff reductions were exchanged between twenty six contracting parties； 5） The fifth round is Dillon Round， named in honor of （为纪念） the US Undersecretary （副国务卿） Douglas Dillon， who proposed the negotiations.The fifth r ound was held in 1962 and was divided into two phases：the first was conc erned with EEC member states for the creation of a single schedule of conc essions for the Community， and the second with further tariff negotiation s， which resulted in about 4，400 tariff concessions exchanged between t wenty six countries covering US$4.9 billion of trade.

The first round was reasonably （相当地） successful.However， ec onomists did not judge the next four rounds in 1949， 1951， 1956， and 1962 as having attained much success.Nevertheless， some multilateral tari ff reductions were achieved.

(2) The Kennedy Round of trade negotiations

To put new life into the trade negotiation process and to avoid being sh ut out by the newly forming European Economic Community, the United St ates led the way into a new round of negotiations from 1964 to 1967.In this round, tariffs on manufactured products were reduced by an average of 35 p ercent, with at least some reduction occurring in 64 percent of manufacture d goods with tariffs.The Kennedy Round achieved little progress in reducin g barriers on agricultural products.In addition, the Kennedy Round did little to ease non-tariff barriers.

(3) The Tokyo Round of trade negotiations

The Tokyo Round during the 1970s was the first major attempt to tackl e trade barriers that do not take the form of tariffs， and to improve the syst em.The Tokyo Round lasted from 1973 to 1979， with 102 countries partici pating.It continued GATT’s efforts to progressively reduce tariffs.The result s included an average one-third cut in customs duties in the world’s nine ma jor industrial markets， bringing the average tariff on industrial products do wn to 4.7％.The tariff reductions， phased （分阶段计划） in over a perio

d of eight years， involved an element of“harmonization”—the higher the t ariff， the larger the cut， proportionally.

In other issues， the Tokyo Round had mixed results.It failed to come to grip with（对……产生强烈影响） the fundamental problems affecting farm trade and also stopped short of （不再） providing a modified agreem ent on“safeguards”（保障措施） （emergency import measures）.Nevert heless， a series of agreements on non-tariff barriers did emerge from the n egotiations， in some cases interpreting existing GATT rules， in others br eaking entirely new ground.In most cases， only a relatively small number of （mainly industrialized） GATT members subscribed （签署） to these agreements and arrangements.Because they were not accepted by the full G ATT membership， they were often informally called“codes”（规则）.

## 3.The Uruguay Round of trade negotiations

The Uruguay Round of 1986-94 was the last and the most extensive of all.It led to the WTO and a new set of agreements.

GATT was provisional with a limited field of action， but its success o ver 47 years in promoting and securing the liberalization of much of world t rade was incontestable （无可争辩的）.Continual reductions in tariffs alon e helped spur very high rates of world trade growth during the 1950s and 19 60s—around 8％ a year on average.And the momentum of trade liberalizati on helped ensure that trade growth consistently out-paced （超过） produc tion growth throughout the GATT era， a measure of countries’ increasing ability to trade with each other and to reap （获得） the benefits of trade.T he rush （激增） of new members during the Uruguay Round demonstrate d that the multilateral trading system was recognized as an anchor （依 靠）for development and an instrument of economic and trade reform.

But all was not well.As time passed, new problems arose.The Tokyo R ound in the 1970s was an attempt to tackle some of these but its achieveme nts were limited.This was a sign of difficult times to come.

GATT's success in reducing tariffs to such a low level， combined wit h a series of economic recessions in the 1970s and early 1980s， drove gov ernments to devise other forms of protection for sectors facing increased for eign competition.High rates of unemployment and constant factory closures led governments in Western Europe and North America to seek bilateral ma rket-sharing arrangements with competitors and to embark on a subsidies ra ce to maintain their holds on agricultural trade.Both of these changes under mined （损害） GATT's credibility and effectiveness.

The problem was not just a deteriorating trade policy environment.By t he early 1980s，the General Agreement was clearly no longer as relevant to the realities of world trade as it had been in the 1940s.For a start， world tr ade had become far more complex and important than 40 years before： the globalization of the world economy was underway， trade in services—not covered by GATT rules—was of major interest to more and more countrie s， and international investment had expanded.The expansion of services tr ade was also closely tied to further increases in world merchandise trade.In other respects， GATT had been found wanting （欠缺的）.For instanc e， in agriculture， loopholes （漏洞） in the multilateral system were he avily exploited， and efforts at liberalizing agricultural trade met with little success.In the textiles and clothing sector， an exception to GATT's normal disciplines was negotiated in the 1960s and early 1970s， leading to the M ultifibre Arrangement[2].Even GATT's institutional structure and its dispute settlement system were causing concern.

These and other factors convinced GATT members that a new effort to reinforce and extend the multilateral system should be attempted.That effort resulted in the Uruguay Round，the Marrakesh Declaration （马拉喀什宣言）， and the creation of the WTO.

The Uruguay Round experienced two phases.

(1) The first four years, 1986-1990

Despite the presence of relatively low tariff rates in the industrialized world， a new round of trade negotiations began in September 1986 and w as to be completed by December 1990.These talks were initiated in Punta d

el Eate （埃斯特角城）， Uruguay， and became known as the Uruguay Round of trade negotiations.Major objectives of this new round included a continuation of the attempt to reduce NTBs， an enlargement of the negotiations to embrace trade in service in addition to the traditional emphasis on trade in goods， and a determination to deal with restrictions on agricultural trade.

The Uruguay Round set forth （阐明） an ambitious agenda.Members established 15 groups to work on reducing restrictions in the following areas： 1）tariffs； 2）NTBs；3）tropical products； 4）natural resource-based products； 5）textiles and clothing； 6）agriculture；safeguards （against sudden“surges” in imports）； 7）safeguards； 8）subsidies and countervailing duties； 9）trade related intellectual property restrictions； 10）trade-related investment restrictions， and services， as well as 11； four other areas dealing with GATT itself （e.g.dispute settlement procedures and implementation of the NTBs codes of the Tokyo Round， especially on dumping）.The biggest controversies （争议） in the negotiations involved services，intellectual property， and agriculture.

The most heated controversy by far concerned agriculture.Most countries use a wide variety of policies to assist the agriculture sector： price support， direct production subsidies，export subsidies， quotas on imports， and others.These interventions lead away from the free market and free trade allocation of resources， since they introduce price distortions.The United States initially proposed a 10 year phase-out （分阶段停止） of all subsidies that affect agricultural trade and of all agricultural import barriers.But the EU wanted to go more slowly and to moderate the extent of reduction in agriculture support.By 1990， the wide disparity （不一致） in subsequent proposals overshadowed （投上阴影） all other aspects of the negotiations，and the four year effort had seemingly ended with no signed agreement on the liberalization of trade.

(2) Continued negotiations lead to success, 1993

Despite the failure of the Uruguay Round talks to meet the originally scheduled completion deadline of December 1990, negotiations continued.H

ope of success for the Uruguay Round began to reappear at the end of 1992 owing to a trade policy threat.The United States had been concerned about a European Community agricultural support program that harmed U.S.exports of oilseeds, and had twice received backing from GATT that the EC program should be modified.In retaliation for the EC subsidy, the United States threatened to impose 200 percent tariffs on EC exports to the United States valued at $300 million; if the EC in turn retaliated against this tariff, the United States was ready to take a second round of tariffs on $700 million of manufactured exports from the EC to the United States.With this stimulus to renewed negotiation on agriculture, an accord was eventually reached by which the oilseeds export subsidies were to be reduced 36 percent by value and 21 percent by quantity over a six-year period.

This positive development then set off activity to work again on many other aspects of the Uruguay Round.Finally， after intense discussions， the 117 participating countries in the Uruguay Round reached agreement on December 15， 1993 （the deadline date）， and the signing took place on April 15， 1994， in Marrakesh （马拉喀什）， Morocco.After ratification by participating countries， the agreement took effect on January 1， 1995.

(3) Provisions of the Uruguay Round agreement

Only a brief look is provided here of the features of this broad agreement.

1) Tariffs on average were cut by 34 percent (39 percent by developed countries);

2) The value of agriculture export subsidies was to be cut by 36 percent and most domestic support for agriculture by 20 percent, and an average developed country agricultural tariffs were to be reduced by 36 percent over a six-year period;

3) Textiles and apparel trade was to be moved from the existing quota framework of the Multi-fiber Arrangement into the GATT framework, with tariffs to be phased out over 10 years;

4) Revised rules were adopted regarding dumping and export subsidies, and voluntary export restraints (VERs) were to be eliminated;

5) Actions on trade-related intellectual property rights (TRIPS) provided for minimum standards for trademarks, patents, and copyrights.(For example, patents will be in force for 20 years).

6) Some trade-related investment measures (TRIMs), such as local content requirements for foreign investors, were to be eliminated within two years by developed countries, five years by developing countries, and seven years by“least developed” countries.

7) A specific General Agreement on Trade in Services (GATS) calls for“national treatment” in services, meaning that any country is to treat foreign service providers in the same fashion as domestic service providers, as well as for MFN treatment for services.

8) New procedures were adopted for the settlement of disputes.

9) GATT itself was replaced by a new organization, the World Trade Organization, which is now supervising the implementation of the Uruguay Round agreement and is handling trade disagreements.

It is clear that the Uruguay Round agreement will have important benefits for the world economy.

Table 10-1 GATT trade rounds

| Year | Place/name | Subjects covered | Countries |
|---|---|---|---|
| 1947 | Geneva | Tariffs | 23 |
| 1949 | Annecy | Tariffs | 13 |
| 1951 | Torquay | Tariffs | 38 |
| 1956 | Geneva | Tariffs | 26 |
| 1960-1961 | Geneva<br>Dillon Round | Tariffs | 26 |
| 1964-1967 | Kennedy Round | Tariffs and anti-dumping measures | 62 |
| 1973-1979 | Tokyo Round | Tariffs, non-tariff measures, "framework" agreements | 102 |
| 1986-1994 | Uruguay Round | Tariffs, non-tariff measures, rules, services, intellectual property, dispute settlement, textiles, agriculture, creation of WTO, etc. | 123 |

## 4.Two GATTs

It is probably best to be clear from the start that the General Agreement on Tariffs and Trade (GATT) involved two things: 1) an international agree ment, i.e.a document setting out the rules for conducting international trade, and 2) an international organization created later to support the agreement.T he text of the agreement could be compared to law, and the organization wa s like parliament and the courts combined in a single body.

As its history shows， the attempt to create a fully-fledged （成熟的） international trade agency in the 1940s failed.But GATT's drafters agr eed that they wanted to use new rules and disciplines， if only provisionall y.Then government officials needed to meet to discuss issues related to the agreement， and to hold trade negotiations.These needed secretarial suppor t，leading to the creation of an ad hoc （临时性的） organization—that co ntinued to exist for almost half a century.GATT， the international agenc

y， no longer exists.It has now been replaced by the World Trade Organizat ion.In light of the entry into force of the Marrakesh Agreement establishing the World Trade Organization as of 1 January 1995 and its ratification by al most all GATT Contracting Parties， those parties decided to terminate the GATT 1947 as of 31 December 1995.

While GATT no longer exists as an international organization, the Agr eement does still exist.But it is no longer the main set of rules for internatio nal trade.And it has been updated.The old text is now called“GATT 1947”.T he updated version is called“GATT 1994”.What happened? When GATT w as created after World War II, international commerce was dominated by tra de in goods.Since then, trade in services—transport, travel, banking, insura nce,telecommunications, consultancy and so on—has become much more i mportant.So has trade in ideas—inventions and designs, and goods and serv ices incorporating this“intellectual property”.

The General Agreement on Tariffs and Trade always dealt with trade in goods, and it still does.It has been amended and incorporated into the new WTO agreements.The updated GATT lives alongside the new General Agre ement on Trade in Services (GATS) and Agreement on Trade-Related Aspec ts of Intellectual Property Rights (TRIPS).The WTO brings the three togeth er within a single organization, a single set of rules and a single system for r esolving disputes.In short, the WTO is not a simple extension of GATT.It is much more.

## 5.WTO vs.GATT: main differences

(1) Nature

The GATT was ad hoc and provisional.The General Agreement never got ratified in members’ parliaments, and it contained no provision for the c reation of an organization.The WTO and its agreements, however, are perm anent.As an international organization, the WTO has a sound legal basis bec ause members have ratified the WTO agreements, and the agreements them selves describe how the WTO is to function.

(2) Scope

The GATT rules applied to trade in goods.The WTO Agreement covers trade in goods,trade in services and trade-related aspects of intellectual property rights.

(3) Approach

Whilst the GATT was a multilateral instrument， a series of new agreements were adopted during the Tokyo Round on a plurilateral （诸边的）， that is， selective basis， causing a fragmentation （分裂） of the multilateral trading system.The WTO has been adopted， and accepted by its Members， as a single undertaking： the agreements which constitute the WTO are all multilateral， and therefore involve commitment for the entire membership of the organization.

(4) Dispute settlement

The WTO dispute settlement system has specific time limits and is therefore faster than the GATT system； it operates more automatically， thus ensuring less blockages than in the old GATT； and it has a permanent appellate body （上诉机构） to review findings by dispute settlement panels （专门小组）.There are also more detailed rules on the process of the implementation of findings.

# 10.2 WTO

## 1.An overview

The WTO is the only global international organization dealing with the rules of trade between nations.WTO is one of the results of Uruguay Round， and was established in the light of the Marrakesh Agreement Establishing the World Trade Organization， which is included in the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Organizations （包括世界贸易组织乌拉圭回合结果的最后文件）.The Marrakesh A

greement entered into force on 1 January 1995.By September 2009， the WTO had 153 members，accounting for over 97％ of world trade.

The WTO's overriding （最重要的） objective is to help trade flow smoothly， freely， fairly and predictably.It does this by： Administering trade agreements； Acting as a forum for trade negotiations； Settling trade disputes； Reviewing national trade policies； Assisting developing countries in trade policy issues， through technical assistance and training programmes；Cooperating with other international organizations.

## 2.The fundamental principles of the WTO

The WTO agreements are lengthy and complex because they are legal texts covering a wide range of activities.They deal with: agriculture, textiles and clothing, banking,telecommunications, government purchases, industrial standards and product safety, food sanitation regulations, intellectual property, and much more.But a number of simple,fundamental principles run throughout all of these documents.These principles are the foundation of the multilateral trading system.

(1) Trade without discrimination

1) Most-favoured-nation treatment (MFNT): treating other people equally.Under the WTO agreements, countries cannot normally discriminate between their trading partners.Grant someone a special favour (such as a lower customs duty rate for one of their products)and you have to do the same for all other WTO members.

This principle is known as most-favoured-nation (MFN) treatment.It is so important that it is the first article of the General Agreement on Tariffs and Trade (GATT), which governs trade in goods.MFN is also a priority in the General Agreement on Trade in Services (GATS)(Article 2) and the Agreement on Trade-Related Aspects of Intellectual Property Rights(TRIPS) (Article 4), although in each agreement the principle is handled slightly differently.Together, those three agreements cover all three main areas of trade handled by the WTO.

Some exceptions are allowed.For example, countries can set up a free t rade agreement that applies only to goods traded within the group— discrim inating against goods from outside.Or they can give developing countries sp ecial access to their markets.Or a country can raise barriers against products that are considered to be traded unfairly from specific countries.And in serv ices, countries are allowed, in limited circumstances, to discriminate.But the agreements only permit these exceptions under strict conditions.In general, MFN means that every time a country lowers a trade barrier or opens up a market, it has to do so for the same goods or services from all its trading par tners—whether rich or poor, weak or strong.

2) National treatment: Treating foreigners and locals equally.Imported and locallyproduced goods should be treated equally—at least after the fore ign goods have entered the market.The same should apply to foreign and do mestic services, and to foreign and local trademarks, copyrights and patents. This principle of"national treatment" (giving others the same treatment as o ne's own nationals) is also found in all the three main WTO agreements(Art icle 3 of GATT, Article 17 of GATS and Article 3 of TRIPS), although once again the principle is handled slightly differently in each of these.

National treatment only applies once a product, service or item of intel lectual property has entered the market.Therefore, charging customs duty o n an import is not a violation of national treatment even if locally-produced products are not charged an equivalent tax.

(2) Freer trade: gradually, through negotiation

Lowering trade barriers is one of the most obvious means of encouragi ng trade.The barriers concerned include customs duties and measures such a s import bans or quotas that restrict quantities selectively.From time to time other issues such as red tape （烦琐手续） and exchange rate policies have also been discussed.

Opening markets can be beneficial, but it also requires adjustment.The WTO agreements allow countries to introduce changes gradually, through"p rogressive liberalization".Developing countries are usually given longer tim e to fulfill their obligations.

（3） Predictability （可预见性）： through binding and transparency

Sometimes, promising not to raise a trade barrier can be as important as lowering one,because the promise gives businesses a clearer view of their future opportunities.With stability and predictability, investment is encouraged, jobs are created and consumers can fully enjoy the benefits of competition—choice and lower prices.The multilateral trading system is an attempt by governments to make the business environment stable and predictable.

In the WTO, when countries agree to open their markets for goods or services, they“bind” their commitments.For goods, these bindings amount to ceilings on customs tariff rates.Sometimes countries tax imports at rates that are lower than the bound rates.Frequently this is the case in developing countries.In developed countries the rates actually charged and the bound rates tend to be the same.

A country can change its bindings, but only after negotiating with its trading partners,which could mean compensating them for loss of trade.One of the achievements of the Uruguay Round of multilateral trade talks was to increase the amount of trade under binding commitments.In agriculture, 100％ of products now have bound tariffs.The result is a substantially higher degree of market security for traders and investors.

The system tries to improve predictability and stability in other ways as well.One way is to discourage the use of quotas and other measures used to set limits on quantities of imports—administering quotas can lead to more red-tape and accusations of unfair play.Another is to make countries’ trade rules as clear and public (“transparent”) as possible.Many WTO agreements require governments to disclose their policies and practices publicly within the country or by notifying the WTO.The regular surveillance of national trade policies through the Trade Policy Review Mechanism provides a further means of encouraging transparency both domestically and at the multilateral level.

(4) Promoting fair competition

The WTO is sometimes described as a“free trade” institution, but that i s not entirely accurate.The system does allow tariffs and, in limited circums tances, other forms of protection.More accurately, it is a system of rules ded icated to open, fair and undistorted competition.

The rules on non-discrimination—MFN and national treatment—are d esigned to secure fair conditions of trade.So too are those on dumping (expo rting at below cost to gain market share) and subsidies.The issues are compl ex, and the rules try to establish what is fair or unfair,and how governments can respond, in particular by charging additional import duties calculated to compensate for damage caused by unfair trade.

Many of the other WTO agreements aim to support fair competition in agriculture,intellectual property, services, for example.The agreement on go vernment procurement (a“plurilateral” agreement because it is signed by on ly a few WTO members) extends competition rules to purchases by thousan ds of government entities in many countries.

(5) Encouraging development and economic reform

The WTO system contributes to development.On the other hand, devel oping countries need flexibility in the time they take to implement the syste m’s agreements.And the agreements themselves inherit the earlier provision s of GATT that allow for special assistance and trade concessions for develo ping countries.

Over three quarters of WTO members are developing countries and co untries in transition to market economies.During the seven and a half years of the Uruguay Round, over 60 of these countries implemented trade liberal ization programmes autonomously.At the same time,developing countries a nd transition economies were much more active and influential in the Urugu ay Round negotiations than in any previous round, and they are even more s o in the current Doha Development Agenda.

At the end of the Uruguay Round， developing countries were prepare d to take on （承担）most of the obligations that are required of developed countries.But the agreements did give them transition periods to adjust to th e more unfamiliar and， perhaps， difficult WTO provisions—particularly

so for the poorest，“least-developed” countries.A ministerial decision adopted at the end of the round says better-off countries should accelerate implementing market access commitments on goods exported by the least-developed countries， and it seeks increased technical assistance for them.More recently， developed countries have started to allow duty-free and quota-free imports for almost all products from least-developed countries.On all of this， the WTO and its members are still going through a learning process.The current Doha Development Agenda includes developing countries’ concerns about the difficulties they face in implementing the Uruguay Round agreements.

## 3.The structure of the WTO

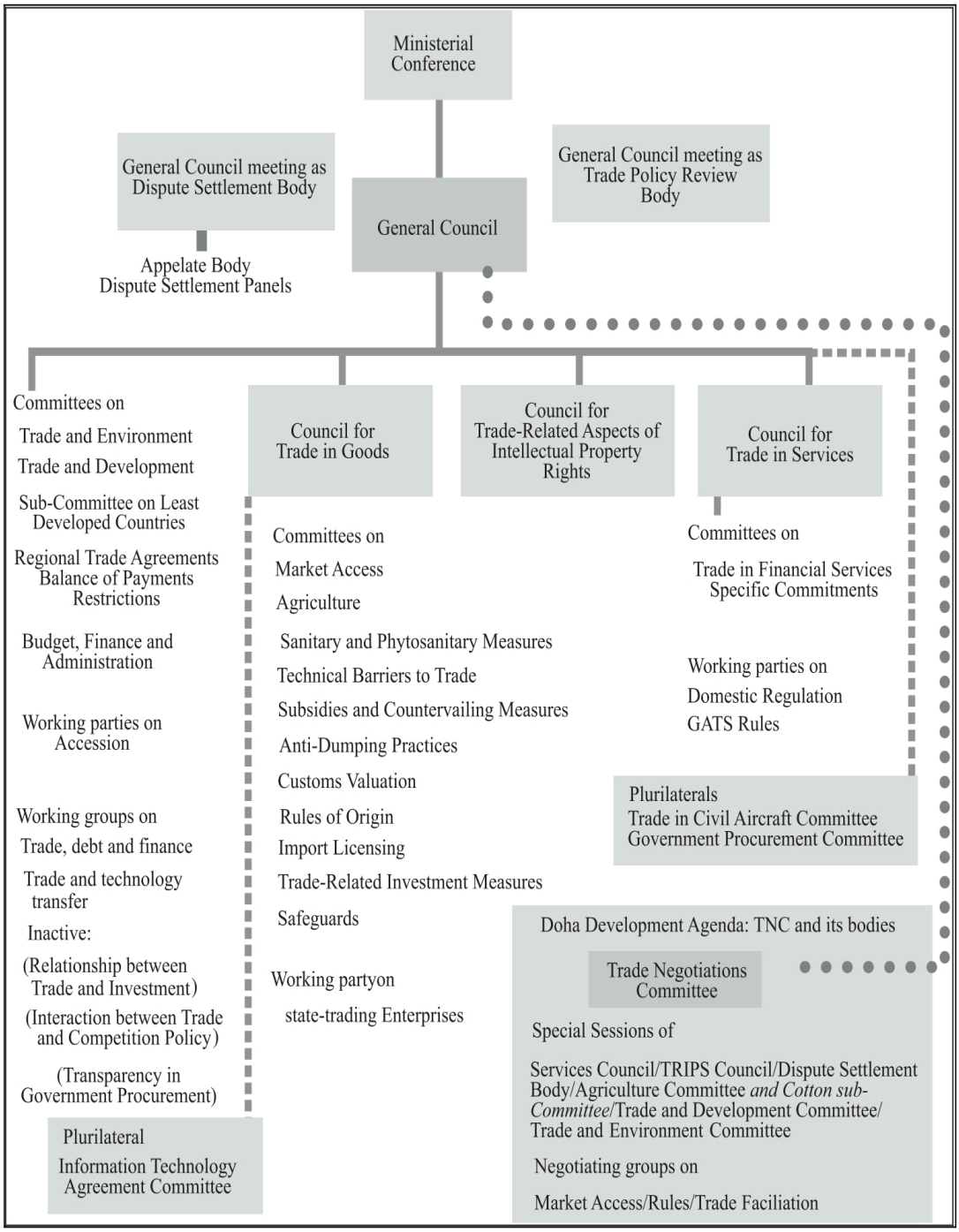
The WTO organization is as follows (see Table 10-1):

1） The highest authority is the Ministerial Conference （部长级会议）.It is composed of representatives of all Members.The Ministerial Conference is authorized to carry out the functions of the WTO， take the actions necessary to the effect， and take decisions on matters under any of the Multilateral Trade Agreements if so requested by a Member.The Ministerial Conference is to meet at least once every two years.The first WTO Ministerial Conference was held in Singapore in December， 1996， the second in Geneva in May， 1998， the Third in Seattle， Washington State， US between 30 November and 3 December 1999， and the fourth in Doha， Qatar from 9 to 13 November 2001.

2） The second level is General Council （总理事会） in three guises （方式）.The day to day business of the WTO is conducted by the General Council， also composed of representatives of all WTO Members， which meet on a regular basis （normally once every two months）.It acts on behalf of the Ministerial Conference in the periods between its meetings， and reports directly to it.The General Council convenes （召集） also as the Dispute Settlement Body （DSB）and Trade Policy Review Body.

3) The third level is councils for each broad area of trade including the Council for Trade in Goods (Goods Council); the Council for Trade in Servi ces (Services Council); and the Council for Trade-related Aspects of Intelle ctual Property Rights (TRIPS Council).As their names indicate, the three ar e responsible for the workings of the WTO Agreements dealing with their re spective areas of trade.The three also have subsidiary bodies.Six other bodi es report to the General Council.The scope of their coverage is smaller, so t hey are“committees”.They cover issues such as trade and development, env ironment, regional trading arrangements,and administrative issues.The Sing apore Ministerial Conference in December, 1996 decided to create new wor king groups to look at investment and competition policy, transparency in g overnment procurement, and trade facilitation.Four more subsidiary bodies dealing with the plurilateral Agreements (which are not signed by all WTO Members) keep the General Council informed of their activities regularly.

Table 10-1 WTO structure




Reporting to General Council (or a subsidiary)

Reporting to Dispute Settlement Body

Plurilateral committees inform the General Council or Goods Council of their activities,although these agreements are not signed by all WTO members

Trade Negotiations Committee reports to General Council

The General Council also meets as the Trade Policy Review Body and Dispute Settlement Body.

The negotiations mandated by the Doha Declaration take place in the Trade Negotiations Committee and its subsidiaries.This now includes the negotiations on agriculture and services begun in early 2000.The TNC operates under the authority of the General Council.

4) The fourth level is committees dealing with specific subjects and working party.Each of the higher level councils has subsidiary bodies.The Goods Council has 11 committees dealing with specific subjects (such as agriculture, market access, subsidies, antidumping measures and so on).Again, these consist of all Member countries.

## 4.WTO agreements

The WTO agreements are the founding charter of the organization and the basis for everything the WTO does.Most of the WTO's agreements were outcome of the 1986-1994 Uruguay Round.Some, including GATT 1994, were revisions of texts that previously existed under GATT as multilateral or plurilateral agreement.Some, such as GATS, were new.The full package of multilateral Uruguay Round agreements is called the round's Final Act.

The table of contents of"The Results of the Uruguay Round of Multilateral Trade Negotiations： The Legal Texts" is a daunting （使人畏惧的） list of about 60 agreements， annexes， decisions and understandings.In fact， the agreements fall into a simple structure with six main parts： an umbrella agreement （框架协定） （the Agreement Establishing the WTO）； agreements for each of the three broad areas of trade that the WTO covers （goods， services and intellectual property）； dispute settlement； and reviews of governments' trade policies （see Table 10-2）.

Table 10-2　The structure of the WTO agreements

The basic structure of the WTO agreements: how the six main areas fit together—the umbrella WTO Agreement, goods, services, intellectual property, disputes and trade policy reviews.

| Umbrella | **AGREEMENT ESTABLISHING WTO** | | |
|---|---|---|---|
| | Goods | Services | Intellectual property |
| Basic principles | **GATT** | **GATS** | **TRIPS** |
| Additional details | Other goods agreements and annexes | Services annexes | |
| Market access commitments | Countries' schedules of commitments | Countries' schedules of commitments(and MFN exemptions) | |
| Dispute settlement | **DISPUTE SETTLEMENT** | | |
| Transparency | **TRADE POLICY REVIEWS** | | |

The agreements for the two largest areas—goods and services—share a common three-part outline, even though the detail is sometimes quite diffe rent.They start with broad principles: the General Agreement on Tariffs and Trade (GATT) (for goods), and the General Agreement on Trade in Services (GATS)[3].Then come extra agreements and annexes dealing with the special requirements of specific sectors or issues.

Finally, there are the detailed and lengthy schedules (or lists) of commi tments made by individual countries allowing specific foreign products or s ervice-providers access to their markets.For GATT, these take the form of bi nding commitments on tariffs for goods in general, and combinations of tari ffs and quotas for some agricultural goods.For GATS, the commitments stat e how much access foreign service providers are allowed for specific sector s,and they include lists of types of services where individual countries say t hey are not applying the"most-favoured-nation" principle of non-discrimina tion.

Underpinning （巩固） these are dispute settlement， which is based on the agreements and commitments， and trade policy reviews， an exerc ise in transparency.

Much of the Uruguay Round dealt with the first two parts: general prin ciples and principles for specific sectors.At the same time, market access ne gotiations were possible for industrial goods.Once the principles had been worked out, negotiations could proceed on the commitments for sectors suc h as agriculture and services.

Table 10-3 is an outline of these agreements.

Table 10-3 The WTO's major legal text

| **Marrakesh Agreement Establishing the World Trade Organization** |
|---|
| **Annex 1A: Multilateral Agreements on Trade in Goods** |
| General Agreement on Tariff and Trade 1994 |
| Agreement on Agriculture |
| Agreement on the Application of Sanitary and Phytosanitary Measures |
| Agreement on Textiles and Clothing |
| Agreement on Technical Barriers to Trade |
| Agreement on Trade-Related Investment Measures |
| Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (Antidumping) |
| Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 (Customs Valuation) |
| Agreement on Preshipment Inspection |

to be continued

| |
|---|
| Agreement on Rules of Origin |
| Agreement on Import Licensing Procedures |
| Agreement on Subsidies and Countervailing Measures |
| Agreement on Safeguards |
| **Annex 1B: General Agreement on Trade in Services** |
| **Annex 1C: Agreement on Trade-Related Aspects of Intellectual Property Rights** |
| **Annex 2: Understanding on Rules and Procedures Governing the Settlement of Disputes** |
| **Annex 3: Trade Policy Review Mechanism** |
| **Annex 4: Plurilateral Trade Agreement** |

continued

Marrakesh Agreement Establishing the World Trade Organization.It called for （要求） a single institutional framework encompassing the GATT， as modified by the Uruguay Round，all agreements and arrangements concluded under its auspices （支持）， and the complete results of it.Institutionally， it is headed by a Ministerial Conference meeting at least once every two years.

(1) Annex 1A: Multilateral Agreements on Trade in Goods

1) General Agreement on Tariff and Trade 1994.Texts on the interpretation of the following GATT articles were included in the Final Act.(a) Article II on schedules of concessions, (b) Article XVII on state trading enterprises, (c) balance of payments provisions,(d) Article XXIV on customs union and free trade areas, (e) Article XXV on waivers of GATT discipline, (f) Article XXVII on the modification or withdrawal of GATT schedules.And (g) Article XXXV on the non-application of the general agreement to an acceding country.

2) Agreement on Agriculture.This agreement establishes guidelines for“initiating a process of reform of trade in agriculture”.Its ultimate goal is the establishment of a market-oriented system for trade in agricultural products that is free of restrictions and distortions.To begin the process of reform, t

he Agreement (a) specifies the agricultural products it governs; (b) requires that non-tariff barriers to agricultural imports be converted into customs tari ffs; (c) defines permissible forms of domestic supports; (d) defines export s ubsidies;(e) phases in initial reductions in tariffs, impermissible domestic su pport measures,and export subsidies during a 6 year implementation period (developing countries are given a 10 year period); and (f) progressively inte grates international trade in agricultural products into the GATT system.

The agricultural products governed by the Agreement include foodstuff s (except for fish and fish products), hides, skins, animal hairs, raw cotton, r aw flax, raw hemp, raw silk, and certain related products.

3) Agreement on the Application of Sanitary and Phytosanitary Measur es.This agreement concerns food safety and animal and plant health regulati ons.The Agreement recognizes that such measures should not be applied arb itrarily or unjustifiably to discriminate between members where identical or similar conditions prevail.

4) Agreement on Textiles and Clothing.The objective of this negotiatio n was to secure the eventual integration of the textile and clothing sector wh ere much of the trade was subject to bilateral quotas negotiated under the M ultifiber Arrangement (MFA) into the GATT on the basis of strengthened G ATT rules and disciplines.Integration of this sector into the GATT would ta ke place according to an agreed schedule, beginning from January 1995 and ending in 2005.

5) Agreement on Technical Barriers to Trade.This agreement sought to ensure that technical negotiations and standards, as well as testing and certif ication procedures, do not create unnecessary obstacles to trade.

6) Agreement on Trade-Related Investment Measures (TRIMS).TRIM S are rules that restrict preference of domestic firms and thereby enable inte rnational firms to operate more easily within foreign markets.

7) Agreement on Implementation of Article VI of the General Agreeme nt on Tariffs and Trade 1994 (Antidumping).Negotiations in the Uruguay R ound resulted in a revision of this agreement.In the renewed form it address es many areas in which the previous agreement lacked precision and detail.

8) Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 (Customs Valuation).This agreement is designed to harmonize the methods used by WTO member states to determine the value of those goods.Its detailed rules are meant to provide a fair, neutral, and uniform system of customs valuation.

9） Agreement on Preshipment Inspection.Developing states frequently engage private companies to verify price， quantity， quality， customs classifications， and other characteristics of goods before the goods are shipped from other states.This“pre-shipment inspection”（or PSI） is meant to prevent over and under invoicing and fraud， and thus prevent the flight（外逃）of capital and the evasion （规避） of customs duties.The Agreement on Pre-shipment Inspection authorizes developing states to make use of PSI， but it also tries to limit its harmful trade effects.

10) Agreement on Rules of Origin.This agreement aimed at long-term harmonization of rules of origin, other than rules of origin relating to the granting of tariff preferences, and to ensure that such rules do not themselves create unnecessary obstacles to trade.

11) Agreement on Import Licensing Procedures.The revised agreement strengthened the discipline on the users of import licensing systems—which, in any event, are much less widely used now than in the past—and increased transparency and predictability.Forms and procedures are to be as simple as possible and applicants should have to deal only with a single administrative body.

12) Agreement on Subsidies and Countervailing Measures.The agreement contained a definition of subsidy and introduced the concept of a“specific” subsidy.For the most part, a subsidy is available only to an enterprise or industry or group of enterprises or industries within the jurisdiction of the authority granting the subsidy.

13) Agreement on Safeguards.Safeguards are emergency actions that a WTO member state may take to protect its domestic industries from serious injury from a sudden increase in the quantity of an imported product.The agreement stipulated that members cannot seek, take,or maintain any voluntar

y export restraints, orderly marketing arrangements, or any other similar me asures on the export or import side.A WTO member state may apply safegu ard measures against a product only after conducting an official investigatio n to determine that the product is being imported into its territory in such in creased quantities and under such conditions as to cause or threaten to cause serious injury to the domestic industry that produces like or directly compet itive products.

(2) Annex 1B: General Agreement on Trade in Services

This new agreement has three principal elements.The first is a Framew ork Agreement containing basic obligations which apply to all member cou ntries.The second concerns national schedules of commitments containing s pecific national commitments which are the subject of a continuous process of liberalization.The third is a number of annexes addressing the special situ ations of individual services.

(3) Annex 1C: Agreement on Trade-Related Aspects of Intellectual Pro perty Rights

The agreement addressed the applicability of basic GATT principles an d of relevant international intellectual property agreements; the provision of effective enforcement measures for those rights; multilateral dispute settlem ent; and transitional arrangement.

(4) Annex 2: Understanding on Rules and Procedures Governing the S ettlement of Disputes

The dispute settlement understanding (DSU) established an integrated system permitting WTO members to base their claims on any of the multilat eral trade agreements included in the annexes to the Agreement establishing the WTO.To this end, a dispute settlement body (DSB)is to exercise the aut hority of the General Council.The DSU takes into account the specific inter ests of the developing and least developed countries.

(5) Annex 3: Trade Policy Review Mechanism

This agreement encouraged greater transparency in national trade polic y making.

(6) Annex 4: Plurilateral Trade Agreements

The two“plurilateral” agreements civil aircraft and government procurement are not signed by all members.

## 5.Ministerial conferences

Since its establishment in 1994, WTO has held seven ministerial conferences as depicted below.

1） First ministerial conference： The inaugural （开幕的） ministerial conference was held in Singapore in 1996.Disagreements between largely developed and developing economies emerged during this conference over four issues initiated by this conference， which were collectively referred to as the“Singapore issues”.

2) The second ministerial conference was held in Geneva in Switzerland in 1998.

3) The third conference was held in Seattle, Washington in 1999 and ended in failure,with massive demonstrations and police and National Guard crowd control efforts drawing worldwide attention.

4) The fourth ministerial conference was held in Doha in Persian Gulf nation of Qatar in 2001.The Doha Development Round was launched at the conference.The conference also approved the joining of China, which became the 143rd member to join.

5) The fifth ministerial conference was held in Cancún, Mexico, in 2003, aiming at forging agreement on the Doha round.An alliance of 22 southern states, the G20 developing nations (led by India, China and Brazil), resisted demands from the North for agreements on the so-called“Singapore issues” and called for an end to agricultural subsidies within the EU and the US. The talks broke down without progress.

6) The sixth ministerial conference was held in Hong Kong Special Administrative Region of China in 2005.It was considered vital if the four-year-old Doha Development Agenda negotiations were to move forward sufficie

ntly to conclude the round in 2006.In this meeting, countries agreed to phas e out all their agricultural export subsidies by the end of 2013,and terminate any cotton export subsidies by the end of 2006.Further concessions to devel oping countries included an agreement to introduce duty free, tariff free acc ess for goods from the Least Developed Countries, following the Everythin g But Arms initiative of the European Union—but with up to 3％ of tariff li nes exempted.Other major issues were left for further negotiation to be com pleted by the end of 2010.

7) The seventh ministerial conference: The Seventh Session of the WT O Ministerial Conference in Geneva, Switzerland, took place from 30 Nove mber to 2 December 2009.The general theme for discussion was“The WTO, the Multilateral Trading System and the Current Global Economic Environ ment”.

The Doha Development Round started in 2001 and continues today.Th e WTO launched the current round of negotiations, the Doha Development Agenda (DDA) or Doha Round, at the fourth ministerial conference in Doh a, Qatar in November 2001.The Doha round was to be an ambitious effort t o make globalization more inclusive and help the world’s poor,particularly by slashing barriers and subsidies in farming.The initial agenda comprised b oth further trade liberalization and new rule-making, underpinned by comm itments to strengthen substantial assistance to developing countries.

The negotiations have been highly contentious （有争议的） and agr eement has not been reached， despite the intense negotiations at several m inisterial conferences and at other sessions.Disagreements still continue ove r several key areas including agriculture subsidies.

# 10.3 China and the WTO

## 1.China’s accession to the WTO

China was one of the 23 original signatories of the General Agreement on Tariffs and Trade (GATT) in 1948.After the establishment of the Peopl e's Republic of China, the United Nations and the GATT wanted to impose an embargo on China, but this was not possible as long as China still was a member.Nearly 40 years later in 1986, China notified the GATT of its wish to resume its status as a member of the GATT.A working party was establis hed in 1987 and China's long way of entering the GATT/WTO began.

Initially, the Working Party on China's status was established under G ATT in 1987 and concerned only China's trade regime for goods.In 1995, it was converted to a WTO Working Party and its scope was broadened to incl ude trade in services, new rules on non-tariff measures and rules relating to intellectual property rights.

China's accession Working Party membership is open to all interested WTO member governments.A substantial part of China's accession process involves bilateral negotiations between China and WTO members.These are usually conducted privately, either at the WTO in Geneva or in capitals.Oth er meetings concern either informal or formal sessions of the Working Part y.While several areas of China's trade policies, i.e.schedules of market acce ss commitments in goods and specific commitments on services, have been the focus of bilateral and plurilateral negotiations, it is the responsibility of t he Working Party to maintain an overview of how the negotiations run and ensure that all aspects of China's trade policies shall be addressed.

The Working Party has two tasks： to complete a report based on its d eliberations （审议）and to complete a Protocol of Accession.It is not unus ual that WTO accession working parties attach a number of annexes to the p rotocol.The annexes are an integral （不可或缺的） part of the protocol an d are legally binding and address specific issues related to the applicant's tr ade regime.As with other accessions， the annexes， which have been a fo cus of the negotiations， are meant to provide WTO members with guarant ees that the reforms or other transitional measures promised by the applican t will actually be implemented.In other words， they serve as a kind of a ne gotiated timetable for bringing the applicant's trade regime into full confor mity with the WTO's rule and obligations.

On September 17, 2001, the 18th Session of the Working Party on China, also the final meeting of the Working Party, was held.It marks the final conclusion of negotiations on China's WTO accession.On November 10, 2001, the Doha Ministerial Conference approved by consensus the text of the agreement for China's entry into the WTO.After notifying the WTO's ratification of its membership, China has become the WTO's 143rd full member as of December 11, 2001.

## 2.Opportunities and challenges to China

(1) Opportunities

1) China can be offered multilateral, unconditional and stable MFN treatment by all WTO Members.As a developing country, China can obtain some preferential treatment or transition arrangement accorded by the WTO.All these privileges can provide support for China's industries which have competitive advantages to exploit the foreign markets.

2) As a full member, China can take part in all negotiations regarding various areas,stipulating and amending the relative regulations as well as the construction of the system of the multilateral trade system.Thus China can have more says in world affairs, especially trade areas to safeguard China's position and legal privileges in world trade.

3) By making use of the mechanism and procedures of trade dispute settlement of the WTO, China can solve trade disputes with other countries more fairly and reasonably.

4) By making use of the WTO forum, China may publicize its policy of reform and opening to the outside world, actively develop cooperation and communication with other countries in the field of economics, trade and technology.

(2) Challenges

China shall undertake its obligations of reducing customs tariffs， publishing trade restrictions measures， opening services market， enlarging p

rotection scopes of intellectual property rights and eliminating the restrictio ns in introducing foreign capitals.Thus many protection environments can n o longer exist.All in all， China’s domestic market must be opened more wi dely to foreign enterprises.Some industries with higher cost and disadvanta ges in non-price factors may be thrashed （击败）.China’s commitments in WTO cover the following main aspects：

1) Transparency and predictability: Systemic reforms to effect a more t ransparent and predictable regime for business dealings are underway in Ch ina.Laws and regulations including those not previously available to the pub lic must be regularly published (in the WTO languages as well).A 30-day pe riod for obtaining information and commentary is planned prior to the imple mentation of new laws and regulations.China commits to the uniform and i mpartial application, administration and implementation of laws and regulat ions throughout the nation.

2） Tariffs： China must significantly reduce its tariffs on industrial p roducts by January 2005 to 8.9％ （down from an average of 25％）.Produ cts which have their tariffs eliminated completely are furniture， toys and b eer.Tariffs will be significantly reduced on medical equipment， scientific e quipment， motor vehicles， cosmetics， distilled spirits （蒸馏酒）， p aper products， and textiles.Products under the Information Technology Ag reement which China joined， must be eliminated by January 2005.

3) Service commitments: Elimination of market access restrictions can liberalize the service sectors including telecommunications, insurance, bank ing, and professional services such as accounting, legal and management se rvices.

4) Trading rights and distribution: The previous restriction on the num ber of companies that have the right to import and export goods must be rel axed.All enterprises in China must be granted full trading rights (except for limited products reserved for trade by state enterprises).The previous prohib ition on foreign companies distributing products through their own wholesal e and retail systems or to provide related distribution services, such as repai r and maintenance must be lifted under China’s commitments.At accession,

China also committed to allow foreign service suppliers to distribute chemi cal fertilizers, processed oil and crude oil.

5) Import licensing: China's import licensing system previously posed a trade barrier.This must be lifted and licensing must comply with the princi ples of national treatment and non-discrimination.

6) Importation and investment approvals: Importation and investment approvals can become easier with the removal of many pre-conditions.The WTO Agreement on Trade-related Investment Measures and the TRIPS Agr eement must be followed in enforcing,imposing or applying laws and regula tions related to the transfer of technology.

7) Trade-related intellectual property rights: China's development of th e protection of intellectual property rights must be via full implementation o f the TRIPS Agreement.

8) Technical barriers to trade: China must comply with WTO Technical Barriers to Trade(TBT) Agreement (e.g.inspection, testing, domestic taxes, and other measures).Technical regulations must be based on international st andards and applied equally to domestic and foreign products.China must b e required to apply science-based sanitary and phytosanitary standards to all agricultural goods, including grains, meats, and fruits.

9) Taxes: China must ensure that its laws and regulations relating to int ernal taxes(national, provincial and local) and import charges comply with WTO rules, and are applied non-discriminatingly.

10) Subsidies: All subsidies on industrial goods prohibited under WTO rules must be eliminated.

(3) Changes after WTO accession

Since its accession to the WTO, China has seen great achievements in economy, foreign trade and many industries.In 2015, China had become the world second largest economy as measured by GDP; and its ranking in term s of GDP per capita had jumped from No.130 in 2000 to No.77 in 2015 in t he world, amounting to US$8141.Trade value increased from US$1.4 trillio n, accounting for 3％ in the world in 2000 to US$3.95 trillion, accounting f

or 11.9％ in 2015, ranking the first in the world.And unexpectedly, high-tech product’s share in China’s export also increased rapidly.Actually almost all sectors that have been opened have witnessed strong growth, such as the automobile sector, telecom, transportation, legal sector,etc.Competitiveness is improved.Openness attracts more foreign direct investment (FDI),increases FDI related employment, and tax income from foreign companies.Steady progress was made in the reform of economic system and in the structural adjustment.Human development indicators also had considerable improvements.

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[1]Here refers to the Bretton Woods Conference held in 1944 in Bretton Woods， New Hampshire，the United States， to make financial arrangements for the postwar era after the expected defeat of Germany and Japan.Representatives of 44 countries agreed to create the International Bank for Reconstruction and Development （World Bank） and the International Monetary Fund.

[2]The Multifibre Arrangement [MFA， also known as the Agreement on Textile and Clothing （ATC）] governed the world trade in textiles and garments from 1974 through 2004， imposing quotas on the amount developing countries could export to developed countries.It expired on 1 January 2005. The MFA was introduced in 1974 as a short-term measure intended to allow developed countries to adjust to imports from the developing world.Developing countries have a natural advantage in textile production because it is labor intensive and they have low labor costs.

[3]The third area, Trade-Related Aspects of Intellectual Property Rights (TRIPS), also falls into this category although at present it has no additional parts.

# Section II International Trade Practice

# Chapter 11　International Trade Terms

Learning Objectives

In this chapter, you will learn:

- Role of trade terms and Incoterms 2020
- Six commonly used trade terms
- Other five trade terms

Trade terms are standardized terms used in international trade contracts that describe the place and manner for the transfer of goods from the seller to the buyer.A trade term is a combination of letters or words， which specifies certain obligations within international trade contract， for example，FOB or Free On Board （装运港船上交货）.A trade term embraces （包括） three basic elements.1） Transfer of risks.A trade term specifies when the risks of loss of or damage to goods are transferred from the seller to the buyer； 2） Transfer of obligations.A trade term specifies where and how the seller must make the goods available to the buyer and how the buyer must take delivery of the goods； 3） Division of costs.A trade term specifies how the normal costs relating to the export and import of goods should be divided between the seller and the buyer.

The most commonly used trade terms are those published by the International Chamber of Commerce[1] （国际商会）（ICC）， i.e.Incoterms.Discussion of trade terms in this chapter focuses on the latest version of Incoterms—the Incoterms 2020.This chapter first gives a brief introduction to Incoterms and changes of Incoterms 2020 and then in section 2， makes in-depth analysis on the six commonly used trade terms， namely， FOB， CFR， CIF， FCA， CPT and CIP.In the third section， other five trade term

s—EXW， FAS， DAP， DPU and DDP are discussed.Finally， the issue of shipment contract and the choice of trade terms are examined.

# 11.1 Introduction to the Incoterms

## 1.Trade terms and the Incoterms

Trade terms have been developed in practice for many years.Howeve r， parties to a contract are frequently unaware of the different trading pract ices in their respective countries.This can give rise to （引起） misunderst andings， disputes and litigation （诉讼） with all the waste of time and money that this entails （伴有）.In order to remedy （解决） these proble ms，the International Chamber of Commerce first published in 1936 a set o f international rules for the interpretation of trade terms.These rules were kn own as the Incoterms 1936.Amendments and additions were later made in 1 953， 1967， 1976， 1980， 1990， 2000， 2010 and 2020 in order to br ing the rules in line with current international trade practices.The latest vers ion the Incoterms 2020 came into force on Jan.1， 2020.

It must be borne in mind that whilst the Incoterms are widely used inte rnationally， other standard rules on trade terms do exist， such as the War saw-Oxford Rules 1932 （1932年华沙−牛津规则） （W.O.Rules， 193 2） which are rules for CIF contracts drafted at a conference of the Internati onal Law Association in Warsaw and adopted in Oxford on August 12， 19 32， and the Revised American Foreign Trade Definitions which emerged i n US in 1919 and were revised in 1941 and 1990 respectively.The ICC Inco terms are the most complete of all such rules and deserve careful study.

## 2.Scope of the Incoterms

The Incoterms deal with a number of identified obligations imposed on the parties—such as the seller’s obligation to place the goods at the disposal

of the buyer or hand them over for carriage or deliver them at destination—and with the allocation of risk between the parties in these cases.Further, they deal with the obligations to clear the goods for export and import, the packing of the goods, the buyer's obligation to take delivery as well as the obligation to provide proof that the respective obligations have been duly fulfilled.The Incoterms also deal with costs, defining which party is responsible for which cost, for example, transport,packaging, loading or unloading costs, and checking or security-related costs.

Although the Incoterms are extremely important for the implementation of the contract of sale， a great number of problems which may occur in such a contract are not dealt with at all，like transfer of ownership and other property rights， breaches （违反） of contract and the consequences following from such breaches as well as exemptions from liability in certain situations.These questions must be resolved by other stipulations in the contract of sale and the applicable law.

## 3.Status of the Incoterms

The Incoterms are well recognized throughout the world， and their use in international sales is encouraged by trade councils， courts， and international lawyers.However， the Incoterms have no status at law unless there is specific legislation providing（规定）for them，or they are confirmed by court decisions.Hence， parties who adopt the Incoterms should make sure they express their acceptance clearly.For example， FOB Shanghai Incoterms 2020.The Incoterms will then become legally binding upon all parties.Finally， parties should be wary（谨慎的） about making additions to or varying the meaning of any particular term， and it is important to clearly specify the chosen version of the Incoterms being used （i.e.Incoterms 2020， Incoterms 2010， or any earlier version）.

# 11.2 Incoterms 2020

# 1.Incoterms 2020 v.s.Incoterms 2010: key changes

The Incoterms 2020 version has not introduced any significant changes as compared to the previous version of 2010.In this regard, the key element s of the 2010 version are retained,in particular, classification into 11 Incoter ms, priority of the multimodal Incoterms as compared to the Maritime Incot erms, the 10 obligations for each party although some minor changes have b een made, goods in containers only with multimodal Incoterms.

The key changes in Incoterms 2020 to the 2010 edition are as follows:

1) DAT (Delivered at Terminal) is renamed Delivered at Place Unloade d (DPU)

In Incoterms 2020, the Incoterm DPU is created to replace DAT in Inc oterms 2010.The obligations and functions of both terms are exactly the sa me.

DPU is the only Incoterm in which the goods are delivered unloaded at the place of destination.The change of name is substantiated as the goods ca n be unloaded not only at a transport of terminal or infrastructure (port, airp ort, dock, etc.) but also at any other point in the destination country.

2) FCA (Free Carrier) now allows for Bills of Lading to be issued after loading

Incoterms 2020 includes the option of Bill of Loading with on board n otation in the“Explanatory Notes to the Incoterm FCA” section and not in t he“Obligations of the Buyer Party”, indicating this is an option rather than a n obligation for the buyer.Nevertheless, this option must be agreed between the seller and the buyer in their sales contract.

This option is specified for maritime transport so that the buyer may in struct the carrier to issue a Bill of Lading on behalf of the seller with the an notation of“aboard” (on-board), which specifies that the goods have been lo aded aboard the ship.

3) Insurance coverage in CIF (Cost, Insurance and Freight) and CIP (C arriage and Insurance Paid To)

CIF and CIP set out new standard insurance arrangements, but the leve l of insurance continues to be negotiable between the buyer and the seller.CI P now requires as default insurance coverage ICC(A) or equivalent.It was I CC(C) under Incoterms 2010.Required insurance coverage under CIF remai ns, i.e., minimum coverage, which corresponds to ICC(C).The reasoning be hind this is that CIF is more often used with bulk commodity trades and CI P(as a multimodal term) is more often used for manufactured goods.

4) Further breakdown in cost allocation

Where listed, cost allocation between the buyer and the seller is stated more precisely—one article lists all costs the seller and the buyer are respon sible for.Thus, for example, whilst in Incoterm CIP the seller and buyer mus t bear 8 and 7 costs respectively in the 2010 version,in the 2020 version, the re are 3 and 6 respectively.

5) Inland transport with seller's or buyer's own means

The inland transport in the country of origin (FCA) or in the destinatio n (DAP, DPU,DDP) may be undertaken by the seller or the buyer using thei r own means of transport.This could be the case, for example, a Chinese sell er located in Beijing who carries out the delivery of goods"FCA Port of Tia njin, China, Incoterms 2020", made the transport of goods from Beijing to Tianjin in a truck owned by the seller.

6) Transport security requirement.

The Incoterms 2020 address the security liability more precisely under international transport of goods and customs clearance formalities and proc edures.In the case of international transport of goods, the security liability is assumed by the party who executes the carriage of goods contract: seller (C FR, CIF, CPT, CIP, DAP, DPU and DDP) and buyer (EXW,FAS, FOB, FC A).As customs clearances are concerned, the security liability lies with the party which must undertake the clearance.

## 2.Classification of Incoterms 2020

Incoterms 2020 are classified into four groups (C, D, E, F).There are a total of 11 Incoterms which are classified according to the fees, risk, respon sibility for formalities, as well as issues related to import and export (see Ta ble 11-1).

Group C (Main Carriage Paid) includes such Incoterms as CFR, CIF, C PT, and CIP.In this group, the seller concludes a transport contract with the f orwarder and takes the costs.In this case, the seller is responsible for conduc ting export clearance.The risk is transferred at the time of posting the goods to the buyer.All matters arising after loading costs related to transporting ar e paid and other events are the buyer's responsibility.

Group D (Arrival) includes such Incoterms as DAP, DPU, and DDP.Th is group assumes that the seller is obliged to deliver the goods to a specific place or the port of destination.

Group E (Departure) includes only one Incoterms—EXW.In this grou p, the seller makes the goods available to the buyer at the delivery point indi cated by the seller.The seller is not obliged either to customs or export clear ance and does not bear the risk and costs of loading.

Group F (Main Carriage Unpaid) includes such Incoterms as FCA, FA S, and FOB.Group F obliges the seller to perform export customs clearance. The seller does not pay transport and insurance costs.

The 11 terms in Incoterms 2020 are presented in two distinct classes (s ee Table 11-1).The first class includes terms for any mode or modes of trans port: EXW, FCA, CPT, CIP, DAP,DDU and DDP.The second class includes four terms: FAS, FOB, CFR and CIF for sea and inland waterway transport. Under these terms, the point of delivery and the place to which the goods ar e carried to the buyer are both port.

Table 11-1 The 11 Incoterms under Incoterms 2020

| | Freight Collect Terms | | | | Freight Prepaid Terms | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Groups | Any Mode or Modes of Transport | | Sea and Inland Waterway Transport | | | | Any Mode or Modes of Transport | | | | |
| Incoterm® | EXW | FCA | FAS | FOB | CFR | CIF | CPT | CIP | DAP | DPU | DDP |
| | Ex Works (Place) | Free Carrier (Place) | Free Alongside Ship (Port) | Free On Board (Port) | Cost and Freight (Port) | Cost Insurance & Freight (Port) | Carriage Paid To (Place) | Carriage & Insurance Paid to (Place) | Delivered at Place (Place) | Delivered at Place Unloaded (Place) | Delivered Duty Paid (Place) |
| Transfer of Risk | At Buyer's Disposal | On Buyer's Transport | Alongside Ship | On Board Vessel | On Board Vessel | On Board Vessel | At Carrier | At Carrier | At Named Place | At Named Place Unloaded | At Named Place |
| Obligations & Charges: | | | | | | | | | | | |
| Export Packaging | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller |
| Loading Charges | Buyer | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller |
| Delivery to Port/Place | Buyer | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller |
| Export Duty, Taxes & Customs Clearance | Buyer | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller |
| Origin Terminal Charges | Buyer | Buyer | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller |
| Loading on Carriage | Buyer | Buyer | Buyer | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller |
| Carriage Charges | Buyer | Buyer | Buyer | Buyer | Seller | Seller | Seller | Seller | Seller | Seller | Seller |
| Insurance | Negotiable | Negotiable | Negotiable | Negotiable | Negotiable | *Seller | Negotiable | **Seller | Negotiable | Negotiable | Negotiable |
| Destination Terminal Charges | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Seller | Seller | Seller | Seller | Seller |
| Delivery to Destination | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Seller | Seller | Seller |
| Unloading at Destination | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Seller | Buyer |
| Import Duty, Taxes & Customs Clearance | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Seller |

"*CIF requires at least an insurance with the minimum cover of the Institute Cargo Clause (C) (Number of listed risks,subject to itemized exclusions)"

"**CIP now requires at least an insurance with the minimum cover of the Institute Cargo Clau se (A)(All risks, subject to itemized exclusions)"

Source: IncoDocs.Global Trade Guide.

https://help.incodocs.com/en/articles/2048556-download-global-trade-guide.

# 11.3 FOB, CFR and CIF

Among the eleven trade terms, FOB, CFR and CIF are the most comm only used terms.All are used only for sea or inland waterway transport.Thes e three terms have no difference in that the allocation of risks and the way o f transferring the title to goods are completely the same.The differences exis t in the allocation of responsibilities with respect to transportation and insur ance and the relevant expenses.

## 1.FOB—Free on Board （...named port of shipme nt）
## 装运港船上交货（……指定装运港）

(1) Allocation of risks and obligations in FOB

The term FOB specifies that the seller delivers the goods on board the vessel nominated by the buyer at the named port of shipment or procures th e goods already so delivered.The risk of loss of or damage to the goods pass es when the goods are on board the vessel, and the buyer bears all costs fro m that moment onwards.

The FOB term, as its name suggests, is a maritime trade term and is us ed only for sea or inland waterway transport.Thus, the FOB term is not appr opriate where goods are handed over to the carrier before they are on board the vessel, for example, where goods are handed over to a carrier at a contai ner terminal.In this case, parties should consider using the FCA term rather than the FOB term.

The seller is required to obtain permission to export products, clear the goods for export,where applicable, deliver the goods to the vessel at the pla ce designated by the buyer, inform the buyer that the goods have been deliv ered to the ship, and take all costs connected with these issues.

The buyer is required to make a contract for carriage, inform the seller about designated port, the name of the vessel and the delivery date, clear the goods for import, and take all costs connected with these issues.

（2） Variants （变形） of FOB

In practice， it frequently happens that the parties themselves， by adding words to an incoterm， seek further precision （准确性） than the term could offer.For instance， expressions frequently used in charter parties （租船合同） are sometimes used in contracts of sale in order to clarify （明确） the division of loading cost.

The Incoterms 2020 do not prohibit such alteration, but there are dangers in so doing.In order to avoid any unwelcome surprises, the parties would need to make the intended effect of such alterations extremely clear in their contract.Thus, for example, if the allocation of costs in the INCOTERMS 2010 terms is altered in the contract, the parties should also clearly state whether they intend to vary the point at which the risk passes from seller to buyer.

The variants of FOB are used to specify the division of loading cost.The commonly used variants of FOB are:

1） FOB Liner Terms （FOB班轮条件）.Such cost of loading is normally covered by the freight when the goods are carried by regular shipping lines.Thus under this FOB variation， the cost of loading is for the account of the buyer who contracts for carriage and bears the freight.

2） FOB Under Tackle （FOB吊钩下交货）.This term only requires the seller to bear the cost for sending and placing the goods on the wharf within the reach of the ship’s tackle.Loading cost incurred thereafter is borne by the buyer.

3） FOB Stowed （FOB包括理舱费）.The word“stow” means the act of putting cargo tidily in the hold.This term requires the seller to assume the loading cost including stowing cost.

4） FOB Trimmed （FOB包括平舱费）.When we say trim a vessel， it means we level the bulk cargo so that the vessel can sail smoothly and

safely.Under this term， the seller bears the loading cost including trimmin g cost.

5） FOB Stowed and Trimmed （FOB包括理舱费和平舱费）.This t erm requires the seller to bear the loading cost including both stowing and tr imming cost.

(3) FOB in the Revised American Foreign Trade Definitions 1990

There are six kinds of FOB in the Revised American Foreign Trade De finitions 1990.But only the fifth FOB, i.e.FOB vessel (named port of shipm ent) is close to the FOB in Incoterms 2020.FOB vessel differs from FOB in Incoterms 2020 in that FOB vessel requires the buyer rather than the seller t o pay export taxes, or other fees or charges levied because of exportation,to obtain documents which may be required for the purposes of exportation[2] a nd be responsible for any loss or damage, or both after goods have been loa ded on board the vessel.So if the buyer is not prepared to carry out export cl earance when contract is made on FOB vessel, it is strongly recommended t hat a clause like“The seller must obtain at his own risk and expense any exp ort license or other official authorization and carry out customs formalities necessary for the export of the goods” be stipulated in the contract.

## 2.CFR—Cost and Freight （...named port of destination）
## 成本加运费（……指定目的地）

(1) Allocation of risks and obligations in CFR

The term CFR specifies that the seller delivers the goods on board the vessel or procures the goods already so delivered.The risk of loss of or dam age to the goods passes when the goods are on board the vessel, such that th e seller is taken to have performed its obligation to deliver the goods wheth er or not the goods actually arrive at their destination in sound condition,in t he stated quantity or, indeed, at all.

CFR differs from FOB in that in CFR the seller rather than the buyer must contract for and pay the costs and freight necessary to bring the goods to the named port of destination.CFR is also only used for sea or inland water way transport.

CFR may not be appropriate where goods are handed over to the carrier before they are on board the vessel, such as goods in containers, which are typically delivered at a terminal.In such circumstances, the CPT term should be used.

In CFR, the seller owes no obligation to the buyer to purchase insurance cover, the buyer would be well-advised therefore to purchase some cover for itself.

(2) Shipping advice

Whatever terms are used, the seller is obliged to send shipping advice [3] to the buyer to inform it or its agent to make preparations for taking delivery of goods.However, in CFR, this is particularly important.As in CFR, the buyer must take risks for a period of carriage during which the buyer has no means of controlling or limiting those risks.The carrier used, the costs incurred for carriage and the timing of the carriage are all under the seller's control.The shipping advice sent plays an important role, which is to inform the buyer to take out insurance promptly.If, however, the seller fails to do this, it will have to bear the risks of loss of or damage to the goods incurred in transit.

(3) Variants of CFR

The variants of CFR are used to specify the division of unloading cost.

1） CFR Liner Terms （CFR班轮条件）.Since such cost of unloading is normally covered by the freight when the goods are carried by regular shipping lines， this variation means that the cost of unloading is for the account of the seller who contracts for carriage and bears the freight.

2） CFR Ex Ship's Hold （CFR舱底交货）.This term means that the buyer is liable for the unloading cost.

3） CFR Landed （CFR卸到岸上）.This term requires the seller to bear the unloading cost including barging and dockage charges （驳船和船坞使用费）.

4） CFR Ex Tackle （CFR吊钩下交货）.This variant requires the buyer to bear the cost of unloading.

The parties should clarify whether the variants only mean the unloading cost the relevant party should bear or both of the cost and risks.

## 3.CIF—Cost， Insurance and Freight （...named port of destination）
## 成本、保险费加运费（……指定目的地）

CIF represents CFR with the inclusion of insurance.The cautions and notes made regarding CFR equally apply to CIF.

In the CIF term, the seller must pay the cost and freight necessary to bring the goods to a named port of destination, and must also procure marine insurance against the buyer’s risk of loss of or damage to the goods during the carriage, such that the seller is taken to have performed its obligation to deliver the goods whether or not the goods actually arrive at their destination in sound condition, in the stated quantity or, indeed, at all.CIF is only used for sea or inland waterway transport.

CIF differs from CFR in that the seller is liable for effecting insurance and paying the corresponding premium （保险费）， against the buyer’s risk of loss of or damage to the goods from the port of shipment to at least the port of destination.Under the Incoterms 2020 CIF， the seller is required to obtain limited insurance cover complying with Institute Cargo Clauses or similar clauses， rather than with the more extensive cover under Institute Cargo Clauses.It is，however， still open to the parties to agree on a higher level of cover.

CIF is the most important and commonly used shipping term.It is preferred by buyers because it means that they have little to do with the goods un

til the goods arrive at a port of destination in their country.A CIF price quot ation also allows the buyers to compare prices from the sellers around the w orld without having to take into consideration of differing freight rates, sinc e the seller pays the freight and insurance.Sellers are often under pressure fr om their governments to use domestic carriers and insurers, so they too like the term.On the other hand,sellers may not be able to find domestic carriers or insurers; and the buyers, under pressure from governments that are also c oncerned about employing national carriers, and insurers,may settle for an F OB contract.

## 11.4 FCA, CPT and CIP

### 1.FCA—Free Carrier （...named place of deliver y）
### 货交承运人（……指定目的地）

The term FCA specifies that the seller delivers the goods to carrier or a nother person nominated by the buyer at the seller’s premises or another na med place.A carrier is the party with whom carriage is contracted.The partie s are well advised to specify as clearly as possible the point within the name d place of delivery, as the risk passes to the buyer at that point.

The seller’s delivery is completed: 1) if the named place is the seller’s premises, when the goods have been loaded on the means of transport provi ded by the buyer; 2) in any other case,when the goods are placed at the disp osal of the carrier or another person nominated by the buyer on the seller’s means of transport ready for unloading.That is to say that the chosen place of delivery has an impact on the obligations of loading and unloading the go ods at that place.If delivery occurs at the seller’s premises, the seller is resp onsible for loading.If delivery occurs at any other place, the seller is not res ponsible for unloading.

FCA represents an excellent alternative to FOB which is inappropriate in most modern port operations.Under FCA the seller hands over risks/control of the cargo at a point prior to the vessel, frequently prior to the port.In the air shipment, technically speaking, goods placed in the custody of an air carrier is considered as delivery.In practice, many importers and exporters still use the term FOB in the air shipment.

FCA requires the seller to clear the goods for export, where applicable. However, the seller has no obligation to clear the goods for import, pay any import duty or carry out any import customs formalities.

FCA is used for any mode of transport or more than one mode of transport.

## 2.CPT—Carriage paid to （...named place of destination）
## 运费付至（……指定目的地）

CPT specifies that the seller delivers the goods to the carrier or another person nominated by the seller at an agreed place (if any such place is agreed between the parties)and that the seller must contract for and pay the costs of carriage necessary to bring the goods to the named place of destination.This means that the buyer bears all risks and any other costs occurring after the goods have been so delivered.CPT requires the seller to clear the goods for export, where applicable.However, the seller has no obligation to clear the goods for import,pay any import duty or carry out any import customs formalities.

CPT may be used for airfreight, roadfreight, railfreight, seafreight (when the ship’s rail serves no purpose) or a combination of such modes.If subsequent carriers are used for the carriage to the agreed destination, the risk passes when the goods have been delivered to the first carrier.However, responsibility for freight only transfers when the goods arrive at the stated place where carriage is“paid to”.The place where carriage is paid to may be any point in the country of destination.

CPT is used for any mode of transport or more than one mode of trans port.

### 3.CIP—Carriage and Insurance Paid to （...named place of destination）
### 运费与保险费付至（……指定目的地）

CIP （运费、保险费付至） represents CPT with the inclusion of ins urance.CIP specifies that the seller is responsible for contracting and paying for carriage and insurance （against the buyer's risk of loss of or damage to the goods during the carriage） to the"named place of destination".

As noted earlier, in the Incoterms 2020 CIP, insurance coverage ICC (A) or equivalent is required.CIP is used for any mode of transport or more than one mode of transport.

The cautions and notes made regarding CPT equally apply to CIP.

## 11.5 Other Trade Terms

### 1.EXW—Ex Works （...named place）
### 工厂交货（……指定地点）

The term EXW specifies that the seller delivers when it places the goo ds at the disposal of the buyer at the seller's premises or another named plac e (i.e.works, factory, warehouse,etc.), not cleared for export and not loaded on any collecting vehicle.

EXW represents the minimum obligation for the seller and the maximu m obligation for the buyer.The seller has no obligation to the buyer to load t he goods and the buyer is responsible for loading the goods on truck or cont ainer at the seller's premises, and for the subsequent costs and risks.In cases

where the seller is in a better position to load the goods,FCA, which obliges the seller to do so at its own risk and expense, is usually more appropriate.

A buyer who buys from a seller on an EXW basis for export needs to be aware that the seller has an obligation to provide only such assistance as the buyer may require to effect that export.The seller is not bound to organize the export clearance.Buyers are therefore well advised not to use EXW if they cannot directly or indirectly obtain export clearance.In such circumstances, the FCA term should be used.

EXW is used for any mode of transport or more than one mode of transport.

## 2.FAS—Free Alongside Ship （...named port of shipment）
## 装运港船边交货（……指定装运港）

The term FAS specifies that the seller delivers when the goods are placed alongside the vessel (e.g., on a quay or a barge) at the named port of shipment.This means the risk of loss of or damage to the goods passes when the goods are alongside the ship, and the buyer bears all risks from that moment onwards.

FAS requires the seller to clear the goods for export, where applicable. However, the seller has no obligation to clear the goods for import, pay any import duty or carry out any import customs formalities.

FAS is only used for sea or inland waterway transportation.

## 3.DAP—Delivered at Place （...named place of destination）
## 目的地指定地点交货（……指定目的地）

The term DAP specifies that the seller delivers when the goods are placed at the disposal of the buyer on the arriving means of transport ready for unloading at the named place of destination or at the agreed point within that place, if any such point is agreed.The seller bears all risks involved in bringing the goods to the named place or the agreed point within that place, if any such point is agreed.

The parties are well advised to specify as clearly as possible the destination place or the point within the agreed place of destination, as the risks to that place or point are for the account of the seller.The seller is advised to procure contracts of carriage that match this choice precisely.If the seller incurs costs under its contract of carriage related to unloading at the place of destination, the seller is not entitled to recover such costs from the buyer unless otherwise agreed between the parties.

DAP requires the seller to clear the goods for export, where applicable. However, the seller has no obligation to clear the goods for import, pay any import duty or carry out any import customs formalities.If the parties wish the seller to clear the goods for import, pay any import duty and carry out any import customs formalities, the DDP term should be used.

The seller is not required to unload the goods from the arriving means of transportation.

However, if the seller incurs costs under its contract of carriage related to unloading at the place of delivery/destination, the seller is not entitled to recover such costs separately from the buyer unless otherwise agreed between the parties.

DAP is used for any mode of transport or more than one mode of transport.

## 4.DPU—Delivered at Place Unloaded （...named place of destination）

## 目的地指定地点交货，已卸货（……指定目的地）

The term DPU specifies that the seller delivers when the goods, once u nloaded from the arriving means of transport, are placed at the disposal of t he buyer at the named place of destination or at the agreed point within that place, if any such point is agreed.The seller bears all risks involved in bringi ng the goods to and unloading them at the named port or place of destinatio n.

DPU is the only Incoterms rule that requires the seller to unload goods at destination.The seller should therefore ensure that it is in a position to org anize unloading at the named place.Should the parties intend the seller not t o bear the risk and cost of unloading, the DPU rule should be avoided and DAP should be used instead.

DPU requires the seller to clear the goods for export, where applicable. However, the seller has no obligation to clear the goods for import or for po st-delivery transit through third countries,to pay any import duty or to carry out any import customs formalities.

DPU is used for any mode of transport or more than one mode of trans port.

## 5.DDP—Delivered Duty Paid （...named place of destination）
## 目的地指定地点交货，关税已付（……指定目的地）

The term DDP specifies that the seller delivers the goods when the goo ds are placed at the disposal of the buyer, cleared for import, on the arriving means of transport, ready for unloading, at the named place of destination o r at the agreed point within that place, if any such point is agreed.The seller

bears all the costs and risks involved in bringing the goods to the place of d estination and has an obligation to clear the goods not only for export but al so for import, to pay any duty for both export and import and to carry out al l customs formalities.

The seller takes full responsibility for the added logistics costs such as increased inland or ocean transportation costs.Many details must be conside red, such as trade barriers, duties,currency exchange, reputability of service providers, and delivery to the final destination.For example, if the product i s a large, custom-made piece of machinery for a factory, the seller needs to consider: Are there local out-of-gauge, heavy lift service providers? Does th e road to the factory allow access by an oversized truck? How will you repa ir any damage that may occur during transit? etc.

Whilst the EXW term represents the minimum obligation for the seller, DDP represents the maximum obligation for the seller and the minimum obl igation for the buyer.This term should not be used if the seller is unable dire ctly or indirectly to obtain the import clearance.If the parties wish the buyer to bear all risks and costs of import clearance, the DAP term should be use d.

Any VAT or other taxes payable upon import are for the seller’s accoun t unless expressly agreed otherwise in the sales contract.

DDP is used for any mode of transport or more than one mode of trans port.

# 11.6 Shipment Contract and Choice of Tr ade Terms

## 1.Shipment contract

As previously stated, among the eleven trade terms in Incoterms 2020, only with the D-terms (DAP, DPU and DDP) is the seller’s delivery obligati

on extended to the country of destination.Under the other trade terms, the se ller fulfills the delivery obligation in its own country, either by placing the g oods at the disposal of the buyer at its (the seller's) premises(EXW), or by h anding over the goods to the carrier for shipment (FCA, FAS, FOB, CFR, C IF,CPT and CIP).

To make the important distinction between this fundamentally different natures of the trade terms, contracts of sale are often classified accordingly, as, for example, when the D-terms would turn the contracts of sale into arri val contracts.Contracts using F-terms or C-terms would fall into the categor y of shipment contracts.

It is important to note that the seller's obligation to arrange and pay for the carriage does not in itself extend its delivery obligation up to the point o f destination.On the contrary, the risk of loss of or damage to the goods will pass at the point of delivery, and the insurance which the seller has to take o ut under the trade terms CIF and CIP will be for the benefit of the buyer, wh o has to assume the risk after the delivery point.

Hence, the C-terms are distinguishable from all other terms in that they contain two critical points, one indicating the point to which the seller is bo und to arrange and bear the costs of a contract of carriage and another one f or the allocation of risk.When CPT, CIP, CFR or CIF are used, the seller ful fills its obligation to deliver when it hands the goods over to the carrier in th e manner specified in the chosen term and not when the goods reach the pla ce of destination.

For this reason, the greatest caution must be observed when adding obl igations of the seller to the C-terms which seek to extend the seller's respon sibility beyond the aforementioned critical point for the allocation of risk.It is of the very essence of the C-terms that the seller is relieved of any further risk and cost after it has duly fulfilled its contract by contracting for carriag e and handing over the goods to the carrier and by providing for insurance u nder the CIF and CIP terms.

In particular, the seller should not—and indeed could not, without chan ging the very nature of the C-terms, undertake any obligation with respect t

o the arrival of the goods at destination, since the risk of any delay during th e carriage is borne by the buyer.Thus, any obligation with respect to time m ust necessarily refer to the place of shipment or dispatch, for example,“ship ment (dispatch) not later than...”.An agreement for example,“CFR Hamburg not later than...” is really a misnomer and thus open to different possible int erpretations.The parties could be taken to have meant that the goods must a ctually arrive at Hamburg at the specified date, in which case the contract is not a shipment contract but an arrival contract.

## 2.Choice of trade terms

The choice of trade terms depends on various factors such as the abilit y of the parties to obtain the most favorable contract of carriage or insuranc e, the type of cargo, and the buyer’s intention to sell the goods in transit, et c.

In cases where the seller can procure marine insurance at a competitive price and where there are government regulations to use national shipping li nes, it may be appropriate to use CFR and CIF.When the buyer can procure insurance at a competitive rate, the parties may prefer to use FAS or FOB.

Exporters of manufactured goods may sell on extended terms using D AP, DPU and DDP(the seller makes goods available to the buyer at the carg o terminal) to remain competitive.Since such goods are normally containeri zed, the parties can also use FCA, CPT and CIP.Large buyers such as whole salers, department stores may find it advantageous to arrange for transportat ion in order to ensure just-in-time deliveries.

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[1]The International Chamber of Commerce was founded in Paris in 1919 to serve world business by promoting trade and investment， open markets for goods and services， and the free flow of capita l.It is the largest， most representative business organization in the world.Its hundreds of thousands o f member companies in over 130 countries have interests spanning every sector of private enterprise.

[2]In the USA, FOB vessel is mainly used in quotation of the American manufacturers (seller) to the American exporters (the buyer)in domestic trade.That’s why FOB vessel requires the buyer to bear e xport taxes and charges.

[3]Shipping advice is a notice to the importer on summary of the shipment.

# Chapter 12 Quality, Quantity, Packing and Pricing

Learning Objectives

In this chapter, you will learn:

- Types of expressing quality in the contract
- Methods of weight calculation
- Marks on transport packing
- Cost accounting in export
- Quality, quantity, packing and price clauses in the contract

Quality, quantity, packing and price clauses are usually regarded as the major terms and conditions and they are integral parts of a sales contract.

In this chapter, Section One first highlights the importance of the name of commodity and the way of using a proper name for the traded goods.Then it elaborates the various methods of expressing quality in a sales contract. Section Two introduces four systems of weights and measures, the units and ways of quantity calculation.Section Three mainly discusses transport packing including types of and marks on transport packing.It also introduces neutral packing and product code.Section Four examines pricing.It first stresses the points to be considered in pricing, then introduces the way of choosing currency for accounting and payment as well as the cost accounting in export.

## 12.1 Quality

### 1.Name of commodity

The name of commodity constitutes part of the quality clause in a sales contract.If the name of the goods delivered by the seller does not conform to the agreed name of commodity,the buyer reserves the right to lodge a claim, reject the goods or even cancel the contract.Therefore, as a main clause of the sales contract, the name of commodity should be clearly stipulated.

Using a proper name for the traded good is significant in that it helps to avoid confusion，reduce customs duties or save freight.Currently businessmen usually nominate traded goods with names complying with the Harmonized Commodity Description and Coding System （商品名称及编码协调制度） （HS） of tariff nomenclature.HS is an internationally standardized system of names and numbers for classifying traded products.It is developed and maintained by the World Customs Organization （WCO） （formerly the Customs Co-operation Council）which is an independent intergovernmental organization with over 170 member countries based in Brussels， Belgium.

## 2.Methods of expressing quality of commodity in the contract

Quality is one of the major terms and conditions in the contract.According to The United Nations Convention on Contracts for the International Sale of Goods[1]（联合国国际货物销售合同公约） （CISG）， the seller must deliver the goods as required by the contract.Otherwise，the buyer may claim damages， require delivery of substitute goods， or require the seller to remedy （补救）， or even reject the goods and cancel the contract.The quality agreed upon in the contract is the basis of the seller’s delivery.In international transactions， the following ways are commonly used to express the quality of goods in a contract.

（1） Sale as seen （看货买卖）

A sale is made on the basis that the buyer has inspected the goods and is buying them as a result of this inspection and not on any guarantee of qual

ity or condition by the seller.The seller does not guarantee or imply that the goods are suitable for any particular purpose.

This method is of special necessity for particular goods such as ornaments, jewels,paintings, artworks, etc.In many cases, the buyer may be advised to arrange for inspection of the goods before or at the time they are handed over by the seller for carriage.Unless the contract stipulates otherwise, the buyer would himself have to pay the cost for such inspection that is arranged in his own interest.

（2） Sale by sample （凭样品买卖）

A sample is a product, often taken out from a whole lot of consignment or specially designed and processed.It is given for prospective customers to see and buy the product or set aside as the quality standard of the whole consignment.Garments, light industry products, and agricultural native products are generally sold by samples.

If a sale is made by sample, then the quality and condition of the goods delivered should be as good as that of the sample.Sample may be offered either by the seller or by the buyer.

1） Counter sample （回样）.When a sale is made by buyer’s sample， the goods delivered by the seller， may sometimes not be in conformity with the buyer’s sample and thus the buyer may refuse to accept the goods.In order to avoid disputes over the quality of goods in the days to come，it is advisable for the seller to send a reproduced product for buyer’s confirmation before putting into production.This reproduced product is called“counter sample” or“confirming sample （确认样品）”， on which the seller’s delivery will be based.

2） Sealed sample （封样）.Before sending samples or delivering the goods to the buyer， the seller may select some samples and seal them in the presence of the buyer or notary （公认）.This sealed sample is for checking the quality of the delivered goods in the future.

3） Reference sample （参考样品）.When sale is made by description （文字说明）， either the seller or the buyer may send a sample to the o

ther party to let it know more clearly about the products.This sample is ofte n marked“for reference only”.It is not the basis for delivery.

（3） Sale by description （凭文字说明买卖）

Sale by description means a sale is made on the basis that the quality o f the goods sold will correspond to the description given to them in the cont ract of sale.

1） Sale by specifications （凭规格买卖）

Specifications refer to indices relating to chemical composition, conten ts, length, and size of a product.Describing quality by specifications can be simple and accurate.That’s why it is the most widely used way of describing quality.For example,

Printed Shirting“Jumping Fish”

Yarn counts 30×36

No.of threads/inch 72×69

Width (inch) 35/36″

2） Sale by grade （凭等级买卖）

Products with the same specifications fall into the same grade.Products can be divided into different grades based on different specifications.For ex ample,

Fresh hen eggs, shell light brown and clean, even in size

Grade AA: 60～65gm per egg

Grade A: 55～60gm per egg

Grade B: 50～55gm per egg

Grade C: 45～50gm per egg

3） Sale by standard （凭标准买卖）

A standard is an established norm or requirement.It is usually a formal document that establishes uniform engineering or technical criteria， metho

ds， processes and practices.There are various levels of standards including international standards like ISO standard， national standards like BS in Britain， ANSI in the USA and JIS in Japan.When a sale is made by standard， it is important to mark the publication year of the standard.For example.Rifampicin B.P.[2] 1993.

4） Sale by brand and trade mark （凭品牌和商标买卖）

Brand is the name, term, symbol, design or a combination of these to identify a product.It has a narrower meaning in which an enterprise means to distinguish its products from the products of other enterprises.

Trade mark is a legal term.It includes all those words， symbols， or marks that are legally registered for use by a single company.It is a symbol or ornamental printed on a commodity or its packing.The word Buick can be used to explain these differences.The Buick car is branded under the brand name“Buick”.When“Buick” is printed in a certain kind of script （书写物），however， it becomes a trade mark.

Some products may have been sold in the market for many years and enjoy high popularity.Their quality can thus be represented by their trade marks and brands, such as Coca Cola, White Rabbit Creamy Candy.However, some well-known brand products cannot be traded solely by their marks and/or brands, owing to their varieties and complexities.Take SONY as an example, there are Sony televisions, Sony walkmans,Sony DVDs, and so on.In such cases, detailed quality indices or technical descriptions must be clearly stated.

5） Sale by name of origin （凭产地名称买卖）

Whilst some products are well-known for their brands or trade marks, others such as native products are well-known for their place of origin.In the latter case, the place of origin is used to represent the quality of the product in the contract.

6） Sale by descriptions and illustrations （凭说明书和图样买卖）

Products like machinery, instrument, equipment, and transportation tools have complex structure.It is difficult to describe their quality fully, thus sa

le by descriptions and illustrations is applicable.In the contract, the clause o f quality contains not only the name of commodity,the brand but also the ins tructions to illustrate the structure and functions of the product.Clauses lik e“quality and technical data to be strictly in conformity with the description submitted by the seller” are to be stipulated.

## 3.Quality clause in the contract

A quality clause usually consists of the name and specifications, grade, or the serial number and date of the sample.We may use descriptions or sam ple separately or together to describe quality.In order to facilitate the imple mentation of contract, some flexible quality ranges are normally provided in the contract.

1) When a sale is made by sample, as sometimes it is uneasy to ensure the goods being completely in conformity with the sample, it is advisable fo r the seller to stipulate clauses like“the quality of the goods shipped to be ab out equal to the sample.”

2) Flexible quality range for some primary products:

(a) Range

For example,

Printed Shirting“Jumping Fish”

Yarn counts 30×36

No.of threads/inch 72×69

Width (inch) 35/36″

(b) Allowing more or less

For example,

Duck feather: down content 18％, allowing 1％ more or less.

(c) Max.& min.

For example,

Fish Meal　Protein　55％ Min.

Fat　9％ Max.

Moisture　11％ Max.

Salt　4％ Max.

Sand　4％ Max.

3） Quality tolerance （品质公差）

It is not uncommon that some industrial products such as instruments, mechanical products have some tolerances—permissible variation in quality.For example, watches go with a tolerance of ×× seconds.Some of the tolerances are internationally recognized, others are stipulated by the seller and the buyer in the contract.

When the quality difference is within the flexible range， the price of the product may not be adjusted.However， if the difference greatly influences the quality， the price is normally increased or reduced accordingly （相应地）.For example， soybean， if the oil content of the goods shipped is 1％ higher， the price will be accordingly increased by 2％.

# 12.2 Quantity

In international trade， as products vary in their natures and countries may adopt different systems of weights and measures （度量衡制度）， the units and ways of quantity calculation are different.

## 1.The systems of weights and measures

The system of weights and measures is a set of units which can be used to specify anything that can be measured.

1） Metric system （公制）.The metric system is an international decimalized （十进位的）system of measurement， first adopted by France in 1791.Fundamental units under this system are kilogram （kg.）， meter （m.）， square meter （sq.m.） and liter （l.）.Some other derived units are metric ton （M/T）， kilometer （km.） and so on.This system is widely used by the European continent and many other countries.

2） International system of units （国际单位制）.Over the last two centuries， different variants have been considered as the metric system.Since the 1960s， the international system of units has been the internationally recognized standard metric system.The International System is called the SI， using the first two initials of its French name Système International d'Unités.This system is published by international standard metrical organization， and based on the metric system.Its fundamental units include kilogram， meter， second， and so on.SI is the official system of measurement for most nations including China.

3） British system （also called British imperial units）.British imperial units were mostly used in the British Commonwealth and the former British Empire but in most Commonwealth countries they have been largely supplanted （取代） by the metric system.The units are still used for some applications in the United Kingdom but have been mostly replaced by the metric system in commercial， scientific， and industrial applications.

4) American system (also called the United States customary system of units).This system is the most commonly used system of measurement in the United States.While the imperial and US customary systems are closely related, there are a number of differences between them.For instance, the imperial system uses a long ton (L/T) of 2,240 pounds (lb[3].)The American system uses a short ton of 2,000 pounds (lb.).Where these systems most notably differ is in their units of volume.Six U.S.gallons are a little less than five Imperial gallons.

## 2.Quantity units

There are two categories of units which are used to show the quantity of commodity in international trade.One is metrical units （计量单位）， including weight， length， area， volume and capacity； the other is numbers including some customary units such as dozen， gross （罗），great gross， ream （令）， and some packing units like barrel （桶） （for petroleum and oil）， bale （包）（for cotton）， etc.

## 3.Methods for calculating weight

In international trade, a lot of products are measured by weight.According to general commercial practices and rules, the following are the methods of calculating weight.

1） Net weight （净重）.This is the weight of the product itself.According to international rules and practices， weight is calculated by net weight unless otherwise stated in the contract.

2） Gross weight （毛重）.This is the weight of net weight plus the weight of package.Some products can be weighed only when they are packed， and this weight including the weight of package is called gross weight. For some less valued products， we may stipulate in the contract the weight is calculated by gross weight.This is so called gross for net （以毛作净）.If net weight has to be used， we must deduct the weight of package， i.e.the tare （皮重）.The following are some methods of calculating tare.（a） Real tare： the actual weight of each package； （b） Average tare： the average weight of packages； （c） Customary tare （习惯皮重）： the weight of package known to all； （d） Computed tare （约定皮重）： the weight of package agreed upon by the buyer and the seller.

3） Conditioned weight （公量）.This is a weight applicable for weighing products with unstable moisture contents such as wool， cotton， raw silk， etc.In order to determine the moisture contents accurately， the universal conditioned weight is used.Theoretically，conditioned weight is equal to dry weight plus standard moisture content.As the actual weight， the standard moisture regain[4] （回潮率） and the actual moisture regain are avai

lable， the following formula is usually used to calculate conditioned weigh t：

$$\text{Conditioned weight} = \text{actual weight} \times \frac{(1 + \text{standard moisture regain})}{(1 + \text{actual moisture regain})}$$

4） Theoretical weight.This is a calculated weight based on nominal di mensions （标定规格） of a product.Some products are of uniform sizes a nd/or dimensions and the weight of each unit is almost the same.Thus the to tal weight of shipment （船货） can be obtained by multiplying the total u nits of the shipment by the weight of each unit.

## 4.Quantity clause in the contract

(1) The importance of quantity clause

The quantity of commodity is a major indispensable clause in a contrac t.The CISG states that the seller must deliver goods which are of the quantit y required by the contract.If the seller delivers a quantity of goods greater th an that provided for in the contract， the buyer may take delivery or refuse to take delivery of the excess quantity.If the buyer takes delivery of all or pa rt of the excess quantity， he must pay for it at the contract rate.If the quant ity of goods delivered is less than that provided for in the contract， the sell er must replenish （补足） the goods within the stipulated time of deliver y， and without causing unreasonable losses to the buyer and the buyer res erves the right of claiming damages.Therefore， it is very important for bot h sides to stipulate the quantity clause correctly.

（2） More or less clause （溢短装条款）

In practice， it is sometimes not easy to control strictly the quantity of some bulk cargoes like farm products and mineral products.Besides， owin g to changes to supplies and limitation to processing conditions， the actual quantity may be somewhat more or less than the contracted quantity.Under such circumstances， more or less clause is usually stipulated in the contrac

t so that the seller can fulfill the contract more smoothly.The more or less clause is a clause which allows the quantity delivered be a certain percentage more or less than contracted quantity.For example， 2000 M/T， 5％ more or less at seller's option （选择）.However， if the quantity is related to transportation，"at carrier's option" may be stipulated， or"at buyer's option" when the ship is arranged by the buyer.

Settlement for the more or less part is usually based on the contract price.If the parties are concerned about the great changes in price at the time when delivery is made, they may stipulate that settlement for this part is based on the market price at the time when the goods are shipped on board the vessel.

## 12.3 Packing

Packing is critically important for export because the degree of physical protection needed to safeguard items is often greater for exported goods than for domestic sales.Also,foreign countries sometimes have laws requiring that packing conform to certain standards and/or rules on the disposal or compulsory recycling of packing materials.Modification to packages for various countries may be necessary.

Packing can be divided into selling packing and transport packing according to their different functions in commodity circulation.Selling packing is also called small or inner or immediate packing.It is mainly used to protect products, make the products convenient to use, and to promote sales.Inner packing should be in conformity with the laws and regulations of the importing countries.Transport packing is also known as big or outer packing.Its main functions are to protect goods, facilitate storage as well as shipment.In this section, we mainly discuss transport packing.

### 1.Types of transport packing

In transit, not all goods are necessarily packed.With the development of transportation,more and more small and roundish cargoes like grain, cement and liquid cargoes like petroleum are in bulk, i.e., they can be loaded directly into the transportation vehicles with mechanical operation.In this way, the costs of carriage are saved, and the carriage is speeded up.Some cargoes like steel, timber, etc.need only to be bundled up, which are described as goods in naked packing.But for most cargoes, packing is essential in transportation.There are two kinds of transportation packing.

1） Unit packing （单件包装）.The goods are packed in unit.The common unit packing includes.

● Bale （包）： a heap of material pressed together and tied with rope or metal wire， suitable for paper， wool， cotton， and carpets， etc.；

● Bag: made of cotton, plastic, paper or jute, ideal for cement, fertilizer, flour, chemicals,etc.;

● Barrel/drum: made of wood, plastic or metal used for liquid or greasy cargoes;

● Box/case: wooden in structure and of various sizes.Some are airtight, providing strong protection for cargoes as equipment and car accessories;

● Glass container: used for hazardous liquid cargoes such as acid which needs careful handling;

● Carton: a very common form of packing particularly for consumer type of products.It can promote sales to some extent as words can be printed on them;

● Crate/skeleton case: wooden structure between a bale and a case used for light weight goods of large cubic capacity as machinery.

2） Unionization （or combined） packing （集合包装）.It is a kind of packing whereby individual packages are put together and placed into a larger container.The combined packing has such advantages as to protect go

ods effectively， improve efficiency of handling， and save packing costs as well as freight.

## 2.Marks on transport packing

Marks on transport packing help to identify goods, and facilitate correc t operation.According to their functions, marks on transport packing can be divided into shipping mark,indicative mark, warning mark, weight/volume mark, and origin mark.

（1） Shipping mark （运输标志，唛头）

Shipping mark facilitates the identification and count of the goods in th e process of loading and unloading, shipping and storing.Shipping marks ca n also prevent the goods from being wrongly delivered or shipped.

Shipping mark is usually composed of numbers, alphabets, and simple words.However,in some instances, marks have become so lengthy and detai led that the sides of packages can no longer hold them.It has been said that packages become documents.The result is unnecessary costs, mistakes, conf usion and shipment delays.In 1979, the Working Party on Facilitation of Int ernational Trade Procedures, a subsidiary body of the United Nations Econo mic Commission for Europe recommended its established standard simpler shipping marks.The Standard Shipping Mark established should be used for marking on packages moved internationally by all modes of transport, for re production in related documents, and as data elements in trade data intercha nge.The Standard Shipping Mark is made up of the following four elements in the sequence indicated and should be shown both on packages and docu ments.For example,

1) Initials or Abbreviated Name ABC

2) Reference Number 1234

3) Destination BOMBAY

4) Package Number 1/25

Any of the four elements which are considered unnecessary for a ship ment may be omitted.

1) Initials or abbreviated name of consignee or buyer.The seller and th e buyer could usefully agree on a set of initials/abbreviations to be used for all shipments between them.If an abbreviated name is preferred to initials, t he consignees'/buyers' name, as abbreviated in their telex answerback or ca ble address, could be used.

2) Reference number.Reference number should be as brief as possible t o avoid confusion and mistranscription.Only the most important number of those available, e.g., shipment or order or invoice number as agreed betwee n seller and buyer, should be shown.

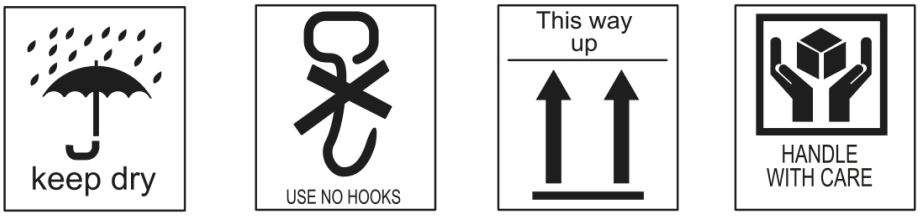
3) Destination.The name of the port or place of ultimate destination of the goods (port of discharge and place of delivery) should always be shown.

4) Package number.The running and, where known, the total number o f packages or pieces should be indicated as, for example,"1/25","2/25", and so on to"25/25".This is shown on documents as"1/25", meaning"packages n umber 1 to 25".

Shipping marks must not exceed ten lines of 17 characters per line.

(2) Indicative mark

Indicative mark is a caution mark reminding people of carefulness in h andling or carrying goods.It is composed of graphs and words, such as KEE P DRY, USE NO HOOK, THIS WAY UP and HANDLE WITH CARE.




(3) Warning mark

Warning mark is also called hazardous mark and is used to indicate ex plosive, poisonous or inflammable goods.It is also composed of graphs or pi

ctures and words.



EXPLOSIVE



INFLAMMABLE



POISONOUS

(4) Weight and volume mark

Weight such as gross weight, net weight and volume are usually marke d on the transport packing to facilitate the arrangement of storing, loading a nd unloading as well as liner space.For example,

N.W.:11.3 KG

G.W.:16.4 KG

MEAS.:45.5×52×55.5 cm

(5) Country of origin mark

As in China， many countries require that the product and the product packing be marked with the country of manufacture or production before th e product can enter the foreign country.The regulations may be quite specifi c， for example， requiring that the country of origin be engraved （刻上） in the product at the time of production.

## 3.Neutral packing

Neutral packing （中性包装） is a special type of packing where ther e is no country of origin on it.Chinese export products are usually marked w ith words like“Made in the People’s Republic of China” or“Made in Chin a”.But sometimes， at the request of the buyer，the seller may accept neutr al packing.Neutral packing is divided into neutral packing with designated b rand （定牌中性包装） and neutral packing without designated brand （无牌中性包装）.

Neutral packing with designated brand refers to the neutral packing wh ere the brand (or trademark) designated by the buyer is marked out on it.Ne utral packing without designated brand refers to the neutral packing without designated brand (or trademark).

Neutral packing is a usual practice in international trade.It may be for t he purpose of breaking economic blockade or facilitating the buyer to resell the goods.But in recent years it has been restricted by some countries.Expor ters should be cautious in adopting it.

## 4.Bar codes

Bar codes （条形码） are widely used on consumer items.There are t wo systems of bar codes.One is the Universal Product Code （U.P.C.） sys tem in the U.S.A.and Canada， which is managed by the Uniform Code Co uncil Inc.（Lawrenceville， New Jersey， U.S.A.）， the other is the Inte rnational Article Numbering （EAN） system in over 90 other countries， which is managed by the EAN International （Brussels， Belgium） throu

gh its Numbering Organizations（NOs）.The U.P.C.numbering system was the original system， from which the EAN system evolved （演变）.

In the early days， EAN signified （表示……意思） European Artic le Numbering Association （欧洲物品编码协会）， formed in 1977 by 1 2 European organizations representing manufacturers and retailers.Since co untries from other continents joined the Association， the name was change d to International Article Numbering Association （EAN International）， currently known as GS1[5].

The purpose of U.P.C.and EAN symbols （codes） is to facilitate auto matic scanning of item numbers and associated price look-up at the point of sale （POS）—the checkout （结账）counter.When a customer buys groc eries at the supermarket or consumer items at department store， discount s tore or other type of chain store， the cashier scans （扫描） the bar code on each product with an infra-red （红外线） gun or moves each product o ver a window where an invisible infra-red laser beam （激光） scans the b ar code.The number goes into the computer which instantly shows the price of the product on the checkout display and adds up the bill.The computer ke eps a record of all products sold and calculates stock levels.It can also be us ed to tell the retailer when to reorder items or work out which products are hot sellers and which are not moving at all.The following is an example of t ypical EAN bar code.




An EAN bar code is divided into four areas: 1) the number system; 2) t he manufacturer code; 3) the product code; 4) the check digit.

The number system consists of two digits (sometimes three digits) whi ch identify the country (or economic region) numbering authority which ass

igned the manufacturer code.It should be noted that the digits associated wit h country of origin don't necessarily specify where the product was manufa ctured, but rather where the bar code itself was registered.So,for example, a product manufactured in China and sold in France could have an EAN-13 b ar code identifying it as a French product.

The manufacturer code is a unique code assigned to each manufacturer by the numbering authority indicated by the number system code.All produ cts produced by a given company will use the same manufacturer code.

The product code is a unique code assigned by the manufacturer.

The check digit is an additional digit used to verify that a bar code has been scanned correctly.

In 1988， China established the Chinese Article Code Center which is now known as GS1 China.As an affiliate of General Administration of Qual ity Supervision， Inspection and Quarantine of the People's Republic of Ch ina （AQSIQ）（中华人民共和国国家质量监督检验检疫总局）， GS 1 China is at present in charge of organizing， coordinating and administrat ing article numbering and Auto-ID work throughout China.GS1 China has b een dedicated to promoting the GS1 system， the globally-adopted， open and cross-industry standard for supply chain management， since it joined GS1 as a Member Organization on behalf of China in April 1991.China's G S1 country codes are 690-695.

## 5.Packing clause in the contract

1） Contents.The packing clause consists of packing material and the way of packing.For example， packing： in cartons containing 30 doz.It is advisable to avoid the use of ambiguous terms such as"seaworthy （适合海运的） packing""customary packing （习惯包装）".

2) Packing marks.It is not common to stipulate packing marks in the co ntract.If,however, the buyer designates the packing marks, it is necessary to stipulate the details of the shipping mark in the contract.

3) Packing charges.Packing charges are usually included in price.But if the buyer calls for special packing, then it is necessary to ascertain who shal l bear the additional charges.The time and methods of payment should also be stated.

# 12.4 Pricing

Pricing is one of the most important and complex tasks in business, an d even more of a problem when linked with exporting.An exporter should s ell its products at a price acceptable to the customers and, at the same time, generate enough revenue to cover all its costs.Appropriate pricing is not eas y and must be treated seriously and carefully.

## 1.Factors to be considered in pricing

The following points are the factors to be considered in arriving at a po tential price:

1) Have a good knowledge of the international market level, establish all relevant market data on competitive prices for similar products and evalu ate them;

2) While referring to the international market situation, consider the po licies and regulations that apply to a particular market area;

3) On the basis of international market level, adjust prices according to the exporter’s specific purposes or the importer’s requirements;

4） As the world market may fluctuate （波动） with the change of s upply and demand pattern， it is important to watch the change of supply a nd demand relationship and the trend of rising and falling of the market pric es.

5) Include adequate profit margin over actual production and distributi on costs, etc.;

6) Other relevant terms such as the quality and quantity of the products contracted,transportation costs, place and terms of delivery etc.will also influence the determination of export prices;

7) Method of payment of the goods and the possible fluctuations of foreign exchange rates are other factors that should be considered when pricing.

## 2.Choice of currency for accounting and payment

Currency for accounting （记账货币） is the currency used for price calculation while currency for payment （支付货币） is the currency for settlement.They are usually the same currency if not otherwise stipulated in the contract.Currency for accounting and payment can be the home currency of the exporter， the importer's currency or a third currency if only these currencies are convertible （可兑换的）.When choosing the currency， the exporter and importer should take foreign exchange rates into consideration， as the fluctuation of exchange rates may influence their interests.

Theoretically， using of hard currency that is reliable， stable and more in demand as payment currency is more favorable to the exporter， while the importer prefers to pay in soft currency whose value may depreciate rapidly or that is difficult to convert into other currencies.Which currency is to be used depends on the consultation between the exporter and the importer.Any party who has to adopt an unfavorable currency as payment currency may take one of the following measures to offset foreign exchange exposures （风险）.

(1) Try to reduce the import price or raise the export price

When entering a contract, we should take the tendency of foreign exchange into consideration.For example, you are an importer, while the currency used is likely to float upward (Note: this is your forecast), you should try to press the exporter to reduce the price.If you are an exporter, while the currency is likely to float downward, you should try to raise the price.Usually s

uch measure is used within a short period, because it is rather difficult to for ecast the tendency of foreign exchange for a long period.

（2） Stipulate exchange proviso clause （订立外汇保值条款）

In the case that the currency for accounting and the currency for paym ent are the same soft currency, i.e., the change of the exchange rate between the present date and the settlement date might be worse to the seller, to prot ect its firm from suffering loss, it is advisable for the seller to define in the c ontract the equivalent contractual amount in another strong currency accord ing to the rate between this soft currency and another strong currency on the day of concluding the contract.On the date of payment, the amount in hard c urrency shall be converted into soft currency at the rate of that date accordin gly.This converted amount of soft currency is what the buyer needs to pay t o the seller.The following is an illustration:

The exchange proviso clause in the contract stipulates“The amount in J apanese Yen under this contract is equivalent to Swiss Francs 124,000 as cal culated according to the ratio between the buying rate of Japanese Yen (JP Y) and that of Swiss Francs (CHF) published by the Bank of China on the d ay of concluding this contract.On the date of payment, the amount in Swiss Francs shall be converted into Japanese Yen for full payment according to t he ratio between the buying rates of Japanese Yen and Swiss Francs publish ed by the Bank of China on that date.”

Here is an example:

The contractual amount was JPY10 million and the exchange rate on t he date of concluding the contract was JPY1/CHF0.0124.Thus the total cont ractual amount in Swiss Franc was CHF124,000.On the date of payment the exchange rate was JPY1/CHF0.011, then in light of the exchange proviso cl ause in the contract, the contractual amount in Swiss Franc(CHF124,000) s hould be converted into JPY11,272,727 at the new rate.The payment for the price should then be JPY11,272,727 instead of the original JPY10 millio n.□

## 3.Commission and discount

In the price clause, sometimes commission or discount is involved.

1） Commission.Commission is a fee charged by a broker or agent for its service in facilitating a transaction.It may be indicated in the price， for example， US$1，000 per M/T CFR Seattle including 2％ commission，or US$1，000 per M/T CFRC2％ Seattle， or US$1，000 per M/T CFRC 2 Seattle.The commission included in the price is known as plain commission（明佣）.Commission which is not included in the price is called secret commission （暗佣）.

Contractual price with commission is called commission-inclusive price (abbreviated as C-inclusive price).Commission is the product of the C-inclusive price and the commission rate.The following formula shows how to calculate commission, net price and the relationship between C-inclusive price and net price.

$$\text{Commission} = \text{C-inclusive price} \times \text{commission rate}$$

$$\begin{aligned}\text{Net price} &= \text{C-inclusive price} - \text{commission} \\ &= \text{C-inclusive price} - \text{C-inclusive price} \times \text{commission rate}\end{aligned}$$

$$\text{C-inclusive price} = \frac{\text{net price}}{1 - \text{commission rate}}$$

Example:

The original price quoted by the exporter is USD20 per piece CIFC2％ New York, now the exporter is requested by the importer to make a new quotation on CIFC5.By how much will the exporter’s net income be reduced if the new quotation remains the same as the original one? And how much should the exporter quote if its original net income is the same as before?

(a) The original net income = CIFC2 – C
= CIFC2 – CIFC2 × 2%
= 20 – 20 × 2%
= US$19.6

(b) The new net income = CIFC5 – C
= CIFC5 – CIFC5 × 5%
= 20 – 20 × 5%
= US$19

Thus the exporter's new net income will be reduced by US$0.6 (US$19.6 − US$19) per piece.

(c) New quotation: $CIFC5 = \frac{\text{net price}}{1 - \text{commission rate}} = \frac{19.6}{1 - 5\%} = US\$20.6$

2) Discount.Discount is a certain percentage of price reduction and a special favor given by the exporter to the importer.It is usually used as a means of promoting and expanding sales.There are different types of discount such as"quantity discount","cash discount", and"special discount" for some special purposes.Discount can also be specified in the price clause, such as"US$ 200 per metric ton CIF London less 3％ discount".

# 4.Cost accounting in export

There are two major economic benefit indices used in cost accounting in export （出口成本核算） by China's foreign trade enterprises：

1） Cost of earning foreign exchange in export （出口换汇成本）.This index means the cost in RMB for earning one dollar in export.It is the ratio of total export cost in RMB to net foreign exchange income in US dollars in export and can be expressed as follows：

$$\text{Cost of earning foreign exchange in export} = \frac{\text{Total export cost (RMB)}}{\text{Net foreign exchange income (USD)}}$$

Where total export cost covers purchasing cost or production cost and domestic charges(storage, management, taxes, and so on).Net foreign exchange income (USD) refers to FOB price.

The following is an example:

Suppose the total cost for per unit of commodity A is as follows: purchasing cost RMB7,270, processing charges RMB900, circulation charges RMB700, other costs RMB30,and the export price is USD1,300 per unit CIF New York, in which USD128 of freight and USD72 of insurance premium are included.Thus:

Total (export) cost (RMB)=7,270 + 900 + 700 + 30=RMB 8,900

Net foreign exchange income=1,300 − 128 − 72=USD1,100

$$\text{Cost of earning foreign exchange in export} = \frac{\text{RMB8,900}}{\text{USD1,100}} = \text{RMB 8.09 / USD}$$

2） Profit or loss ratio in export （出口盈亏率）.This index is the ratio of profit or loss（which is net export income in RMB minus total export cost） to total export cost.Net export income in RMB is the net foreign exchange income in US dollar multiplied by the buying rate of RMB to USD.Positive result and negative result stand for profit ratio in export and loss ratio in export respectively.

$$\text{Profit or loss ratio in export} = \frac{\text{Net foreign exchange income} \times \text{buying rate} - \text{Total export cost}}{\text{Total export cost}} \times 100\%$$

Taking the previous example, suppose the buying rate is RMB6.54/USD, then

$$\text{Profit or loss ratio in export} = \frac{1{,}100 \times 6.54 - 8{,}900}{8{,}900} \times 100\% = -19.17\%$$

Thus the loss ratio in this transaction is 19.17%.

## 5.Price clause in the contract

(1) Constitution of price clause

The price clause consists of two parts: unit price and total amount.Unit price is composed of four parts, i.e., currency unit, unit price figure, measur ement unit and trade term.For example, US$500 per barrel FOB Dalian.

(2) Ways of price stipulation

1) Fixed price: The common way of price stipulation is to define a fixe d price mutually agreed.The fixed price is so clear and definite as to facilitat e accounting.

2) Flexible price: Because of the uncertainty of market situation, price may be flexibly stipulated as“price to be agreed on the date of ×××” or only part of the price is fixed.

3) Price adjustment (revision) clause: For the sales contract of goods w hich need long period of production, like machinery and equipment, price a djustment revision clause may be stipulated in addition to a fixed price (call ed initial price) at the time of contract stipulation.Under this clause, the pric e can be adjusted according to the changes of salaries, and prices of raw mat erials, etc.For example,“the above initial price will be adjusted according to the following formula based on the wage and price indexes published by ×× × (organization) as of ××× (month) 20××(year).”

The following formula is usually adopted in the price adjustment claus e:

$$P = P_0\left(A + B\times\frac{M}{M_0} + C\times\frac{W}{W_0}\right)$$

Where P is the final price; $P_0$ is the initial price; M is the average price or price index of relevant material at the time of calculating the final price; $M_0$ is the average price or price index of relevant material at the time of signing the contract; W is the average wage or wage index at the time of calculating the final price; $W_0$ is the average wage or wage index at the time of signing the contract; A, B, C represent the shares of management expenses and profits,material prices and wages in the price respectively.

For example, Company A imports a set of equipment.The initial contract price is US$8 million, the shares of management expenses and profits, material price and wages are 60%,20%, and 20% respectively.Both the importer and the exporter agree to define the final price by making adjustment to the original price.Suppose at the time of signing the contract, both of the index of material price and wage are 100.At the time of delivery, they are 115 and 110 respectively.Thus the final price is

$$\begin{aligned} P &= P_0\left(A + B\times\frac{M}{M_0} + C\times\frac{W}{W_0}\right) \\ &= 8\times\left(20\% + 60\%\times\frac{115}{100} + 20\%\times\frac{110}{100}\right) \\ &= \text{US\$ } 8.88 \text{ million} \end{aligned}$$

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[1]The United Nations Convention on Contracts for the International Sale of Goods is a treaty offering a uniform international sales law.As of July 2008， it had been ratified by 71 countries that account for a significant proportion of world trade， making it one of the most successful international uniform laws.Japan is the most recent state to have ratified the Convention （for more information about CISG， see Chapter 17）.

[2]B.P.here stands for British Pharmacopoeia （药典）.

[3]Why the abbreviation for pounds is Lbs, not Pds? Lb is short for libra, which is the Latin word for the Roman version of the pound.The symbol pd is used for per diem, a unit of frequency meaning once per day.

[4]Moisture regain is the ratio of water content to dry weight.

[5]GS1 was formally created in 2005 to consolidate the work of the North American UCC and the EAN.GS1 is an international not-for-profit association dedicated to the development and implementati

on of global standards and solutions to improve the efficiency and visibility of supply and demand ch ains globally and across multiple sectors.The GS1 System of standards is the most widely-used suppl y-chain standards system in the world.There are GS1 member organisation offices in 108 countries.F or more information， see http：//www.gs1.org.

# Chapter 13 International Cargo Transportation

Learning Objectives

In this chapter, you will learn:

- Modes of transport
- Calculation of ocean freight
- Various types of B/L and other transport documents
- Shipment clause in the sales contract

International cargo transport refers to the activity that facilitates physical movement of goods from one place to another.In business, it is considered as an auxiliary to trade, that means, it supports trade and industry in carrying raw materials to the place of production and distributing finished products for consumption.Nowadays, goods produced at one place are readily available at distant places.Without transport, business units cannot move a single step.

As seen in Chapter 11, under CIF contract, the seller is responsible for arranging transport of cargo from its country to the buyer's.Even where the sale is not on CIF terms, transport is still an integral part of an international sale transaction.For instance, in an FOB contract, the buyer may arrange transport, or it may ask the seller to arrange transport on his behalf.

This chapter first examines the features of different modes of transport, particularly the ocean transport and the methods of calculating ocean freight.Then it reviews various kinds of bill of lading as well as other transport documents.Finally it discusses shipment clause in the sales contract.

# 13.1 Modes of Transport

Basically transport is possible through land, air or water.On land we use trains, trucks,tractors, etc.to carry goods; In air, we find aero-planes and helicopters to carry goods.Similarly, in water we find ships, steamers, etc.to carry goods.All these are known as various modes of transport.Carriage of goods can also take place by multimodal transport—a combination of the various modes of transport, etc.

## 1.Ocean transport

Ocean transport here refers to movement of goods with the help of ships through sea or ocean waterways.It plays an important role in the development of international trade.For centuries, the ship has been the main instrument of commerce and communications between nations.Today, three-fourths of the trade among nations is transported by water.Water has long been considered the most economical form of mass transport.

Ocean transport has many advantages: It is a relatively economical mode of transport for bulky and heavy goods.It is a safe mode of transport with respect to occurrence of accidents.The cost of maintaining and constructing routes is very low as most of them are naturally made.However, ocean transport is slow, vulnerable to bad weather and less punctual if compared with road or air transport.

Depending on the amount of cargo， a number of options are open to the shipper （托运人）（seller or buyer）.If the cargo is insufficient to fill the entire cargo space of a ship， it is normal for the shipper to find a space on a liner （班轮） service.If the amount of cargo is sufficient to take up the a vessel’s full carrying capacity， it is commonplace （平常的） to charter （租赁） a ship.Thus we are to discuss the two basic types of service in international ocean transportation：liner （berth） service and tramp （charter） service.

(1) Liner transport

Liner transport here refers to the transport of cargoes from one seaport to another along regular maritime routes according to a schedule.Liner rates usually include the stevedoring（装卸作业） charges for loading and unloading.

The freight rate is charged according to the tariff （运费表）—a schedule of shipping rates charged， together with governing rules and regulations.It covers a basic freight rate and various kinds of surcharges （附加费）.

1) Standards of collecting basic freight rates

Weight： For items marked with“W” in the tariff， the freight thereon is to be calculated per metric ton on weight.This method is usually called weight ton （运费吨）.

Measurement： For items marked with“M” in the tariff， the freight is to be calculated per cubic meter （立方米） on measurement.This method is usually called measurement ton （尺码吨）.

Weight or measurement: For items marked with“W/M” in the tariff, the freight is to be calculated on either weight or measurement, whichever is greater.

Ad Val.： For items marked with“Ad Val.”， the freight is to be calculated on the price or value of the cargo.For some valuable goods like gold， platinum （白金）， silver， precision instrument， expensive fur， it is usually 1％～5％ of the price.

W/M or Ad val.: For items marked with“W/M or Ad val.” in the tariff, the highest rate is adopted.

2） Surcharges： In addition to the basic freight rates， there are some surcharges that cannot be ignored such as bunker adjustment factor （燃油附加费）， port surcharges， transshipment surcharges， heavy lift and long length additional （超重超长附加费）.

An example of calculating freight:

Company A exports 100 cases of Good X to London.The volume and gross weight per case are 40cm×30cm×20cm and 30kg respectively.Good X is classified as Class 10 and the freight for Class 10 is calculated on W/M.The tariff (China—London) shows that the basic freight rate for Class 10 is US$222, with 10％ port surcharges.How much is the total freight?

(a) Total weight: 0.03M/T × 100=3 M/T

(b) Total volume: 0.4 × 0.3 × 0.2 × 100=2.4 $M^3$

(c) As the total weight is greater than the total volume, thus weight is the basis for collecting freight.

(d) Total freight=total weight × (basic freight rate + surcharge)

=3 × (222 + 222×10％)

=US$732.6

(2) Charter transport

Charter transport is a tramp service.The term tramp， as used in the ocean transportation，refers to a cargo ship not operating on regular routes and schedules， and picking up cargo only when it is chartered （hired） from the ship owner.While liner transport is for general cargoes，charter shipping is usually for bulk cargoes[1] （大宗货物） like oil， coal， ore， and grain.Charter shipping has the lowest freight rate per unit of weight or measure.There are two types of charter transport： voyage charter （程租船） and time charter （期租船）.

1) Voyage charter

Voyage charter means transport vessel or vehicle charter for one or a specified number of trips （voyages）.The vessel remains under the control of the ship owner who is responsible for equipping and manning （操纵） the vessel.The crew （全体船员） and master are employees of the ship owner， and he is responsible for their wages.The freight rate may be charged by quantity of the goods carried， or a fixed rate regardless of the quantity.

A charter-party （租船合同） is required in voyage charter transportation.A charter-party is a written contract between the ship owner and the charterer.The charter-party will identify the vessel， the cargo it is to carry， the voyage（s） for which the ship is made available， and certain terms in respect of the various responsibilities of the ship owner and the charterer （租船人）.It also includes the ports， freight rate and time involved in the voyage（s）.Here are some terms used specifically in voyage charter-party：

Liner terms (gross terms or berth terms): This term indicates that the ship owner is responsible for costs of loading and unloading as in the case of liner transportation.

FI (Free in): The word“free” as used in the charter shipping term means not including.This term indicates that the charterer of a vessel (i.e., the shipper) is responsible for the cost of loading goods onto the vessel.

FO (Free out): FO indicates that the charterer of a vessel (i.e., the shipper) is responsible for the cost of unloading goods from the vessel.

FIO (Free in and out): FIO indicates that the charterer of a vessel (i.e., the shipper) is responsible for the cost of loading goods onto the vessel and the cost of unloading goods from the vessel.

Lay days （许可装卸期限）： Lay days are also called lay time.They are the number of days allowed by the ship owner to load or unload cargo without incurring demurrage （滞期费） or late charges.Lay days may be expressed as： 1） Running days （连续日）：consecutive days including weekends and holidays； 2） Working days （工作日）：consecutive days excluding weekends and holidays； 3） Weather working days （好天气工作日）： working days on which weather permits continuous work.This is the most commonly used expression.Lay days begin to run when the vessel is berthed （停泊） or when its arrival is recorded as arrived ship.

Dispatch money （速遣费）： When so agreed in the charter-party，this is paid by the ship owner to the charterer as a result of the vessel completing loading or discharging before the stipulated time.

Demurrage: Demurrage is a penalty to be paid by the charter to the ship owner for exceeding lay days in loading or unloading.

2) Time charter

Time charter means the ship owner agrees to charter a vessel to the charterer for a specified period of time.As in a voyage charter, the ship owner retains control of the ship and the employees on board the ship.However, the charterer is responsible for its employment, the number of voyage it takes, and the destination of the voyages.Due to the nature of time charter,the terms of time charter-party concentrate on employment of vessel, speed of vessel, maintenance of vessel, hire period, return of vessel, payment of hire, etc.Time charter generally does not include loading and unloading costs in the charter rate.

## 2.Rail transport

Rail transport is a major mode of transport in terms of capacity， only second to ocean transportation.It is capable of achieving relatively high speed and is very economical especially if it provides the complete trainload for a shipper on a regular basis.Besides， it is less prone （易于发生的） to interruption by bad weather.But it is confined （受限制的） to railroads and therefore less flexible.Rail transport is popular in multimodal transport and transshipment.It is widely used in land-bridge transport[2] （大陆桥运输）.

## 3.Air transport

Basically， air transport is an ideal mode of carriage for valuable goods， delicate goods，physically perishable （易变质的） goods such as food and plants， urgent products such as medicine and very small shipments which are less costly by air than by water， etc.

Air transport is generally perceived （被认为） as expensive.The higher transport charges of air freight （运输）， compared to the charges of land and ocean freight， are compensated for by its various benefits.

(1) Benefits of air transport

1）Faster delivery： The ports worldwide can be reached in 1 or 2 days or in a few hours by air freight， thus reducing the risks of theft， pilferage （行窃） and damage to the goods.Delivery to certain areas may take several weeks to arrive by ocean and land freight.Time sensitive or perishable goods， such as fresh seafood and flowers， often rely on the air freight.

2)Better security: Air transport has a tighter control over its cargo, thus it has better security that reduces the cargo exposure to theft, pilferage and damage.

3)Less packing: Air transport requires less packing because of faster delivery and better security.Less packing may mean saving freight, packing and labor costs.

4)Lower insurance: Air transport is faster and has better security than the land and ocean freight, thus the insurance premium rate generally is lower.

(2) Types of air transport services

There are four types of air transport services： scheduled airline （班机运输）， chartered carrier （包机运输）， consolidation （集中托运） and air express service （航空快递服务）.

1)Scheduled airline: Scheduled airline operates on a scheduled service, over a fixed airline and between fixed airports.They are suitable for conveying fresh, emergent and seasonal goods.

2)Chartered carriers: Chartered carriers are the hire of an aircraft by a shipper or several shippers to deliver cargoes.They are ideal for carrying cargoes of large quantities or carrying cargoes of different shippers to the same destination.

3)Consolidation: Consolidation means that the air freight forwarder usually assembles a number of individual shipments into one consignment and dispatches them on one air waybill.A consolidated shipment made up by several shipments can be dispatched to one common destination.Many shippers prefer this kind of shipment as the freight rate is 7％～10％ lower than that of a scheduled airline published by IATA[3].

4)Air express service: This is an express service for shipping small packages of goods such as medicines in urgent need, samples and shipping documents by air.It includes ground pickup at origin and delivery at destination (called desk to desk service).

## 4.Intermodal transport (multimodal transport)

Intermodal transport （多式联合运输） involves the transportation of freight （货物） in an intermodal container or vehicle， using multiple modes of transportation （rail， ship， and truck）， without any handling of the freight itself when changing modes.The method reduces cargo handling， so improves security， reduces damages and losses， and allows freight to be transported faster.Reduced costs versus over road trucking is the key benefit for intracontinental use.Although different modes of transport （sea， air， rail， etc.） are combined，only one multi-modal transport operator is responsible for taking the cargo from the consignor（托运人） and delivering them to the consignee （收货人）.

(1) The virtue of containerization

Containerization （or containerization） is a system of intermodal freight transport using standard intermodal containers that are standardized by the International Organization for Standardization （ISO）.These can be loaded and sealed intact （完整无缺的） onto container ships， railroad cars， planes， and trucks.

The virtue （优点） of containerization is that by simplifying and speeding up the cargohandling process at each transfer point， it minimizes these interruptions and restores as much efficiency as possible.Because the con

tainer is closed and relatively impregnable （坚固的）， it offers protectio n from the elements （恶劣天气）， reduces the chances of damage， an d virtually eliminates the pilferage that used to plague （困扰） breakbulk （分拨） operations.As such， the container lends itself to （适合于） m echanized （机械化的）， even automated handling.It is this standardizati on and mechanization that has vastly improved the efficiency with which sh ips，trains and trucks are loaded and unloaded and cargo is transferred fro m one mode to another.This increased efficiency has produced significant c ost and time savings for shippers and carriers alike， and most of the savin gs are passed on to the consumers.Containerization has revolutionized cargo shipping.Today， approximately 90％ of non-bulk cargo worldwide moves by containers stacked （堆积） on transport ships； 26％ of all containers originate from China.As of 2005， some 18 million total containers make o ver 200 million trips per year.

(2) Modes of container service

The mode of container services includes CY/CY, CY/CFS, CFS/CY an d CFS/CFS.Before proceeding to the modes of container services, we first e xplain the four concepts of FCL, LCL, CY and CFS involved in container s ervice.

FCL stands for full container load （整箱货） meaning the whole con tainer load， or the load that reaches its allowable maximum （or full） w eight or measurement.LCL stands for less than container load （拼箱货）， or partial container load as opposite to FCL.In the LCL arrangemen t，the shipper is required to deliver the cargo to the carrier’s container freig ht station （CFS）（集装箱货运站） for containerization.CY stands for c ontainer yard （集装箱堆场）， a location where the FCL is delivered.

CY/CY container service: The CY/CY (read as“CY to CY”) container service—doorto-door container service or house-to-house container service —broadly means that the FCL received by the carrier is packed at the shipp er’s or the forwarder’s premises, and the delivery of that same FCL to the c onsignee’s premises.

CY/CFS container service: The CY/CFS (read as“CY to CFS”) container service—door-to-port container service—broadly means that the whole container received by the carrier is packed at the shipper’s or the forwarder’s premises, and that same whole container is emptied at the carrier’s container freight station at the port of destination.The consignee arranges the delivery of the loose cargo from the container freight station to his/her premises.

CFS/CY container service： The CFS/CY （read as“CFS to CY”） container service—port-to-door container service—broadly means that the delivery of the loose cargo （散货） to the carrier’s container freight station at the port of origin is packed into the whole container，and the delivery of that same whole container to the consignee’s premises.

CFS/CFS container service： The CFS/CFS （read as“CFS to CFS”） container service—port-to-port container service or pier-to-pier （码头到码头） container service—broadly means that the delivery of the loose cargo to the carrier’s container freight station at the port of origin is packed into the whole container， and that same whole container is emptied at the carrier’s container freight station at the port of destination.The consignee arranges the delivery of the loose cargo from the container freight station to his/her premises.




Shipping containers at a terminal in Port Elizabeth, New Jersey



Container ship in Istanbul

(3) Measurement of container

There are five common lengths， 20-ft， 40-ft， 45-ft， 48-ft， and 53-ft.Container capacity is measured in twenty-foot equivalent units （TEU， or sometimes teu）（标箱）.An equivalent unit is a measure of containerized cargo capacity equal to one standard 20ft （length） × 8ft （width） ×8’6’ft （height） container.In metric units this is 6.10m （length） × 2.44m （width） × 2.59m（height）， or approximately 38.5 $m^3$.

Many containers today are of the 40-ft (12.2m) variety and are known as 40-foot containers.This is equivalent to 2 TEUs.45-foot (13.7m) containers are also designated 2 TEUs.Two TEUs are equivalent to one forty-foot equivalent unit (FEU).The 20-foot container is the most common container worldwide, but the 40-foot container is increasingly replacing it, particularly since costs tend to be per container and not per foot.The longer container types are also becoming more common, and are especially common in North America.Shorter containers, e.g., 10 foot containers, also exist, but are rarely used.

# 13.2 Major Shipping Documents

## 1.Bill of lading (B/L)

A bill of lading （提单） is a transportation document issued by an ocean carrier to a shipper with whom the carrier has entered into a contract for the carriage of goods.The bill of lading， as indicated in Chapter 11， plays a vital role in international trade.

(1) Three functions performed by the B/L

1) Receipt for goods: The bill of lading acts as a receipt for the goods received.A bill of lading describes the goods put on board a vessel, stating the quantity, and their condition.The form itself is normally filled out in advance by the shipper, then, as the goods are loaded aboard the ship, the carrier will check to see that the goods loaded comply with the goods listed.The carrier, however, is responsible only to check for outward compliance—that is, that the labels comply and that the packages are not damaged.If all appear proper, the appropriate agent of the carrier will sign the bill and return it to the shipper.

2） Evidence of the contract of carriage： The B/L is an evidence of the contract of carriage between the shipper and the carrier.The bill becomes conclusive （确凿的） evidence of the terms of the contract of carriage once it is negotiated （转让） to a good faith[4] third party （善意的第三方）.

3） Document of title （所有权） to the goods： The named consignee or the holder of a bill of lading， provided （如果） he has received it in good faith through due negotiation， has a claim to title and， by surrendering （交出） the bill， to delivery of the goods.The carrier is under obligation to deliver the cargo only against an original bill of lading.If the carrier delivers goods without the production （出示，提供） of a bill of lading， he will be liable in contract or in tort （民事侵权） to the bill of lading holder.

Since possession of the bill of lading is regarded as good as （如同） possessing the goods，the buyer can sell the goods on while they are at sea to a third party by simply endorsing[5]（背书） the bill of lading and delivering it to the third party.The third party， by becoming the holder， can demand delivery of the goods on arrival.Furthermore， as a document of titl

e， the bill of lading also serves a vital function in providing for security，for example， in letter of credit[6] transactions.

It is this function of bill of lading as a document of title that makes the bill of lading a very important document in maritime （海上的） trade.

Not all bills of lading， however， are transferable.To impart （赋予） transferability to a bill of lading， it must be drafted as an order （指示） bill—that is， where the carrier is to deliver the goods to a named consignee or his order or assigns （受让人）.It must be noted that bills of lading made out （作成） to named consignees （收货人）， known as straight bills of lading （记名提单）， are not transferable.

(2) Types of bill of lading

There are a number of different types of bill of lading.The following lists those encountered the most often.

1） Shipped （on board） B/L （已装船提单） and received for shipment B/L （备运提单）

■ Shipped B/L is issued by the shipping company after the goods are actually shipped on board the designated vessel.Both the name of the vessel and the date of issue of the B/L are indicated on the shipped B/L.Since shipped bill of lading provides better guarantee for the consignee to receive the cargo at the destination, the importer will normally require the exporter to produce shipped B/L and most bill of lading forms are preprinted as“Shipped Bill”.

■ Received for shipment B/L arises where the word“shipped” does not appear on the bill of lading.It merely acknowledges that the goods have been received by the carrier for shipment.Therefore, the goods could be in the dock or warehouse.

2） Clean B/L （清洁提单） and unclean B/L （foul B/L or claused B/L） （不清洁提单）

■ A clean B/L is a B/L that is free from any adverse remarks （不良批注）， made by the shipping company about the condition， packing， or

quantity of the goods being shipped.Usually the words“apparent good order and condition”，“clean on board” or the like are indicated on the B/L.A cle an bill of lading provides proof that up until the time goods were transferred to the carrier， no damage has occurred.This assists in placing responsibilit y if in fact goods are eventually delivered in other than undamaged conditio n.

Sample bill of lading

SERIAL - A № 50490

PARTICULARS FURNISHED BY SHIPPER OF GOODS

*Shipper:

CMC UNIVERSAL IMPORT AND EXPORT COMPANY WEST WING SICHUAN MANSION, BEIJING 100037 P.R.CHINA

**BILL OF LADING** B/L No.: 1364/TBIK/04

*Islamic Republic of Iran Shipping Lines*



Consignee:

BANK MELLAT FERDOWSI SQ.BRANCH TEHRAN I.R.OF IRAN

*Notify address: (carrier not to be responsible for failure to notify)

Tolypers Co, No.247 Tolidaroo Building Jamhouri Islami St., Tehran/Iran Tel. 6718080-2

*Local vessel: *from:

(Ocean) vessel: IRAN MOBIN PJL1364 Port of loading: XINGANG,CHINA

| Port of discharge: | *Final destination (if on-carriage): | Freight payable at: | Number of original Bs/L: |
|---|---|---|---|
| BANDAR IMAM KHOMEINI (PERSIAN GULF) IRI | | | TWO |

| Marks & Nos.: | Number and kind of packages; description of goods: | Gross weight kg |
|---|---|---|
| TOLYPERS CO.,<br>TPS-02110-2/78<br>BAGS NO.1030<br>QAZVIN VIA B.I.K<br>MADE IN CHINA | 1030 MT NET SODIUM TRIPOLY PHOSPHATE 92 PCT MIN | 1033 MT 1496 CBM |

CLEAN ON BOARD
FREIGHT PREPAID

23 SEP 1998

PACKING:IN 25KG PP BAG,40 BAGS IN ONE JUMBO BAG.TOTAL 1030 JUMBO BAGS.

REMARKS:1. AS PER PROFORMA INVOICE NO.98MIR5219-69 DD 980928 ON CFR BASIS.
2. CUSTOM TARIFF NO.2835/31 AND CB NO.82788698 AND THE CREDIT NO.62026/7820196/4
3. INSURANCE EFFECTED IN IRAN BY BIMEH ALBORZ TLX NO.214134 UNDER INSURANCE POLICY NO.B78/100/2404

Original

TOTAL:SAY ONE THOUSAND AND THIRTY JUMBO BAGS ONLY.

Shipper's Ref.: F/P NO.14530/6/86785

Freight and charges:

SHIPPING CO'S REPRESENTATIVE
IN IRAN:
ISLAMIC REPUBLIC OF IRAN SHIPPING LINES B.IMAM KHOMEINI BRANCH
ESTABLISHMENT OFFICE OF IMAM KHOMEINI PORT
P.O.BOX:111
TEL:(06532)4211 (0651)4011
FAX:(0651)4012 TLX:612062-612041
BANDAR IMAM KHOMEINI I.R.OF IRAN

SHIPPED in apparent good order and condition unless otherwise specified on board the aforementioned vessel the goods described above (the particulars given being supplied by the Shipper and the measurement, weight, quantity, brand, contents, marks, numbers, quality and value being unknown to the carrier) for the carriage to the port of discharge or so near thereunto as she may safely go subject to the terms, conditions and exemptions of this Bill of Lading.

In accepting this Bill of Lading the Owners of the goods expressly accept and agree to all its stipulations on both pages, whether written, printed, stamped or otherwise incorporated, as fully as if they were all signed by the Owners of the Goods.

In WITNESS whereof the Master, Purser or Agent of the said vessel has signed the number of original Bills of Lading stated above, all of this tenor and date, one of which being accomplished, the others, stand void. One of the Bills of Lading must be given up, fully endorsed in exchange for the goods.

Place and date of issue: TIANJIN 23 SEP 1998

XXXXXXXX

AS AGENT FOR THE CARRIER
ISLAMIC REPUBLIC OF IRAN
SHIPPING LINES

■ Unclean B/L also called foul B/L or claused B/L, is a B/L with adverse remarks or notations (called“clauses”) by the carrier that the goods received for shipping (or their packing) look wet, damaged, or otherwise in doubtful condition, or not of correct quantity.Importers and their banks normally do not accept foul B/L for payment under a letter of credit.

3） Straight B/L， blank B/L and order B/L （记名提单、空白提单及指示提单）

■ Straight bill of lading has designated consignee.Under this bill, only the consignee at the destination is entitled to take delivery of the cargo.As it is not transferable, it is not commonly used in international trade and normally applies to high value shipments or goods for special purposes.

■ Blank B/L also called Open B/L or Bearer B/L, means that there is no definite consignee of the goods.They usually appear in the field of consignee words like“To bearer”.Anyone who holds the bill is entitled to the goods the bill represents.No endorsement is needed for the transfer of the blank bill.Due to the exceedingly high risk involved, this bill is rarely used.

■ Order B/L is widely used in international trade.It means that the goods are consigned or destined to the order of a named person.In the field of consignee,“To order”,“To order of the shipper”, or“To order of the consignee” is marked.This type of bill of lading is a negotiable instrument.That is, it may be used to transfer title to goods being shipped to another party.The transfer may occur at any time during the transit process simply by conveying the order bill to another party.Unless provided otherwise, a consignment that is“to order” means to order of the shipper.

Order B/L can be transferred only after endorsement （背书） is made.Endorsement here means a signature used to legally transfer the B/L.There are two types of endorsement： blank endorsement （空白背书） and special endorsement （记名背书）.The blank endorsement is an open endorsement that carries only the signature of the endorser and does not specify in whose favor it is made （who is the new endorsee）.In such instance， whoever bears the B/L after endorsement holds the title to the goods.Special endorsement names the endorsee and requires its endorsement for further neg

otiation.If the B/L is made out“To order of the consignee”， the consignee will endorse the bill to transfer it.

4） Direct B/L， transshipment B/L and through B/L （直运提单、转运提单及联运提单）

■ Direct B/L means the B/L that indicates the goods are shipped from t he port of loading direct to the port of destination without involving transshi pment.

■ Transshipment B/L means the B/L that indicates the goods need to b e transshipped at an intermediate port as there is no direct service between t he shipment port and the destination port.

■ Through B/L is usually issued for containerized door-to-door shipme nts that have to use different ships and/or different means of transportation (aircraft, railcars, ships, trucks,etc.) from origin to destination.Unlike in cas e of a multimodal Bill of Lading, the principal carrier or the freight-forward er (who issued the through B/L) is liable under a contract of carriage only f or its own phase of the journey, and acts as an agent for the carriers executin g the other phases.

5） Liner B/L， charter-party B/L and container B/L （班轮提单，租船提单及集装箱提单）

■ Liner B/L is issued by a liner company for shipment on scheduled po rt calls （停靠港）through scheduled routes.

■ Charter-party B/L is issued by the carrier (or its agent) based on the charter-party.This bill of lading is subject to the clauses of charter-party.Tha t’s why when a charter-party B/L is accepted by the bank or the buyer, the c opy charter-party is required.

■ Container B/L is issued when the goods are conveyed by container.

6） Long form B/L and short form B/L （全式提单和简式提单）

■ Long form B/L is more detailed with the terms and conditions of carr iage which are printed on the back of the page.The long form bill of lading i s commonly used in international shipping.

■ Short form B/L (or blank back B/L) is an abbreviated type of document.The terms and conditions of carriage on the reverse (back) of the bill of lading (B/L) are omitted, instead they are listed on a document other than the B/L.Unless otherwise stipulated in the letter of credit (L/C), a short form bill of lading is acceptable.The short form B/L saves the cost of printing (i.e., no printing on the back of the B/L) and if the terms and conditions of carriage change, there is no need to reprint the B/L form.

7） Miscellaneous B/L （其他提单）

■ On deck B/L （舱面提单）： A B/L contains the notation that the goods have been loaded on the deck of the vessel.It applies to goods like live stock， plants， dangerous cargo， or awkwardly shaped goods that can not fit into the ship’s hold.On deck transit is more dangerous than if cargo is carried in the hold of a ship.Insurance and financing for such transit may be more difficult to obtain or may be more costly.

■ Stale B/L （过期提单）： A B/L presented to the consignee or buyer or its bank after the stipulated expiry date of presentation or after the goods are due at the port of destination are described as a“Stale B/L”.It is important that the Bill of Lading is available at the port of destination before the goods arrive or， failing this， at the same time.Otherwise， the buyer cannot collect the goods.The late arrival of this important document could bring about undesirable consequences， for instance， incurring additional warehouse rent.Sometimes especially in the case of short sea voyages， it is necessary to add a clause of“Stale B/L is acceptable”.

■ Ante-dated B/L （倒签提单）： This is a B/L which is dated before the date on which it is issued.When the actual shipment date is later than that stipulated in the L/C， the carrier sometimes， at the shipper’s request， issues a B/L with a date of signature that suits the requirement so as to avoid non-acceptance by the bank.Due to the risk of the goods being rejected by the buyer arising from the issuance of such a bill， it is advisable to avoid this malpractice （不法行为） even when it seems necessary in certain circumstances.

■ Advanced B/L （预借提单）： Advanced B/L is the B/L issued in advance when the expiry date of the L/C is due but the shipment hasn't yet been effected.The purpose of issuing such a bill is to negotiate payment wit h the bank in time within the validity of the L/C.The issuance of advanced B/L is also a malpractice and should be avoided.

All the above mentioned bills are not independent of each other.Severa l types may be combined into one like"Clean on board, to order, blank endo rsed B/L".A receipt for shipment bill may also be a straight and clean bill.B s/L are made out in sets, consisting of a number of originals[7] (usually thre e) and a number of copies and marked"original" and"copy"respectively.Onl y the originals signed by the carrier enable the consignee to take delivery of the goods.The copies are just for reference.

(3) Three rules governing bill of lading

The three rules governing bill of lading are The Hague Rules （海牙规则）， The Hague-Visby Rules （海牙–维斯比规则） and the Hambur g Rules （汉堡规则）.

1) The Hague Rules

The Hague Rules was drawn up by the International Law Association i n 1921 in Hague（the Netherland）.After some amendments， they were i ntroduced at the International Brussels Convention of 25 August 1924 and k nown as the International Convention for the Unification of Certain Rules o f Law Relating to Bills of Lading （关于统一提单若干法律规则的国际公约）.So they are also referred to as the Brussels Convention， although t hey are normally called The Hague Rules.The Hague Rules represented the efforts made by the international community to achieve uniformity in ocean bills of lading in order to provide a degree of predictability for international shipping.Prior to these rules， ship-owners often thwarted （阻挠）cargo damage claims by inserting limits in bills of lading.The Hague Rules were g enerally well received and have been adopted by 58 maritime nations.

The major weaknesses of The Hague Rules are： （a） The scope of application of the Rules is limited to the outward shipment， i.e.shipment fr

om a port of the contracting states to a foreign port； （b） No liability for delay in delivery of the goods.The Rules does not impose any liability on th e carrier if the delivery of the goods is late or if the voyage takes longer tha n that contracted for； （c） The Rules are not compatible （相容的） wi th container transport； （d） The deck cargo is entirely excluded； （e） The maximum limit of carrier's liability is limited to 100 pound sterling per package or unit， or the equivalent of that sum in other currency， unless t he shipper has made a declaration of value； （f） The carrier's liability o nly covers the period from the time when the goods are loaded on to the tim e when they are discharged from the ship，known as"tackle to tackle"； （g） Navigational fault （航行过失） is excepted.

2) The Hague-Visby Rules 1968

Due to the prominent weaknesses of The Hague Rules, they were later replaced by The Hague-Visby Rules 1968 (a Brussels Protocol).Nonetheles s, The Hague-Visby Rules should not be considered as a separate conventio n with The Hague Rules.The Rules are amendments to the Brussels Conven tion.The important amendments to The Hague-Rules are in three aspects: (a) Its territorial application is extended; (b) The Rules increase the maximu m amount for limitation of liability of a carrier and introduce a new weight-based criterion; (c) The Rules are compatible with container transport.

3) The Hamburg Rules

But The Hague-Visby Rules still do not resolve other weaknesses of T he Hague Rules.That is why the UNCITRAL[8] initiated the re-examination of the appropriate rules to regulate carriage of goods by sea by adopting Th e UN Convention on the Carriage of Goods by Sea （联合国海上货物运输公约） in Hamburg in 1978， known as the Hamburg Rules.A driving fo rce behind the convention was the attempt of developing countries to level t he playing field.It came into force on 1st November 1992.

The major amendments made by The Hamburg Rules are: (a) Scope of application.Both inward shipments and outward shipments from a contracti ng state are subject to the Rules;(b) Period of responsibility.The responsibili ty of the carrier covers the period during which the carrier is in charge of th

e goods at the port of loading, during the carriage and at the port of discharg e; (c) Liability limits.The carrier is liable for loss resulting from loss or dam age to the cargo as well as delay in delivery; (d) Liability amount.The amou nt of limitation set by The Hamburg Rules is far above that set by The Hagu e Rules or the Hague-Visby Rules.The Special Drawing Right (SDR)[9] is th e unit of account used.The carrier's liability is limited to an amount equival ent to 835 units of account per package or other shipping unit, or 2.5 units o f account per kilogram of gross weight of the goods lost or damaged, which ever is greater.

However only 20 nations have approved the Hamburg Rules， with no table exceptions such as the UK， US， and other developed nations.Many economies adopted the Rules such as France， UK，Canada， Japan， Si ngapore， Korea， Indonesia， Germany， Hong Kong Special Administr ative Region of China and Taiwan Province of China.China and Thailand ap ply the hybrid （混合） regime （体系）of The Hague Rules， The Hagu e-Visby Rules and The Hamburg Rules.

## 2.Other shipping documents

（1） Sea waybill （海运单）

The use of the negotiable bill of lading which has to be surrendered to the carrier at the port of destination in order to obtain delivery of the goods i s traditional， but not without disadvantages.The document has to follow th e goods and often， for commercial or financial reasons， passes through a variety of hands， resulting in the goods being held up （耽搁） at their de stination pending （直到） arrival of the document—and thus expenses an d additional risks are incurred and customers' goodwill is probably lost.

This can be resolved through the use of a non-negotiable type of transp ort document—sea waybill—in place of （代替） the negotiable traditiona l bill of lading.A sea waybill is a non-negotiable document that constitutes e vidence of the contract of carriage and of the receipt of the goods by the car rier.It is not a document to the title of the goods and cannot be used to transf

er ownership of the goods.A sea waybill needs not to be presented for taking delivery of the goods； the carrier tenders delivery to the named consignee who needs only to prove his identity.

Today there is a trend toward an increased use of sea waybills as substitutes for traditional bills of lading.It has been estimated that as much as 90％ of all containerized cargoes shipped over the Atlantic Ocean are carried under sea waybills.The sea waybill is the natural choice for shippers or consignees who do not plan to sell the goods en route （在途中）， for trading between established consignors and consignees， such as multinational companies and associated companies， who have been trading for many years， and also for open account sales （赊销）.

Sea waybills, however, have also significant disadvantages.They are not negotiable and they do not afford the security that traditional bills of lading provide.Therefore, they are not suitable for transactions of goods that are negotiated repeatedly during transit.Furthermore,the sea waybill cannot act as security for letter of credit transactions.

（2） Air waybill （航空运单）

Air waybill is the consignment note （运单） used for the carriage of goods by air.It is basically a receipt of the goods for dispatch and evidence of the contract of carriage between the carrier and the consignor （发货人）.This document is approximately the equivalent to the sea freight bill of lading， but the air waybill is not a negotiable title to goods in the same way as is an ocean bill of lading although it is widely used as a valuable receipt and evidence of dispatch and can be utilized within the framework of letter of credit， etc.

Air waybills are made out in three originals.Normally original 1， in green， for the issuing carrier， is to be retained by the carrier for accounting purposes and to serve as documentary evidence.Original 2， in pink， for the consignee， is to accompany the consignment to its final destination and is to be presented to the consignee to enable him to collect the goods.Original 3， in blue， for the shipper， is returned to him as a receipt and evidence of his affreightment contract （包租合同） with the airline.

（3） Multimodal transport document （多式联运单据）

The multimodal transport document evidences the contract of carriage of goods by at least two modes of transport, issued by a multimodal transpo rt operator under a multimodal transport contract.Multimodal transport docu ment could be regarded as an extension of the through bill of lading.

The essential difference is that under a through bill of lading， the prin cipal carrier concludes several separate contracts of carriage for subsequent segments of the transport as agent for the shipper or as agent for the on-carr iers （接运承运人）.It does not normally accept responsibility for segment s undertaken by the other carriers involved.The multimodal transport docu ment goes a step further.Under this contract of carriage， the multimodal tr ansport operator or freight forwarder takes responsibility as principal （委托人） for the entire carriage.The multimodal transport operator may in fac t offer a complete service， but often the principal carrier will subcontract with other carriers.It does this not as an agent of the shipper but as the princ ipal party to the subcontracts.So far as the shipper is concerned it can rely o n one contract of carriage with the multimodal transport operator.

## 13.3 Shipment Clause

Shipment clause usually covers time of shipment, port (place) of shipm ent and destination, partial shipment and transshipment, etc.

### 1.Time of shipment

As previously noted, INCOTERMS 2000 provides that in FOB, CFR, CIF, FCA, CPT,and CIP contract, the seller fulfills its obligation of delivery when the goods are shipped on board the vessel or delivered to the carrier.A ll these contracts are shipment contracts.As such,in these contracts the time of shipment is the equivalent of the time of delivery.The time of shipment is a very important condition contained in the shipment clause in a contract.A

ny delay or advance of delivery constitutes violation of contract.There are s everal ways of stipulating time of delivery in a contract.

1) Time of shipment definitely stated.For example: Shipment during D ecember 1997.

2) Shipment within ×× days after receipt of L/C.For a contract in whic h payment is made by L/C, in order to avoid the risks of losses resulted fro m the buyer's failure in opening L/C, or for the purpose of making use of L/ C as a means of financing preparation for goods,the seller would like to stip ulate the time of delivery in this way.

## 2.Port of shipment and destination

Generally, the contract defines one port of shipment and one port of de stination.But sometimes two or more than two ports may be specified.If the port(s) of shipment or destination can't be defined definitely when the contr act is concluded, optional ports like EMPs which stands for European Main Ports, AMPs which stands for African Main ports may also be adopted.In su ch cases, the contract should specify: 1) Which ports are EMPs and AMPs; 2) Any additional freight incurred will be on the buyer's account; 3) The bu yer should notify the seller of the final port when opening L/C.

## 3.Partial shipments and transshipment

（1） Partial shipments （分批装运）

Partial shipments， also described as shipment by installments， mea n the goods in one contract are to be shipped in lots.In international trade， sometimes partial shipments have to be made because of large quantity of th e transaction， or the limitation of supplies and transportation.If no such cl ause is stated in the contract， partial shipments are construed （被理解 为） as not allowed.But some international rules stipulate oppositely， for example， UCP600[10]provides that partial drawings and/or shipments are al

lowed.In view of the above differences， it is advisable to make it clear in t he contract as to whether partial shipments are allowed or not allowed.

1) Simply state that partial shipments are allowed.The exact time of de livery, the quantity of each lot and the total lots are not stipulated in the cont ract.This way of stipulation is favorable to the seller since the seller has opti on on the quantity and the time of delivery of each lot in light of the supplie s available and the transportation conditions.

2) State the specific time of delivery and quantity of each lot.For instan ce, shipment from March to June in four equal monthly lots.This way is usu ally adopted when the buyer needs to resell the goods or has some special re quirements in use.If the seller fails to carry out any of the lots, it shall be res ponsible for breaching the contract.

UCP600 Art.31 provides that transportation documents evidencing shi pment commencing on the same means of conveyance （运输工具） for th e same journey， provided they indicate the same destination， will not be regarded as covering partial shipments， even if they indicate different date s of shipment or different ports of loading， places of taking in charge or di spatch.

This means that the shipment is not considered as a partial shipment if it is effected as the follows: 1) Same means of conveyance; 2) For the same journey; 3) To the same destination,even if the dates of shipment, ports of lo ading, places of taking in charge or dispatch are different.

Thus, on the one hand, the determination of partial shipments does not depend on the shipping documents being signed by the same carrier or his a gent, and evidencing the same date of issuance and place of taking in charge or receipt.On the other hand, shipping has to be effected by the same vessel; i.e.shipping the goods on several trucks or railway carriages is no longer per missible.

(2) Transshipment

According to the UCP600, transshipment means a transfer and reloadi ng during the course of carriage from one conveyance or vessel to another c

onveyance or vessel, within the same mode of transport or from one mode o f transport to another mode of transportation.Unless transshipment is prohib ited by the terms of the credit, it is allowed.

However， in the absence of terms as to whether transshipment is allo wed or not in the contract， transshipment is to be construed （被解释为） as not allowed.

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[1]Bulk cargoes refer to those cargoes which are produced， traded or transported in large quantities.

[2]Land-bridge transport means transport from one seaport to another by railway across continents in stead of by ocean ship.At present， there are two common routes for using land-bridge transportation in the world.One is Asia—America—Europe land-bridge， the other is Europe—Asia land-bridge.C hina started Eurasia land-bridge transportation business in 1980.It mainly used the mode of railway-r ailway combined transportation.

[3]IATA: Abbreviation for International Air Transport Association, the trade and service organization for airlines of more than 100 countries serving international routes.IATA activities on behalf of shipp er in international air freight include development of containerization programs, freight handling tech niques and, for some airlines, uniform rates and rules.

[4]Good faith is an abstract and comprehensive term that encompasses a sincere belief or motive with out any malice （恶意） or the desire to defraud （诈骗） others.It derives from the translation of t he Latin term bona fide， and courts use the two terms interchangeably.

[5]Endorsing here means writing a signature to legally transfer a negotiable instrument.For more info rmation， see Chapter 15.

[6]A letter of credit is a conditional undertaking of payments by a bank.For more information， see Chapter 15.

[7]When an L/C calls for full set of B/L, it means all the original copies of B/L are required.

[8]UNCITRL stands for United Nations Commission on International Trade Law.

[9]The SDR (Special Drawing Right) is an artificial“basket” currency used by the IMF (International Monetary Fund) for internal accounting purposes.The SDR is also used by some countries as a peg fo r their own currency, and is used as an international reserve asset.The International Monetary Fund pr epares a daily web page with today’s SDR valuation.

[10]UCP 600 refers to the Uniform Customs and Practice for Documentary Credits， ICC publicatio n No.600 published by the International Chamber of Commerce （ICC）.The UCP is an internationa lly recognized set of rules governing the use of documentary credits.For more information， see Cha pter 15.

# Chapter 14　International Marine Cargo Insurance

Learning Objectives

In this chapter, you will learn:

- Perils and losses in ocean transportation
- Coverage of the Ocean Marine Cargo Clauses of CIC
- Coverage of Institute Cargo Clause
- Insurance clause in the contract
- Ocean cargo insurance practice in China

Marine cargo insurance is the insurance against in-transit cargo loss or damage over waterways, land, and air.The need for export (or import) cargo insurance often differs from exporter to exporter (or importer to importer) and from consignment to consignment.Depending on the international trade terms, either the exporter or the importer is responsible for insuring the cargo.The exporter is obligated to insure the cargo in the CIF and CIP terms.

According to the method of transportation， marine， air or overland insurance may be effected.This chapter only deals with marine insurance.It first briefly introduces the common perils （风险） and losses in ocean transportation， then explains the insurance covers （险别） provided by the Ocean Marine Cargo Clauses of China Insurance Clause of the People's Insurance Company of China[1] as well as the well-known insurance covers provided by the Institute Cargo Clause （协会货物条款） of the Institute of London Underwriters （伦敦保险人协会）.Finally， ocean cargo insurance practice in China is discussed.

# 14.1 Perils and Losses in Marine Transport

## 1.Perils and risks

1） Perils of the sea （海上风险）： Perils of the sea include natural calamities （自然灾害）such as bad weather （恶劣气候）， thunder and lightning， flood， drift ice， earthquake， tsunami（海啸）， etc.and fortuitous accidents （意外事故） like being stranded （搁浅）， striking a rock，sinking， collision， fire， exploding and missing， etc.

2） Extraneous risks （外来风险）： Extraneous risks are risks other than perils of the sea，including general extraneous risks such as theft， breakage， leakage， contamination （沾污），sweating and heating （受潮受热）， taint of odor （串味）， hook damage， shortage， rust， etc.and special extraneous risks resulted from military affairs， political and administrative rules such as war， strike， failure to deliver， rejection， etc.

## 2.Ocean average and charges

（1） Average （海损）

In the context of insurance， the word“average” means loss.Average can be divided into total loss and partial loss according to the extent of the loss.Total loss covers actual total loss and constructive total loss （推定全损）.Partial loss is any loss other than a total loss.It may include particular average （单独海损） and general average （共同海损）.

1） Actual total loss.Where the subject matter insured （投保标的物） is destroyed， or so damaged as to cease to be a thing of the kind insured， or where the assured is irretrievably （无可挽救地） deprived （被剥夺） thereof， there is an actual total loss.Furthermore， actual total los

s， within the meaning of the definition， may be construed in three distinct ways， namely：（a） When the subject matter is totally destroyed；（b） When the subject matter is so damaged as to cease to be a thing of the kind insured， and （c） When the assured is irretrievably deprived thereof.

2） Constructive total loss.The concept of constructive total loss is unique to marine insurance.Constructive total loss refers to the loss where an actual total loss appears to be unavoidable or the cost to be incurred in recovering or reconditioning （修复） the goods together with the forwarding （运输） cost to the destination named in the Policy （保险合同）would exceed their value on arrival.In constructive total loss cases， the insured may either treat the loss as a partial loss or abandon the property by giving a“notice of abandonment”（委付通知） to the insurer who then assumes all rights to the property.

3） Particular average.In the context of insurance， the word“particular” means partial.If the average （damage） is accidentally occasioned （引起） by some perils insured against， and not by the deliberate act of a person for the common benefit， that loss must be sustained （承担）exclusively by the person upon whom the damage falls and is termed a particular average.

4） General average.A general average is a loss caused by or directly consequential on a general average act.A general average act consists of any sacrifice or expenditure made intentionally and reasonably to preserve property involved in a sea voyage.For there to be a general average act， certain criteria （标准） must be met.The act must be：

（a） Extraordinary （特殊性）.For there to be a general average loss， there must be an“extraordinary” sacrifice or expenditure which is made for the benefit of all the parties to the common adventure.The former is a physical act， whilst the latter is a financial outlay （花费），but both are losses in general average.The sacrifice may take the form of cargo or ship’s apparel （船上用具） being deliberately cast away （抛弃） for the benefit of the whole venture.For example， an abnormal use of the engines and an

abnormal consumption of coal in endeavoring to refloat a steamship stranded in a position of peril is an extraordinary sacrifice and an extraordinary expenditure.A mere extra user of coal， however， in order to accelerate the speed of a vessel would not be a general act.

（b） Voluntarily and reasonably made （自愿并合理地做出的）. “Voluntarily made” infers（意味着） that the action of making a sacrifice is intentionally made on willingness rather than on the orders of others.“Reasonably made” infers that the master of a vessel must act reasonably when making a sacrifice for which others will eventually be partly liable.Similarly，any expense incurred must be governed by the same criteria of reasonableness.The issue of excessive or unreasonable expenditure is raised in the case below：

An arrangement existed between two shipping companies， Company A and Company B，both of whom operated up the Yangtze River.This arrangement was such that， should either company’s vessels need assistance， the other company would provide that assistance for a fixed fee of $3，500.Thus， when the steamship X ran aground （搁浅） in the river， the steamship Y came to her assistance and towed （拖） her off for the fixed sum previously agreed.When Company A， the owner of S.S.X， sought to recover from the cargo-owners in general average，the cargo owners objected to the payment， as they contended （主张） that the price had been fixed by the owners but not the master， and that the fee was unreasonable.

（c） In time of peril （处于危险中）.A loss may be claimed in general average act which caused that loss was carried“in time of peril”.The peril must be real and actually exist.For example， Shipping Company A shipped a number of barrels of rosin （松香） aboard the steamship.During the voyage， the captain thought he saw—what was later proved mistakenly—smoke coming out from a cargo hold and， as a result， ordered the crew to put out the fire by water.In the process of quenching （扑灭） the fire， the rosin was damaged and a claim was lodged （提出） against the insurer for a general average loss.The insurer refused to indemnify （赔偿） the insured for the loss arguing that no peril actually existed， therefore， they were not liable.

（d） Be successful.The actions of the ship’s master should be successful in saving the voyage.For instance， the ship is no longer listing （倾侧） because the jettisoned （抛弃的） cargo righted the ship； the tugboat （拖船） successfully kept the ship from running aground （搁浅）；the fire was successfully put out.If， however， making the general average sacrifice or expenditure， no property in the venture is saved， there would be no forthcoming contributions（分摊）， because nobody has benefited from the general average act.

When there is a general average, the party on whom it falls is entitled to a ratable contribution from the other parties interested, and such contribution is called a general average contribution.

（2） Sue and labor expenses （施救费用） and salvage charges （救助费用）

Sue and labor expenses are extraordinary expenditures made in time of peril to avert （避免） or minimize any loss of or damage to the subject matter insured.Unlike general average，sue and labor expenses are not something that are carried out for the benefit of a common adventure， but what are carried out specifically for the singular benefit of the subject matter insured.Expenses incurred for suing and laboring are recoverable （可收回的）.

Salvage charges means charges recoverable by salvor （救难者） independently of contract.They do not include the expenses of services in the nature of salvage rendered by the insured or his agents， or any person employed for hire by them， for the purpose of averting a peril insured against.Such expenses， where properly incurred， may be recovered as particular charges or as a general average loss， according to the circumstances under which they were incurred.

（3） Extraneous losses （外来损失）

Extraneous losses refer to losses resulted from risks not incidental （伴随而来的） to transport by sea， including losses caused by general extraneous risks and special extraneous risks.

# 14.2 Ocean Marine Cargo Clauses of the CIC

Having outlined several types of losses and charges, attention may nex t be directed to a discussion of the leading kinds of marine insurance.The O cean Marine Cargo Clause of China Insurance Clause (CIC) of the People's Insurance Company of China (PICC) was constituted in 1972 and revised in 1976 and 1981.There are mainly two types of insurance coverage:basic cov erage and additional coverage.Basic coverage includes FPA, WPA and All R isks.Additional coverage includes general additional coverage and special a dditional coverage.

## 1.Basic ocean marine cargo insurance

The basic ocean marine cargo insurance of CIC is classified into the fo llowing three conditions.

（1） Free from Particular Average （FPA） （平安险）

In insurance parlance, the words"free from" mean the insurer (the insu rance company) is not liable for whatever follows the words"free from".As such, the words"free from particular average" mean excluding partial loss.T his insurance covers:

1) Total or constructive total loss of the consignment caused by natural calamities such as heavy weather, lightning, tsunami, earthquake and flood.

2) Total loss or partial loss caused by fortuitous accidents such as stran ding, striking upon the rocks, icebergs or other objects, collision, fire and ex plosion.

3） Partial loss of the insured goods attributable （可归于） to heavy weather， lightning and/or tsunami， where the conveyance has been grou nded， stranded， sunk or burnt irrespective of whether the event or events took place before or after such accidents.

4) Partial or total loss resulting from the falling of entire package or pa ckages into sea during loading, transshipment or discharge.

5) Reasonable cost incurred by the insured on salvaging the goods or a verting or minimizing a loss recoverable under the Policy, provided that suc h cost shall not exceed the sum insured of the consignment so saved.

6） Losses attributable to discharge of the insured goods at a port of di stress （避难港）following a sea peril as well as special charges arising fro m loading， warehousing and forwarding of the goods at an intermediate p ort of call （停泊港） or refuge （避难港）.

7) Sacrifice in and contribution to general average and salvage charge s.

8） Such proportion of losses sustained （承担） by the ship-owners as is to be reimbursed（偿付） by the cargo owner under the Contract of A ffreightment Both to Blame Collision clause（运输契约船舶互撞责任条款）[2].

（2） With Average （WA） （水渍险）

The words“with average” and“with particular average” mean including partial loss.Aside from the risks covered under F.P.A.conditions as above, th is insurance also covers partial losses of the insured goods caused by heavy weather, lightning, tsunami, earthquake and/or flood.

（3） All Risks （一切险）

Aside from the risks covered under the F.P.A.and W.A.conditions as ab ove, this insurance covers all risks of loss of or damage to the insured goods whether partial or total,arising from general extraneous risks in the course o f transit.

## 2.W/W clause

Just as the usual practice in international insurance market， with rega rd to the duration of liability of the insurer in ocean marine cargo insuranc

e， CIC adopts warehouse to warehouse clause （W/W clause）， which means insurance coverage of risks to a shipment of goods from the time the goods leave the warehouse for commencement （开始） of transit and continue during ordinary course of transit until delivered to final warehouse at destination， or until the expiration of 60 days as of the moment of the insured goods are unloaded （if the shipment fails to reach the aforesaid warehouse）， but with exception that the goods be transported to other place of destination not indicated on the insurance documents.

## 3.Additional risks

1) General additional risks.The following general extraneous risks are to be covered subject to additional premium.

（a） Risk of theft， pilferage and non-delivery （TPND） （偷窃、提货不着险）.This risk refers to the risk against the cargo's being stolen in transit of voyage and the risk against loss of complete packages （including box， case， drum， etc.） due to improper unloading or for some unknown reasons.

（b） Risk of fresh water and/or rain damage （FWRD） （淡水雨淋险）.The risk of damage to the goods by fresh water and/or rain is covered by this coverage.

（c） Risk of clash and breakage （碰损破碎险）.Under this coverage is the risk of breakage of the fragile goods by vibration （震动）， clash or pressing （挤压）.

（d） Risk of leakage （渗漏险）.It covers the risk of seepage （渗漏） and leakage of the liquid goods caused by the damaged container.

（e） Risk of shortage （短量险）.This risk covers the shortage of weight for the goods due to the external packing broken.However， normal shortage of weight in transit is not covered.

（f） Risk of intermixture and contamination （混杂、沾污险）.Damage to the goods caused by its being intermixed or contaminated with eac

h other is covered by this risk.

（g） Risk of taint of odor（串味险）.Edibles， herbal medicine（草药）， cosmetics or raw materials may sometimes be tainted by odor of their own.Such a risk is under this coverage.

（h） Risk of sweat and heating （受潮受热险）.Under this coverag e is the risk of damage of the goods by sweating and heating as a result of th e sudden change of temperature or the ventilation （通风设备） on the ves sel being out of order， etc.

（i） Risk of rust （锈损险）.It covers the risk of damage to the goo ds by rust caused by contamination with sea water.But goods getting rusty b y itself or due to its own flaw are excluded.

（j） Risk of breakage of packing （包装破损险）.Damage to the go ods caused by rough handling is covered by this risk.

(k) Hook damage.It covers damage to the goods caused by hooks in th e process of loading and unloading, such as the losses of cereals due to the damage of packing bags by hooks.

General additional risks cannot be covered independently and should b e covered together with FPA or WPA.They are included in All Risks covera ge.

2） Special additional risks.Special additional risks cover the damage or losses arising from special additional reasons such as political events， military affairs， national policies and acts， and administrative measures. Special additional risks include： War Risk， Strike Risk，Failure to Deli very Risk， Import Duty Risk， On Deck Risk， Rejections Risk， Aflato xin Risk（黄曲霉素险）， Fire Risk Extension Clause （FREC）—for st orage of cargo at destination Hong Kong Special Administrative Region of China， including Kowloon or Macao Special Administrative Region of Ch ina（货物出口到中国香港特别行政区包括九龙或中国澳门特别行政区 火险责任存仓条款）.

All the above additional coverage including general additional coverag e and special additional coverage must be taken out together with one of the

three basic coverage.That is to say, they cannot be covered independently.

## 14.3 Institute Cargo Clauses (ICC)

The Institute Cargo Clauses have been in wide use in the insurance industry.They were initially published by the Institute of London Underwriters（保险人） in 1912 and have been amended many times.The ICC clauses were revised in 1982.After more than 25 years， the Institute Cargo Clauses have been revised， and the newest clauses came into effect on Jan.1， 2009[3].

The overall result of the amendments to the ICC 1982 is to make the clauses more favorable to the assured （被保险人）.As in the 1982 version， the new clauses also provide Institute Cargo Clause A， or ICC（A）， the widest insurance cover； Institute Cargo Clause B， or ICC（B） a more restrictive cover； Institute Cargo Clause C， or ICC（C）， the most restrictive cover； Institute War Clause （Cargo）； Institute Strikes Clause （Cargo）.ICC（A）， ICC（B） and ICC（C） have replaced the older“All Risks”，“With Average” and“Free of Particular Average”clauses respectively.

The structures of the above clauses basically includes eight parts: 1) risks covered;2) exclusions; 3) duration; 4) claims; 5) benefit of insurance; 6) minimizing losses; 7) avoidance of delay; 8) law and practice.

## 1.ICC(A)

(1) Risks covered

This insurance covers all risks of loss of or damage to the subject-matter insured and general average and salvage charges except the exclusions below, and indemnifies the Assured against liability incurred under any Both to Blame Collision Clause in the contract of carriage.

(2) Exclusions

1） General exclusions： wilful misconduct （故意不法行为） of the Assured； ordinary leakage， ordinary loss in weight or volume， ordinary wear and tear （自然磨损）； unsuitable packing； inherent vice （内在缺陷）； delay； insolvency or financial default （破产或不履行债务）of the owners， managers， charterers or operators of the vessel； any weapon or device employing atomic or nuclear fission （裂变） and/or fusion （聚变）.

2） Exclusions of unseaworthiness （不适航） and unfitness （不适货）： unseaworthiness and unfitness of vessel for the safe carriage of the subject-matter insured， where the Assured are privy to （私下知情的） such unseaworthiness or unfitness， at the time the subject-matter insured is loaded； unfitness of container or conveyance for the safe carriage of the subject-matter insured.

3） Exclusions of war： war， civil war， revolution， rebellion， insurrection （叛乱）， civil strife（冲突）， or any hostile act by or against a belligerent （交战的） power； capture， seizure， arrest，restraint or detainment （扣留） （piracy excepted）， and the consequences there of or any attempt thereat； derelict （废弃的） mines （地雷）， torpedoes （鱼雷）， bombs or other derelict weapons of war.

4） Exclusions of strikes： strikers， locked-out （停工） workmen， or persons taking part in labor disturbances （骚乱）， riots or civil commotions （暴乱或民变）； strikes， lock-outs， labor disturbances，riots or civil commotions； any act of terrorism being an act of any person acting on behalf of， or in connection with， any organization； any person acting from a political，ideological or religious motive.

## 2.ICC(B)

1) This insurance covers:

■ fire or explosion;

■ vessel or craft being stranded， grounded， sunk or capsized （倾覆）；

■ overturning （倾覆） or derailment （出轨） of land conveyance；

■ collision or contact of vessel, craft or conveyance with any external object other than water;

■ discharge （卸货） of cargo at a port of distress；

■ earthquake, volcanic eruption or lightning;

■ general average sacrifice;

■ jettison or washing overboard （抛货或浪击落海）；

■ entry of sea， lake or river water into vessel， craft hold， conveyance， container， liftvan（大型海运箱） or place of storage；

■ total loss of any package lost overboard or dropped whilst loading on to, or unloading from, vessel or craft.

2) In addition to the exclusions of ICC(A), ICC(B) shall not cover:

■ deliberate damage to or deliberate destruction of the subject-matter insured or any part thereof by the wrongful act of any person or persons (while ICC(A) only excludes loss,damage or expense attributable to wilful misconduct of the Assured);

■ actions of pirates.

## 3.ICC(C)

1) This insurance covers:

■ fire or explosion;

■ vessel or craft being stranded grounded sunk or capsized;

■ overturning or derailment of land conveyance;

■ collision or contract of vessel craft or conveyance with any external object other than water;

■ discharge of cargo at a port of distress;

■ general average sacrifice;

■ jettison.

2) The exclusions of ICC(C) are the same as that of ICC(B).

# 14.4 Export and Import Insurance Practice in China

## 1.Insurance clause in the contract

Insurance clause is one of the important parts of international sales (or purchase) contract.The contents vary when different trade terms are employed.

In FOB, CFR or FCA, CPT contract, the insurance clause may simply be stipulated as:“Insurance: To be covered by the Buyer.” In CIF or CIP contract, however, the clause should clearly state who is responsible for effecting insurance, the risks covered, the insurance amount as well as the insurance clauses adopted.Ambiguous clauses such as“usual risks” or“customary risks” should be avoided.

The following is an example of an insurance clause in a CIF contract: “Insurance to be covered by the Sellers for 110％ of total invoice value against All Risks, as per and subject to the relevant ocean marine cargo clauses of the People’s Insurance Company of China, dated 1/1, 1981.”

## 2.Insurance practice in China’s export and import

(1) Export insurance practice

When export transaction is made on CIF and CIP basis, insurance should be taken out by the exporter against the risks and for the amount stipulated in the contract.

It is customary to insure for the CIF or CIP value of the shipment, plus 10% of CIF value.This means, for example, that if the CIF price of the goods is US$10,000, you should insure for US$11,000.The extra 10 percent is to repay you for your time and trouble, lost profit, and perhaps lost customers because you could not fulfill your obligations.The premium is calculated upon the insurance amount and the rate.

If the insured amount is not clearly stated in the contract， according to the usual practice，it is the CIF or CIP price plus 10% CIF or CIP price.If the buyer asks for a increased addition rate （加成率）， say 20% of the CIF or CIP price， it is generally acceptable.But the additional premium should be borne by the buyer.Thus，

$$\text{Insured amount} = \text{CIF (or CIP)} \times (1 + \text{addition rate})$$

If only the CFR (or CPT) price is known, then the CIF (or CIP) price should be:

$$\text{CIF (or CIP) price} = \frac{\text{CFR (or CPT) price}}{1 - [\text{premium rate} \times (1 + \text{addition rate})]}$$

For example: Good A is to be shipped from Shanghai to New York, the total CFR amount is $30,000.Now the quotation is to be made on CIF.How much is the CIF price? Suppose insurance is to be effected against All Risks (premium rate: 0.6%) and War Risks (premium rate 0.03%), insurance amount is 110% of CIF amount.

$$\begin{aligned}\text{CIF (or CIP) price} &= \frac{\text{CFR (or CPT) price}}{1 - [\text{premium rate} \times (1 + \text{addition rate})]} \\ &= \frac{30{,}000}{1 - [(0.6\% + 0.03\%) \times (1 + 10\%)]} \\ &= \text{US\$}30{,}209.35\end{aligned}$$

(2) Import insurance practice

When import transaction is made on FOB， CFR， FCA and CPT bas is， the importer shall take out insurance.In such cases， a marine cargo op en policy （预约保险单） is often underwritten （签署）.An open policy （also called open cover）， in the context of insurance， is an agreement between the insured and the insurer to insure all goods in transit within the agreement.The insured agrees to declare details of all shipments that fall wit hin the scope of the policy， and the insurance company agrees to insure su ch shipments according to the terms and conditions of the policy.An insuran ce automatically applies to all of the exporter’s shipments during a specified period of time， rather than just to one shipment.The advantages of an open policy are： It avoids the need to arrange separate policies for each shipme nt； the cost of insurance is usually lower than if separate policies are arran ged.

(3) Claim procedure

In the event of loss or damage for which the insurer may be liable， an d for the purpose of averting or minimizing a loss and to ensure that all righ ts against carriers or other third parties are properly preserved and exercised （行使）.The insured or their agents are required：

1) Apply for survey.In the event of any damage to the goods, the insure d shall immediately apply for survey to the Surveyor stipulated in the Polic y.

2) Claim for damages on the carrier and/or other parties concerned.If t he carrier or the other relevant authorities (Customs and Port Authorities et c.) are responsible for such damages,the insured shall lodge a claim with the m in writing and, if necessary, obtain their confirmation of an extension of t he time limit of validity of such claims.In addition, the insured shall obtain f rom the carrier or other relevant authorities certificate of loss or damage.

3） Take proper measures.The insured shall also， take proper measur es immediately in salvaging the goods or preventing or minimizing a loss or damage thereto.The measures so taken by the insured shall not be considere

d respectively， as a waiver （放弃） of abandonment hereunder， or as an acceptance thereof.

4） Prepare documents for claim.To enable claims to be dealt with promptly， the insured or their agents should submit all available supporting documents without delay， including when applicable： （a） Original policy or certificate of insurance； （b） Original or copy shipping invoices， together with shipping specification and/or weight notes （重量单）； （c） Original bill of lading and/or other contract of carriage； （d） Survey report or other documentary evidence to show the extent of the loss or damage； （e） Landing account and weight notes at final destination.

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[1]The People's Insurance Company of China （PICC） is now renamed the People's Insurance Company （Group） of China Limited.

[2]An ocean marine insurance provision stipulating that upon the collision of two or more ships， when all ships are at fault， all owners and shippers having monetary interests in the voyage of the ships involved must share in all losses in proportion to the monetary values of their interests prior to the occurrence of the collision.

[3]The new clauses can be found on the website： http：//www.rhlg.com/pdfs/CargoClauses09.pdf.

# Chapter 15　International Payment

Learning Objectives

In this chapter, you will learn:

● Instruments of payment

—bill of exchange, promissory note and check

● Methods of payment

—remittance, collection, letter of credit and bank guarantee

● Terms of payment in international sales contract

No export transaction can be said to be successful until payment has been received for the goods delivered overseas, and the proceeds have been safely credited to the seller's account.Compared with payment arrangements for domestic transactions, international payment arrangements are much more complicated and difficult.

This chapter concentrates on instruments of payment, methods and terms of payment in international merchandise trade.Special attention is given to draft and letter of credit.

## 15.1　Instruments of International Payment

In international trade， it is rare that the seller delivers the goods and the buyer makes the payment in person.The common practice is that the seller delivers the goods and hands over the documents， and the buyer makes payment against documents.Banks are intermediaries.Bills are instruments of payment.These are the features of modern international trade payment.N

owadays non-cash payment is universally adopted.Under non-cash paymen t， negotiable instruments such as bills of exchange （汇票）， promissor y notes （本票） and checks （支票） are commonly used as payment ins truments.

## 1.Bills of exchange (draft)

Bills of exchange date from the fourth century BC and became popular in the eighteenth and nineteenth centuries as a means of financing expandin g world trade.They are widely used in the money market.

(1) Definition of bill of exchange

A bill of exchange （or draft as it is sometimes called） is a written， dated and signed instrument that contains an unconditional order from the d rawer （出票人） that directs the drawee （受票人） to pay a definite su m of money to a payee （收款人） on demand （立即） or at a specified f uture date.

Simply put, a bill of exchange is a written order by the drawer to the dr awee to pay money to the payee.

A bill of exchange requires in its inception （开始） three parties—th e drawer， the drawee，and the payee.The person who draws the bill is cal led the drawer.He gives the order to pay money to a third party.The party up on whom the bill is drawn is called the drawee.He is the person to whom th e bill is addressed and who is ordered to pay.He becomes an acceptor （承 兑人） when he indicates its willingness to pay the bill.The party in whose favor the bill is drawn or is payable is called the payee.

A bill of exchange is a useful instrument because it allows one party （the drawer） to direct another （the drawee） to pay money either to hi mself， to his agent， or to a third party.Of course，the order is valid only if the drawee has an underlying （基础的） obligation to pay money to the drawer.This can arise in situations where the drawee is holding money on ac count of the drawer （i.e.， the drawee is a bank）， where the drawer len

t money to a drawee （i.e.， the drawee is a borrower）， or where the dra wer has sold goods to the drawee and the drawee owes the sale price to the drawer （i.e.， the drawee is a buyer）.

(2) Contents of bills of exchange

A bill of exchange must fulfill the following requirements:

■ indicating the word“draft” or“exchange”;

■ an unconditioned order in writing;

■ certain amount;

■ payer’s (drawee’s) name, usually the buyer or its nominated bank;

■ payee’s name, usually the seller or its nominated bank;

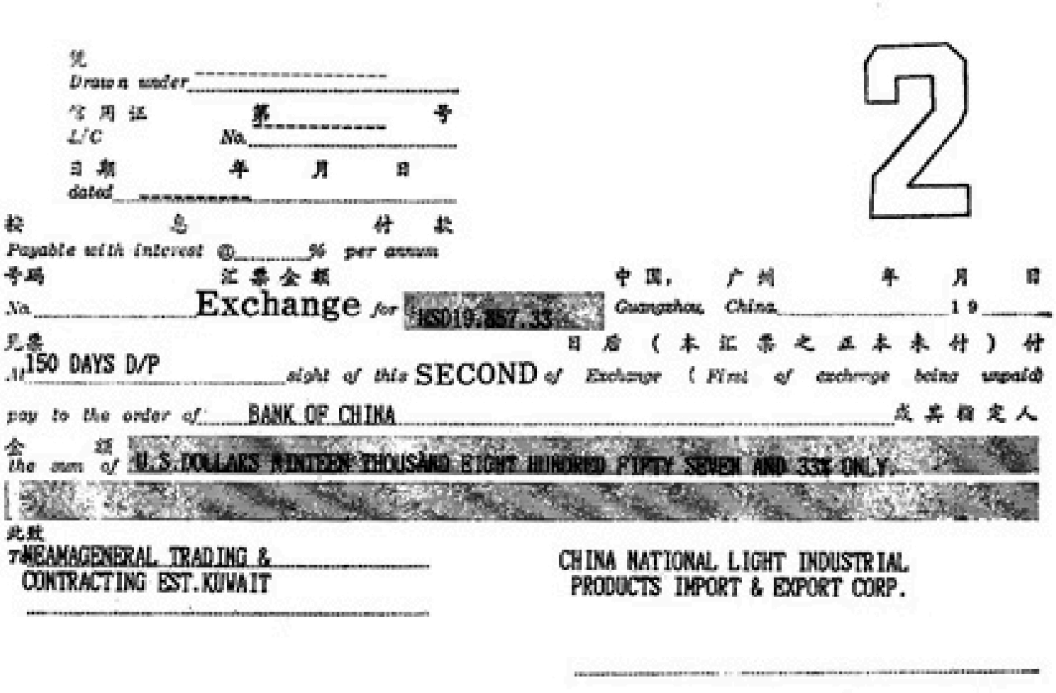
■ date and place of issuance;

■ signature of the drawer, usually the seller.

(3) Usage of bills of exchange

1） Issuance （出票）.Issuance means the drawer’s action of drawing and giving out （交付）of a draft.Upon issuance， the drawer has a contin gent liability （或有负债） on the bill until it matures as， in the event of default （不履行责任） by the acceptor， the drawer is obliged to pay out the face value of the bill on its due date to the holder.

Sample bill of exchange




The sample draft shown above is the second draft, marked“Second of Exchange (First Unpaid)” and the number“2”.In the first draft, if any is issued, is marked“First of Exchange(Second Unpaid)” and the number“1”.Some drafts may not be numbered“1” or“2”.

2） Presentment （提示）.Presentment means a demand to pay or accept the draft made to the drawee.

3） Acceptance （承兑）.Acceptance is an agreement generally on the part of the drawee to pay the bill.The drawee of the bill makes acceptance by simply writing down the word“accepted”， marking the date and signing its name across the face of the bill.Upon acceptance，the drawee， now the acceptor， becomes the principal debtor and the party primarily liable for the payment of the bill.The drawee of a bill is under no legal obligation to accept the bill， even if he is indebted to the drawer to the amount of the bill， or has funds of the drawer in its possession to that amount， unless he has agreed to accept it.

4） Payment.On the expiry date of draft， the payer makes sufficient payment to the legal bearer， the latter then writes off （勾销） the draft and return it to the payer as a receipt.

5） Endorsement （背书）.Endorsement is the act of a payee， or holder of a draft in signing the back of the draft to transfer rights in the draft to another.In financial market， the typical endorsement is discount （贴现） of draft， i.e.， the bearer transfers a time （远期的） and accepted draft to a bank or a discounting company， who， as transferee， will deduct the interest as per discount rate and pay the remaining sum to the bearer.The payee appears as the first endorser on the reverse of the bill and this endorsement starts the chain of ownership of the bill.

6） Dishonor and recourse （拒付和追索）.Dishonor means the payer refuses or fails to pay or accept the bill when the holder makes presentment to him.When dishonored， the holder shall pursue the right of recourse by giving notice of dishonor to the drawer and each endorser.

7） Protest （拒绝证书）.After a bill is dishonored by non-acceptance or by non-payment，and a notice of dishonor is sent， the holder may hand the bill to a Notary Public （法定公证人）who will present it again for acceptance or for payment as the case may be， so as to obtain a legal proof of the act of dishonor.As it is dishonored again， the Notary Public then draws up a protest， i.e.， an official certificate evidencing the act of dishonor and stating the reason for the protest， demands made on the drawee （or the acceptor） and the response received.

(4) Types of drafts

1） Trade draft （商业汇票） and banker’s draft.A trade draft is a draft issued by a trader and a banker’s draft is a draft drawn by a bank.

2） Sight draft and time draft （即期汇票和远期汇票）.Basically there are two types of drafts： sight draft and time draft.A sight draft （also called demand draft） is payable on presentation to the drawee.A time draft （also called usance draft） allows a delay in payment.The time of payment in a time draft may be expressed in the following three ways： （a） at... days after sight； （b） at...days after date； （c） at a fixed date.

3） Trade acceptance draft and banker’s acceptance draft （商业承兑汇票和银行承兑汇票）.When a time draft is drawn on and accepted by a business firm， it becomes a trade acceptance draft.When it is drawn on an

d accepted by a bank， it becomes a banker’s acceptance draft and as such i t is the unconditional promise of that bank to make payment on the draft wh en it matures.In fact， the quality of a banker’s acceptance draft is particula rly identical to a marketable （可销售的） bank certificate of deposit.Thus this kind of draft is more preferable and negotiable than trade acceptance dr aft and is more acceptable in the discount market.

4） Clean draft and documentary draft （光票和跟单汇票）.Draft is also classified as clean and documentary.A clean draft is a draft without shi pping documents attached thereto （随附）.When used in trade， the selle r usually sends the shipping documents directly to the buyer， who can obt ain the possession of the goods independent of its payment （on a clean sig ht draft） or acceptance （on a clean time draft）.Multinational corporatio ns frequently use clean draft when shipping to their affiliates （附属公司） because matters of trust and credit are not involved.Most drafts in internatio nal trade are documentary drafts， which mean the shipping documents are attached thereto.Payment （for sight drafts） or acceptance （for time draf ts） is required in order to obtain possession of those documents， which a re in turn needed to obtain the merchandise involved in the transaction.

## 2.Promissory note

(1) Definition of promissory note

A written promise to pay a determinate sum of money made between t wo parties is a promissory note, or simply a note.The party who promises to pay is called the maker; and the party who is to be paid is the payee.

A sample promissory note



Promissory Note

Singapore, 31.01.2010 Amount US$ 250,000

On 25 April 2010 we promise to pay against this Promissory Note

the sum of US Dollars Two hundred and fifty thousand

to the order of UK Export Company Ltd

for value Received

Payable at:

UK Export Banking Company plc
Sterling Street
London, UK

For and on behalf of:

Import Buyer Company
Singapore

C.E.Lee

Managing Director

(2) Differences between a bill of exchange and a promissory note

The nature of a promissory note has much in common with that of a bil l of exchange.However, there are some differences between these two instru ments, which lie in:

1) A promissory note is a promise to pay, whereas a bill of exchange is an order to pay;

2) There are only two parties to a promissory note, namely the maker a nd the payee,whereas there are three parties to a bill of exchange, namely th e drawer, the drawee and the payee;

3) The maker is primarily liable on a promissory note, whereas the dra wer is primarily liable, if it is a sight bill, and the acceptor becomes primaril y liable, if it is a time bill;

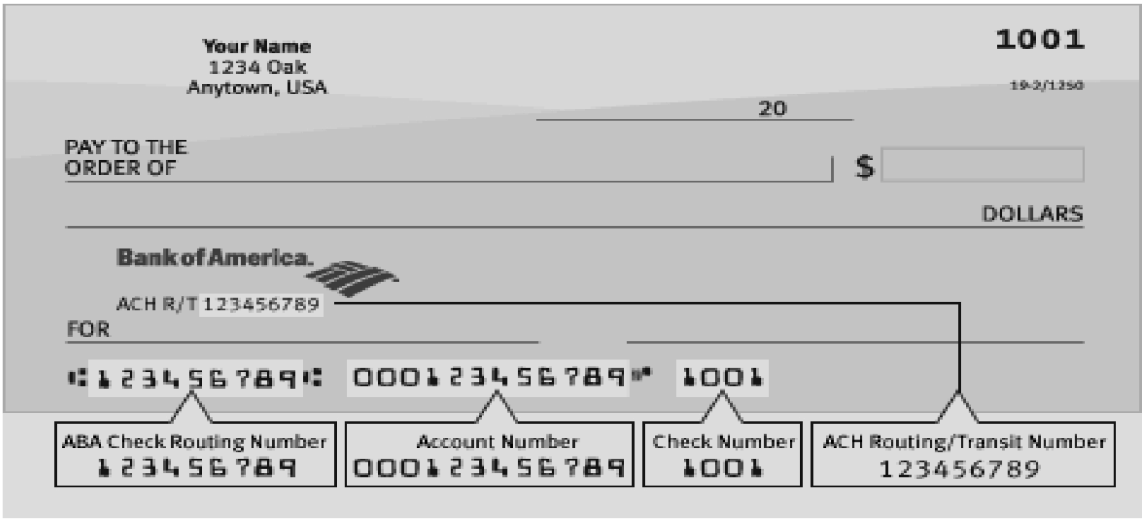
4) When issued, a promissory note has an original note only, whereas a bill of exchange may be either a sole bill or a bill in a set, i.e., a bill drawn with the second of exchange and third of exchange in addition to the origina l one.

Simply put, the major difference between a promissory note and a bill of exchange is that the maker of a note promises to personally pay the paye e, rather than ordering a third party to do so.

## 3.Check

A check is a bill of exchange drawn on a bank payable on demand.If th e drawer has not enough deposit in the bank for the check amount， the che ck will be dishonored， and this kind of check is called“bounced check” （空头支票）， which is not allowed.

A sample check




# 15.2 Remittance and Collection

## 1.Remittance

Remittance （汇付） here refers to the transfer of funds from one part y to another among different countries， that is， a bank （the remitting ba nk） （汇出行）， at the request of its customer（the remitter） （汇款 人）， transfers a certain sum of money to its overseas branch or correspon

dent bank （代理行） （the paying bank） instructing it to pay to a named person or corporation （the payee or beneficiary） domiciled （位于） in that country.Simply put， remittance here means the process of sending mo ney to remove an obligation.

(1) Parties related to a remittance

1) Remitter: The party who requests its bank to remit funds to a benefi ciary in a foreign country.In international trade, it is usually the buyer.

2) Payee or beneficiary: The party who is addressed to receive the remi ttance.In international trade, it is usually the seller.

3) Remitting bank: The bank transferring funds at the request of a remi tter to its correspondent or its branch in another country and instructing the l atter to pay a certain amount of money to a beneficiary.In international trad e, it is usually the buyer’s bank.

4) Paying bank: The bank entrusted by the remitting bank to pay a cert ain amount of money to a beneficiary named in the remittance advice.It is u sually the correspondent bank or branch of the remitting bank.

(2) Ways of remittance

There are three basic ways for a bank to transfer funds for its client fro m home country to abroad, namely, remittance by airmail, remittance by ca ble/telex/SWIFT and remittance by banker’s demand draft.

1） Remittance by airmail （M/T）.Remittance by airmail （信汇） is more generally known as mail transfer， i.e.M/T.A mail transfer is to tran sfer funds by means of a payment order （付款委托书） or a mail advice （信汇委托书）， or sometimes a debit advice （借记通知书） issued b y a remitting bank， at the request of the remitter.A payment order， mail a dvice or debit advice is an authenticated （具有法律效力的） order in wri ting addressed by one bank to another instructing the latter to pay a certain s um of money to a specified person or a beneficiary named thereon.

The procedure for M/T (or T/T) is illustrated in Figure 15-1.

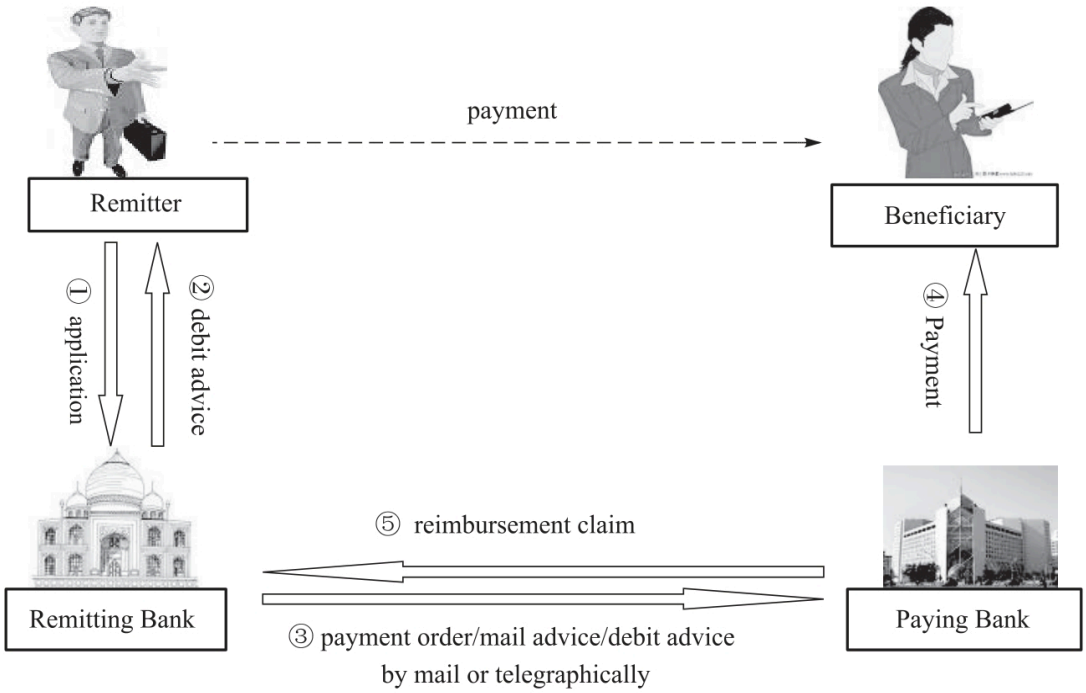



Figure 15-1 M/T or T/T flow diagram

The procedure for M/T or T/T:

(a) The remitter (a bank's customer) makes out the necessary applicati on form instructing its bank to issue an M/T or T/T.

(b) The remitting bank debits its customer's account with the amount t o be remitted together with its commission or expenses (if any).

(c) The remitting bank issues a payment order to its branch or correspo ndent in the place where the beneficiary is domiciled.The payment order m ust be authenticated with the authorized signatures of the remitting bank.

(d) Upon receipt of the payment order, the paying bank verifies the aut horized signatures (in the case of M/T)or test keys (in the case of T/T), notif ies the beneficiary and pays to him the stated amount minus expenses charg ed by itself.

(e) The paying bank claims reimbursement from the remitting bank in accordance with the latter's instructions.

2） Remittance by cable/telex/SWIFT （T/T）.Remittance by cable/t elex/SWIFT （电汇） is often referred to as cable transfer， telegraphic tr

ansfer or electronic transfer， namely T/T.It is exactly the same as a mail tr ansfer， except that instead of by airmail， instructions from the remitting bank to the paying bank are transmitted by wire or through the SWIFT[1] sys tem （the Society for Worldwide Interbank Financial Telecommunication）（环球银行金融电讯协会）.

3） Remittance by banker's demand draft （D/D）.Remittance by ban ker's demand draft（票汇） is often referred to D/D.Here a banker's draft drawn by a bank on its overseas bank is used as an instrument for effecting t ransfer of money.The difficulty with this method is that the draft must be ph ysically transferred to the payee， and the payee must then present the draft for payment.The procedure for D/D is shown in Figure 15-2.

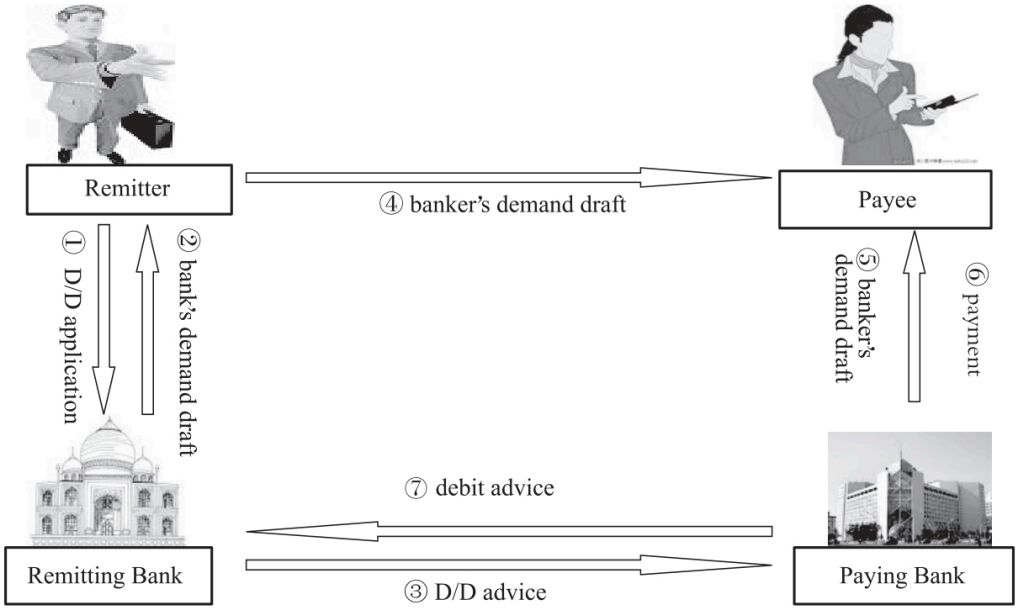



Figure 15-2 D/D flow diagram

The procedure for D/D:

(a) The remitter's (a bank's customer's) written request to issue a bank er's demand draft.

(b) The remitting bank debits its customer's account with the amount o f the draft plus bank commission(if any) and issues a banker's demand draft to the remitter.

(c) The remitting bank sends an advice (a special letter of advice or a n on-negotiable copy of the draft)by airmail to the drawee's bank, namely its overseas branch or its correspondent bank abroad,instructing the latter to pa y it on the presentation of the original banker's demand draft.

(d) The remitter forwards the draft to the payee.

(e) The payee presents the draft to the paying bank for payment.

(f) The paying bank verifies the signatures, pays the draft and claims re imbursement from the remitting bank.

(g) The paying bank forwards the debit advice to the remitting bank.

Generally speaking, a large number of international remittances are car ried out by T/T.M/T is less used than T/T or D/D nowadays, except for smal l amount remittances made by individuals for family maintenance, cash gift, etc.T/T is favorable to the payee in that he can get money at an early date, s peed up the turnover of funds, increase the income of interests and avoid th e risk of fluctuation in the exchange rate.

(3) Application of remittance

Remittance is mostly applied in the settlement of open account sales （赊账交易） and payment in advance sales （预付货款交易）.

1） Open account sales： In open account sales， the buyer is trusted to pay the seller after receipt of goods.This method is generally used when t he seller and the buyer are related entities or where there is a history of tran sactions between the parties， as a result of which the seller is satisfied （确信的） that the buyer can be relied on to pay for the goods.The seller a ssumes great risks.

2) Payment in advance sales: The converse of open account sales is pa yment in advance sales, in which the seller will not ship the goods until the buyer has remitted payment to him.This may be acceptable if the seller is a reputable international supplier with whom the buyer has long-standing trad ing relationship.It places the buyer in hazardous position if there is any likel ihood that the seller will not perform.

In both open account and payment in advance transactions, all shippin g documents,including title documents are handled directly between the tra ding partners.The role of banks is to effect a clean payment to the seller as r equired.

## 2.Collection

（1） Definition of collection （托收）

Collection is a payment arrangement whereby a bank acts on behalf of a seller for collecting and remitting payment for a shipment.The seller prese nts the shipping and collection documents to his bank (in his own country) which sends them to its correspondent bank in the buyer’s country.The forei gn bank hands over shipping documents to the buyer in exchange for payme nt or a firm commitment to pay on a fixed date.

The banks involved in the collection act only in a fiduciary （受托人） capacity （身份） to collect the payment but make no guaranties.The y are liable only for correctly carrying out the seller’s collection instructions and may， if so instructed， sue the non-paying or non-accepting buyer on the seller’s behalf.

(2) Parties to a collection

1） Drawer or principal （委托人）： The party who entrusts the col lection items to his bank.In the context of international trade， it is usually the seller.

2） Drawee （受票人，付款人）： The party to whom the collectio n items are to be presented for acceptance or payment.In the context of inter national trade， it is usually the buyer.

3） Remitting bank （托收行）： The bank to which the drawer entr usts the collection items.Upon receipt of the collection items from the selle r， the remitting bank forwards them to the collecting bank， in accordanc e with the collection instructions given by the principal.

4） Collecting bank （代收行）： The bank entrusted by the remittin g bank to present the collection items to the drawee.The collecting bank is g enerally a branch， a correspondent or an agent of the remitting bank.

5） Case of need （需要时的代理）： Sometimes， in case of non-a cceptance and/or non-payment， there might be another party and that is th e case of need.It is a representative appointed by the principal as case of nee d in the event of non-acceptance and/or non-payment，whose power should be clearly and fully stated in the collection.

(3) Types of collection

Basically there are two types of collection： clean collection （光票托收） and documentary collection （跟单托收）.

1) Clean collection: Clean collection means collection on financial inst ruments without being accompanied by commercial documents, such as inv oice, bill of lading, insurance policy, etc.

Under clean collection， only the draft， if necessary， an instruction letter are sent out for collection.The documents are sent directly by the selle r to the buyer or the seller’s foreign agent.The seller is， in fact， shipping on open account terms.Clean collection may be used when the goods are shi pped to overseas agent on consignment[2] （寄售）.A clean collection may represent an underlying trade transaction or a purely financial transaction in volving no movement of merchandise and， therefore， no documents.

2） Documentary collection： A documentary collection is so-called b ecause the seller requires the remitting bank to forward commercial docume nts （or both the commercial documents and financial documents ） relatin g to the transaction to the buyer via collecting bank.In terms of release of do cuments， documentary collection can be subdivided into two categories： documents against payment （D/P） （付款交单） and documents against acceptance（D/A） （承兑交单）.

（a） Documents against payment （D/P）： In this case， documen ts are released to the buyer only when the payment has been made.Accordin

g to the time of making payment， D/P can be divided into D/P at sight （即期付款交单） and D/P after sight （远期付款交单）.

■ D/P at sight: Under this payment, the draft issued is demand draft.When the collecting bank makes presentation to the drawee (the buyer), the latter should make payment upon presentation.The collecting bank will then release the documents to him.

■ D/P after sight: Under this payment, time draft is used.When the collecting bank makes presentation, the buyer shall first make acceptance after checking the documents, and will make payment at maturity.

(b) Documents against acceptance (D/A): In this case, documents are released to the buyer only against acceptance of a draft.Payment can later be demanded.

(4) Procedure for payment by D/P at sight

Procedure for payment by D/P at sight is illustrated in Figure 15-3.We will not go into the procedures for D/P after sight and D/A as they are similar to D/P at sight except the following three aspects: 1) Under both D/P after sight and D/A, a time draft rather than a sight draft is utilized; 2) Under D/P after sight, the drawee (buyer) should first accept the draft and then make payment before getting the documents; 3) Under D/A, the buyer gets the documents on acceptance and makes payment at maturity of the draft.

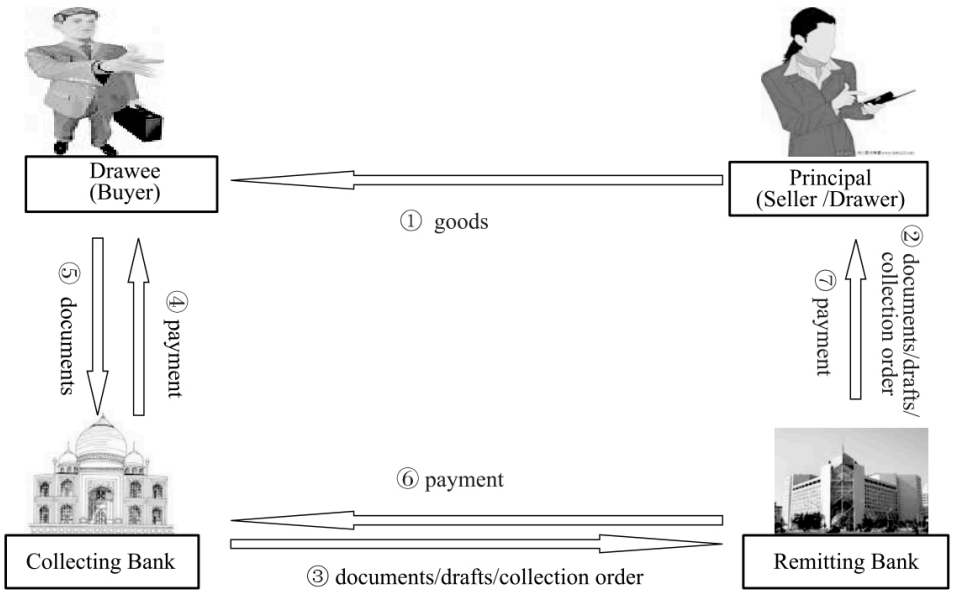



Figure 15-3 D/P at sight flow diagram

The procedure for D/P at sight:

(a) The seller ships the goods to the buyer as agreed in the sales contra ct.

(b) The seller submits to his bank, the remitting bank, documents, a sig ht draft drawn on the buyer, and collection order.

(c) The remitting bank sends documents, drafts and collection order to the collecting bank in the buyer's country.

(d) The buyer pays the face amount of the draft plus any charges the bu yer is responsible for, as stated in the collection order.

(e) The collecting bank releases the documents to the buyer.

(f) The collecting bank deducts its fee and sends the buyer's payment t o the remitting bank.

(g) The remitting bank credits the seller's account for the face value mi nus any fees and charges for which the seller is responsible.

(5) Risk management under payment by collection (for the seller)

Under payment by collection, the major risks the seller faces are as follows.

1） Non-acceptance risk.One common danger is that the buyer may refuse to accept the goods.The buyer may base the refusal on some small， inadvertent （非故意的） infraction （违约）of the sales contract.The real reason for the non-acceptance of the goods is that between the order was placed and the draft received， there has been a significant drop in the market price.When this happens， the seller is stuck with （被困住） its goods in a foreign port， probably incurring a heavy storage charge and a market at a greatly reduced price.

2） Non-payment of trade acceptance draft risk.Payment by collection infers that the seller is providing the financing and dependent upon the buyer's integrity （信誉） to pay the draft at maturity （到期）.The risk for the seller is if the buyer fails to pay the draft at maturity， the banks at both ends who only act as collection agents， are not obliged to honor payment.The seller is assuming all the risk.Generally， D/A is riskier than D/P after sight.In the latter case，at least the title to the goods is retained by the seller even if non-payment occurs.In the case of payment by D/A， however， the buyer has control of the goods， thus preventing the seller from selling the goods elsewhere.

Therefore, the seller should take some measures to manage the risks involved:

Firstly， make sure that the buyer is of good credit and financial standing.Buyers who have unsatisfactory creditworthiness may reject the goods on some pretext （借口） after its arrival， in the hope of driving the seller into a price reduction.

Secondly, take into account the economic and political conditions in the importing country.For instance, if the market price of the imported goods falls, the buyer may also find a pretext to refuse to make payment.

Finally, the amount of transaction should be moderate.

(6) Financing under documentary collection

Financing by banks under documentary collection for the seller takes the form of collection bill purchased which means the remitting bank purchases the documentary bill drawn by the seller on the buyer.The bank may purchase the documentary bill if the export goods enjoy great popularity in the market abroad and both the seller and the buyer are thought reliable.The bank pays the seller the net amount after deducting from the face value the bank fees and the interest incurred.

Financing by banks under documentary collection for the buyer takes the form of trust receipt （信托收据）.When payment is paid by D/P after sight， if the collecting bank has a great degree of trust in the buyer， the bank may be willing to release the negotiable bill of lading to the buyer against a trust receipt.A trust receipt is a written declaration by the buyer to the collecting bank that ownership in goods released by the bank is retained by the bank， and that the buyer has received the goods in trust （被托管） only and will act as the trustee of the bank to arrange the discharge， customs clearance， transportation and insurance of the goods.After the buyer has made the final sales and received the proceeds， it then pays the collecting bank which granted the advance.

## 15.3 Letter of Credit

As previously noted, international payment can be made in several different ways: by the buyer remitting payment before the seller makes shipment; by open account whereby the buyer remits payment at an agreed time after receiving the goods; or by documentary collection through a bank in which case the buyer pays the collecting bank in exchange for shipping documents which would include, in most cases, the document of title to the goods.In the aforementioned methods of payment, the seller relies entirely on the willingness and ability of the buyer to effect payment.

When the seller has doubts about the credit-worthiness of the buyer and wishes to ensure prompt payment, the seller can insist that the sales contract provides for payment by irrevocable letter of credit.Letters of credit are t

he predominant method of payment in South America, Middle East, Asia, A frica and Russia[3].

## 1.Definition of letter of credit

A letter of credit is a written undertaking by a bank (issuing bank) give n to the seller(beneficiary) at the request, and in accordance with the buye r's (applicant) instructions to effect payment—that is by making a payment, or by accepting or negotiating bills of exchange (drafts)—up to a stated am ount, against stipulated documents and within a prescribed time limit.

The UCP600 explicitly defines a credit as"any arrangement， howeve r named or described， that is irrevocable and thereby constitutes a definite undertaking （保证） of the issuing bank to honor （承付） a complying presentation （相符交单）."

In simple terms, a letter of credit is a conditional undertaking of payme nts by a bank.

## 2.Parties to a letter of credit

1） Applicant or opener （申请人）.The applicant or the opener is th e party （usually the buyer） who fills out and signs an application form， requesting the bank to issue a letter of credit in favor of a seller abroad.He i s in duty bound to ensure that the credit is issued in compliance with the ter ms and conditions laid down in the sales contract within a proper or reasona ble time.After the payment is effected by the issuing bank， the opener mus t pay the bank against correct shipping documents or refuse to pay if the do cuments are not in order.

2） Beneficiary （受益人）.The beneficiary is the party （usually the seller） in whose favor the credit is issued.If there is a discrepancy （不相 符） between the credit opened and the sales contract， the beneficiary ma y have the option to accept it as it stands or persuade the opener to have it a

mended so as to be in line with the contract.Once the beneficiary accepts th e credit，he must deliver the goods in compliance with the contract.Then h e tenders to his bank or any other bank all the relevant documents as stipula ted in the credit.He is responsible not only for the correctness and genuinen ess （真实性） of the documents but also for the goods which must confor m with the contract.If the issuing bank does not pay or is in liquidation （清算）， the beneficiary can claim from the opener for the payment.

3） Issuing bank or opening bank （开证行）.The issuing bank is the one which issues a letter of credit at the request of an applicant.An issuing b ank is irrevocably bound to honor as of the time it issues the credit.If the ap plicant fails to pay after the issuing bank makes payment， the latter has th e right to sell the goods and claim from the applicant if the proceeds are not sufficient.It is primarily liable to the beneficiary， no matter whether the ap plicant is in default or not.

4） Advising bank （通知行）.The advising bank is the one which ad vises the credit to the beneficiary in accordance with stipulations on the cre dit.It is located in the place of the beneficiary and is usually the issuing ban k’s branch or correspondent acting as an agent of the opening bank in accor dance with the instructions given.

5） Negotiating bank （议付行）.A negotiating bank is the nominate d bank[4] who purchases drafts （drawn on a bank other than the nominate d） and/or documents by advancing or agreeing to advance funds to the ben eficiary on or before the banking day on which reimbursement （偿付） is due to the nominated bank.

This definition emphasizes that negotiation relates to the purchase of a draft drawn on a bank other than the nominated bank.If it was drawn on the nominated bank， it would be a payment or acceptance credit.Further， ne gotiation is either the advancing or agreeing to advance funds to a beneficia ry.Use of agreeing to advance allows the bank and beneficiary to determine the terms under which negotiation will occur.These terms would include wh en， for how much and whether or not the advance is with or without recou rse （通常）.

The negotiating bank naturally becomes the holder in due course of the draft after its negotiation.And so it normally has a right of recourse against t he drawer, namely the beneficiary in the credit, in the event of dishonor by t he issuing bank.

6） Paying bank （付款行）.The paying bank is always the drawee o f a draft stipulated in the credit.Or we may say it is a bank nominated by the issuing bank to make payment under the credit.Sometimes the paying bank is the issuing bank itself.

7） Reimbursing bank （偿付行）.Reimbursing bank is the agent of t he issuing bank.It honors the reimbursement claims of a paying bank or an accepting bank or a negotiating bank under a particular credit in accordance with the instructions or authorization given by the issuing bank.

## 3.Procedure for letter of credit operations

The documentary （跟单的）[5] credit procedure involves three basic groupings of steps in the procedure： Issuance （开证）—Amendment （改证）—Utilization （用证） （see Figure 15-4）.

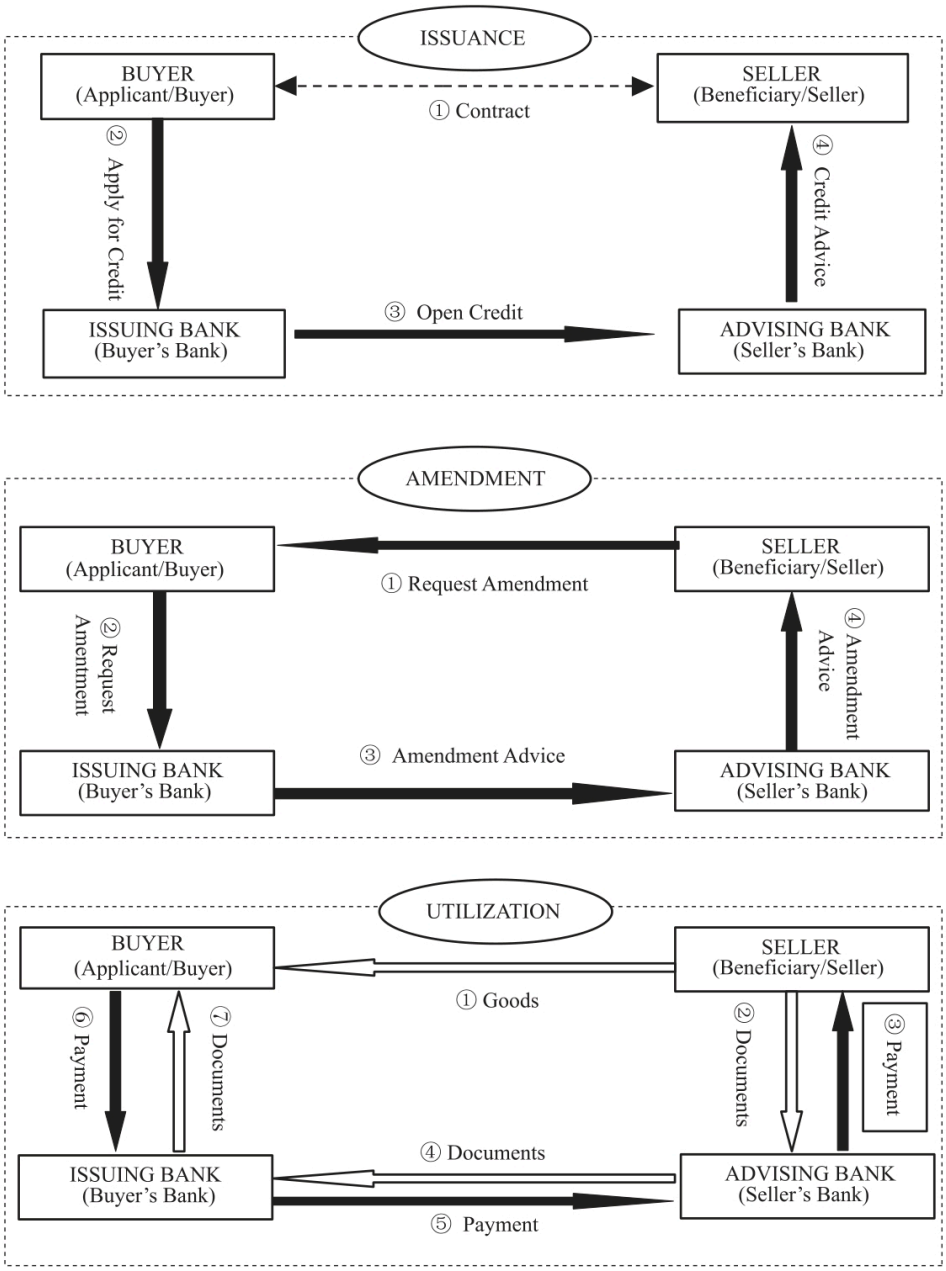



Figure 15-4 L/C operation flow diagram: issuance—amendment—utilization

(1) Issuance

Issuance describes the process of the buyer's applying for and opening a documentary credit at the issuing bank and the opening bank's formal noti fication of the seller through the advising bank.

1) Contract to settlement by a letter of credit.The buyer and seller agre e on the terms of sale: (a) specifying a documentary credit as the means of p

ayment, (b) naming an advising bank (usually the seller's bank), and (c) listi ng required documents.

2) Requesting for issuing a letter of credit.The buyer applies to his ban k (issuing bank) to open a documentary credit naming the seller as the benef iciary based on specific terms and conditions that are listed in the credit.

3) Opening of a letter of credit.After accepting the application, the ope ning bank shall stipulate L/C clauses strictly conforming to the instructions of application form and mail or telex or send by SWIFT to the advising ban k named in the credit.

4) Advising the beneficiary.After verifying the authenticity of the credi t, the advising bank shall advise the beneficiary of L/C or just transferring t he L/C to him.A copy is usually kept for file.

There are two ways of advising: one is to deliver the L/C directly to th e beneficiary, attached with a signed advice note.The other is when the addr essee of the L/C is the advising bank, the advising bank shall copy word by word in its own advice note, sign, and deliver it to the beneficiary.

(2) Amendment

Amendment describes the process whereby the terms and conditions of a documentary credit may be modified after the credit has been issued.

After receiving the documentary credit， the seller must examine it cl osely to determine if the terms and conditions （i） reflect the agreement o f the buyer and seller， and （ii） can be met within the time stipulated.Up on examination， the seller may find problems.If the seller still wants to pr oceed （接着做） with the transaction， but with modification to the term s of the credit，he should contact the buyer immediately and request an am endment.

Amendments must be authorized by the buyer and issued by the issuin g bank to the seller through the same channel as the original documentary cr edit.This can be an involved （耗费很多时间的） undertaking （工作） s o any amendments should be initiated only when necessary and as soon as a problem is identified.

(3) Utilization

Utilization describes the procedure for the seller's shipping of the good s, the transfer of documents from the seller to the buyer through the banks, and the transfer of payment from the buyer to the seller through the banks.

1) The seller (beneficiary) ships the goods to the buyer and obtains a n egotiable transport document (negotiable bill of lading) from the shipping fi rm/agent;

2) The seller prepares and presents a document package to the advising bank consisting of documents such as negotiable transport document, comm ercial invoice, insurance document,inspection certificate, etc.;

3) The advising bank reviews the document package making certain th e documents are in conformity with the terms of the credit and pays the sell er.In the case of a credit available by negotiation, the negotiating bank (usua lly be the advising bank) negotiates the documents with recourse to the ben eficiary.After negotiation, the negotiating bank will claim reimbursement fr om the issuing bank or the reimbursing bank in accordance with the reimbu rsement terms indicated in the credit and documents will be sent to the issui ng bank;

4） The advising bank sends the document package by mail or by cour ier （快递） to the issuing bank；

5) The issuing bank reviews the document package making certain the documents are in conformity with the terms of the credit, pays the advising bank and advises the buyer that the documents have arrived;

6) The buyer reviews the document package making certain the docum ents are in conformity with the terms of credit, and makes a cash payment (with a sight draft) to the issuing bank, or signs an acceptance (promising to pay at a future date);

7) The issuing bank sends the document package by mail or courier to the buyer who then takes possession of the shipment.

# 4.Content of a letter of credit

At present, most Ls/C are opened by telecommunication.Although the forms are different,their contents are, in the main, the same.The following d etails are to be found on all credits.

1) Name and address of the issuing bank;

2) Type of the credit.Every credit must indicate whether it is revocable or irrevocable.Whether it is a transferable credit or a confirmed credit must also be indicated in the credit;

3) Name and address of the beneficiary;

4) Amount of the credit and its currency;

5) Expiry date of the credit and its place to be expired;

6) Name and address of the applicant;

7) L/C number and date of issuing;

8) Drawer and drawee as well as tenor of the draft.The drawer is alway s the beneficiary,the drawee may be the issuing bank or any other bank;

9) Full details of the goods;

10) Full details of the documents to be presented;

11) Partial shipment permitted/not permitted;

12) Transshipment allowed/not allowed;

13) Port of shipment and port of discharge;

14) Latest date for shipment, and presentation of documents;

15) Instructions to the advising bank, negotiating bank or paying bank;

16) Other special terms and conditions;

17) The undertaking clause of the issuing bank;

18) The indication“This credit is subject to the Uniform Customs and Practice for Documentary Credit (2007 revision), International Chamber of Commerce Publication No.600.”

A sample irrevocable documentary letter of credit

THE BANK OF TOKYO, LTD.
New York Agency
100 Broadway New York, N.Y. 10005

| | |
|---|---|
| **Date**: June 21,2008 | **Credit number:** 110 LCI 985467 |
| **Advising bank**<br>Pre-advised by: Telex Through<br>Bank of China<br>Qingdao, China | **Applicant**<br>Kanematsu-Gosho (Canada) Inc.<br>400 de Maisonneuve Blvd. W.<br>**Montreal**, Quebec |
| **Beneficiary**<br>China National Textiles Imp. & Exp. Corp.<br>No.78 Jiangxi Road, Qingdao, China | **Amount**<br>Abt.CAD174,000.00 (ABOUT CANADIAN DOLLARS ONE HUNDRED SEVENTY FOUR THOUSAND AND 00/100) |
| **Irrevocable Documentary Credit** | **Expiry** for negotiation on August 15, 2008 |

Dear Sirs,

- We hereby issue the Irrevocable Documentary Letter of Credit which is available by beneficiary's drafts on us for full invoice value at sight bearing the credit number and date of issue, and accompanied by the following documents:
- Signed Commercial Invoice in quintuplicate;
- Canadian Customs Invoice in quintuplicate;
- Packing list in quintuplicate;
- Weight and Measurement Certificate in quintuplicate;
- Full set of clean on board Bills of Lading issued to order of shipper marked "Freight prepaid" and notify accountee.

Evidencing shipment of:
About 300,000 yards of 65% Polyester, 35% Cotton Grey Lawn as per buyer's order No. S-0578, CFR Montreal.
We are informed insurance is to be covered by buyer.

| | |
|---|---|
| Shipment from China to Montreal latest July 31, 2008 | Partial shipment permitted |
| | Transshipment permitted |

All other bank charges are for the account of beneficiary.
Documents must be presented to negotiating bank or paying bank within 15 days after the on board date of Bills of Lading, but within validity of letter of credit.
Special Conditions:
Two sets of non-negotiable shipping documents must be airmailed direct to Kanematsu-Gosho (Canada) Inc., Montreal and beneficiary's certificate to this effect is required.
Special instructions for reimbursement:
We will pay the negotiating bank as per their instructions upon receipt of documents.
The amount of any draft drawn under this credit must, concurrently with negotiation, be endorsed on the reverse hereof, and the presentment of any such draft shall be a warranty by the negotiating bank that such endorsement has been made and that documents have been forwarded as herein required.
Special Conditions:
We hereby engage with the drawers, endorsers and bona fide holders of drafts drawn and negotiated under and in compliance with the terms of this credit that the same shall be duly honored on due presentation to the drawee.
The advising bank is requested to notify the beneficiary without adding their confirmation.
This credit is subject to the Uniform Customs and Practice for Documentary Credit (2007 revision), International Chamber of Commerce Publication No.600.

Yours faithfully,

## 5.Features of letter of credit business

1) A letter of credit business is a banker's credit

The issuing bank undertakes to effect payment, provided the documents presented are in compliance with the terms and conditions of the letter of credit.Thus the bank assumes a primary liability rather than a secondary liability for payment.

2) A letter of credit is a self-sufficient instrument

Although the credit is issued on the basis of the sales contract， banks are in no way concerned with or bound by such contract， even if any reference whatsoever to such contract is included in the credit.The bank， when issuing the credit has no regard for （不考虑） the sales contract but follows an application handed in by the buyer.

3) Banks deal with documents

In letter of credit business， banks deal with documents and not with goods， services and/or other performances to which the documents may relate.They examine exclusively on the basis of the documents presented to them whether the terms of the credit are fulfilled.They are not in a position to verify （核实） whether the goods supplied actually conform with those specified in the credit.They are not to hold liable for a discrepancy （不一致） between the goods invoiced and those actually delivered.If the documents presented are not in compliance with the terms and conditions of the credit， the bank will refuse to pay no matter whether the goods shipped are agreed with those mentioned in the contract.

## 6.UCP600

The UCP600 refers to the Uniform Customs and Practice for Documentary Credits （跟单信用证统一惯例）， ICC publication No.600 published by the International Chamber of Commerce （ICC）.

The UCP is an internationally recognized set of rules governing the use of documentary credits.It is utilized by bankers and commercial parties in more than 175 countries in trade finance.The UCP rules were first published in 1933, and revised by the ICC in 1951, 1962, 1974,1983 and 1993.The current version the UCP600 came into force on July 1, 2007, replacing its predecessor, the UCP500.It contains a total of 39 articles covering the following areas, which can be classified as seven sections according to their functions and operational procedures (see Table 15-1).Table 15-2 shows some of the key changes in the UCP600.

Table 15-1 Structure of the UCP600

| Serial No. | Article | Area | Consisting |
|---|---|---|---|
| 1 | 1 to 3 | General | Application, Definition and Interpretations |
| 2 | 4 to 12 | Obligations | Credit vs. Contracts, Documents vs. Goods |

to be continued

continued

| Serial No. | Article | Area | Consisting |
|---|---|---|---|
| 3 | 13 to 16 | Liabilities and responsibilities | Reimbursement, Examination of Documents, Complying, Presentation, Handling Discrepant Documents |
| 4 | 17 to 28 | Documents | Bill of Lading, Charter Party Bill of Lading, Air Documents, Road Rail etc. Documents, Courier, Postal etc. Receipt. On board, Shippers' count, Clean Documents, Insurance documents |
| 5 | 29 to 33 | Miscellaneous Provisions | Extension of dates, Tolerance in Credits, Partial Shipment and Drawings, House of Presentation |
| 6 | 34 to 37 | Disclaimer (免责) | Effectiveness of Document, Transmission and Translation, Force Majeure (不可抗力), Acts of an Instructed Party |
| 7 | 38 to 39 | Others | Transferable Credits, Assignment of Proceeds (款项让渡) |

Table 15-2 Some of the key changes in the UCP600

| | |
|---|---|
| Application of UCP Article 1 | The UCP600 does not apply unless it is expressly mentioned in the text of the L/C. |
| Definitions and Interpretations Articles 2 and 3 | ✧ A list of definitions includes some substantive elements, e.g. negotiation, nominated bank.<br>✧ The default type of L/C is now irrevocable L/C. Parties wishing another type of L/C need to expressly clarify this.<br>✧ Unless required to be used in a document, words such as "prompt", "immediately" and "as soon as possible" will be disregarded. |
| Availability Article 6 | Every documentary credit must state the bank with which it is available or whether it is available with at any bank. |
| Nomination Article 12 | By nominating a bank to accept a draft or incur a deferred payment undertaking, the issuing bank expressly authorizes the nominated bank to prepay the draft accepted or deferred payment undertaking or to discount it to the beneficiary. Thus the risk of any fraud is transferred from the nominated bank to the issuing bank. |
| Standard for Examination of Documents Article 14 | ✧ Banks now have a maximum of five banking days following the day of presentation, and no longer the "reasonable time not exceeding 7 banking days".<br>✧ Data in a document, when read in context with the credit, the document itself and international standard banking practice, need not be identical to, but must not conflict with data. |
| Multimodal or Sea Transport Documents Articles 19, 20, 21 and 22 | ✧ If a transport document is signed by an agent "for or on behalf of the master", the name of the master does not need to be listed.<br>✧ The terms "multimodal transport document" and "marine/ocean bill of lading" have been replaced by the terms "transport document covering at least two different modes of transport" and "bill of lading".<br>✧ A charter party bill of lading may now be signed by the charterer or his agent. |
| Air Transport Document Article 23 | If the air waybill has a specific notation indicating the actual date of shipment, this date is considered the date of shipment, even if such a notation was not required in the documentary credit. In all other cases, the date of issuance will be considered to be the date of shipment. |
| Force Majeure Article 36 | This article now includes provision for acts of terrorism. |

Most letters of credit in international transactions are subject to the UC P.Since the ICC lacks legislative authority, meaning it is not the arm of or a uthorized by any government but rather a trade association, the UCP are no laws.In other words, the UCP does not automatically apply to a credit if the credit is silent as to which set of rules it is subject to.In international trade, h owever, most parties choose to use the UCP.Where a credit is issued subject

to the UCP600, the credit will be interpreted in accordance with the entire s et of 39 articles contained in the UCP600.However, exception to the rules c an be made by express modification or exclusion.

## 7.Classification of letters of credit

(1) According to the attaching of documents

1） Clean credit （光票信用证）

A clean credit is a credit against which the beneficiary of the credit ma y draw a bill of exchange without presentation of documents.Payment will be effected only against a draft without any shipping documents attached th ereto or sometimes, against a draft with an invoice alone attached thereto.

2） Documentary credit （跟单信用证）

A documentary credit is universally used as a method of payment in int ernational trade.It is a credit under which payment will be made against doc uments representing title to the goods and thus making the transfer of title p ossible.

(2) According to the nature of credit

1） Revocable credit （可撤销信用证）

A revocable credit is a credit which can be amended or cancelled by th e issuing bank at any moment and without notification.A revocable credit te nds to be less favorable to the seller than an irrevocable credit because it off ers little security to the seller, therefore a revocable credit is generally unacc eptable and rarely used.

2） Irrevocable credit （不可撤销信用证）

An irrevocable credit is a credit which constitutes a definite undertakin g of the issuing bank and can be amended or cancelled by the issuing bank only on condition that all parties concerned, that is, the issuing bank, the be neficiary and the confirming bank, if any, do agree.This credit gives the ben

eficiary greater assurance of payment.As a result, this type of credit is the most widely used one in international trade.

UCP600 Art.3 provides“A credit is irrevocable even if there is no indication to that effect”.The UCP600 does not contain any reference to the issuing or handling of revocable credits due to the minimal usage of revocable today.

(3) According to the adding of confirmation

1） Confirmed credit （保兑信用证）

A confirmed credit is a credit which is advised to the beneficiary with another bank’s confirmation added thereto.In cases where the financial conditions in the importing country and/or the solvency （偿付能力） of the issuing bank are in doubt， the seller may demand that another bank， preferable in the exporting country， should undertake to honor by adding its confirmation which means a definite undertaking of the confirming bank， in addition to that of the issuing bank， to honor or negotiate a complying presentation.In this way， the seller is assured that payment will be made by the confirming bank no matter the issuing bank is insolvent or not.Only the issuing bank can request another bank to add its confirmation.

The confirming bank usually adds on the credit such words as“This credit is confirmed by us.” or“We hereby add our confirmation to this credit” and then signs thereon.The confirming bank is also irrevocably bound to honor or negotiate as of the time it adds its confirmation to the credit.

2） Unconfirmed credit （非保兑信用证）

A letter of credit advised to the beneficiary without adding any other bank’s confirmation is called an unconfirmed credit.Usually the word“unconfirmed” is not indicated in the credit.

(4) According to the time of payment

1） Sight credit （即期信用证）

A letter of credit calling for （要求） the presentation of sight drafts is a sight credit， under which the beneficiary （the drawer） is entitled to r

eceive payment at once on presentation of his draft to the drawee bank or to the issuing bank if drawn on the issuing bank， once the relevant documents have been checked and found to be in order.

Sometimes the sight credit bears a T/T[6]reimbursement clause （电报索偿条款）.This clause means the negotiating bank is authorized to request by cable， telex or SWIFT to the issuing/confirming/reimbursing bank to make reimbursement.After verifying the documents， the negotiating bank will notify the opening bank of its confirmation of receipt of compliant documents and claim reimbursement.On receipt of claim from the negotiating bank， the issuing/confirming/reimbursing bank will reimburse to the negotiating bank （even before receipt of original documents）.This mode is much faster.In normal course， the opening bank will release payment to the negotiating bank only after they receive the documents and verify them （for which the UCP provides 5 banking days）.This takes much more time as compared to T/T reimbursement clause.

2） Usance or time credit （远期信用证）

If a letter of credit specifies that drafts are to be drawn at any length of time, such as 30 days, 60 days, 90 days or 120 days, after sight, it is called a usance or time credit.Under such credit, the drafts may be drawn on and accepted by the opening bank, or the paying bank as indicated therein.In this case, the seller issues his draft, presents it for acceptance, together with all the shipping documents, to the issuing bank or the confirming bank or the paying bank,as stipulated in the credit.Once the draft is accepted, this means that the accepting bank promises to pay the full amount of the draft at a specified future date.The accepted usance draft can be discounted in the discount market.Usance credit may require no drafts at all.

（5） According to the ways of availability （兑用方式）

The primary function of a letter of credit is to provide payment security for an international trade transaction coupled with the opportunity for banks to provide financing thereunder （据此）.UCP600 Art.6 has specific rules as to how credits can be made available with banks to facilitate payment and permit financing.

A credit must state the bank with which it is available (nominated bank) or whether it is available with any bank.A credit available with a nominated bank is also available with the issuing bank.If a credit is available with a nominated bank, the presentation of documents will typically be made to that nominated bank, however, documents may be presented directly to an issuing bank.

A credit must also state whether it is available by sight payment, deferred payment,acceptance or negotiation.

1） Sight payment credit （即期付款信用证） （draft is optional）

A sight payment credit is a credit available by sight payment.Under this credit, the nominated bank, acted on its nomination, the confirming bank, if any or the issuing bank is authorized to pay at sight upon receiving a complying presentation (with or without a draft)under the credit by payment at sight.“Available with ××× Bank by payment at sight” is stipulated in the sight payment credit.

2） Deferred payment credit （延期付款信用证） （draft not required）

A deferred payment credit is a credit available by deferred payment.Under this credit，the nominated bank， acted on its nomination， the confirming bank， if any or the issuing bank is authorized to incur （承担） a deferred undertaking and pay at maturity upon receiving a complying presentation.No draft is required for this credit.Provisions like“Available by deferred payment” are stipulated in the deferred payment credit.

3） Acceptance credit （承兑信用证） （ time draft required）

An acceptance credit is a credit available by acceptance.Under this credit, the nominated bank, acted on its nomination, the confirming bank, if any or the issuing bank is authorized to accept the time draft and pays at maturity.The clause used in the credit is as follows:“This credit is available by acceptance of draft drawn on ×× bank.”

By accepting the draft under the credit， the accepting bank signifies （表示……意思） its commitment to pay the face value thereof （其中）

at maturity.The beneficiary may discount the accepted draft with its own bank or in local money market if he wishes to get paid immediately.However， sometimes for the purpose of facilitating financing， or taking advantage of the banker's accepted draft to obtain financing at a favorable discount rate which is normally lower than the commercial credit rate， the buyer may apply for an acceptance credit while stipulating sight payment in the contract between him and the seller.The credit usually states"The usance draft is payable on a sight basis， discount charges and acceptance commission are for buyer's account." Since the discount charges and acceptance commission are borne by the buyer， such a credit is called"buyer's usance credit".[7] It is also known as"fake usance credit".Under this credit， the beneficiary can get full sight payment.Meanwhile， he takes risks of being demanded for payment if the usance draft is dishonored at maturity.

4） Negotiation credit （议付信用证） （draft is optional）

A negotiation credit is a credit under which a nominated bank is authorized to negotiate or a credit which is freely negotiable by any bank.A credit treated as negotiable is either a sight credit or a time credit, calling drafts to be drawn on the issuing bank or on any other drawee bank.A negotiation credit assures any bank negotiating the drafts thereunder that it will be duly honored by the opening bank provided all the terms stipulated therein are complied with.

(6) Other credits

There are numerous special letters of credit designed to meet specific needs of buyers,suppliers and intermediaries.Special credits usually involve increased participation by banks,so financing and service charges are higher than those for basic credits.The following is a brief description of some special credits.

1） Revolving credit （循环信用证）

This is a type of credit that renews （复原） itself after its amount is drawn （获取）.To define it more clearly， it is a credit where， under the terms and conditions thereof， its amount is renewed or reinstated （恢

复） without any specific amendment made thereto.To facilitate continuous repeated purchases from the same supplier， a revolving credit is often use d.So far as this type of credit is concerned， the opening bank issues only o ne letter with a fixed amount available for each defined calendar period.The delivery of the goods is made in instalments and at stipulated intervals （间隔时间）.When the drawing is made by the beneficiary the original credit a mount becomes again available for the next period.

There are the following different ways of revolving:

■ Automatic revolving: The total amount of the credit shall be restored automatically when the drawing is made by the beneficiary.

■ Semi-automatic revolving: The total amount of the credit shall be res tored if the negotiating bank is not advised of stopping renewal within a cert ain period of time after each negotiation.

■ Non-automatic revolving: The total amount of the credit shall be rest ored only upon receipt of issuing bank’s notice stating that the credit might be renewed.

2） Transferable credit （可转让信用证）

A transferable credit is a credit that specifically states it is“transferabl e”.This credit allows the beneficiary (“first beneficiary”) to transfer all or p art of the proceeds of the credit to a second beneficiary.Unless otherwise sti pulated in the credit, the second beneficiary cannot transfer the L/C to any s ubsequent third beneficiary.The second beneficiary can retransfer the L/C to the first beneficiary.Unless otherwise agreed between the first and second b eneficiary,the first beneficiary (the exporter) must pay the transferring bank charges (including commissions, fees, costs, or expenses) in respect to a lett er of credit transfer.

The credit can be transferred only on the terms and conditions stipulate d in the original L/C， except with the following which may be reduced or curtailed （缩短）： L/C amount， unit price， expiry date， period for presentation and shipping date.

In practice, the first beneficiary (usually the middleman) returns the original credit to the transferring bank with a covering letter requesting the transfer.The bank then advises the second beneficiary (usually the actual supplier of the goods) of the terms of transfer through a transferred credit[8] in favor of the second beneficiary.The second beneficiary then acquires two rights: authority to perform the terms and conditions of the transferred credit instead of those terms having to be performed by the first beneficiary; and the right to obtain payment if the terms and conditions of the credit are satisfied. The second beneficiary effectively substitutes for the first beneficiary in respect of the transferred part of the credit and the bank accepts the performance by the second beneficiary instead of the first beneficiary.

The first beneficiary has the right to substitute its own invoice and draft for those of the second beneficiary for an amount not in excess of that stipulated in the credit, and upon such substitution, the first beneficiary can draw under the credit for the difference between its invoice and the invoice of a second beneficiary.Figure 15-5 shows how the transferable credit works.

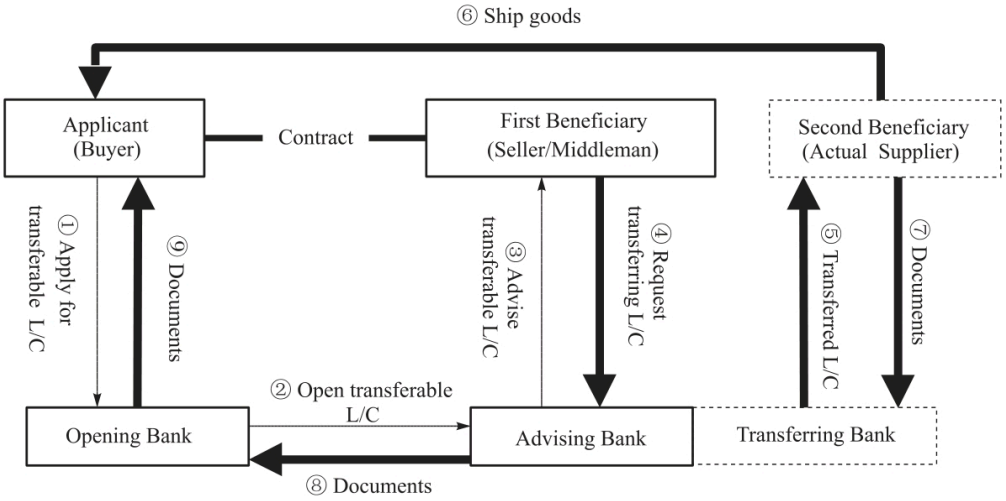



Figure 15-5 Transferable L/C flow diagram

3） Back-to-back credit （背对背信用证）

Back-to-back credit is a letter of credit opened on the basis of an already existing， nontransferable credit （first L/C or original L/C）.In practice， the middleman receives a letter of credit from the ultimate buyer （the

applicant of the first L/C） and then requests a bank（usually the advising bank） to open another letter of credit in favor of the actual supplier.The ap plicant （actual supplier） is the beneficiary of the second L/C.The first let ter of credit is used as collateral （附属担保品） for the second credit.The second credit makes price adjustments from which come the middleman's p rofits.

In contrast to a transferable letter of credit, permission of the ultimate buyer or that of the issuing bank, is not required in a back-to-back L/C.It is used mainly by middlemen(intermediaries) to hide the identity of the actual supplier or manufacturer.The middleman is responsible for paying the secon d L/C regardless of receipt of payment under the first L/C (see Figure 15-6).

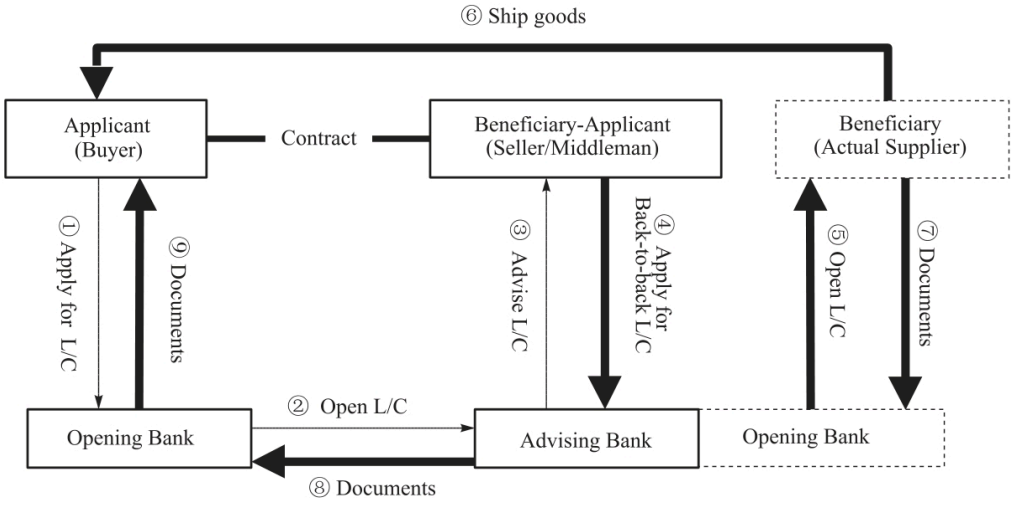



Figure 15-6　Back-to-back L/C flow diagram

The difference between back-to-back credit and transferable credit, is t hat in a transferable credit, the rights under the existing credit are transferre d.In a back-to-back transaction, different letters of credit are actually issued.

4） Red clause credit （红条款信用证）

Often a seller does not have the funds to produce products to fill curren t orders.A letter of credit may have already been issued by the buyer in antic ipation of goods being exported.If allowed by the terms of the letter of credi t， the seller may draw upon the letter to obtain funds to produce goods.On ce the goods are delivered， the seller may then submit the proper documen

ts to obtain the balance of the letter of credit.This type of interim （暂时的） financing is referred to as coming from a“Red Clause Letter of Credit”.

It is normally used only where the buyer and seller have close working relationship because, in effect, the buyer is extending an unsecured loan to the seller (bears the financial risk and the currency risk).

The red clause credit was originally used by sheep farmers in Australia who faced the high cost of shipping their sheep from the Australian interior （内陆） to the load port on the coast.By drawing the advance funds from the letter of credit， they were able to finance this part of the shipment and allow the sheep to be exported.The reason it is called a red clause letter of credit is simply that， originally， the clause relating to the advance funds was written in red ink.

5） Standby credit （备用信用证）

This credit is primarily a substitute for a performance bond （履约保函） or payment guarantee.It is used primarily in the United States because U.S.banks are prevented by law from giving certain guarantees.Standby credits are often called non-performing letters of credit because they are only used as a backup payment method if the collection on a primary payment method is past due.Standby credit can be used to guarantee repayment of loans，fulfilled by subcontractor （分包商）， securing the payment for goods delivered by third parties.For example， an organization is seeking to bid （投标） on the construction of a dam in another country.Generally， bids on such projects require a good faith guarantee on the part of the bidder to assure the bid will be accepted if granted and that work will be done on time and in a workmanlike （工作熟练的） manner.

Ten percent of the bid amount is not uncommon.One of the methods of securing this guarantee is to obtain a standby letter of credit in favor of the government of the foreign country.If the bidder defaults, the foreign government is paid from the letter of credit.The bank issuing the letter then has recourse against the bidding company.

6) SWIFT credit

A SWIFT credit refers to the credit sent in SWIFT form.Letters of cred it may be sent by mail， by cable or by tested telex， usually in a free form at.At present， SWIFT is increasingly replacing other forms of transmissio n.A SWIFT credit indicates the issuing bank at the top （“received from”） and has tags （标识） at the left for specific information such as：

- 40 A: Form of Documentary Credit
- 20: Documentary Credit Number
- 31C: Date of Issue
- 31D: Date and Place of Expiry
- 51a: Applicant Bank
- 50: Applicant
- 59: Beneficiary
- 32A: Currency Code, Amount
- 39A: Percentage Credit Amount Tolerance
- 39B: Maximum Credit Amount

## 15.4 Banker’s Letter of Guarantee

In international trade， each party of the contract wants to be ensured t hat the other party is in a position to honor its commitment as contracted.Su ch security may be obtained through banks in the form of letter of guarante e.A banker’s letter of guarantee （银行保函） （L/G） or bond is a contra ct by which a bank （the guarantor） agrees to pay another’s debt or to perf orm another’s obligation only if that other individual or legal entity fails to pay or perform.A banker’s letter of guarantee is usually a separate contract f rom the principal agreement， therefore it is secondarily liable to the third person.

# 1.Parties to banker’s letter of guarantee

1） Principal （委托人）.The principal is the person who applies for the issuance of L/G.For instance， in loan guarantee， the principal is the borrower.

2） Guarantor （保证人）.The guarantor is a bank or a financial institution which issues a letter of guarantee undertaking to make payments to the beneficiary in the event of non-performance of a contract by the principal.

3） Beneficiary （受益人）.The beneficiary is the person in whose favor the guarantee is issued.For example， in import guarantee， the beneficiary is the seller.He will obtain a certain sum of money if the principal fails to fulfil its obligations.

# 2.Types of banker’s letter of guarantee

The main types of banker’s letter of guarantee are tender guarantee （投标保函） and performance guarantee （履约保函）.

(1) Tender guarantee (tender bond or bid bond)

A tender guarantee is a guarantee issued by a bank or a financial institution (the guarantor) at the request of a tenderer (the principal) in favor of a party inviting tenders abroad (the beneficiary), whereby the guarantor undertakes, in the event of default by the principal in the obligations resulting from the submission of tender, to make payment to the beneficiary within the limits of a stated sum of money.As a rule, the guaranteed amount is 1％～5％ of the amount offered.The period of validity is usually between three and six months until the signing of the contract or issuing of a performance bond (see“A sample tender guarantee”).

A sample tender guarantee

Tender Guarantee

To: EUROCO Tendering Corporation Date: Sept. 4th, 2007, Tender Guarantee No.02090001

Re: Tender guarantee for Tender No.EUROCO 67890

This guarantee is hereby issued to serve as the tender guarantee of Ruby Electronics Inc., PO Box 456, Grain Valley, Missouri 46029 USA (hereinafter called the tenderer) for Tender No.EUROCO 67890 for supply of HB Detection Equipment to Euroco, Ningbo, China.

The Bank of China, Beijing, hereby unconditionally and irrevocably guarantees and binds itself to pay you immediately without recourse, the sum of Japanese Yen … upon receipt of your written notification stating any of following effects:

1. The Tenderer has withdrawn its tender after submission of the Tender and before the expiration of its validity period, or

2. The Tenderer has failed to enter into contract with you after notification of contract awards, or

3. The Tenderer as successful tenderer has failed to establish acceptable performance bond(s) within fourteen (14) calendar days after the effective date of the contract.

It is fully understood that this guarantee takes effect from its issuing date and shall remain valid until Jan. 5, 2008 and during the period of any extension thereof that may be agreed upon between you and the Tenderer with notice to the surety, unless sooner terminated and/or released by you.

Notwithstanding anything to the contrary, if the Tenderer is awarded the contract, this guarantee shall remain in full force and effect after expiration of the above-mentioned period until the Tenderer shall have entered into contract with you and furnished the necessary performance bond.

Sincerely,

(2) Performance guarantee or performance bond

A performance guarantee is a letter of guarantee issued by a bank or a f inancial institution(the guarantor) at the request of one party of a contract (t he principal) to another party of a contract (the beneficiary), whereby the gu arantor guarantees, in the event of the principal’s failure to perform the cont ract in compliance with its terms, to make payment to the beneficiary within

the limits of a stated sum of money.The guaranteed amount is usually 10％of the contract amount.The bond remains valid for the full amount until complete performance of the contract.

The following are abstracts of two performance letters of guarantee in international sales of goods:

1) Abstracts of an import L/G to a Chinese seller by a foreign bank at the request of a foreign buyer

"...We upon receipt of your statement, certifying that buyer failed to fulfill any of the said contract terms and specifying the fixed amount to be claimed, accompanied by the certificate issued by the Bank of China, Shanghai, stating that seller's statement is true and genuine, shall immediately remit the amount to your account with Bank of China, Shanghai."

2) Abstracts of an export L/G to foreign buyer by the Bank of China at the request of a Chinese seller

"At the request of ××× (hereinafter referred to as the Seller) and in consideration of your agreeing to pay to the Seller, in accordance with the contract signed by you (hereinafter referred to as the Buyer) and the Seller, the price for the ship in instalments before delivery of the ship, we, the Bank of China, hereby guarantee to repay you upon your demand all or part of the aforesaid instalments with interest if and when the aforesaid instalments become repayable to you and the Seller fails to effect the repayment as required by the contract stipulation."

The second type of performance guarantee is also described as repayment （还款）guarantee.In practice， in addition to the above mentioned types of guarantees， there are also guarantees for repayment of money borrowed by the account party， for payment due under a lease， and for deferred payment of equipment under a project， etc.

## 3.Differences between letter of guarantee and letter of credit

1) In terms of the issuing bank's liability, the issuing bank of a letter of credit is primarily liable to the beneficiary, no matter whether the applicant i s in default or not;whereas under a letter of guarantee, the issuing bank is lia ble only if the principal fails to fulfill its obligations.[9]

2) The letter of credit is used in the condition that the international sale s contract of goods are smoothly performed.The seller (beneficiary) is assur ed to get payment if his/her documents are in conformity with the credit.Th e letter of guarantee, however, is used only in the event of non-performance of a contract by the principal.

3) As far as the basis for payment is concerned, the documentary letter of credit calls for documents which are in conformity with the credit and ha s no relevance with the sales contract.But under a letter of guarantee, when t he beneficiary makes claim for payment with the guarantor, the latter usuall y needs to verify that its principal actually breaches the contract and refuses to make reimbursement.Thus the guarantor is usually involved in the disput es of parties to the contract.

## 15.5 Terms of Payment in the Contract

### 1.Payment by remittance

The following are examples of terms of payment by remittance.

1)"The Buyer shall pay the total value to the Seller in advance by T/T (M/T or D/D) not later than June 30, 2008."

2)"Payment by T/T: Payment to be effected by the Buyer shall not be l ater than 30 days after receipt of the documents listed in the contract."

### 2.Payment by collection

The following are examples of terms of payment by collection.

1) Payment by D/P at sight

“Upon first presentation, the Buyer shall pay against documentary draf t drawn by the Seller at sight.The shipping documents are to be delivered ag ainst payment only.”

2) Payment by D/P after sight

“The Buyer shall duly accept the documentary draft drawn by the Selle r at 60 days sight upon first presentation and make payment on its maturity. The shipping documents are to be delivered against payment only.”

3) Payment by D/A

“The Buyer shall duly accept the documentary draft drawn by the Selle r at 90 days sight upon first presentation and make payment on its maturity. The shipping documents are to be delivered against acceptance.”

If long business relationship has been established and customary practi ces have been adopted between the buyer and seller, the terms of payment b y collection may be simplified,like“D/P at sight”,“D/P ×× days after sight” or“D/A at ×× days’ sight”, etc.

## 3.Payment by letter of credit

When payment is made by letter of credit, conditions such as time of o pening credit,issuing bank, beneficiary, type, amount and expiry date of L/ C, etc.are usually clearly stipulated.

For example,“The Buyers shall open through a bank acceptable to the Sellers an Irrevocable Letter of Credit at 30 days’ sight to reach the Sellers ×× days before the month of shipment, valid for negotiation in Shanghai unt il the 15th day after the month of shipment.”

Like the terms of payment by collection, the terms of payment by letter of credit may also be simplified as“Payment by Irrevocable Sight Credit”, o r“By Irrevocable Credit at 30 days’sight”.

[1]SWIFT is a bank group established in Brussels in May 1973 and has set-up global standards for se nding and receiving authenticated instructions for wire transfers and letters of credit.SWIFT also mea ns a highly sophisticated message switching or communication system.The SWIFT system operates 2 4 hours per day， seven days a week， delivering a very high level of online performance to its mem bers.See http：//www.swift.com for more information.

[2]A sale arrangement whereby the exporter （consignor） delivers the merchandise to an agent （c onsignee） under an agreement that the agent will sell it for the account of the exporter.Under this ki nd of arrangement， the consignor/exporter retains title to the goods until they are sold， while the c onsignee/agent sells the goods in exchange for a commission and remits the net proceeds to the consi gnor.

[3]Letters of credit usage by geographic region: European Union 9％, Rest of Europe 20％, North A merica 11％, Latin America 27％,Middle East 52％, Asia Pacific 43％, Africa 49％, Asia 46％, Aust. & New Zealand 17％.(Source: http://www.sitpro.org.uk/reports/ lettcredr/lettcredr.pdf)

[4]Nominated bank means the bank with which the credit is available or any bank in the case of a cre dit available with any bank（UCP 600 Art.2）.

[5]See：“Classification of letters of credit” in this section for the definition of documentary credit.

[6]T/T simply means“Telegraphic transfer” （or in some cases“tested telex”）.

[7]Under an ordinary acceptance credit， the discount charges and acceptance commission is for the seller’s account.Thus， such a credit is also called“seller’s usance credit”.In China， it is also know n as“real usance credit”.

[8]A transferred credit differs from a transferable credit in that a tranferable credit is the letter of cred it that was transferred or made available to the second beneficiary.

[9]In practice, some letters of guarantee state that the beneficiary asks the guarantor to make payment first.In this case, the issuing bank undertakes the primary liability.Thus whether the guarantor is prim arily liable to the beneficiary depends on the terms.

# Chapter 16　Inspection, Claim, Force Majeure and Arbitration

Learning Objectives

In this chapter, you will learn:

- Inspection clause in the contract
- Liabilities of breach of contract
- Claim clause in the contract
- Consequences of force majeure
- Arbitration agreement

In international trade, it is ideal that the seller delivers the goods conforming to the contract in respect of quality, specification, quantity and packing, and hands over the documents concerning the goods at the right time and place stipulated in the contract.On the other hand, the buyer makes payment for the goods and takes delivery of them in the same manner specified in the contract.However, there always exists a gap between ideal and reality.Complaints or claims, sometimes, still arise in spite of well planned and careful work in the performance of a contract.In practice, it is not uncommon that the seller or the buyer neglects or fails to perform any of his obligations, thus giving rise to breach of contract and various trade disputes, which, subsequently, leads to claim, arbitration, or even litigation.

In order to avoid disputes or properly handle with their consequences， some preventive（预防性的） clauses such as commodity inspection（商品检验） clause， matters of claim （索赔事务）， force majeure（不可抗力） and arbitration （仲裁） are usually stipulated in the contract.

# 16.1 Commodity Inspection

Commodity inspection refers to the examination of goods to determine if the goods are in proper quantity and condition, and if they conform to the applicable or specified requirements.

## 1.Importance of commodity inspection

Commodity inspection is an indispensable （必不可少的） part in the transfer of the goods.When the seller makes delivery of the goods， the buyer， unless otherwise agreed， is entitled to request that he be given a reasonable opportunity of examining the goods for the purpose of ascertaining whether they are in conformity with the contract.A buyer who has not previously examined the goods is not deemed to have accepted them and， consequently， has not lost his right to reject them unless and until he has had a reasonable opportunity of examining them.

Inspection may be made by the contracting parties themselves.But on most occasions， as the seller does not transfer the goods to the buyer in person， inspection by authoritative，impartial （公正的） inspection bodies （机构） is required.The certificates issued by these bodies serve as proofs for transferring the goods， lodging （索赔） and settling claims （理赔）.

## 2.Time and places of commodity inspection

(1) Provisions in the CISG

The CISG provides that except where the parties have agreed otherwise, the buyer has the right to inspect the goods.CISG Art.38 stipulates the time and place of inspection as follows:

1) The buyer must examine the goods, or cause them to be examined, within as short a period as is practicable in the circumstances.

2) If the contract involves carriage of the goods, examination may be deferred until after the goods have arrived at their destination.

3) If the goods are redirected in transit or re-dispatched by the buyer without a reasonable opportunity for examination by him and at the time of the conclusion of the contract the seller knew or ought to have known of the possibility of such redirection or re-dispatch, examination may be deferred until after the goods have arrived at the new destination.

(2) Three ways of stipulating the time and place of inspection in the contract

In practice, the buyer and the seller may stipulate the time and place in the contract in the following three ways.

1） Shipping quality， weight or quantity as final （以离岸品质、重量或数量为准）

This means that inspection of quality， weight or quantity at the seller's factory or at the port of shipment is final.The buyer can re-inspect the goods at the port of destination， but normally it cannot claim for loss of or damage to the goods.Thus the buyer's right of inspection is actually excluded and it is detrimental （损害的） to the buyer.

2） Landing quality， weight or quantity as final （以到岸品质、重量或数量为准）

This means inspection carried out at the port of destination is final.This arrangement is favorable to the buyer.

3） Inspection at the port of shipment and re-inspection at the port of destination （在装运港检验，在目的港复验）

Under this method, the certificate of inspection at the port of shipment is the basis for collecting payment while the buyer retains the right to re-inspect and claim against the seller if the unconformities are due to the seller's liability.This method is popular in international trade as it is fair to both contracting parties.

# 3.Commodity inspection body

There are mainly two types of inspection body： governmental and non-governmental.Governmental inspection refers to the inspection made by organizations of or pertaining （与……有关系的） to the government bodies such as General Administration of Quality Supervision， Inspection and Quarantine of the People's Republic of China （AQSIQ）[1] in China and the Food and Drugs Administration （FDA） （美国食品药物管理局） in the USA which specializes in inspection of particular merchandise （grain， drug， etc.）.International commodity inspection is， however， mainly undertaken by non-governmental bodies which have the same legal status as notary organizations.The notable bodies are Societe Generale De Surveillance S.A.（SGS）（瑞士日内瓦通用鉴定公司） in Geneva， Swiss， Underwriters Laboratory （UL） （美国保险人实验室） in the USA， Lloyd Surveyor， B.V.（英国劳合氏公证行） in Britain and Japan Marine Surveyor & Sworn Measurer's Association （NKKK） （日本海事鉴定协会）， etc.

According to the Law of the People's Republic of China on Import and Export Commodity Inspection[2] (the Law) and the Regulations for the Implementation of the Law of the People's Republic of China on Import and Export Inspection (the Regulations), the State Commodity Inspection Authorities (of China) are in charge of the inspection of import and export commodities throughout the country.Their basic tasks are as follows.

（1） Statutory inspection （法定检验） on import and export

Statutory inspection refers to the compulsory inspection required by laws of a specific country and is applied to those commodities which involve social and public interests.In the light of the need in the development of foreign trade， the state inspection agency formulates，adjusts and publishes a List of Import and Export Commodities Subject to Inspection Enforced by the Commodities Inspection Authorities （the List）.The List varies with the development of foreign trade.For example， the List adopted on July 1， 1995， involves 18 categories， covering 2012 commodity codes wide

ly used in Harmonized Description and Coding System.The statutory inspection on imports and exports includes the following items： 1） inspection of import and export commodities included in the List of Commodities； 2） hygiene （卫生）inspection on the foods for export； 3） testing and inspection on the performance and employment of the packages and containers for dangerous export goods； 4） cargo worthiness inspection （适载检验） on such means of transportation as vessels' holds and containers for carrying perishable foods and frozen goods for export； 5） inspection of imports and exports to be conducted by the commodity inspection authorities according to relevant international treaties； 6） inspection of imports and exports to be carried out by the commodity inspection authorities as stipulated in other laws and administrative regulations.

（2） Survey （鉴定） of import and export commodities

The State Inspection Authorities and their designated or approved inspection agencies may accept the entrustment （委托） of the international trade interested parties， relevant units in China and abroad or foreign inspection agencies for surveying services of import and export commodities within the specified scope and may issue certificates of survey.The commonly issued inspection certificates are Inspection Certificate of Quality， Inspection Certificate of Weight， Inspection Certificate of Quantity， Inspection Certificate of Health， Inspection Certificate of Origin， Inspection Certificate of Value， Inspection Certificate on Damaged Cargo，and Disinfection （消毒） Inspection Certificate.

（3） Supervision and control （监督和管理）

This Law and the Regulations hold that the State Commodity Inspection Authorities exercise supervision and control over the inspection conducted by the inspection agencies and personnel designated or accredited （受委托的） by the consignees， consignors， manufacturers，trading units， storage and transport units of the import and export commodities.The principal measures of supervision and control include：

1) System of import safety license and export quality license.No import commodities subject to the import safety license system shall be allowed f

or import unless they have been granted an import safety license by the Stat e Commodity Inspection Authorities.No export commodities subject to the export quality license system shall be allowed for export unless they have b een granted an export license.

2) Hygiene registration system.Manufacturers of foods for export whic h are subject to a hygiene registration system shall apply to the commodity i nspection authorities for hygiene registration; they shall not be allowed to p roduce, process or store foods for export unless they have obtained the appr oval from the State Commodity Inspection Authorities.

3) Quality certification marks.The State Commodity Inspection Author ities shall conclude quality certification agreement on import and export co mmodities with relevant foreign bodies and shall conduct quality certificati on for import and export commodities according to the relevant agreements or upon entrustment by relevant foreign bodies.For those import and export commodities and their manufacturers which are found qualified through cer tification, due certificates shall be issued, and the use of quality certification marks for import and export commodities shall be allowed.

4） Commodity inspection marks.The commodity inspection authoriti es may affix （贴上）commodity inspection marks on the import and expo rt commodities found up to standard through inspection； and carry out the sealing for the import and export commodities found up to the standard or t hose must be sealed.

## 4.Commodity inspection standards

Inspection on import and export commodities performed by the comm odity inspection authorities shall cover quality, specifications, quantity, wei ght, packing and the requirements for safety and hygiene.The commodity in spection authorities shall conduct inspection according to the following stan dards:

1） If the compulsory （强制性的） standards or other inspection sta ndards which must be complied with are specified by laws or administrative

regulations， the inspection shall be performed according to the standards as specified by laws and administrative regulations；

2) In cases the compulsory standards or other inspection standards which must be complied with as specified by laws or administrative regulations are lower than the standards agreed upon in the international trade contract, the inspection shall be conducted according to the standards agreed upon in the international trade contract.If the trade is conducted against the sample, the inspection shall be performed simultaneously according to the sample provided;and

3) In the absence of compulsory standards or other inspection standards which must be complied with as specified by laws and administrative regulations, and in case inspection standards are either not agreed upon or agreed upon unclearly in the contract, the inspection shall be conducted according to the standards of the manufacturing country, or relevant international standards or the standards designated by the state inspection agency.

## 5.Commodity inspection clause in the contract

Inspection clause in the contract usually covers the following aspects: the types of inspection certificate required, the inspection body, the time and place of inspection, etc.The following is an example:

“It is mutually agreed that the Inspection Certificate of Quality and Quantity (weight)issued by the Manufacturer (or ××× Surveyor) at the port of shipment shall be part of the documents to be presented for negotiation under the relevant L/C.The Buyers shall have the right to re-inspect the quality and quantity (weight) of the cargo.The re-inspection fee shall be borne by the Buyers.”

# 16.2 Claim

Claim means legal demand or assertion （声明，主张） by a claiman t （索赔人） for compensation， payment， or reimbursement for a loss u nder a contract， or an injury due to negligence.Claims with regard to perfo rmance of sales contract arise mainly because of the breach of contract by t he relevant parties.

# 1.Liabilities of breach of contract

（1） Implication of breach of contract （违约）

Breach of contract means contracting party's actual failure or refusal to perform (or a clear indication of its intentions to not perform) its obligations under the contract without a legitimate legal excuse.

A seller may be in breach of a contract when:

■ he fails to deliver the goods;

■ he fails to make delivery according to shipment date stipulated in the contract;

■ he delivers the goods that are not in accordance with the contract in r espect of quality,specifications, quantity and packing, etc.;

■ he presents shipping documents that are incomplete and inadequate.

A buyer may be in breach of a contract where

■ under an L/C, he fails to open the relevant L/C according to the stipu lated period;

■ he wrongly refuses to accept the goods;

■ under FOB, he fails to dispatch the vessel according to the stipulatio ns of the contract.

(2) Liabilities of breach of contract

Since international trade contract has a legal binding force （法律约束力） upon the contracting parties， any party who has violated the contr act shall be legally held responsible for the breach， and the aggrieved part

y（受害方） can exercise his right to claim damages against the opposite party.What liabilities should the party in breach take？ This may depend on the nature of breach of contract.How to determine the nature of breach of co ntract，however， differs in laws from country to country and international practices.

The laws of some countries， like Britain， stipulate that if any party to a contract violates the substantive（重大的） clauses， the breach is ca lled“breach of condition”（违反要件）.Conditions are terms of contract t o which the parties， when making the contract， attach such importance t hat it can truly be described as being of the essence（精髓） of the contrac t.It goes to the root of the contract.For example， the quality and quantity o f the goods delivered by the seller don’t conform to stipulations of contrac t， or the goods are not delivered according to the stipulated date in the con tract， etc.In such cases， the aggrieved party is entitled to discharge（终 止） the contract and raise claim against the other party.This means that it n eeds to do nothing further on the contract， and of course has the right to su e for breach of contract if he so wishes.If the violated clauses are minor one s， such a breach is called“breach of warranty（违反担保）”.Warranties are terms of the contract which are not vital to the overall contract.But if the y are broken， the aggrieved party is only entitled to compensation for brea ch of warranty but will not lead to the aggrieved party regarding the contrac t as discharged（解除） by breach.For instance， the buyer does not make payment on the stipulated date， the seller can perhaps sue the buyer for de laying the payment， but cannot discharge the contract.

Whether a term in the contract is a condition or a warranty depends up on the statements made by the parties concerned at the time.If it is made cle ar by one party that he regards a particular term as vital, it will usually be re garded as a condition of the contract.

The CISG classifies“breach” into“fundamental breach”（根本性违 约） and“non-fundamental breach”（非根本性违约）.A fundamental bre ach permits the aggrieved party to terminate performance of the contract， i n addition to entitling that party to sue for damages while non-fundamental breach entitles the aggrieved party to sue for damages only.

A breach of contract committed by one of the parties is fundamental if it results in such detriment （损害） to the other party as substantially （实质上） to deprive （剥夺） him of what he is entitled to expect under the contract， unless the party in breach did not foresee and a reasonable person of the same kind in the same circumstances would not have foreseen such a result[3].

## 2.Claim clause in the contract

Since the interpretations and stipulations for breach of contract and its consequences differ in laws from country to country or international practices, it is important and necessary for us to get familiar with them.Only in this way can we stipulate the claim clauses in import or export contracts properly and execute them smoothly in practice.

（1） Discrepancy and claim clause （异议和索赔条款）

Discrepancy and claim clause are usually stipulated to guard against that the quality or package of the goods delivered by the seller do not conform to the contract.In addition to stipulating that if any party breaks a contract, the other party is entitled to lodge claim against the party in breach, discrepancy and claim clause also includes other items, for instance, proofs presented when lodging a claim, the amount of money claimed and effective period for filing a claim, etc.

Proofs to be presented when lodging a claim should be complete and clear, and the authority should be competent for issuing the relevant certificate.Otherwise, the claims can be refused by the other party.Proofs include lodging proofs and fact proofs.The former refers to the sales contract and the relevant governing laws and regulations, and the latter refers to the facts and the relevant written evidence in respect of the breach.

Period for claim refers to the effective period within which the claimant can make a claim against the party in breach.Claims beyond the agreed effective period can be refused by the party in breach.Therefore, claim period should be reasonably fixed.Generally speaking, a period that is too long ma

y put the seller under heavy responsibility and a period that is too short may make it impossible for the buyer to file a claim.What's more, a detailed stip ulation in respect of the starting date for making a claim should also be incl uded in the clause.

The following is a typical example of discrepancy and claim clause in a contract:

"In case discrepancy on the quality of the goods is found by the Buyers after arrival of the goods at the port of destination, claim may be lodged aga inst the Sellers within 30 days after arrival of the goods at the port of destin ation being supported by Inspection Certificate issued by a reputable public surveyor."

In all circumstances, the carrier and the ship shall be discharged from a ll liabilities in respect of loss or damage unless suit is brought within one ye ar after delivery of the goods or the date when the goods should have been d elivered.

（2） Penalty clause （罚金条款）

Most of the contracts concerning the sale of general goods contain onl y the"discrepancy and claim" clause， but contract for bulk commodities or machines and equipment will include not only"discrepancy and claim" clau se but also"penalty" clause.Clause in respect of penalty in a contract should stipulate that"any party who fails to perform the contract shall pay an agree d amount as penalty for compensating the other party for the damages".Pen alty clause is fixed where the seller fails to make timely delivery； the buye r fails to open the relevant L/C or the buyer fails to take delivery on time.Th e penalty ceiling （上限） is also included in the contract.Two examples of penalty clause in a contract are shown below.

1) Penalty clause regarding the Seller's delay in delivery

"Should the Sellers fail to make delivery on time as stipulated in the co ntract， the Buyers shall agree to postpone the delivery on condition that th e Sellers agree to pay a penalty which shall be deducted by the paying bank from the payment under negotiation， or by the Buyers direct at the time of

payment.The rate of penalty is charged at 0.5％ of the total value of the goo ds whose delivery has been delayed for every seven days， odd （零碎 的） days less than seven days should be counted as seven days.But the tot al amount of penalty， however， shall not exceed 5％ of the total value of the goods involved in the late delivery.In case the Sellers fail to make delive ry ten weeks later than the time of shipment stipulated in the contract， the Buyers shall have the right to cancel the contract and the Sellers， in spite of the cancellation，shall still pay the aforesaid penalty to the Buyers witho ut delay.”

2) Penalty clause regarding the Buyer’s delay in opening of L/C

“Should the Buyers for its own sake fail to open the letter of credit on t ime stipulated in the contract， the Buyers shall pay a penalty to the Seller s.The penalty shall be charged at the rate of 0.5％ of the amount of the Lett er of Credit for every ten days of delay in opening the Letter of Credit， ho wever， the penalty shall not exceed 5％ of the total value of the Credit wh ich the Buyers should have opened.Any fractional （零碎的） days less th an ten days shall be deemed to be ten days for the calculation of penalty.The penalty shall be the sole compensation for the damage caused by such dela y.”

# 16.3 Force Majeure

## 1.The meaning of force majeure

As previously noted, if the contracting party fails to perform any of its obligations under the contract, the other party has the right to claim damage s.However, a contracting party who fails to perform any of its contractual o bligations will not be liable if its failure is due to force majeure.

Force majeure （French for“superior force”）， also called irresistibl e force， is an impediment （障碍） beyond the contracting party’s contro l， which the contracting party could not reasonably be expected to have ta

ken into account at the time of concluding the contract or to have avoided o r overcome it or its consequences.

Force majeure is especially relevant in international trade, where many contracts frequently exist over a substantive period.Transactions in internati onal trade also generally imply a greater element of uncertainty, because the y are subject to political and economic influence in foreign countries.

There are different interpretations to force majeure among countries in the world.But in most cases， it refers to those accidents caused by natural phenomena or social factors， such as earthquake， flood， tempest （暴风雪）， war and governmental prohibition of import and export of certain commodities.In order to clarify what the term of force majeure covers under a particular contract， different ways have been adopted.

## 2.The consequences of force majeure

A contract may be suspended （被推迟） or terminated （终止） bec ause of the consequence of a force majeure case.If the performance of contr act is just delayed by a force majeure case temporarily or for a short time， the contract may suspend.After the force majeure accident finishes， the co ntract should resume.For example， if there is a delayed shipment because of industrial strike， the contract will suspend.But when the strike is ove r， the contract should continue and the seller has to go on to ship the good s.If the force majeure accident has damaged or destroyed the basis of the co ntract， for example， the fire has burnt a famous painting by Pablo Picass o， then the contract can be terminated.

## 3.Force majeure clause in the contract

The force majeure clause usually contains:

1) The scope of force majeure events: Since there is still no definite ex planation as to which events should be regarded as force majeure, the seller and the buyer usually stipulate in their contract the scope of force majeure e

vents.Force majeure events include certain natural disasters such as fire, flood, storm, heavy snow, earthquake, etc.and social disturbances like war, strike, sanctions, etc.

2) Time limit of notifying the other party: In case of a force majeure event, the party seeking to use the clause of force majeure has a duty to promptly notify the other party of"the impediment and its effect on his ability of perform".

3） The issuer of the certificate： A force majeure event should be verified by a certificate that attests （证实） such an event.The issuer of the certificate should be mentioned in the clause.

The following is an example of force majeure clause:

"Force majeure： If the shipment of the contracted goods is prevented or delayed in whole or in part by reason of war， earthquake， flood， fire， storm， heavy snow or other causes of Force Majeure， the seller shall not be liable for non-shipment or late shipment of the goods or non-performance of this contract.However， the seller shall notify the buyer by telex or fax and furnish the latter by registered airmail with a certificate issued by the China Council for the Promotion of International Trade[4] （中国国际贸易促进委员会） attesting such event or events."

# 16.4 Arbitration

## 1.The ways of settlement of disputes

In international trade， many ways can be taken to settle disputes.The most satisfactory way for the seller and buyer to settle the disputes is by means of conciliation （调解）， through which， the disputes can be settled in an amicable （友好的） way， where goodwill （友好） and friendly atmosphere between the disputing parties are so maintained as to least affect their future business relationship.But it is often the case that disputes cannot be amicably settled by conciliation， then it is necessary to resort （求

助于） to arbitration.Arbitration， in fact， has become the most popular method in international trade to settle disputes in that it brings about a friendly atmosphere and is more flexible， less expensive and much quicker in handling the case than litigation.What's more， the arbitral award is final and binding on both parties.So， it is universally believed that arbitration is better than litigation， conciliation better than arbitration， and prevention of disputes better than conciliation.

## 2.Features of arbitration

Arbitration is a means of settling a dispute between two parties through the medium of a third party who is not partial （偏袒） to either of the parties to the dispute， and whose decision on the dispute is final and binding， i.e.， neither party shall bring an appeal （上诉） for revision （复审） before a court of law or any other organizations.

Settling disputes by arbitration has the following features:

1） A written agreement to resolve disputes by arbitration between the parties to a contract is required.Such a provision may be inserted in a contract for resolution of future disputes or may be an agreement to submit to arbitration an existing dispute.The parties to the dispute enjoy a great deal of autonomy （自主权） for the purposes of determining the arbitration institute， arbitrators， the place of arbitration， the language spoken during the arbitration process as well as arbitration rules.

2） The arbitration body is a civilian institute （民间机构）， which does not have statutory jurisdiction （司法权）.Impartial and knowledgeable neutrals （中立人士） serve as arbitrators.Arbitrators are selected for specific cases because of their knowledge of the subject matter.

3） Arbitration awards are final and binding without the recourse to appeal or retrial （复审）.Court intervention and review is usually limited.Most arbitration rules and clauses provide for final and binding awards which are enforcement in the domestic courts of the parties.

4） The arbitral award is legally enforceable （可执行的）.If one party refuses to execute its obligations as stipulated in the award， the other party is entitled to apply to the court for enforcement on a compulsory basis.

## 3.Advantages over court proceedings

Arbitration has certain advantages over court proceedings （诉讼）.

1） Speed.In many cases an arbitration can be heard （审理） without the long delay that is often necessary for a case to go to court as it is possible to choose arbitrators to suit the timetable of the parties.

2） Flexibility.Unlike court rules which are usually set out in formal procedures which are never varied， parties to an arbitration contract are free to customize and refine the basic arbitration procedures to meet their particular needs.If the parties agree on a procedure that conflicts with the rules of the Arbitration body selected， the arbitration body will respect the procedure opted-for （选择的） by the parties unless these would， in the experience of the tribunal （审理委员会）， be unworkable.

3） Confidentiality （保密性） and Goodwill.The arbitration proceedings maintain confidentiality and are not revealed to the public.Without the consent of the parties， a third party will not be allowed to participate in the process and the progress of arbitration will not be exposed to the media.Arbitration hearings are usually held in a less adversarial （对抗性的）setting where the parties feel that a business disagreement is being sorted out （解决）， not that they are going to war.The more business-friendly nature of arbitration is therefore a form of insurance against loss of goodwill.

## 4.Arbitration agreement

Whenever one party applies for enforcement to the competent foreign court, he shall submit written application for enforcement together with the arbitration agreement, the original copy of arbitral award and the corresponding translation copy.

Arbitration agreement is a prerequisite （前提条件） to arbitrate a dispute.Any party of a dispute， when requesting for arbitrating a dispute， should mention the arbitration agreement.Without it， the arbitration would be groundless （无根据的）.An arbitration clause in any import or export contract， generally， should clearly stipulate the place of arbitration， the organization of arbitration， the procedure of arbitration， the applicable arbitration rules， the arbitral award and arbitration fees.

1) Place of arbitration

It is known that applicable laws concerning arbitration differ from country to country， and different applicable laws differ in their interpretations in respect of the rights and obligations of the parties concerned.Therefore， parties concerned are always making efforts to choose a place of arbitration in one's country or a place they trust and know quite well.For example， if possible， Chinese businessmen always prefer to submit any disputes arising from or in connection with the contract to The China International Economic and Trade Arbitration Commission[5] of The Council for the Promotion of International Trade， Beijing for arbitration in accordance with its procedure.In this case， the arbitration is conducted in Beijing， a place in plaintiff's （申请人的） country.However， in general practice， the place of arbitration may be also in the defendant's （被申请人的） country or in a third country agreed upon where neither party is situated.

2) Organization of arbitration

The name of a certain organization of arbitration by which arbitration is to be held is usually included in an arbitration clause.In international trade， disputes may be either referred to （提交到） a permanent arbitration organization for arbitration which should be stipulated in the arbitration agreement by parties concerned or submitted for arbitration to a provisional organization formed by the arbitrators agreed by the two parties.In most of the countries， some of the international organizations and some special trade associations have their permanent arbitration organizations， such as the Arbitration Court of International Chamber of Commerce， the London Court of Arbitration， American Arbitration Association， China International Ec

onomic and Trade Arbitration Commission， the Incorporated Oil Seed Association， and London Corn Trade Association， etc.

The provisional （临时的） organizations are temporarily and specially formed and composed of the arbitrators appointed by the parties concerned for the purpose of hearing the case of disputes and shall be automatically dissolved （解散） after the hearing of the case is finished.Under such a circumstance， the two parties should make it clear in the arbitration clause in respect of manner of arbitration， the number of arbitrators， etc.As permanent organizations have won merits （优点） in their smooth operation and good management due to the services normally provided by their permanent staff， permanent organizations， other than provisional organizations hold dominant positions in arbitration clause.

3) Procedure of arbitration

Almost every permanent organization of arbitration has its own procedures of arbitration to deal with arbitration.The procedures mainly stipulate the ways concerning how to apply for arbitration, appoint arbitrators, arbitrate the case, and also lay down the effect of the award and which party to bear the cost of the arbitration, etc.

4) Applicable rules of arbitration

The place of conducting arbitration is a matter of importance because the place of arbitration has much to do with the application of the country’s arbitration rules and laws.Thus, the country where the arbitration is going to be made and the relevant applicable arbitration rules should be specified in the contract.However, arbitration rules do not always go with the arbitration place.According to the usual international practice of arbitration, the arbitration rules in the arbitration place in principle, shall be applied.But it is legal for the parties concerned to agree in their contract that the arbitration rules of the arbitration organization by which the arbitration is going to be conducted may also be applied.

5) Award of arbitration

Once the award of arbitration is made， it is usually final.The arbitration clauses in contracts often bear such words that“The arbitration award is final and shall have binding force upon the two parties” so as not to cause ambiguities （歧义）.

6) Fees of arbitration

An arbitration clause shall provide that the arbitration fees shall be borne by the losing party.The following is an example of arbitration clause in a contract:

“Any dispute, controversy or claim arising out of or relating to this contract, or the breach,termination of invalidity thereof, shall be settled amicably through negotiation.In case no settlement can be reached through negotiation, the case shall then be submitted to the China International Economic and Trade Arbitration Commission of the China Council for the Promotion of International Trade, Beijing for arbitration in accordance with its Rules of Arbitration.The arbitral award is final and binding upon both parties.The arbitration fees shall be borne by the losing party.”

## 5.Enforcement of an award

The parties must automatically execute the arbitral award within the time limit specified in the arbitral award.In case one party fails to execute the arbitral award， the other party may apply to the competent （有资格的） court for enforcement.If the residence or the properties of the losing party is located within the territory of China， the other party may apply to the Intermediate （中级） People’s Court in the place where the residence of the losing party or the property of the losing party is located for enforcement of the award； if the residence or the property of the losing party is located outside China， and the country in which the residence or the property of the losing party is located has already acceded （加入） to the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards （承认和执行外国仲裁裁决公约） （Abbr.“the 1958 New York Convention”）， the other party may apply to the competent court in that country for

enforcement in accordance with the Convention.The 1958 New York Conve ntion became effective in China on April 22， 1987.Thus the arbitral award made by the CIETAC can be enforced by the competent courts of about 142 countries and regions in accordance with the Convention.

Box 16-1

The Arbitral Proceedings of China International Economic and Trade Arbitr ation Commission

1.Application for Arbitration, Defense and Counter-claim

The Claimant shall submit an Application for Arbitration in writing wit h attachments of relevant documentary evidence.The Claimant shall appoint an arbitrator from among the Panel of Arbitrators of the Arbitration Commis sion or authorize the Chairman of the Arbitration Commission to make such appointment.The Claimant shall pay an arbitration fee in advance to the Arb itration Commission.

Upon receipt of the Application for Arbitration and its attachments, if t he secretariat of the Arbitration Commission, after examination, finds that t he Claimant has completed formalities required by arbitration, the secretaria t shall promptly send to the Respondent a Notice of Arbitration, together wit h one copy of the Claimant's Application for Arbitration and its attachment s, the Arbitration Rules, the Panel of Arbitrators and the Arbitration Fee Sch edule of the Arbitration Commission.

The Respondent shall, within 45 days from the date of receipt of the N otice of Arbitration,submit his written defense and relevant documentary ev idence to the secretariat of the Arbitration Commission.The Respondent sha ll, at latest within 45 days from the date of receipt of the Notice of Arbitrati on, file with the secretariat of the Arbitration Commission his counterclaim in writing, state in his written Statement of Counterclaim his specific claim and facts and reasons upon which his claim is based.The Claimant shall also attach to his written Statement of Counterclaim any relevant documentary e vidence and pay an arbitration fee in advance to the Arbitration Commissio n.

2.The composition of the Arbitration Tribunal

Each of the parties shall appoint one arbitrator from among the Panel o f Arbitrators of the Arbitration Commission or entrust the Chairman of the Arbitration Commission to make such appointment.A third arbitrator shall b e jointly appointed by the parties or appointed by the Chairman of the Arbitr ation Commission upon the parties' joint authorization.In case the two parti es fail to jointly appoint a third arbitrator or fail to jointly entrust the Chair man of the Arbitration Commission to appoint a third arbitrator within 20 d ays from the date on which the Respondent receives the Notice of Arbitratio n, the third arbitrator will be appointed by the Chairman of the Arbitration Commission.The third arbitrator will act as the presiding arbitrator.The pres iding arbitrator and the two appointed arbitrators will jointly form an arbitra tion tribunal to jointly hear the case.

The Claimant and the Respondent may jointly appoint or jointly author ize the Chairman of the Arbitration Commission to appoint a sole arbitrator to form an arbitration tribunal to hear the case alone.If both parties have agr eed to have a sole arbitrator to hear their case but failed to agree on the pers on selected for such purpose within 15 days from the date on which the Res pondent receives the Notice of Arbitration, the Chairman of the Arbitration Commission will make the appointment.

3.Hearing

The arbitration tribunal will hold oral hearings.At the request of the pa rties or with their consent, the arbitration tribunal may, if it also considers or al hearings unnecessary, hear and decide a case on the basis of documents o nly.

The date of the first oral hearing shall be decided by the arbitration trib unal in consultation with the secretariat of the Arbitration Commission.The secretariat shall notify the two parties of the decision 20 days before the dat e of the hearing.Any party having justified reasons may request a postpone ment of the hearing, but a written request must be submitted to the secretari at of the Arbitration Commission 5 days before the date of the hearing.The arbitration tribunal will then decide whether to postpone the hearing or not.

The arbitration tribunal shall not hear cases in open sessions.However, if both parties request that an open session hearing be held, the arbitration tr ibunal shall decide whether to do so or not.

4.Arbitral award

The arbitration tribunal shall render an arbitral award within 6 months from the date on which the arbitration tribunal is formed.The Secretary-Gen eral of the Arbitration Commission may extend this time limit at the request of the arbitration tribunal if the Secretary-General of the Arbitration Commi ssion considers that it is necessary and the reasons for extension are truly ju stified.

Where a case is heard by an arbitration tribunal composed of three arbi trators, the arbitral award shall be decided by the majority of the arbitrators and the minority opinion may be recorded and placed on file.When the arbit ration tribunal cannot reach a majority opinion, the arbitral award shall be d ecided in accordance with the residing arbitrator's opinion.

The arbitration tribunal shall state in the arbitral award the claims, the f acts of the dispute,the reasons on which the arbitral award is based, the resu lt of the arbitral award, the allocation of the arbitration costs, the date on wh ich and the place at which the arbitral award is made.

5.The enforcement of arbitral awards

The arbitral award is final and binding upon both disputing parties.Neit her party may bring a suit before a law court or make a request to any other organization for revising the arbitral award.

The parties must automatically execute the arbitral award within the ti me limit ecified in the arbitral award.If no time limit is specified in the arbit ral award, the parties shall carry out the arbitral award immediately.

In case one party fails to execute the arbitral award, the other party ma y apply to the Chinese court for enforcement of the arbitral award pursuant t o Chinese law or apply to the competent foreign court for enforcement of th e arbitral award according to the 1958 Convention on Recognition and Enfo

rcement of Foreign Arbitral Awards or other international treaties that China has concluded or acceded to.

Source: http://www.huanzhonglaw.com/hzlaw/gjmy/gjmy-zc_e.htm.

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[1]In addition to entry-exit commodity inspection， AQSIQ is also in charge of national quality， metrology， entry-exit health quarantine， entry-exit animal and plant quarantine， import-export food safey， certification and accreditation， standardization， as well as administrative law-enforcement.For more information， see http：//english.aqsiq.gov.cn/AboutAQSIQ/Mission/.

[2]This law was adopted at the 6th Meeting of the Standing Committee of the Seventh National People's Congress on February 21,1989 and promulgated by Order No.14 of the President of the People's Republic of China on February 21, 1989, amended in accordance with the Decision on Amending the Law of the People's Republic of China on Import and Export Commodity Inspection, adopted at the 27th Meeting of the Standing Committee of the Ninth National People's Congress on April 28, 2002.

[3]See CISG Art.25， Art.49（1）， Art.64（1） and Art.81（1）.

[4]The China Council for the Promotion of International Trade （CCPIT） was established in May 1952.It comprises VIPS，enterprises and organizations representing the economic and trade sectors in China.It is the most important and the largest institution for the promotion of foreign trade in China.The CCPIT started to adopt a separate name—China Chamber of International Commerce （CCOIC）—in 1988， which is used simultaneously with the CCPIT.

[5]The China International Economic and Trade Arbitration Commission （CIETAC） is one of the major permanent arbitration institutions in the world.Formerly known as the Foreign Trade Arbitration Commission， the CIETAC was set up in April 1956 under the China Council for the Promotion of International Trade （CCPIT）.To meet the needs of China's ever-developing economic and trade relations with foreign countries after the adoption of the"reform and opening-up" policy， the Foreign Trade Arbitration Commission was firstly renamed as the Foreign Economic and Trade Arbitration Commission in 1980， and then as the China International Economic and Trade Arbitration Commission in 1988.Since 2000， the CIETAC is also known as the Arbitration Court of the China Chamber of International Commerce （CCOIC）.For more information， see http：//www.cietac.org/index.cms.

# Chapter 17　Negotiation and Formation of Contract

Learning Objectives

In this chapter, you will learn:

- The constitution of an offer
- The withdrawal and revocation of an offer
- The constitution and withdrawal of an acceptance
- Forms and content of an international sales/purchase contract

International sale contracts are formed through negotiation between the buyer and the seller.Negotiation normally involves enquiry （询盘）， offer （发盘）， counter-offer （还盘） and acceptance （接受）.Offer and acceptance are two essential elements in forming a contract among others.In this chapter， issues regarding the formation of contract are addressed in the light of the United Nations Convention on Contracts for International Sales of Goods （the CISG）.

## 17.1　International Trade Negotiation

International trade negotiation may be conducted through letter, fax, telephone or e-mail,etc.Whatever the form of negotiation is, the following four elements are generally involved in the process of negotiation.

### 1.Enquiry

An enquiry is an invitation to an offer.Both the buyer and the seller ma y make an enquiry to the other party to initiate a potential transaction.By m aking an enquiry, the seller may make a conditional suggestion to the buyer about a deal, and the buyer may aim to find out certain terms for a desired tr ansaction.

Either party should attach much importance to the enquiries sent by the other party who could be a potential customer of the seller.Each enquiry ma y infer a sale or purchase opportunity.An enquiry may be made in a way lik e“We are interested in your Butterfly Brand sewing machines.Please make us a quotation at your earliest convenience.”

## 2.Offer

Offer is a proposal that is made to a certain individual or legal entity to enter into a contract, which is definite in its terms, and which indicates the o fferor’s intention to be bound when it is accepted by the offeree.An offer ma y be made either by the seller or by the buyer.An offer made by the seller is also called“selling offer”; whereas an offer made by the buyer is called“buy ing offer”, also known as a“bid”.Terms like“offer”“offer firm”“quote”“boo k”“bid”,etc.are frequently used in making offers.The following is a typical e xample of an offer:

“We are making you an offer for 2000 dozen sport shirts as Sample N o.1234 at a unit price of US$90 per dozen CIF New York.The packing is of export standard and shipment is to be effected in May/June 2008.Payment is to be made by irrevocable sight L/C.This offer is subject to your reply reach ing here on 20th inst.”

## 3.Counter-offer

A counter-offer is a reply to an offer that adds to， limits， or modifie s materially （实质性地） the terms of the offer.A seller， for example，

who accepts an offer from the buyer but informs the buyer that goods will be a different color， has made a counteroffer.

Virtually， a counteroffer is a new offer made by the offeree of the original offer.Once an original offer is counter offered， it becomes null and void （失效的） and its offeror is not bound by it any more.Counter-offers may be made repeatedly between the buyer and the seller.The following is a typical example of counter-offer：

“Your letter dated Sept.3rd is received.We regret that we are unable to accept it as your competitors are quoting for goods of similar quality at a price of US$55.Please reply immediately.”

## 4.Acceptance

An acceptance is an unconditional assent （同意） to an offer or an assent to an offer conditioned on only minor （微小的） changes that do not affect any material terms of the offer.For example， a letter reading“We accept your offer of 14th” is a typical acceptance.

# 17.2 Formation of Contract

As previously noted， offer and acceptance are two essential elements in the contract formation process.A contract is formed， and the parties are bound by its provisions， when an offer to buy or sell a good is accepted.This section discusses offer and acceptance at length（详尽地）.

## 1.Offer

（1） Constitution of an offer （发盘的构成）

In order to constitute an offer to sell or buy goods in the international market， a given proposal must meet certain minimum requirements.CISG

Art.14 provides that“a proposal for concluding a contract addressed to one or more specific persons constitutes an offer if it is sufficiently definite and indicates the intention of the offeror to be bound in case of acceptance.A proposal is sufficiently definite if it indicates the goods and expressly （明确地） or implicitly（暗示地） fixes or makes provision for determining the quantity.”

1) To one or more specific persons

For a proposal to be an offer， it must be addressed （写给） to“one or more specific persons.” In order for a person to accept an offer， that offer must have been addressed to him.In the usual case， the requirement causes no difficulties since the offer to buy or sell goods will have been addressed to one specific person or， if the goods are to be bought or sold by two or more persons acting together， to those specific persons.The specifications of the addressee （收信人） will usually be by name， but it could be made in some other ways such as“the owner or owners of...”.

Proposals made to the public at large （一般公众） are ordinarily intended to be nothing more than invitations to negotiate.For example， an advertisement in a newspaper for the sale of goods at a particular price might put the advertiser in the awkward position of having to deliver more goods than he has on hand because of heavier than expected demand， or of absorbing （承受） a substantial loss because of an increase in the cost of the goods between the time the advertisement was placed and the time it appeared. The CISG， accordingly， adopts the rule that public offers are only invitations to negotiate“unless the contrary is clearly indicated”.

2) Sufficiently definite

As mentioned above, CISG Art.14 provides that a proposal is sufficiently definite if it contains three elements: indication of the goods; the quantity of the goods; the price of the goods.Both quantity and price can be expressly or implicitly provided.

（a） To be sufficiently definite， a proposal must indicate the goods. There is no express requirement that the proposal indicate the quality of the goods.A proposal to buy“Nanfeng Orange of middle and better quality” is s

ufficiently definite because a reasonable person in the same circumstances a s the recipient of the proposal could perceive （认为） the proposal as suffi ciently definite.If， however， the parties are unable to agree on the qualit y of the goods ordered， there is no contract.

(b) Fixing or determining the quantity.To be sufficiently definite, a pro posal must expressly or implicitly fix or make provision for determining the quantity.The following quantity designations have been sufficiently definit e:“All the ores produced by the seller in the whole year of 2008”—because the buyer accepted the ores delivered without objections,“three truck loads of eggs”—because the other party understood or ought to have understood t hat the trucks should be filled to their full capacity.

(c) Fixing or determining the price.To be sufficiently definite, a propos al must expressly or implicitly fix or make provision for determining not on ly the quantity but also the price.

The CISG does not require that the proposal include all the terms of th e proposed contract.If, for example, the parties have not agreed on the place of delivery or the mode of transportation, the Convention may fill the gap.

In practice， however， for the purpose of avoiding or minimizing dis putes， it would be proper to make a proposal which is complete， clear an d without reservation （保留条件） in its content.“Complete” infers that th e six essential terms， namely， description of commodity，quantity， pa cking， price， shipment and payment are included in the proposal.“Clear” infers that the proposal is clearly expressed and will not result in misunderst anding.If a proposal quotes a price as“about US$500”， it does not meet th e requirement of clarity.A proposal that contains words like“subject to our fi nal confirmation” shall be considered as“with reservation”， therefore it is not an offer.

3） Indicating the intention （意向） of the offeror to be bound in cas e of acceptance.

To be deemed as an offer, a proposal to conclude a contract not only m ust be addressed to one or more specific persons and sufficiently definite, it should also indicate the intention of the offeror to be bound if the addressee

s accept the proposal.A buyer was found to have indicated its intention to be bound when it sent the seller“an order” that stated“we ordered”and that called for immediate delivery.

(2) Term of validity of an offer

Term of validity of an offer is the period for acceptance， or a period within which the offeree can make acceptance and the offeror is only bound.It indicates that the offer lapses （失效） after the period specified.Usually each offer has its term of validity.It may be defined expressly in the offer， otherwise a reasonable time should be regarded as the term of validity.The term of validity may be expressed in the following ways.

1) Stating the latest time.For example,“This offer is subject to your reply reaching us before 15th August.”

2） Stating a period of time.For example，“This offer is valid for 3 days.” The drawback（缺点） of this expression is that it is difficult to determine the point of time of commencement of the term of validity.

（3） Withdrawal （撤回） and revocation of an offer

1) Withdrawal.“Withdrawal” of an offer means termination of an offer by the offeror before or at the same time as the offer reaches the offeree.An offer becomes effective when it reaches the offeree.Thus, offers—including offers that promise they are irrevocable—can be withdrawn prior to their reaching the offeree.

2） Revocation.“Revocation” of an offer means termination of an offer by the offeror after the offer reaches the offeree.CISG Art.16（1） provides that“Until a contract is concluded an offer may be revoked if the revocation reaches the offeree before he has dispatched （发送） an acceptance.”

There are, however, certain restrictions on the right to revoke the offer:

Firstly, the right of revocation will be lost once the acceptance has been dispatched.

Secondly, CISG Art.16(2)(a) provides that“an offer cannot be revoked if it indicates,whether by stating a fixed time for acceptance or otherwise, th

at it is irrevocable.” While whether a particular statement or conduct indicat es the intention on the part of the offeror that the offer is irrevocable has to be determined on its facts, in practice, however, use of words such as“irrevo cable”“binding” or“firm” would be strongly suggestiveness of an intention t o make the offer irrevocable.

Thirdly, CISG Art.16(2)(b) prevents the offeror revoking its offer wher e“it is reasonable for the offeree to rely on the offer as being irrevocable an d the offeree has acted on reliance of the offer.” Both conditions must be sat isfied for the provision to apply.Whether it is reasonable for the offeree to re ly on the offer as being irrevocable is a question of fact to be decided in the light of all the circumstances of the case.The offeree must also show that it has acted in reliance on the offer being irrevocable.Such an act or conduct may consist of entering into other contracts, preparing for production, incur ring expenses, purchasing or hiring materials for production or perhaps eve n taking on new employees.An example where reliance was reasonable and an act was a result of reasonable reliance on the offeror’s offer is presented i n the following case.

Constructor A made an enquiry with B for 10,000 M/T steel on May 15 th and told B that this enquiry was made with the purpose of calculating the price for its submission of a bid for a construction project, which was due to begin on June 1st and the result of the bid would be published on June 15th. The next day B made an offer to A.The offer neither indicated the term of v alidity nor bore the indication of being irrevocable.On May 25th, A made its bid in the light of B’s offer.On June 10, however, A unexpectedly received a facsimile from B informing that its offer was revoked.A few days later, A w as notified that it won the tender.

In this case, it was reasonable for A (the offeree) to rely on B’s offer as being irrevocable since A informed B of the purpose of its enquiry.In additi on, A had acted in reliance on B’s offer (it had submitted a tender in the ligh t of B’s offer).According to CISG Art.16(2)(b), B was not allowed to revoke its offer.

(4) Termination

An offer is terminated and thereafter ceases to be available for acceptance when 1） it lapses； 2） it is rejected or declined； 3） it is legally withdrawn or revoked； 4） law is applied （适用）.An offer may be terminated because of the application of law in some particular circumstances.For example， the offeror loses its ability to act （e.g.， go bankrupt） before the offer is accepted， a unique work of art was burnt in a fire， etc.

## 2.Acceptance

A contract is established at the moment when an offer is accepted.

(1) Requirements for an effective acceptance

In the light of CISG Art.18（1） which provides“A statement made by or other conduct of the offeree indicating assent to an offer is an acceptance. Silence or inactivity （不行动） does not in itself amount to （等于） acceptance.” An effective acceptance should meet the following four requirements：

1) The acceptance must be made by the offeree.As previously noted, an effective offer must be made to one or more specific persons.Therefore, it must be the offeree specified in the offer to accept the offer.In other words, an acceptance made by any person(s) other than the offeree is not effective.

2） It must conform to the offer.Where the offeree in its reply does not unqualifiedly （无条件地） accept the terms offered but instead seeks to introduce new terms or in some other way qualifies （限制） or modifies the original offer， it will not generally be treated as having accepted the offer.Instead the reply will be treated as a rejection of the original offer and as amounting （等同） to a counter-offer set out in the reply.This rule is contained in CISG Art.19（1） which provides that“A reply to an offer which purports （声称） to be an acceptance but contains additions， limitations or other modifications is a rejection of the offer and constitutes a counteroffer.”

However， CISG Art.19（1） does not mean that the offeree is not allowed to make any additions， limitations or other modifications when mak

ing an acceptance.The question is whether the alteration is material or not.CISG Art.19（2） states that“a reply to an offer which purports to be an acceptance but contains additional or different terms which do not materially alter the terms of the offer constitutes an acceptance， unless the offeror， without undue （不适当的） delay， object orally to the discrepancy or dispatches a notice to the effect）.If he does not so object， the terms of the contract are the terms of the offer with the modifications contained in the acceptance.”

The above article shows that where a particular modification is treated as non-material,unless the offeror objects it orally or dispatches a notice to that effect, the reply to the offer constitutes an acceptance.If the offeror does not object, the terms of contract are the terms of offer with the modifications contained in the acceptance.Where a timely objection is made,the effect is that no contract has been concluded.

CISG Art.19(3) provides list of terms that are considered to materially alter the terms of the offer.It states that“Additional or different terms relating, among other things, to the price,payment, quality and quantity of the goods, place and time of delivery, extent of one party’s liability to the other or the settlement of disputes are considered to alter the terms of the offer materially.”

Thus, terms proposing an increase in the price of the goods, a different time of payment,and a change in the quality of goods have all been held material.So too, has a term relating to time and place of delivery, and a term proposing a different place of jurisdiction.

3) It must be made within the period of time for acceptance.As previously noted, an offer usually contains the term of validity, implying the offeror is bound within this term.An acceptance is only effective on condition that it reaches the offeror within the term of validity.An acceptance that reaches the offeror after the period of time for acceptance is late acceptance.

As a general rule, a late acceptance is not effective; no contract is, therefore, concluded and the offer lapses.However, that is not to say that the contracting process thereby comes to an end.CISG Art.21 states that

“1.A late acceptance is nevertheless effective as an acceptance if witho ut delay the offeror orally so informs the offeree or dispatches a notice to th at effect.

2.If a letter or other writing containing a late acceptance shows that it h as been sent in such circumstances that if its transmission had been normal i t would have reached the offeror in due time, the late acceptance is effective as an acceptance unless, without delay, the offeror orally informs the offeree that he considers his offer as having lapsed or dispatches a notice to that eff ect.”

Under CISG Art.21， a distinction between two reasons for lateness w as drawn， namely obvious delay in transmission [Art.21（2）] and late ac ceptance for reasons other than obvious delay in transmission， e.g.dispatc h of acceptance [Art.21（1）].In both cases， the Convention allows a con tract to be formed by the late acceptance， albeit （尽管） under different conditions.

In the case of an obvious transmission delay, a late acceptance will be t reated as effective and a contract concluded unless the offeror objects in a ti mely manner.Thus, if the offeror wishes to prevent a contract coming into e xistence, it must take positive steps to do so, i.e.,orally inform the offeree th at it considers its offer having lapsed or dispatch a notice to that effect.If it f ails to do so the contract is treated as having been concluded at the moment when the late acceptance reached the offeror.In the case of late acceptance f or reasons other than an obvious transmission delay, the acceptance will onl y be effective if the offeror gives notice to that effect.

4) The acceptance must be indicated.As a general rule, an acceptance must be indicated either by a statement or by other conduct.

(a) By a statement.The offeree may indicate its assent to an offer orally or in written form.This is the widespread approach of acceptance.

(b) By other conduct.“by other conduct” means by performing an act.F or example, by effecting shipment of the goods, or by opening an L/C, or by manufacturing the subject goods,etc.It should be noted, however, that the ac

t should be performed as required by the offer or the usual practice between the parties concerned.

CISG Art.18（1） states that“silence or inactivity does not in itself am ount to an acceptance”.This language can be interpreted as （a） silence or inactivity alone does not constitute an acceptance； （b） silence or inacti vity when coupled with other behavior may indeed be indicative of an acce ptance.For example， if the seller sends the buyer an offer that says，“I kn ow that this is such a good deal that I will assume that you have accepted un less I hear otherwise，” the fact that the buyer does not respond will not cre ate a contract.A different result would occur， however， if the seller were to send the buyer an invitation to negotiate that says，“Unless you hear oth erwise from me within 3 days after I receive your order， I will deliver the widgets （装饰品） you need at $100 each.” In such a case， the seller’s s ilence would constitute an acceptance.In the first instance， the seller attem pted to force acceptance on the buyer.In the second instance， the seller vol untarily assumed the duty to respond.

(2) The moment when an acceptance becomes effective

CISG Art.18(2) provides that“An acceptance of an offer becomes effec tive at the moment the indication of assent reaches the offeror.An acceptanc e is not effective if the indication of assent does not reach the offeror within the time he has fixed or, if no time is fixed, within a reasonable time, due ac count being taken of the circumstances of transaction, including the rapidity of the means of communication employed by the offeror.An oral offer must be accepted immediately unless the circumstances indicate otherwise.”

(3) Withdrawal of an acceptance

CISG Art.22 provides that“An acceptance may be withdrawn if the wit hdrawal reaches the offeror before or at the same time as the acceptance wo uld have become effective.”

## 3.Formation of contract

Once an acceptance is effectively made, the contract is concluded.In practice, however, a formal contract is usually made out to further specify the rights and obligations of both sides for legal purpose.The formation of contract represents the conclusion of some possible difficult negotiations and accordingly, particular care should be taken regarding the preparation of its terms.

(1) Forms of contracts

There is no specific requirement about the forms of international import/export contracts.The commonly used forms are: Sales Contract, Purchase Contract, Sales Confirmation,Purchase Confirmation, Sales Agreement, Purchase Agreement, Sales Memorandum, Purchase Memorandum, etc.Contract or confirmation is more commonly used by Chinese foreign trade entities which generally have their own printed set format of contract or confirmation.Once a deal is made, traders may sign two copies of contract in person.Or the seller may send two copies signed by him to the buyer for counter-signature and the buyer should return one copy to the seller for file.Thus each party retains a copy of the contract.

(2) Content of the contract

An international sales/purchase contract usually includes three parts：preamble （约首），body （本文） and witness clause （约尾条款）.（See“A sample sales confirmation”）

A sample sales confirmation

**SALES CONFIRMATION**

S/C NO. S/C200F-1

Date: Oct. 12, 2016

**The Seller:** Shanghai Textiles Imp. & Exp. Corp.
**Address:** 27. CHUNGSHAN ROAD E.1
SHANGHAI, CHINA

**The Buyer:** CRYSTAL KOBE LTD.
**Address:** 1210, BROADWAY, ROOM
205 NY, NY10018, USA

We, the Seller, hereby confirm having sold to you, the Buyer, the following goods on terms and conditions as specified below:

Commodity: "Spring Flower" Brand Woolen Blankets

Specifications: 220cm × 200cm per piece; Brown: 60%; Green: 40%

Quantity: 3,000 pieces

Unit price: at US$150 per piece CIF New York

Total amount: US$450,000 (SAY US DOLLARS FOUR HUNDRED AND FIFTY THOUSAND ONLY)

Packing: 5 pieces in a carton in the right color proportion, 4 cartons to a seaworthy wooden case.

Insurance: To be effected by the Seller for 110% of the invoice value, covering All Risks and Risk of Intermixture and Contamination as per China Insurance Clause of Jan. 1, 1981.

Terms of Shipment: To be shipped in one lot on or before November 15, 2016 with transshipment prohibited.

Port of shipment: Shanghai, China

Port of destination: New York

Shipping mark: At the seller's option

Terms of payment: By irrevocable L/C at sight in favor of the Seller to be opened by the Buyer through a first class bank for 100% of the invoice value to reach the Seller 40 days before shipment.

Remark: Please sign and return one Original of this Sale Confirmation to us for file.

THE SELLER _____ THE BUYER _____

1) The preamble of a sales/purchase contract includes name and addres s of the seller and the buyer; the date of contract and purpose of the contrac t, etc.The preamble may take the following statement as the opening remar

k:“The contract is concluded and made by and between ABC Co.(hereinafte r called“the sellers”) and XYZ Co.(hereinafter called“the buyers”), whereas the sellers are willing to sell the buyers the commodity listed hereunder.”

2) The body of a sales/purchase contract includes clauses regarding na me and specifications of commodity, quantity, packing, price; terms of pay ment, shipment, insurance,general terms and conditions such as claim, arbit ration, and force majeure, etc.

3) The witness clause includes the effectiveness of language and signat ure, etc.For example, a sales contract is ended with the statement“The contr act is made out in Chinese and English, both versions being equally authenti c”.

# Chapter 18 Implementation of International Sales Contract

Learning Objectives

In this chapter, you will learn:

- Requirements for preparing goods
- Examination of and amendment to L/C
- Documentation
- Collection of export proceeds in foreign exchange
- Verification and writing-off of the export proceeds in foreign exchange and export tax rebate

Once a contract is concluded, both the seller and the buyer should honor their obligations.The seller must deliver the goods, hand over any documents relating to the goods and transfer the property in the goods, as required by the contract and the Convention[1].The buyer must pay the price for the goods and take delivery of them as required by the contract and the Convention[2].The implementation procedure for a particular export sales contract depends on the specified terms and conditions.

In this chapter, we concentrate on the procedure for carrying out CIF and L/C transactions.From the perspective of the seller, implementing such a contract mainly involves the following stages: preparing the goods; urging the opening of L/C, checking L/C, asking the amendment to L/C; arranging shipment, effecting insurance, clearing export customs, making out documents and collecting export proceeds in foreign exchange.Discussions of the relevant issues in this chapter are largely in accordance with the CISG and the UCP600.

# 18.1 Cargo Readiness

## 1.Contractual quantity, quality and packing conformity requirements

CISG Art.35(1) provides that“the seller must deliver goods which are of the quantity,quality and description required by the contract and which are contained or packaged in the manner required by the contract”.

(1) Contractual quantity requirements

The seller must deliver to the buyer the exact quantity of goods stipulated in the contract for sale.A failure to deliver the exact quantity, whether more or less than the stipulated amount,constitutes a breach of contract.

Parties to international sales contracts frequently state the quantity of the goods to be delivered as approximate amount， leaving a margin as to the exact quantity to be delivered by using words such as“more or less”“not less than” or“about”.By such a stipulation， the seller gains some latitudes（自由） as to the amount he can deliver and still fulfil his obligation of delivering the goods that conform to the quantity.For example， if the parties agreed that the seller should deliver 100 metric tons of rice“5 percent more or less”， the buyer would be obliged to take delivery of any delivery between 95 metric tons and 105 metric tons.However，in the event that the seller delivers less than 95 metric tons， say 90 metric tons or more than 105 metric tons， say 110 metric tons， the buyer is entitled to resort （采取某手段） to remedies available to him in the case of， respectively， insufficient and excessive delivery.

(2) Contractual quality, description and packing requirements

In determining the quality and description of the goods， the requirements in the contract will prevail （占上风）： the overriding source for the standard of conformity is the contract itself.

In many cases, lack of conformity is often caused by the inadequate pa cking of the goods.The way in which the goods are packaged has to be suffi cient to protect and preserve the goods after they were handed over by the s eller to the carrier.The goods have to be packaged in a way which is suitable for the carriage of those goods, also in case of any delay, and which will last until the goods are handed over to the buyer at their destination.

## 2.Fitness for ordinary and particular purposes

(1) Fitness for ordinary purposes

CISG Art.35(2)(a) provides that goods do not conform to the contract unless they are fit for the purposes for which goods of the same description would“ordinarily” be used.

Goods are always purchased with some purposes in mind and the buye r is entitled to expect fitness for“ordinary purposes”： Canned fruits must b e suitable for human consumption；bowling balls must be suitable for bowl ing， etc.Durable goods （耐用品） such as washing machines， automo biles and industrial machinery are not for their“ordinary” purposes unless th ey remain durable （usable） for an“ordinary period of time”.Thus， a wa shing machine which remains functional for only a few weeks can hardly be considered fit for the ordinary purposes（long-term use）.The precise perio d is， of course， a determination which will vary depending upon the natu re of the particular goods （and their price）.

Within the context of international trade,“resale” should also be consid ered an ordinary use, so a buyer who purchases for resale is entitled to expe ct goods resalable in the ordinary course of business.What constitutes“resal able” will depend on the expectations of the ultimate purchasers.

(2) Fitness for a particular purpose

The seller is also responsible for the goods being fit for a particular pur pose if the purpose has been“expressly or impliedly made known to the sell er at the time the contract was concluded except where the circumstances sh

ow that the buyer did not rely, or that it was unreasonable for him to rely, on the seller's skill and judgment"[3].

A special purpose may exist, for example, if a buyer of machinery inte nds to use such equipment in exceptional climatic conditions.Also the buyer must have reliance on the seller's skill and judgment.There will usually be s uch reliance if the seller is an expert in the manufacture or sale for the partic ular purpose intended by the buyer.

## 3.To timely fulfil the obligation to deliver

To timely fulfil the obligation to deliver, the seller must perform, in co mpliance with the deadlines established in the contract or under CISG Art.3 3.Delivery after the date or period for delivery is a breach of contract.If tim ely delivery was of the essence of the contract, late delivery amounts to a fu ndamental breach, and the contract can be avoided.

The time of delivery is governed first by the provisions of the contract. If the parties have fixed a date for delivery, or that such a date can be inferre d from the contract (e.g.,"15 days after Christmas"), the seller must deliver on that fixed date.Delivery at a later time constitutes a breach of contract.

Under a contract clause providing for a period for delivery, e.g., provid ing delivery"until end December", delivery at some point between the concl usion of the contract and the end of December would conform to the contra ct, whereas delivery after 31 December would constitute a breach of contrac t.Similarly, if delivery is to be"effected in 1993-1994", delivery any time be tween 1 January 1993 and 31 December 1994 constitutes timely performanc e.

If no delivery date or delivery period can be inferred from the contract, delivery should be made within a reasonable time after the conclusion of th e contract[4].

In case of partial shipments being allowed, delivery must be effected in accordance with the relevant provisions in the contract.UCP600 Art.32 prov

ides“If a shipment by instalments within given period is stipulated within th e credit and any instalment is not shipped within the period allowed for that instalment, the credit ceases to be available for that and any subsequent inst alment.”

This article applies only， if the credit stipulates specific dates for the performance of partial shipments.For example，“Four partial shipments ea ch of which is not to exceed the amount of … in March， April， May， J une 2002.” If the beneficiary misses only one deadline for a partial shipmen t， he forfeits （丧失） the right to claim payment under the credit for any subsequent deliveries.The beneficiary cannot choose to miss a partial shipm ent and later still claim payment for subsequent partial shipments.

This article does not apply, if the credit only stipulates the number of p artial shipments without linking them to specific dates.For example,“Five p artial shipments between January and May 2002”.

## 4.Ensuring freedom from third party claims

The seller should ensure that the goods it delivers are not subject to rig hts or claims by a third party.Freedom from such rights or claims permits th e buyer to enjoy undisturbed possession and ownership of the goods.The sel ler will be in breach of his duties under the Convention if it does not meet t he requirements[5].

In addition， the seller is also required to ensure the goods he delivers do not infringe （侵犯） on the industrial property rights （工业产权） or other intellectual property rights[6] （知识产权） of the third party.

However, the seller is not liable if the third party’s right or claim is one of which the buyer“knew or could not have been unaware” when the contra ct was concluded, or if the right or claim arose from the seller’s compliance with technical specifications (“technical drawings,designs, formulae or othe r such specifications”) that the buyer itself supplied to the seller.[7]

# 18.2 Examination of and Amendment to the L/C

## 1.Urging the opening of L/C

In the following cases, the seller may urge the buyer to open the L/C.

1） The buyer fails to issue an L/C within the time stipulated in the co ntract.In this case， the buyer breaches the contract.However， if the seller still does not want to break off （终止）the transaction， he may urge the buyer to open the L/C.The seller， though， reserves the right to claim aga inst the buyer.

2) In the case that the goods are ready for shipment, the seller may also urge the buyer to open the L/C in order to advance shipment.

## 2.Examining L/C

After receiving the letter of credit (L/C), the seller must check the L/C immediately and thoroughly to ensure that the terms and conditions stipulat ed in the L/C are correct and conform to the sales contract, and that he can c omply exactly with the L/C requirements.Otherwise, the seller must immedi ately ask the buyer to amend the L/C.If any terms and conditions of the L/C are not complied with, no matter how small, a discrepancy is said to occur a nd it can delay or prevent the payment.

Errors in the terms and conditions of a letter of credit may occur as a re sult of the applicant’s error in preparing the L/C application and/or the issui ng bank’s error in preparing the L/C.When checking credit, the UCP600 wil l apply fully unless the credit expressly states that it is subject to different te rms.The seller should check the details of letter of credit including the follo wing.

1) The political background and financial standing of the issuing bank. If the issuing bank is domiciled in a country which has friendly relations wit h China, but its nationality is not acceptable, this credit is not acceptable.If t he issuing bank is a very small bank with a very poor financial standing, thi s credit is unacceptable too.

2) The nature of the credit and the liabilities of the opening bank.Credi t with a word like“revocable” is not acceptable.The undertaking clause of th e issuing bank should be included.Sometimes although there is the word“irr evocable” in the L/C, some“limitation clauses”regarding the undertaking of the issuing bank also include such clauses as“This credit is not effective unt il we receive the notification of import licenses”.Credits with such clauses a re not acceptable.

3) The unit price and total amount.The unit price, if stated in the L/C, s hould conform to the contract price.The total amount should also conform t o the contract amount.If there is a“more or less” clause in the contract, the a mount of the L/C should cover the“more or less”part.The amount in words s hould correspond with the amount in figures.

4) The quality, quantity, packing clauses.The quality, quantity and pack ing clauses should be in conformity with the contract.The words“about” o r“approximately” in a credit permits up to a ±10％ variation in the amount s tated in the credit, quantity or the unit price[8].A tolerance of ±5％ is allowe d provided the credit does not state the quantity in terms of a stipulated num ber of packing units or individual items and the total amount of the drawing s does not exceed the amount of the credit[9].

5） The latest date for shipment， date and place of credit expiry.Ther e is usually a reasonable interval （间隔） between the latest date of shipm ent and the expiry date of the L/C.In this way， the seller has sufficient tim e to prepare documents and make settlement.The expiry place is usually in t he beneficiary place.

6) Partial shipments and/or drawings are permitted or allowed.

7) Transshipment is permitted or allowed.

8) The documents required are obtainable.

9) Other special clauses.

## 3.Amendment to L/C

If the seller finds that the terms stipulated in the credit are not in line w ith those specified in the contract or not acceptable， he must notify the bu yer in the shortest possible time.Meanwhile he should also keep in mind tha t shipment could not be effected until the L/C amendment （修改书） arriv es.

Partial acceptance of an amendment is not allowed and will be deemed to be notification of rejection of the amendment[10].

# 18.3 Shipment, Insurance and Customs Clearance

## 1.Shipment

In arranging shipment， the seller （the shipper） shall fill in the ship ping note （订舱单） to book the shipping spaces in a liner.If the shipping company accepts the order， it will then issue a shipping order （S/O） （装货单） to the shipper with a confirmed space booking，authorizing th e receiving clerk （cargo checker） at the container terminal or dock to rec eive a specified amount of goods from the named shipper.

A shipping order typically contains the space booking number, names and addresses of the shipper and customs broker or forwarder, vessel and vo yage number, sailing time, delivery date and location, customs closing date, and number and type of packages.

After receiving the S/O from the shipping company， the seller may st art to ensure the loading of the goods.The seller should supervise the loadin g process.After the goods being loaded on board the vessel， the Captain or the Mate （大副） will issue a receipt， which is known as the Mate's Rec eipt （大副收据）.The seller shall exchange it for the Bills of Lading from the shipping company after making payment of the freight.

## 2.Insurance

The seller should take out at his own expense cargo insurance as agree d in the contract once the shipping date and shipping vessel are determined.

The date of the insurance document should not be later than the date of shipment, unless it appears from the insurance document that the cover is ef fective from a date not later than the date of shipment.

## 3.Customs clearance

According to the Customs Law of the People's Republic of China, decl aration of export goods shall be made by the consignor 24 hours prior to loa ding unless otherwise specially approved by the Customs.

The seller should declare the export goods to the customs by filling in certain customs declaration forms （报关单） and submitting appropriate documents such as commercial invoice，export license， copy of sales con tract， inspection certificates and shipping order， etc.The customs will ins pect the export goods and decide if the shipment can be cleared through.

# 18.4 Documentation

Presentation of documents plays a vital role in the process of document ary credit operation because it will lead to the final settlement of the credit. Whether the beneficiary can collect export proceeds successfully after he pr

esents the documents to the bank depends largely on the carefulness in hand ling the documents.

## 1.Quality requirements for documents

The quality of documents should meet the following general requireme nts.

1） Accuracy.In handling the documents the doctrine of strict complia nce must be observed （遵守）.It should be noted that the documents have to comply with the terms of the credit and the documents themselves ought to be consistent with one another.

2) Completeness.All detailed requirements for documents such as type s of documents,numbers of originals and copies and items for each docume nt in the credit should be met.

3) Promptness.Make sure the documents are ready when they are need ed to avoid any delay or confusion.

4） Conciseness.No redundant （冗余的） words or expressions shou ld be used.

5) Cleanness.No correction should be made on the documents.

Documents are an integral part of all international payment methods.T he documents called for by a payment type will differ somewhat according t o the nature of the goods and the countries of export and import.Some docu ments, however, such as draft, invoice, bill of lading, insurance policy, certi ficate of origin, inspection certificate, and packing list are usually specified in all CIF and L/C transactions.

## 2.Period of time for presentation of documents

The beneficiary must present not only the right documents, but also at t he right time,namely, within the period of time for presentation laid down in

the credit and rules in the UCP600.The time limit for presentation of documents is determined by the following three factors.

1) The expiry date of the credit.UCP600 Art.6 (d)(i) provides that"A credit must state an expiry date for presentation.An expiry date stated for honor or negotiation will be deemed to be an expiry date for presentation." After this date, the credit will cease to exist and can no longer be drawn on.Therefore, documents must be presented on or before the expiry date in the credit.

2） The period of time for presentation specified in the credit.Credits may specify date for presentation as being ××× days after the date of shipment.In such case， the date for presentation is deduced （推算） according to the date of shipment.But in any way， it should not be later than the expiry date of the credit.

3) 21 days after the date of shipment.If, however, no such period of time for presentation is specified, the presentation must be made not later than 21 calendar days after the date of shipment, but in any event not later than the expiry date of the credit[11].

## 3.Types of documents required by the credit

(1) Draft

As previously noted, drafts are particularly used in international trade for collecting payment from importers abroad.Financing of foreign trade can be arranged in a number of ways by means of the bill of exchange.Sight payment L/C sometimes needs no draft, whereas time payment L/C always calls for a draft as it represents the payment instrument thereunder.In theory, the draft under L/C is not usually considered as one kind of the shipping documents required, though in practice, it is easily taken as one of the documents when mentioning"documents are not in compliance with credit terms".Drafts drawn under letters of credit should be, as mentioned above, in strict compliance with the credit terms, in addition to being possessed of its own characteristics.

The following are the detailed content of a draft:

■ A draft drawn clause such as“drawn under ××× Bank L/C No.××× da ted ×××”;

■ The date of the draft;

■ The number of the draft;

■ The amount of the draft in figure;

■ The place of the draft;

■ Time of payment;

■ The payee of the draft.The payee may be a negotiating bank or the b eneficiary himself,who will then endorse the draft to the negotiating bank;

■ The amount of the draft in words;

■ The drawee of the draft.The drawee of the draft can be an opening b ank, an advising bank or any other third bank as stipulated in L/C;

■ The drawer of the draft.The drawer of the draft here refers to the ben eficiary, or the exporter.

(2) Commercial invoice

The commercial invoice is the key accounting document describing the commercial transaction between the buyer and the seller.The commercial in voice includes the following elements:

■ Name and address of the seller;

■ Name and address of the buyer;

■ Date of issuance;

■ Invoice number;

■ Order or contract number;

■ Quantity and description of the goods.

It is vitally important that the description of the goods in the commercial invoice corresponds precisely to the description of goods in the credit.Unit price, total price and other charges agreed upon are stated in the currency of the contract or letter of credit

The invoice amount should match exactly (or at least should not exceed) the amount specified in the credit.Banks have the right to refuse invoices issued for amounts in excess of the amount stated in the credit.There is an exception, i.e.when a documentary credit specifies“about” in relation to the currency amount and quantity of merchandise, in which case the invoice may specify an amount equal to plus or minus 10 percent of the stipulated amount of the credit.

Shipping details, weight of the goods, number of packages, shipping marks and numbers,terms of delivery, payment and any other information as required in the sales contract or letter of credit (e.g., country of origin) are all included.

(3) Miscellaneous invoices

1） Pro-forma invoice （形式发票）.Pro-forma invoice is an abridged or estimated invoice sent by the seller to a potential buyer.Pro-forma invoices are commonly used as a preliminary invoice with a quotation.It is often required by the buyer so that an import license and/or foreign exchange permit will be approved by the authorities concerned.

2） Customs invoice （海关发票）.Some countries require a customs invoice.A customs invoice is an extended form of commercial invoice （often in a specific format） required by customs authority of the importing country.The invoice includes information which the country desires to know but which is not found on the ordinary commercial invoice.It may form the basis of calculating the import duty and serve to prevent dumping of imports at low prices.The customs use it for statistical purposes and for certifying the origin of goods.

3） Consular invoice （领事发票）.Consular invoice is a specially printed invoice to be issued by the importing country’s consulate in the exporting country.This invoice evidencing the details of the shipment is used by th

e importing country to prevent dumping of foreign made goods at low prices.Serving as a certificate of origin， it may also form the basis of calculating the import duty and help the merchandise pass the customs entry in the importing country.For certification the consulate will charge a fee， often based on a certain percentage of the commercial invoice value of the imported goods.

(4) Shipping documents

There are various types of shipping documents including ocean/marine bill of lading,non-negotiable sea waybill, rail waybill, air waybill, parcel post receipt and multimodal transport document, etc.The following is a brief introduction to the contents of ocean bill of lading.

1) Name of ocean bill of lading

In practice, like any other documents, the name of shipping document is usually indicated on its face.

2) Shipper

The shipper is usually the beneficiary of the Credit, i.e.the exporter.Unless otherwise stipulated, the bank will also accept the bill of lading with another party other than the beneficiary as the shipper.This kind of bill of lading is described as the third party B/L.

3) Consignee

In practice, the B/L is usually made out“to order” or“to order of shipper”.This kind of B/L is negotiable only after it is endorsed by the shipper.

4) Notify party

The notify party is usually the importer or its agent to be notified by the shipping company upon arrival of the goods.The name and address of the notify party must be filled in detail.

5) Port of loading & port of discharge

6) Description of the goods as well as its marks and numbers

7) Freight charges prepaid or to collect

8) An indication or notation that the goods have been loaded“on boar d” or shipped on a named vessel, the date of issuance and date of loading.A ccording to UCP600 Art.20(a)(ii),the date of issuance of the bill of lading w ill be deemed to be the date of shipment unless the bill of lading contains an on board notation indicating the date of shipment.

9) Copies of signed (or original) bill of lading

10) Name of carrier with a signature identified as that of carrier, or shi p’s master, or agent for or on behalf of either the carrier or ship’s master

(5) Insurance policy (or certificate)

This is a document indicating the type and amount of insurance covera ge in force on a particular shipment.In documentary credit transactions, the insurance document is used to assure the consignee that insurance is provid ed to cover loss of or damage to cargo while in transit.A complete insurance document includes the following elements:

■ the name of the insurance company;

■ the name of the insurance document;

■ the number of the insurance document;

■ description of the goods insured;

■ description of risks covered and sum insured;

■ name of place where claims are payable;

■ means of transportation, name of vessel, loading port and destination port;

■ issuing date of insurance document;

■ signature of the insurer.

(6) Packing documents

These are documents describing packing conditions of the goods.They are supplementary documents to commercial invoices.Packing documents u

sually include packing list (or packing slip), weight list (or weight note), me asure list, weight memo, etc.

(7) Certificate of origin

This is a document evidencing the origin of the goods or the place of manufacturing.It may be issued by the China Council for the Promotion of I nternational Trade, other competent inspection bodies or the exporter himse lf.

A GSP (Generalized System of Preference) certificate of origin is a cer tificate used to obtain the treatment of preference customs duty imposed by the developed country on the developing countries.The main document und er GSP is the GSP certificate of origin form A.

(8) Inspection certificate

An inspection certificate is a document issued by an authority indicatin g that goods have been inspected (typically according to a set of industry, c ustomer, government, or carrier specifications) prior to shipment and the res ults of the inspection.Inspection certificates are generally obtained from neu tral testing organizations (e.g.a government entity or independent service co mpany).In some cases the inspection certificate can come from the manufac turer or shipper.

The most common inspection certificates used in international trade ar e:

- inspection certificate of quality;
- inspection certificate of weight;
- inspection certificate of quantity;
- veterinary inspection certificate;
- inspection certificate of health;
- disinfection inspection certificate;
- inspection certificate of origin;

■ inspection certificate of value;

■ inspection certificate on damaged cargo.

(9) Other documents

Other documents may be provided according to the stipulation of the Credit.These documents may be prepared by the exporter himself or by others at the request of the exporter.The common documents are:

■ beneficiary's certificate for dispatch of documents;

■ beneficiary's certificate for dispatch of shipment samples;

■ post receipt or courier receipt;

■ evidence with regard to shipment, such as evidence of nationality of the vessel.

## 18.5 Settlement of Export Proceeds in Foreign Exchange

Settlement of export proceeds in foreign exchange （出口结汇） means the exporter sells its export proceeds in foreign exchange to the bank who pays it an equivalent amount in RMB according to the foreign exchange rate.

### 1.Three ways of settlement of export proceeds in foreign exchange in China

According to the time when settlement is made （i.e.when the bank at the seller's side credits the beneficiary's account in RMB）， there are three ways of settlement of export proceeds in foreign exchange in China， namely，"settlement after payment has been made"（收妥结汇），"settlem

ent on a fixed date”（定期结汇） and“settlement by negotiation”（议付结汇）.

“Settlement after payment has been made” means that after receiving the documents presented by the beneficiary， the remitting bank[12]（寄单行） shall dispatch the documents to the paying bank if no discrepancies are found between the documents and the Credit.When the paying bank credits the sum of foreign exchange to the sender’s （the remitting bank’s） account， the latter shall then convert the seller’s export proceeds in foreign exchange to Renminbi yuan at the listed foreign exchange rate on that day and credit the export proceeds in Renminbi yuan to the seller’s account.

“Settlement on a fixed date” means that after making sure that there is no discrepancy between the documents and the Credit, the remitting bank shall dispatch the documents to the paying bank abroad for payment and shall then convert the seller’s export proceeds in foreign exchange to Renminbi yuan at the listed foreign exchange rate on a previously fixed day.

“Settlement by negotiation” means that the negotiation bank is to purchase the documents and/or draft from the beneficiary.Once documents are found to have complied with the requirements of the credit, the negotiating bank will accept the documents and/or draft and in the meantime credit the net proceeds (the face value of the invoice minus bank charges and interest incurred during the time the bank needs to get reimbursed) in Renminbi to the beneficiary (the exporter) at the listed foreign exchange rate on the negotiation day.

## 2.The ways of handling discrepancies between the documents and the L/C

As previously noted， in L/C operations， the seller is entitled for payment only against documents in strict compliance of the terms and conditions of the L/C.This is the basic principle on which the L/C operates.But， it often happens that the documents tendered are not always in conformity with the terms and conditions of the L/C.According to a study conducted by th

e International Chamber of Commerce （ICC）， Banking Commission，it shows that two-thirds of presentation of the documents against L/C deviate from （与……不同） the terms and conditions of the L/C on first presentation.

Commonly found discrepancies between the letter of credit and supporting documents include:

■ letter of credit has expired prior to presentation of draft;

■ bill of lading evidences delivery prior to or after the date range stated in the credit;

■ stale dated documents;

■ changes included in the invoice not authorized in the credit;

■ inconsistent description of goods;

■ insurance document errors;

■ invoice amount not equal to draft amount;

■ ports of loading and destination not as specified in the credit;

■ description of merchandise is not as stated in credit;

■ a document required by the credit is not presented;

■ documents are inconsistent as to general information such as volume, quality, etc.;

■ names of documents not exact as described in the credit.

■ invoice or statement is not signed as stipulated in the letter of credit.

When a discrepancy is detected by the negotiating bank, a correction to the document may be allowed if it can be done quickly while remaining in the control of the bank.If time is not a factor, the exporter should request that the negotiating bank return the documents for corrections.

If there is not enough time to make corrections, the exporter may handle the discrepancies in the following ways.

（1） Negotiation against indemnity （凭保议付）

Negotiation against indemnity[13]， also known as negotiation under reserve， is a provisional（暂时的） negotiation made to the beneficiary of a letter of credit where the documents submitted under the L/C requirements have discrepancies.

When discrepancies exist, negotiating banks may decide whether: to refuse the request for payment by the seller or to pay against indemnity from the seller.It is easy for a bank to refuse to pay against non-confirming documents but this will have negative consequences especially if the seller is a valued customer of the bank.Therefore, banks do negotiate documents against an indemnity from the seller.The bank’s decision to negotiate the documents against an indemnity or under reserve is dependent mainly upon evaluation of the credit risk of its customer.

When negotiating documents against indemnity or under reserve， the discrepancies in the documents are listed in bank’s standard indemnity form and executed by the seller.By doing so， the seller has full knowledge and is aware of the discrepancies， possibility of rejection by the issuing bank and his obligation to refund （退款） the negotiating bank in the event the issuing bank refuses to take up the documents and pay the negotiating bank.

(2) Documents sent on approval basis

In the event that the discrepancies are rather complex， the exporter should request that the negotiating bank send the documents to the issuing bank on an approval basis or notify the issuing bank by wire， outline the discrepancies， and request the authority to pay.（In China， this is called“电提” meaning wire notification.） Payment cannot be made until all parties have agreed to jointly waive the discrepancies.

(3) Payment under collection

In the majority of cases, the discrepancies are not of a significant nature, payment can be made against indemnity or under reserve or documents sent on approval basis.It is, however,also possible for the discrepancies of a material nature.For instance, the description of the goods may differ; invoice i

s based on an FOB basis, while the credit stipulates CIF as the term of delivery, etc.In such cases, the bank will only be prepared to handle the documents on a collection basis, or in other words, it will undertake collection of the amount of the invoice,but will not be willing to make payment to the beneficiary in advance.In such case, the exporter runs great risks of non-payment.

## 18.6 Verification and Writing-off of Export Proceeds in Foreign Exchange and Export Tax Rebate

In accordance with relevant provisions of the State Administration of Foreign Exchange（SAFE） of China （国家外汇管理局） and the State Administration of Taxation of China （国家税务总局）， China's exporters， after effecting shipment and documentation， should take out verification and writing-off of export proceeds in foreign exchange （出口收汇核销） and export tax rebate.

### 1.Verification and writing-off of export proceeds in foreign exchange

The system of verification and writing-off of export proceeds in foreign exchange(hereinafter called"verification of export proceeds") in China is an important measure aiming at strengthening the collection, the management and preventing the loss of export proceeds in foreign exchange.Verification here means the acknowledgement of export proceeds in foreign exchange and writing-off here means an cancellation of export proceeds in account books.

Under this system， exporters in China， before making the customs declaration， are required to take out and fill in the verification and writing-off forms （核销单） （with serial number） accurately and completely.

The verification and writing-off forms are uniformly managed by the State Administration of Foreign Exchange， issued by branches and sub-branches of the State Administration of the Foreign Exchange.The customs office will check if the contents and the serial number of the verification forms are in consistent with the relevant contents and the serial numbers of the verification forms stated on customs declaration forms.After checking the goods and ensuring there is no mistakes， the customs office shall then affix the“test-over seal”（验讫章） on both the verification forms and export customs declaration forms.When the nominated bank receives the export proceeds，it shall issue a bank slip which is specially for verification of export proceeds （银行水单出口收汇核销专用联） bearing the serial number of verification form.

With the verification form， the above-mentioned bank slip and other relevant documents，the exporter will then go to the foreign exchange administration of the place where it is located to handle verification procedures. The latter shall affix“verified”（已核销） on the verification form and give back the special page of the verification form for export tax rebate to the exporter.

In order to further improve the management of verification of export proceeds, a new system of verification of export proceeds started on Oct.1, 2003 across the country.The system optimizes and simplifies the process and procedures for verification of export proceeds by substantially increasing the technical content in the management of verification.Box 18-1 exhibits the highlights of the new system.

Box 18-1

Procedures for Verification of Exports in Accordance with the Implementation Rules for the Measures for the Administration of Verification and Writing-off

1.Subscribe to“China Electronic Port” with the customs office, and make the electronic certification of the enterprise legal person IC card of“China Electronic Port” and the enterprise operator IC card of“China Electronic Port” with the relevant administrations.

2.Obtain the verification forms through the“System of Collection of E xport Proceeds in Foreign Exchange of China Electronic Port” with the fore ign exchange administration.

3.Foreign exchange administration transmits the electronic record data of the verification forms to the data center of“China Electronic Port”.

4.Put on record the verification forms with the customs office of the pl ace where the declaration is to be made through the“System of Collection o f Export Proceeds in Foreign Exchange of China Electronic Port”.

5.Make the customs declaration with the customs office who shall, wh en processing clearance formalities for the exporter, affix the“test-over sea l” in the column of“customs verification and clearance” on the verification f orm, and write off the electronic record data of the verification form with th e remark of“used”.It shall, after the clearance, issue the declaration forms m arked with the numbers of the verification forms to the exporter if the expor ter so applies, and transmit the writing-off of the electronic records of the ve rification forms, and the electronic records of the customs declaration form s, etc., to SAFE through the data center of“China Electronic Port”.

6.Tender the verification forms that have been used in the customs decl aration to the foreign exchange administration through the System of Collec tion of Proceeds.

7.Collect the price in good time and full amount.In the case of spot coll ection, the export proceeds shall be collected within 180 days after the clear ance of the goods, and in the case of forward collection, the proceeds shall be collected within the time limit as recorded for forward.

8.With respect to the settlement of account of payments collected direc tly from overseas,the bank shall issue the special page after finishing the for eign exchange settlement or entering the amount into the foreign exchange account for current account transactions.

9.Go to the foreign exchange administration for verification and writin g-off export proceeds in foreign exchange.

Source: The Implementation Rules for the Measures for The Administration of Verification And Writing-off of Export Proceeds in Foreign Exchange, H uiFa (2003) No.107.

## 2.Export tax rebate declaration

When an enterprise applies for export tax rebate, the following docume nts needs to be provided: export declaration form, export commercial invoic e, purchase invoice, the special page of verification form for export tax reba te, bank slip which is specially for verification of export proceeds and the d ocuments as may be required by the tax authority.

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[1]CISG Art.30.

[2]CISG Art.58.

[3]CISG Art.35(2)(b).

[4]CISG Art.33.

[5]CISG Art.41.

[6]Intellectual property （IP） refers to creations of the mind： inventions， literary and artistic wo rks， symbols， names， images， and designs used in commerce.Intellectual property is divided i nto two categories： Industrial property， which includes inventions（patents）， trademarks， in dustrial designs， and geographic indications of source； and Copyright， which includes literary a nd artistic works such as novels， poems and plays， films， musical works， artistic works such a s drawings， paintings， photographs and sculptures， and architectural designs.Rights related to co pyright include those of performing artists in their performances， producers of phonograms in their r ecordings， and those of broadcasters in their radio and television programs.

[7]CISG Art.42(2)(b).

[8]UCP 600 Art.30(a).

[9]UCP 600 Art.30(b).

[10]UCP 600 Art.10(e).

[11]UCP 600 Art.14(c).

[12]Remitting bank here refers the bank that forwards the seller’s shipping documents to the paying b ank.It is usually the notifying bank.

[13]Indemnity is an agreement whereby one party agrees to secure another against an anticipated loss or damage.

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