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**Economic and Social Impact of State Protectionism  
in Foreign Trade**

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## Introduction

The continuing process of globalization, the raising integration of economic markets at global level, and the weakening of geographical restrictions to trade have driven nations to protect increasingly liberal economic markets. Even though the free trade exists since earlier than globalization process, it gained explicit significance after 1970s, when the financial liberation process started. Certainly, nowadays, one of the main aims of many nations is to create the favorable conditions to remove any possible barrier to worldwide trade and the quantity of regional and/or bilateral Free Trade Agreements has congruently increased. Yet, during economic crises when states experience declines in the GDP level along with the unemployment rate growths, even some strongest advocates of the free trade endorse a number of opinions in favor of protectionist policies, particularly in undeveloped economies which could be not prepared for international competition. As it should be familiar, protectionism characterizes a foreign policy which protects native producers from any sort of foreign threat. Therefore, the challenging of free trade *versus* protectionism, which has shown both opponents and supporters at any time, still represents an important trouble for policy makers.

**Purpose.** The purpose of this thesis is to examine the economic and social impacts of protectionist policies, and to assess the basis behind trade protectionism.

**Methodology.** The methodology used in this thesis comprises review of the empirical studies and literature published from 1989 to 2017, and descriptive statistical examination of data issued by international organizations.

**Findings.** Global trade has been extending faster than extension of world gross domestic product, and nations with unrestricted trade policies benefit more than countries with policies that restrict trade. However, trade protectionism remains to be exercised in reply to pressure from select

businesses and political constituencies. The thesis also establishes that trade limitations are damaging to the trading partners' economies.

## **Chapter 1. Theoretical aspects and world experience of protectionism policy of government in foreign trade**

### **1.1 Theoretical basics of economic protectionism policy and its positive world experience.**

Protectionism is the sum of economic policies projected to support domestic producers from foreign producers in a specific industry, by means of raising the price of foreign goods, dropping cost for domestic producers, and limiting foreign producers' entree to domestic market.

In distant past, the Silk Road, the Incense Road, the Spice Route and other trade routes were formed and maintained by governments to enable the exchange of goods between civilization centers in Europe, the Mediterranean, and China. Through this period, protection of domestic manufacturers, was not the main objective of tariffs. The primary aim was to increase the revenue. However, China, between the late tenth and thirteenth centuries, preserved strict control above maritime trade by controlling exports, restricting trade to a limited ports, imposing tariffs on imports, and regulating the buying of dealt Chinese goods.

In the sixteenth century, the mercantilists upheld that gold and silver were the only things of value. In France, Jean Baptiste Colbert (1619-1683) brought all sides of manufacturing under state control, including luxury goods, in order to expand industry in the colonial realm. Moreover, Colbert subsidized the settling of Dutch weavers into France and levied tariffs on imported cloth in order to protect industry against foreign competition. To prevent domestic consumption of exportable luxury goods, excise taxes known as sumptuary taxes were imposed. However, the price of such interference surpassed the value of the benefits and did not bring success to the French economy.

At the beginning of the Industrial Revolution mercantilist beliefs in protectionism policies diminished and interpretations of physiocrats gained fame. The physiocrats held that the land is the source of value and there should be no export tariffs on agrarian goods. Later, Adam Smith and David Ricardo, classical economists, protested against mercantilist's protection policy. They believed that perfect competition, which means free international trade, provides further chances for specialization and the division of labor.

While free trade policies gained standing in nineteenth century, some economist in both America and Europe questioned the supposition of these free trade theories. They claimed that governments must follow activist national policies to stimulate industrialization and economic development. One of these economists was Frederich List of Germany. He shows how, alternatively, free trade or protectionism is useful in dependence of the stage of economic development. List related industrial growth and economic development to the national interest and safety of Germany, and he called for removal of internal tariffs amongst states and for the extension of the custom union. He also claimed for protection of infant industries with tariffs as a part of a wider development strategy that comprised other policies, such as the formation of a national railway network. The infant industry dispute was also reinforced by famous contemporary economists, such as Alfred Marshall and John Stuart Mill.

The use of trade obstructions arose during the two world wars. However, after World War II (1939–1945), worldwide organizations, such as the GATT, brought order to world trade by allowing a many-sided system of rules for government trade policies. Through the financial and oil crises of the 1970s, protectionism inclined to grow again in international trade. However, the formation of the World Trade Organization in 1995 provides an opportunity for trade negotiations and argument resolution among member states. The WTO

has practiced some success in dwindling trade barriers. However, to reduce subsidies in agriculture among developed countries has stayed a challenge for the WTO.

#### Types of protectionism policies

Protectionism may be realized in many ways. All forms of protectionism intended to protect domestic producers against foreign producers. Protection can be done by policies that increase the price of imported products, diminish the cost of domestic products or limit the access of imported goods to the home market in some additional ways. The methods of protectionism include:

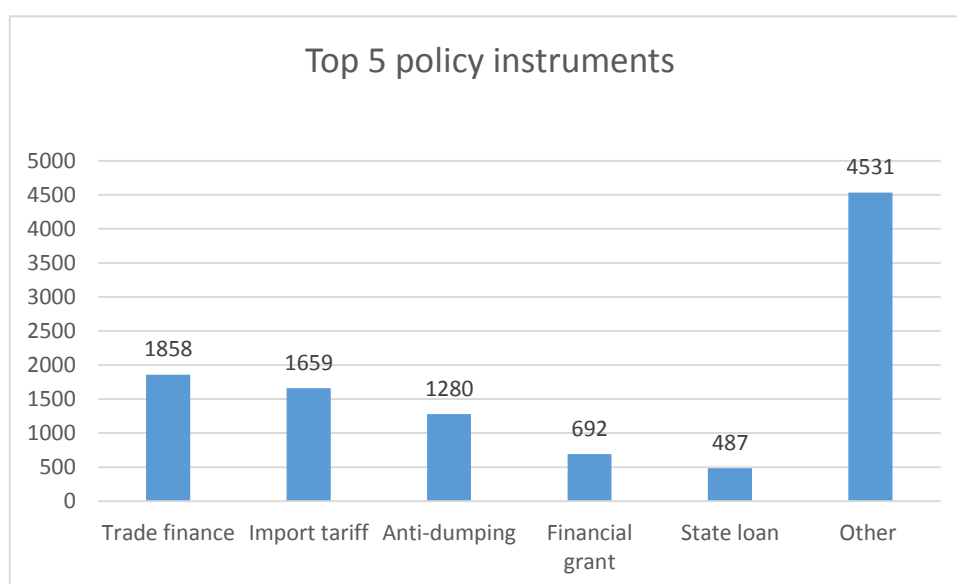
- tariff duties on imports which keep being implemented albeit great advancement under GATT;
- quota ceilings on the number of imported products sold in the local market, which constrain the supply and increase foreign products price;
- regulatory deterrents that put obstacles in the way of imported goods such as product classifications and apparently perpetual records of measures and specifications;
- subsidies to local producers that run from tax deductions to direct cash incentives;
- currency controls to restrain access to foreign currencies or control exchange rates to increase the price of foreign goods and decrease the price of domestic goods.

Table 1. Forms of protectionism policies

Tariff measures	
Tariff changes	
Non-tariff barriers	

Import controls	Export controls
Exchange rate policy	State aid and subsidies
Localization policy	Public procurement policy
Others	
<b>Trade defense measures</b>	
Anti-dumping	Anti-circumvention
Anti-subsidy	Safeguard

Figure1. Top 5 Policy instruments.



Source: GTA database

## Tariffs

A tariff is a tax which aids to increase the prices of imported goods and have been the most common form of protection for national producers. Tariffs



levied on products and services imported from other countries. Tariff method works better in countries with lots of imports.

The widely known example of protectionist tariffs is the Smoot-Hawley tariff. Tariff was imposed in 1930 against agrarian imports from Europe, which stepped up in farming After the World War I. Rather than serving national farmers, it elevated food prices for Americans who were at that point experiencing the Depression. It additionally constrained other countries to react with their own tariffs. That forced worldwide trade down by 65%. Most economists blame the Act for deteriorating the Great Depression.

Non-tariff barriers

Quotas

A quota is a straight limitation on the total amount of products that may be imported within a specified period. Quotas limit total supply and therefore rise the home price of the products on which they are levied. Quotas usually specify that the share of an exporting country in home market may not surpass a certain limit.

The main difference between tariffs and quotas is that quotas do not rise prices of imported goods; tariffs do. A tariff, in the short run, will decrease the incomes of foreign exporters of the products. A quota, however, increases price but not costs of manufacturing and thus may rise profits. Due to the fact the quota executes a restriction on the amount, any profits it creates in other nations will now not result in the entry of new companies that ordinarily removes income in perfect competition. By definition, entry of new overseas corporations to earn the profits available in the U.S is blocked by the quota.

Voluntary Export Restrictions

Naturally, VERs are a consequence of requirements made by the importing state to provide a protectionist measure for its national businesses that

produce competing products. VERs can also be reached at the industry level. VERs are often made because the exporting states would prefer to levy their own limitations than risk sustaining worse terms from quotas and/or tariffs. They have been used by huge, developed countries. VERs are started to be used since the 1930s, and have been imposed to an extensive range of products, from footwear to textiles, steel and automobiles.

The other methods of import controls are import licensing, import ban etc.

### Export controls

Similar to import controls, export controls are sometimes used as a protectionist measures to sustain the competitiveness of a state's industry rather than making fiscal income from exports. Export controls can be in the form of export quotas, export bans and others.

### Exchange rate policy

An exchange rate regulation works by limiting access to the foreign currency necessary to buy foreign goods. For example, a government that desired to defend its import-competing and exporting industries may try to hold its exchange rate falsely low. As a consequence, foreign goods would appear expensive in the national market while home products would be cheap abroad. Local producers indirectly are subsidized and local consumers indirectly taxed. This policy is usually hard to sustain. In order to hold exchange rate low, central bank has to buy foreign currency with domestic currency. This newly issued national currency rises the local money stock and ultimately causes inflation. Inflationary policies are not generally regarded as a practical way of protecting local industry.

### Subsidies

The subsidy is a money given by a government to a specific industry in order to decrease production costs. This lets that industry to decrease its prices

and obtain advantage compared to foreign manufactures. On a worldwide scale, this will diminish the quantity of income in foreign states as most services and goods will be bought locally as it is cheaper. This may end in some foreign industries to stop functioning, or other governments reacting with their individual method of protectionist policy. If a country, however, chooses to react with their own policy of protectionism, this may launch a chain response and lead to an increase in protection in the worldwide economy. This will be harmful to global trade and will reproduce a misallocation of resources, as some of those manufactures will be accepting ineffective means of production.

#### Localization barriers

There is an increasing trend of putting on LBTs in an effort to form domestic jobs and to support domestic enterprises by “systematically disadvantaging foreign rivals.” Local governments typically apply policies leading to mandatory localization for foreign businesses and investors as actions with the nominal aim of:

1. endorsing or defending local businesses and suppliers of service,
2. preserving and strengthening state regulatory management over industries, banking and data, and
3. providing improved safety and privacy for consumers' information.

Protectionism can occur in areas as dissimilar and wide as forced local employment; forced local ownership; forced local data processing and limitations on e-commerce; forced usage of a certain proportion of local content; forced local manufacture as a condition of market entree and of superior tax and investment policies; biased customs requirements and injustice against direct foreign investment.

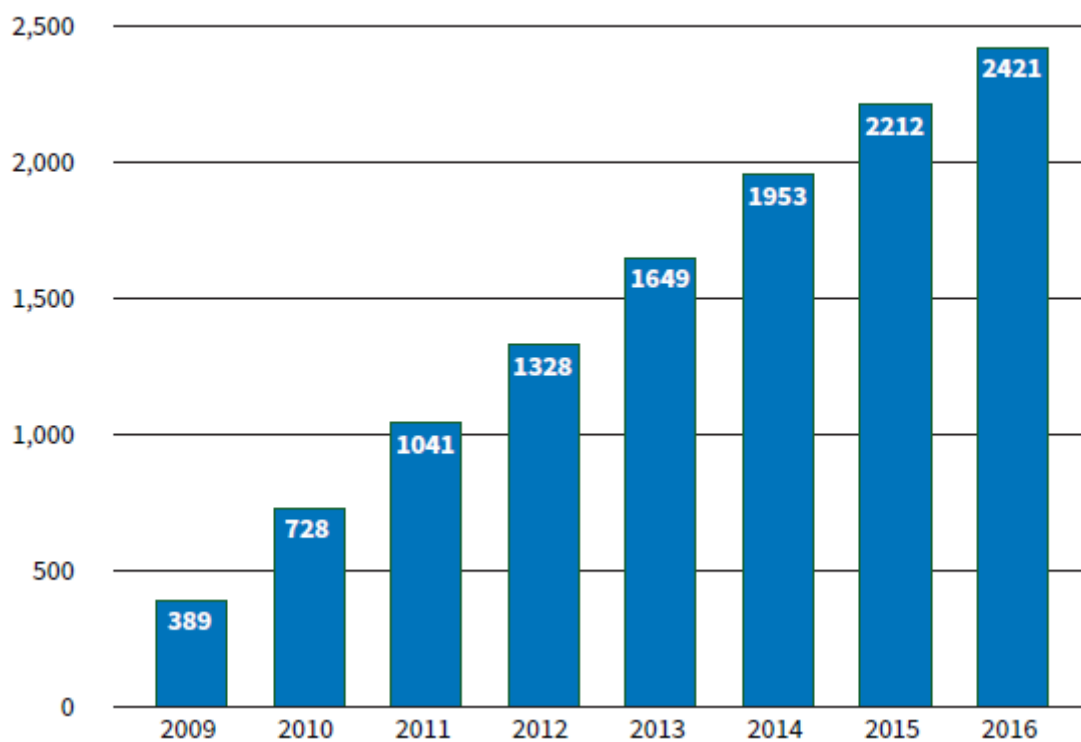
## Public procurement policy

The state policy in the sphere of public procurement regarding support and development of subjects of medium and small business marks out features of their participation as suppliers (performers, contractors). The corresponding purchases are used by the state, providing the economic growth of the state, for attraction of the maximum number of businessmen and increase of the competition, and some stimulating measures are applied to granting advantages of participation in purchases of more vulnerable segment of national economy. Countries can defend their local industries by means of public procurement policies, where national governments choose local firms. For example, local or national governments can choose local suppliers of military and medical products. While numerous WTO members have signed up to the Government Procurement Agreement (GPA) the mainstream have not signed up an agreement for making local public procurement open for foreign competition.

According to GTA statistics, protectionism gradually increased since 2009. Overall, more than 5,600 new protectionist measures have been applied globally between 01.2009 and 07.2017. Over 3,000 of these protective policies have been nontariff barriers. This rise in the implementation of nontariff barriers is a common time tendency experienced across other sources of data.

The stock of nontariff barriers that are now in force raised since 2009. More than 2,400 nontariff barriers that were freshly applied since 2009 were in force up to the end of 2016 (figure 2). Only around one third of the nontariff barriers that were executed since 2009 have been provisionally.

Figure 2. Amount of NTB presently in force (2009-20017)

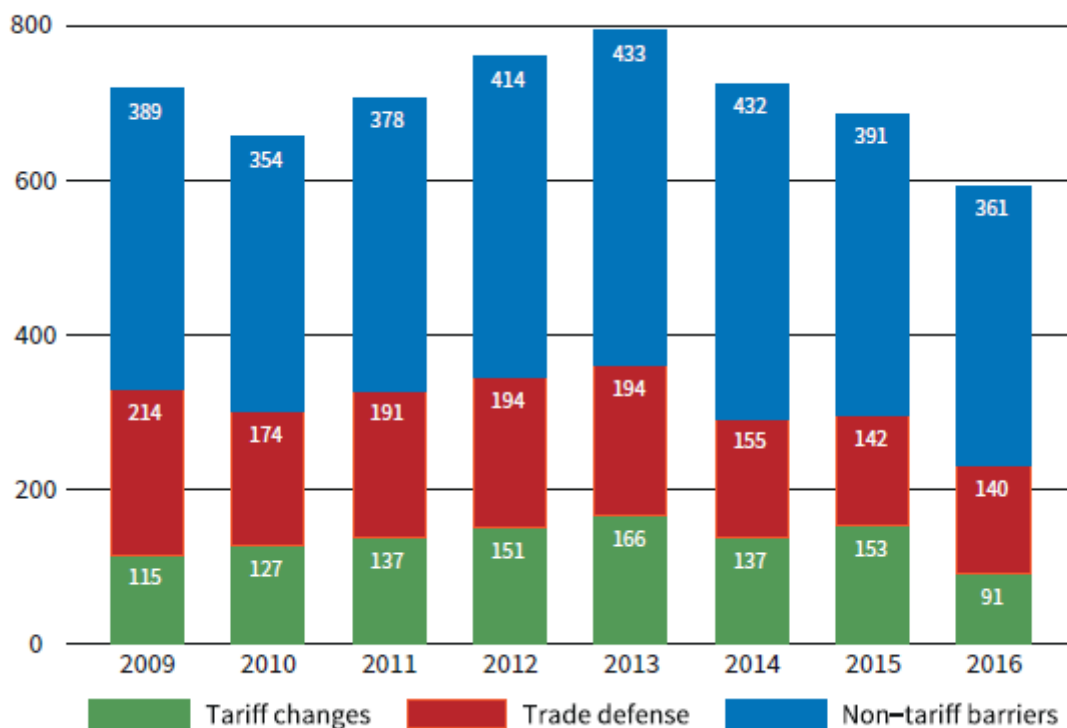


Source: GTA database

Figure 3 and 4 illustrates that tariffs are not the main tool for republics to protect national economies. Instead, nontariff barriers are most frequently implemented. Since 2009, merely 20% of all applied protectionist interferences can be credited to a rise in tariffs. On the contrary, nontariff barriers constitutes on average 55% of the realized protectionist interventions. The usage of nontariff barriers raised steadily comparative to trade defense policcies. Although in 2010 merely 54% of all protectionist interferences were nontariff barriers the use of nontariff barriers amplified to 61% in 2016. Measures of trade defense experienced a slight backdrop. 30% of all implemented protectionist policies in 2009 could still be credited to either safeguards, countervailing duties, or anti-dumping duties. These diminished to only 21% in 2015, while raising slightly over again to 24% in

2016 - mostly driven by the increasing quantity of anti-dumping arguments in industries with overcapacities like the solar panel products or steel sector.

Figure 3. Amount of new protectionist interferences by type.



Source: GTA database

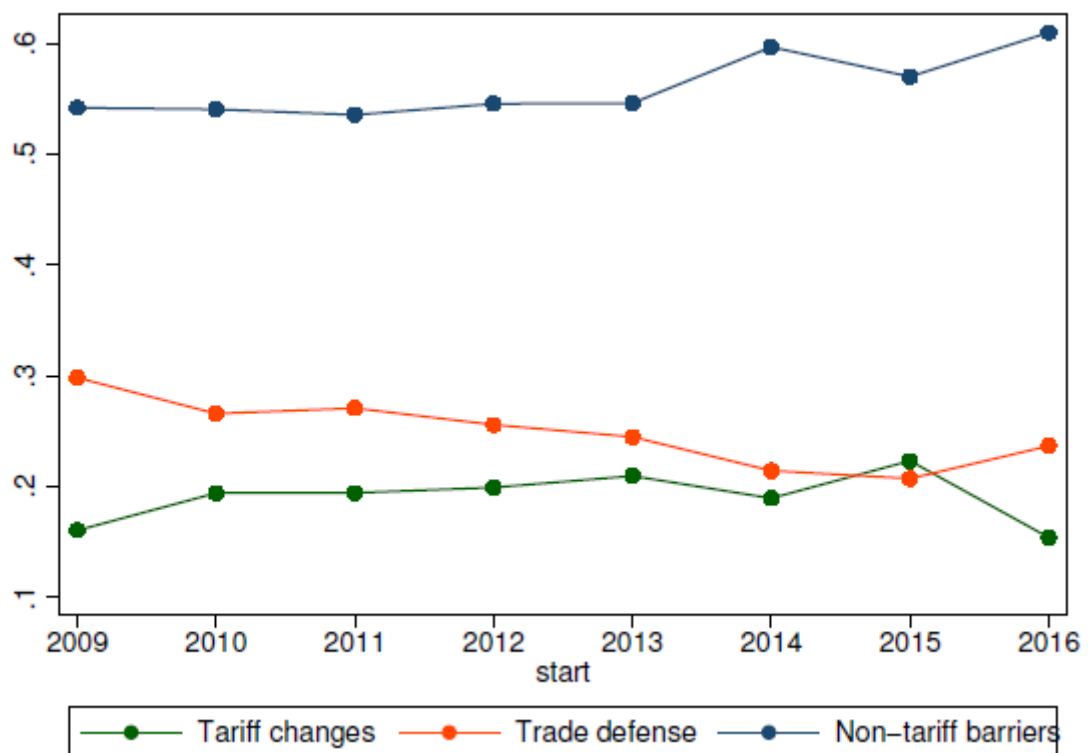
Observing more exactly on the forms of non-tariff barriers implemented, it is obvious, that monetary grants provided to exporting industries are the most often applied nontariff barrier. Figure 6 demonstrates a rank of nontariff barriers, arranged by categories of nontariff barriers, that were most frequently implemented between 2009 and 2017. Six categories are distinguished:

1. - exchange rate policies and capital controls,
2. - import and export policy instruments,
3. - state aid measures and subsidies,
4. -public procurement policies

5. -localization policies
6. -other instruments.

Table 1 provides an outline of intervention types comprised in tariffs and nontariff measures. State aid measures and subsidies make up for the biggest category which is mostly driven by the wide provision of monetary grants provided to national companies that separate from foreign rivals. More than 500 such financial contributions have been imparted. Other significant subsidies and state aid tools have been prejudiced state loans, taxes and bailouts or social-insurance aids. That state aid measures and subsidies make up for the main category of nontariff barriers, particularly compared to direct export and import controls underscores the significance of not only seeing direct trade policies, but spreading the emphasis on more hidden protection.

Figure 4. Share of Tariffs, Trade Defense Measures and NTBs of all New Protectionist Interferences (2009-2016)



Source: GTA database

The large quantity of newly applied public localization and procurement policies also highlights the increasing significance of nontariff trade barriers. About 400 discriminating PPP (public procurement policy) were applied since 2009. Public procurement localization limitations are the second most often implemented nontariff barrier, with more than 360 applied restrictions. Public procurement inclination margins and entree do play minor roles, with fewer than thirty implemented measures each.

Trade defense measures.

World Trade Organization (WTO) law distinguishes three main trade defense instruments (TDI): anti-subsidy, anti-dumping and safeguard tools. The European Commission observes the application of these tools, follows up the



implementation of procedures and negotiates future universal rules with European Union trading partners. Anti-dumping rules are intended to permit countries to take measures against dumped imports that result in or threaten to result in material damage to national industry. Anti-subsidy actions permit importing countries to take measures against certain types of subsidized imports. Generally, 'subsidies' are defined as monetary support from a government to a business or group of businesses. Safeguard actions are defined as "emergency" measures regarding increased imports of certain goods, where such imports have resulted or threaten to result in serious injury to the country's national industry.

#### Anti-dumping

Dumping can be reason for many troubles in the country to which dumped products are exported, causing unemployment. In such a condition, protectionist policies are applied and duties are levied on dumped imports to avoid the short-term dislocation. Anti-dumping policy influences the national economy, in that it protect local companies from the low priced products. Those businesses which may be constrained to close as a consequence of not being able to stand a competition, will cause unemployment, which would then have a stream on effect as consumption volume falls, economic activity diminishes and probably an economic recession. On a worldwide scale, firms looking for to dump products will lose revenue, as they are incapable to sell surplus stock, which mean wastage of resources. Likewise those countries looking for to avoid dumping will miss the chance to surge living standards, as buyers are forced to pay complete price of services and goods.

#### Anti-subsidy

Countervailing measures is connected with government subsidies. The subsidy is a financial donation (or revenue or price support) that gives an advantage: “financial donation” here comprises not only grants but also equity investment and loans gave on favorable terms, as well as tax credits or provision of cut-rate products or services. The contribution can be made by local or central government or even by the state.

However, countervailing measures can be levied by a member of WTO only if a subsidy is:

- “forbidden”: once the subsidy is received in return for export efficiency (for example, a donation that depends on an achievement of a certain volume of exports) or use of local over imported products, or
- “actionable”: once the subsidy is specifically for an industry, company, group of industries, or regions.

These rules’ result is that WTO representatives cannot levy CVMs in response to actions such as a broadly low rate of profit tax in the country of export – but could do so in relation, for instance, to a low corporation tax rate limited to a certain sector or region. Lastly, CVMs can be levied only if the subsidy causes injury to the business of the country of import.

The volume of duty levied has to be depend on the volume of the subsidy. Again, the calculations of the amount of the subsidy are plagued with tough economic and accounting issues, in addition to the difficulty in gaining evidence. Assessment of if the industry of the country of import has underwent injury is also difficult, as it comprises measuring what would have occurred on the affected market in terms of prices if the subsidy hadn’t been granted.

## Safeguard

The member of the WTO can limit import of a product temporarily (take measures of "safeguard") if its local industry is injured or being under the threat of the damages put with the import rise. Here, the injury has to be thoughtful. Protective measures were constantly available under GATT. Yet, they were rarely used, some governments favoring to defend their local industries through "grey area" actions — using two-sided negotiations outside GATT's patronages, they convinced exporting countries to confine exports "voluntarily" or to assent to other means of market sharing. Agreements of this type were reached for an extensive variety of products: steel, automobiles, and semiconductors, for instance.

The WTO agreement prohibits "grey-area" actions, and it sets time restrictions on all safeguard measures. The agreement states that members must not take, seek or uphold any voluntary export restrictions, organized marketing provisions or any other related actions on the import or the export side. The two-sided measures that were not reformed to comply with the agreement were gradually stopped by the end of 1998. States were permitted to save one of these bilateral measures an additional year, but merely the European Union — for limitations on car imports from Japan — had used this provision.

## Anti-circumvention

According to the OECD, circumvention refers to "getting around promises in the WTO such as promises to restrain subsidies for the export of the agricultural goods. It comprises: evading quotas and other limitations by

changing homeland of a product; actions taken by exporters to avoid countervailing or anti-dumping duties.”

The arguments for protectionism comprise national defense, employment, trade deficit, fair trade, and infant industries:

### National defense

Protecting manufacturers in industries such as weapon production is considered practical to protect the country's readiness for times of misfortune. This argument has extensive patriotic appeal, but it also has flaws. Primary, protections given to so-called important industries are very expensive to tax payers and appear to have become repetitive and matter of fact. Secondly, several industries meet the requirements to be crucial for national safety including chemicals, metals, computers and plastics. Must all these industries revel in protection from worldwide competition? Thirdly, in today's global networking's business environment is unimaginable to identify a sensitive industry that is without nets of foreign partners and co-owners. In the defense industry, Raytheon, Boeing and DRS Technologies all have lots of strategic relationships with international clients, partners, suppliers, and foreign governments as well. Moreover, these enterprises do compete globally. Could such businesses compete in contradiction of foreign producers abroad, as Raytheon recently contested with the British company BT Group PLC in the UK, and then revel in protection from the same rivals in the local market (Cole, 2008)? Lastly, some of these state defense corporations are not really national – they are getting foreign owned. Just to exemplify the point, Finmeccanica SpA, an Italian defense servicer, has recently got the US-

based DRS Technologies for \$5.3 billion. US safety review notwithstanding, this safety company is now responsible to a foreign owner.

## Balance of payments

Supporters of protectionism are worried about the shortage in the balance of payments' present account. When trade deficit perseveres and raises, politicians begin to employ protectionism to fight the perceived unfairness in the republic's trade relations. This argument, while popular, ignores key issues. Firstly, study after study in the trade's economics continues to demonstrate that trade deficit in itself is not harmful to the economy. Secondly, focusing only on the balance of trade but an incomplete and restricted view of a country's balance of payments. An absolute balance in an other account, such as the capital account, which calculates capital outflows and inflows, accompanies a deficit in the trade balance. That is the situation in the US balance of payments and it is a fact hardly stated by arguments for protectionism. Thirdly, protections that decrease imports habitually decrease exports and do not alter the deficit situation. Willett and Kaempfer (1987) researched the issue of using additional charge on import to cut the trade deficit and stated that the policy would misrepresent resource distributions and fail to decrease the deficit. They suppose that the other deficit be adjusted, the government budget shortage, for that holds guarantee to decrease trade deficit. Latest studies by the Institute for International Economics reach the same conclusion: restraining imports is not suggested for that will do injury to the GDP(US Current, 2008).

## Employment

A business that has not been get ready for rivalry, domestic or global, loses market share and jobs are lost. Employees and their representatives and

companies lobby the government very toughly to get protections, and they often do. Protections diminish imports and defend some jobs, but the following reduction in exports decreases employment in export industries. Luttrell (1978) revealed that employment improvements from reduced imports and harms from reduced exports counterbalance each other out with a net employment result near zero! Another issue is the cost per job protected. The price to the public can reach hundreds of thousands of dollars per a single job kept. Third, while employment in the shielded industry is spared, it deteriorates in industries that hinge on imports, like industrial consumers of imported goods, trade related service industries, retailers, and so on. In addition, the upsurge in the price of protected products surges the cost of making business in these industries and makes these businesses less competitive. Some end up repositioning or closing, as has been the case in firms reliant on protected steel, timber, sugar, and the like.

### Infant industries

This is an other favored case in developed and developing countries as well. A newly started industry may not revel in the cost and production competences relished by rivals who have been in industry long enough to grow production efficiencies and ground-breaking technologies. Thus, the newly started industry smears pressure on its government to protect it from global competition by means of levying trade limitations in the face of imports for a number of years up until the local industry apparently creates its comparative advantage. Unluckily, the protected business continues to bank on its political power and allies to extend the period of its “infancy” and repel lifting the protections. Such infant industries revel in the luxury of shield and often grow larger and start to resemble an oligopoly with substantial political power to realm and even increase types and levels of protection.

### Level playing field

Supporters of this argument propose that government should levy protection actions against foreign businesses if their governments employ protections of their local industries. The aim is to use reciprocity to force foreign governments to cut or eliminate their protection actions. This argument, also recognized as “fair trade” policy, is employed by governments globally influencing many industries, and often ends in strong regulations mandating the use of reciprocal protections. These defenses, however, give an advantage only to the protected industry and end in a growth of reciprocal trade limitations that injury both economies and impart a relation of hostility, which overthrows one of the key reasons for bilateral trade among countries. Hostile, relations grew between the USA and partners like Canada for the reason of reciprocal protections influencing wooden and other industries. Moreover, studies have shown that charges of such trade limitations experienced by the society outstrip the benefits that may accrue to the protected industry(Coughlin et al., 1988).

There are other arguments for protectionism, for example, spillover effect, income redistribution, strategic trade policy and so on. Yet, the record of trade in contemporary history continues to show that protection is eventually harmful to society.

### World experience

The first country which applied protectionism to defend and improve Lyon silk from foreign rivals by levying custom duties was France (1567). In 1840s, Germany which today is in the situation of the, Europe’s locomotive, which is severely opposed to protectionism however, actually applies protectionist policies for protecting its strategic industries, also has protected its economy with the aim of developing its industry. With the foundation of German Customs Union which was created by Frederic List who established the

German Historical School and protected that provisional customs protections should be applied in order for surviving the national industry, customs obligations among German states were cancelled and protectionist policies were employed with a common trade strategy in the direction of outside. Throughout the 20 years' period amid the World War I and II, policies of protectionism boosted speed and the Wall Street Crash in 1929 had substantial effects on this accumulative protective trend. As it is seen, the fight between free trade and protection has transformed into a challenging which exists in all times in substance.

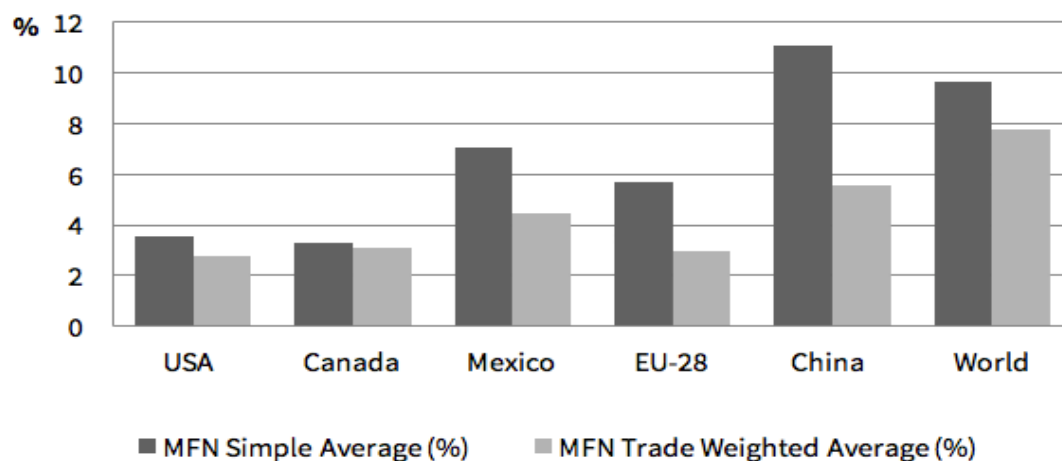
### Protectionism in USA

After the inauguration of Donald Trump, the new US management started a thorough analysis of US trade relationships with other countries. Its goal is to detect evidently increasing “unfair trade practices” by other countries that endangered “well-paid American jobs.” The warmed political discussion over unbiased trade emphasizes on the US’ most significant regional trading partners – Canada and Mexico – but huge trade balance shortages with main partner countries like Germany and China have also criticized. In the event of China, the US government sees subsidies and discernment against US companies as an unbiased trade policy. In the case of Germany, it criticizes local consumers’ weak appetite for US goods. The administration has took three protectionist trade policy actions as possible policies for correcting what it sees to be unfair trade, and for creating a “level playing field.”

The US actually imposes relatively low tariffs in comparison to its partners in trade (Figure 5).

Figure 5. Average MFN tariff by country in percent, 2015





Source:

WITS

Table 2. Top 10 USA sectors of import and their tariffs

GTAP		Imports (in million USD)	Weighted		unweighted	
			Bound	MFN	Bound	MFN
41	Machinery and equipment	40333	1.31	1.30	1.47	1.67
40	Electrical equipment	29673	0.36	0.34	1.02	1.12
38	Vehicles and vehicle parts	29571	3.72	3.69	3.84	3.82
33	Chemicals, rubber, plastic	27412	1.72	1.64	2.63	2.66
16	Oil	12006	0.00	0.00	0.00	0.00
42	Manufactures	7784	1.55	1.55	2.57	2.59
39	Transport equipment	7435	0.93	0.93	2.26	2.28
28	Garments	6892	12.02	12.10	10.45	10.54
30	Wood	6214	0.50	0.56	1.28	1.41
27	Textiles	5487	9.35	9.53	8.07	8.13

Source: WITS -TRAINS Tariff Data; BACI World Trade Database

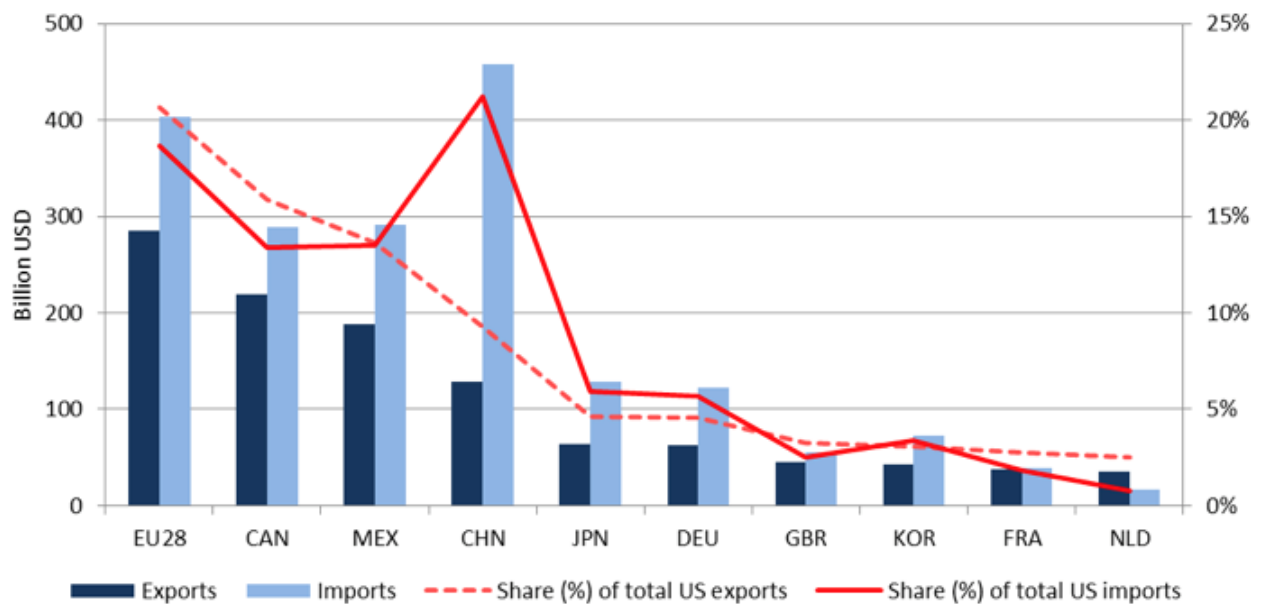
Table 2 shows the top ten US sectors of import in 2015. In addition to the sectoral capacity of US imports, average sectoral charges are shown in percent. Average duties are further discriminated into applied MFN tariffs and WTO bound. While the Bound Tariff shows the maximum tariff rate permissible within the WTO, the MFN tariff is the presently applied tariff reliable with WTO regulations.

If the US is not part of a free-trade agreement with some foreign country, this trading partner is not to be discriminated against by imposing higher tariffs on this country's exports to the US. The MFN tariff is then the maximum possible tariff applied. To evade that very high tariffs weight disproportionately, a further difference between the weighted and unweighted tariffs is made in Table 2. To rule out any prejudices, tariffs are weighted by the sectoral import volume. With the highest MFN tariff of just below 4 percent (vehicles and vehicle parts) the tariff rates in the top 5 US import sectors(of the top 10 US import sectors) are comparatively low. By bearing in mind the Bound tariff rates of the relevant sectors, it is evident that there are not any differences in MFN and Bound tariffs at the sectoral level. This model does not only apply to the US, but is rather mutual for economically greatly integrated economies.

In Parallel to this liberal tariff strategy, the US has been experiencing a high trade deficit for several years, mainly in trade in goods.

Significant deficits in US trade can be seen with eight of the ten best US trading partners (Figure6). Taking into consideration these two phenomena – high trade deficits and low tariffs – at first it seems comprehensible that US political shareholders regard the current trade structure as unbiased. Furthermore, US jobs are mainly accumulated in industries that suffer from the country's open position. These interest groups obviously see the separation of the USA market as an practical cure.

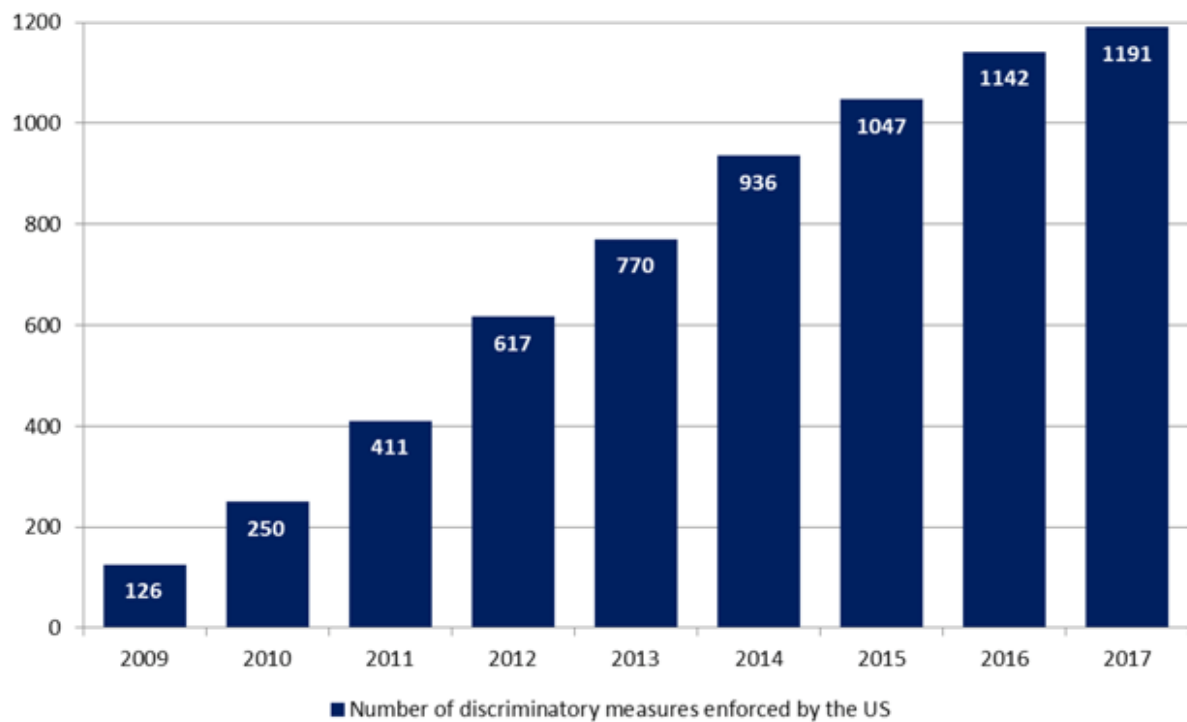
Figure 6. US balance of trade with its top 10 partners in trade, 2015



Source: World Trade Database

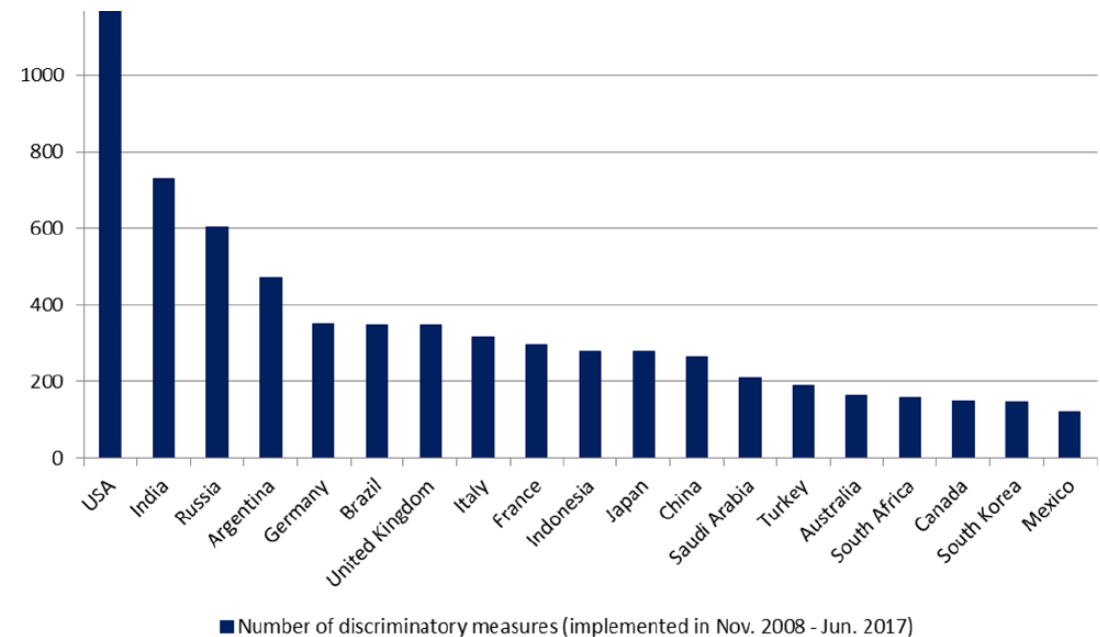
Yet, this assessment disregards non-tariff impairments that limit trade flows. Figure 3 clues at significant evidence of an increasing protectionist approach in the recent past from the US. In accordance to the latest data from the GTA (Global Trade Alert), the US is the most protective country inside the group of G20 countries, as it executes by far the highest amount of non-tariff barriers.

Figure 7 The US discriminatory measures since 2009



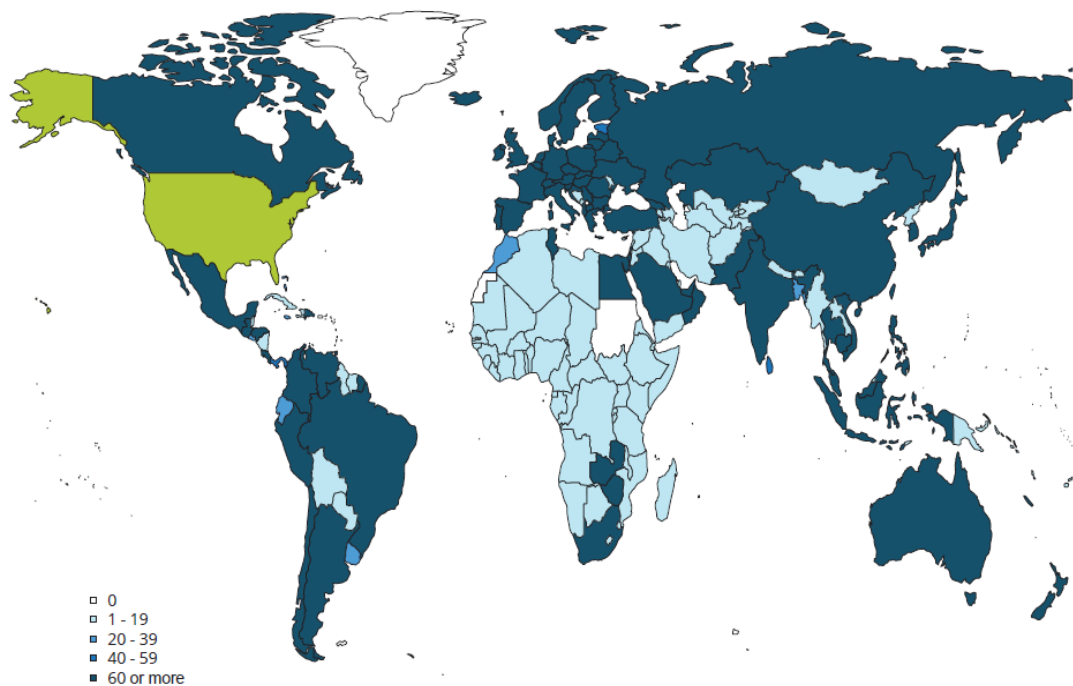
Source: GTA database.

Figure 8. Number of discriminatory measures by G20



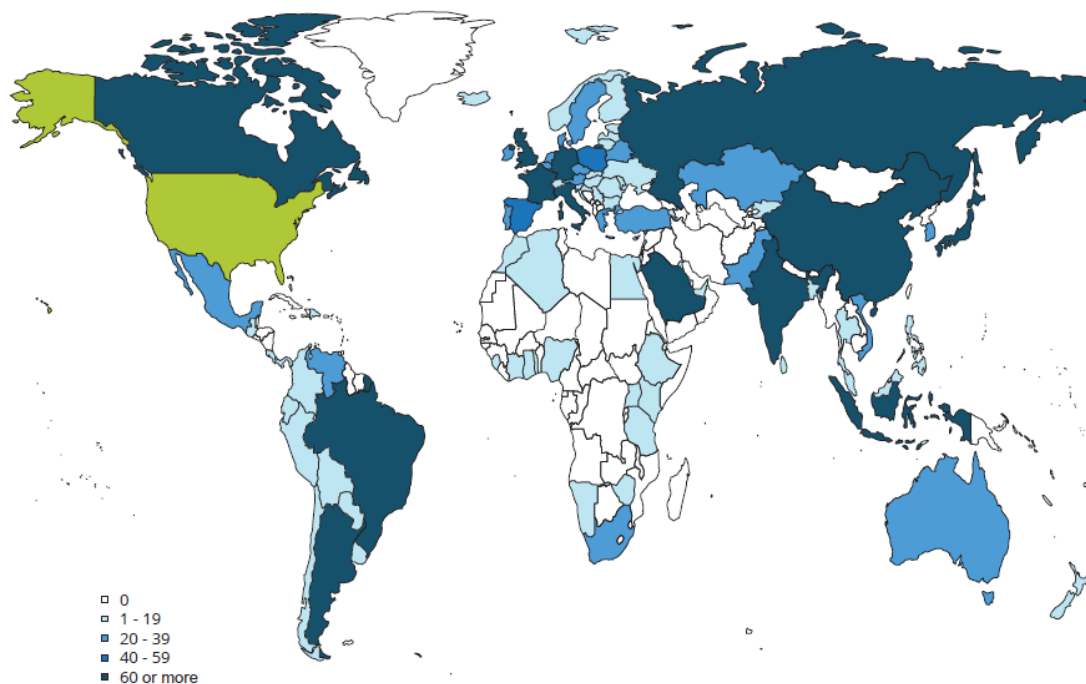
Source: GTA

Figure 9. The number of USA discriminatory measures per country



Source: GTA

Figure 10. Protectionist measures against USA



Source: GTA reports 2017

Latest practical studies prove that in the case of advanced economies, not merely a rise in tariffs but, mainly, a rise in non-tariff obstacles is decisive for welfare losses. Thus, the linked possible protectionist actions of the US might lead to plain economic outcomes.

The US has set the already very progressive negotiated trade agreements with both the trans-pacific countries and the EU on hold – TPP and TTIP will not be applied for the time being. Official papers on the foreign trade approach of the US premier suggest renegotiating old contracts if aims such as the decrease of the trade deficit are not proficient. The US has pronounced a renegotiation of the NAFTA (North American Free Trade

Agreement). In addition, the Korean contract and the circumstances for China's WTO membership are contenders for US protectionism.

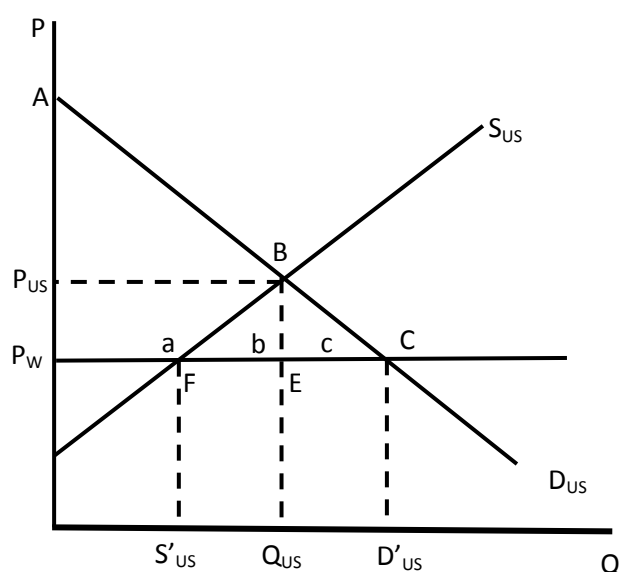
### 1.3 Economic and social effects of government protectionism in foreign trade Gains from free trade and effect of tariff.

In figure 11 the lines  $S_{US}$  and  $D_{US}$  are the US. demand and supply curves for a hypothetical product. Their intersection at B results in the equilibrium values for price and quantity of  $P_{US}$  and  $Q_{US}$ . Supposing the US. has a comparative disadvantage in the manufacture of this product the price will be lesser abroad than in the United States. Let this low world price be  $P_W$  and suppose that US. procurements do not affect this global price. Graphically, this is depicted by the horizontal world supply curve  $S_W$ . If one permits for free trade, this lower world price has two impacts. First, U.S. customers will increase their consumption to  $D'_{US}$ . Second, U.S. producers will contract their production to  $S'_{US}$ . The excess of U.S. purchases from foreign producers (that is imports)

The lower price benefits US consumers and at the same time harms US producers, a fact that causes the recent contentious discussion of US trade policy. The magnitude of these gains and losses using the concepts of consumer and producer surplus can be seen in figure 7. Consumers gain in two ways. Initially, consumers purchased  $q$  at a price per unit of  $p$ . With free trade, they purchase  $q$  at the lower price per unit of  $p$ . This gain is represented by the rectangle  $p$   $be$   $p$ . In addition, the lower price persuades consumers to increase their purchases from  $Q_{US}$  to  $D'_{US}$ . This gain is showed by the triangle BCE. The total gain to consumers is  $P_{US}BCP_W$  or, using the lower case letters to symbolize areas,  $a+b+c$ . Analogously, manufacturers lose due to the lower price they obtain for their output  $S'_{US}$  and due to their reduction of production from  $Q_{US}$  to  $S'_{US}$ . The total loss to producers is  $P_{US}BFP$  or  $a$ .

The nation as a whole gains since the consumer gains of  $a+b+c$  surpassed the producer losses of  $a$  by  $b+c$ . This analysis can also be observed using a good that the United States will have a comparative advantage in the manufacture of a good. For the export good, the change to free trade will cause producer gains that surpass consumer losses.

Figure 10.



To make the protectionist trade policy analysis as straightforward as possible, the impact of a tariff is analyzed. For convenience, the free trade results in figure 7 are duplicated in figure 8. Given the free trade world price of  $P_W$  U.S. consumption, production and imports are  $D'_{US}$ ,  $S'_{US}$  and  $S'_{US} D'_{US}$ . Assume a tariff is imposed, causing the price in the United States to increase to  $P_T$ . The



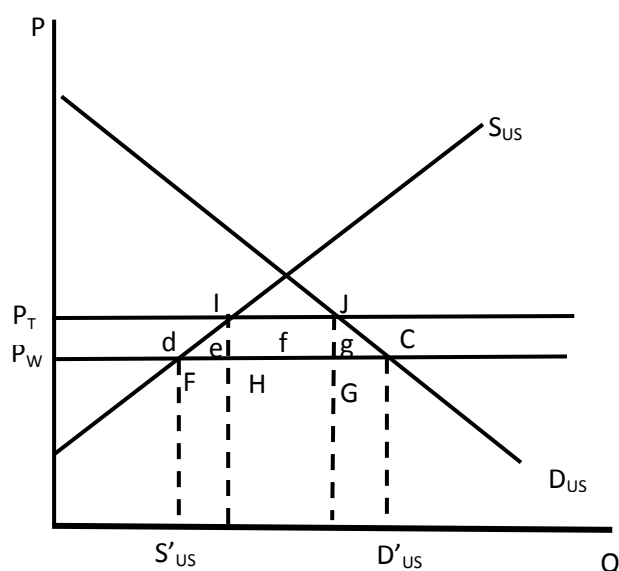
price in the United States now exceeds price in the world by amount of the tariff  $P_W P_T$ .

The higher U.S. price causes consumer purchase to decrease from  $D'_{US}$  to  $D''_{US}$ , domestic production to increase from  $S'_{US}$  to  $S''_{US}$  and imports to decrease from  $S'_{US}D'_{US}$  to  $S''_{US}D''_{US}$ . By imposing the tariff, consumers lose the area  $P_T J C P_W$  or  $d+e+f+g$  and producers gain the area  $P_T I F P_W$  or  $d$ . Domestic producers are protected at the expense of domestic consumers.

One complication stems from tariff revenue. Tariff revenue, which can be viewed as a gain for the government, equals the tariff,  $P_W P_T$  times the quantity of imports  $S''_{US} D''_{US}$ . This revenue is equal to area  $I J G H$  or  $f$

Overall, the nation loses because the consumers' losses of  $d+e+f+g$  exceed the producers' gain of  $d$  and the government gains of  $f$  by  $e+g$ . Area  $e$  is called a "deadweight production loss" and can be viewed as a loss resulting from inefficient (excess) domestic production, while area  $g$  is called a "deadweight consumption loss" and can be viewed as a loss resulting from inefficient (too little) consumption.

Figure 11



$$S''_{US} \quad D''_{US}$$

The impact of possible increases in trade barriers

Assumed the increasing pressures surrounding international trade, persistent policy questions in recent times have shifted away from the costs of liberalization or more openness to the effect of increased barriers in trade. One way to direct this is to deliberate the opposite of the effect of trade liberalization. This permits drawing interesting visions about long-term economic costs and distributional impacts. However, in practice, raised trade defense involves adjustment costs, so only changing the sign of the effect of liberalization doesn't provide an appropriate answer. This is also correct about the political economy aspect, both internally and in relation to trading partners and their probable reprisal.

The discussion about the legitimacy and results of trade protectionism is vague by the frequent classification of foreign competition as being 'unfair'. While it is true that unfair competition warrants protective actions, this is a specific situation which is not the one which was intended to be analyzed here. Before arguing protectionism and its possible consequences, it will be decent to clarify the concept of "unfair" trade performs. WTO agreements involve mutual commitments, they do not describe what is unfair or fair. However, practices such as subsidies and dumping are regarded as warranting measures in response, and for this aim they are often termed unfair, which calls for amplification.

Giving the WTO definition, a good is dumped if the company exports it at a price lower than what the exporter charges in its local market. This explanation differs from the ordinary one in industrial organisation, which is

the practice of selling lower than the cost. In both situations, however, it mentions a practice of trading a product “at less than its standard worth”, with the goal of achievement market shares in order to drive rivals out of business. Practice like this is monopolistic in the sense that its single rational motivation is the view of being able to rise prices once rivals are forced to leave the market. It can be defined as unfair to the degree that it intends at gaining competitive advantages above and over what would be warranted found on the manufacturer’s competitiveness, by relying upon the estimated capacity to endure temporary business losses for longer than competitors, for example due to state provision, cross-subsidization with another activity , or due to preferential access to financing. Pointless to say, it can be harmful for competitors, which are meeting artificially low prices. Because of all these cases, the WTO Agreement on Antidumping specifies how dumping may be formed practically and how antidumping charges may be levied once this is the case. Mention that antidumping actions are merely supposed to be preserved “as long as and to the degree essential to respond dumping which is injuring”. Measures shall also be ended or revised no later than 5 years from their obtrusion, yet many of them are updated in practice, so that the usual duration of antidumping actions levied by the EU on partners with market economy status was 7.9 years for measures introduced in the period 1998-2001.

Subsidies are also severely restrained by WTO Agreements. Not since they would be considered unfair in common, but since they can be utilized by one nation to gain competitive edge at the cost of others. Thus, subsidies depending upon export practice or upon the use of national products are outright forbidden. Other subsidies may cause countering actions inside WTO rules if they induce injury to another member.

In both cases, the imposed duties, or anti-dumping or anti-subsidies, can not be analyzed regardless of the methods of the partners who warranted them. To the extent that they follow completely the rules agreed upon in the relevant agreements, they can not be viewed as a protectionist, but rather as a way to reimburse methods that are incompatible with international obligations that can be considered as having to do with unfair competition. Note, by the way, that the same is not true for safeguards that are measures taken in response to an import rise that is considered harmful, "to the extent compulsory to prevent or heal a serious injury and simplify regulation" (WTO Safeguards Agreement , Article 5). Such actions are temporary (1,5-3 years), they aren't supposed to be determined for the partner, and they are not taken with respect to any given partner methods.

In total, the competition can reasonably be labeled unfair when it involves dumping or relies on actionable subsidies. This resembles to specific situations that guarantee a certain analysis. On the contrary, this section deals with the overall context, where no such methods by partners under threat. The raised trade defense analyzed here may take the form of a change in the system of the country's trade policy (raised MFN rates, for example), or protective measures. This can also be done through non-tariff barriers, for instance, administrative, technical and "local content" necessities that limit trade. However, significant non-tariff barriers are in the comparatively low tariff environment that we have got today, tariffs remain the direct instrument of protectionist policies, and therefore the main emphasis of what follows.

The reverse of a trade liberalization – a long term sight

The long-term economic results of trade affect the long period of the economy's structural balance. In this context, increased protection alters this

balance and can be analyzed as the reverse of the trade liberalization. While some of the discussion turns around tariffs, it is necessary to note that other obstacles will have alike effects.

### Distributional impacts

A worth of this simple method is to suggest what the distributional effects might look like. The first order effect of surging barriers faced by global competition is a easing of the imports' disciplining effects. Import-competing areas will benefit from frailer international rivalry, permitting them to rise profits and/or enlarge output and gain national expenditure shares.

Although import-competing industries and companies gain from greater barriers to enter the national economy, other industries that use imported intermediate and consumers bear the cost of protectionism. Beyond these straight costs, local exporters may also face greater protection charges on markets of foreign countries if some partners rise their protection level in reaction. The WTO Dispute Settlement System(DSS) openly makes it possible to suspend concessions proportionally regarding a partner that would be considered by the DSS to uphold practices irregular with its commitments beneath the WTO; i.e. it makes reprisal part of the system intended at rendering commitments enforceable. Moreover, exporters will suffer from tariff protection in the long run even in the absence of retribution, as the equilibrium level of the state's real effective exchange rate(REER) would rise as a consequence. A rise in the REER infers a rise in the price of national output faced by foreigners, thus obstructing competitiveness on foreign markets. An extra negative effect of protection for exporters is related

to the tax levied on imported intermediary inputs. For instance, while the average EU industry imports 12% of the value of its intermediary inputs, in the “computer, optical and electronic products” industry this share was 31% in 2014. For “basic pharmaceutical preparations and pharmaceutical products” the portion of imported intermediary inputs was 22%, and even in “other transport equipment” (not cars) this share was 20%. In the EU-wide car industry the portion of imported inputs is 10%. In addition, customers will face rises in the prices of consumption products, which is typically both arbitrary and regressive.

The “optimal tariff dispute” for protectionism is intensely flawed

In this context, it is significant to caution against calls for protection based on the so-called “optimal tariff argument”. Theoretically, an absolute tariff may be optimal if raised protection lowers imports demand, which then drops the worldwide prices of these imports related to prices of export— a terms-of-trade gain. This argument applies merely when the tariff is levied by a big country with important impact on world prices and, significantly, when the trading partners do not retaliate.

However, the main cause why the optimal tariff dispute doesn’t paves the way for the positive outcome is that partners usually do react by raising their own trade protection. Such retaliatory policies can simply escalate into a complete trade war. Indeed, like any other war, when a trade war starts, it can spin out of control and take a long time to wind down.

In fact – and this is essential to understand – it took decades after the World War II to wind down the results of the trade war that started in the 1930s, over several rounds of negotiations within the GATT framework, and the formation of the WTO in 1995. Alongside the backdrop of the subsequent Great Depression, the Smoot-Hawley Tariff Act of 1930 was accepted in the United

States. The act raised tariffs sharply for 890 products. Not all imports were influenced, but for those imports that affected, the “dutiable tariff rate” (tariff income divided by dutiable imports) rose to nearly 60%. Retaliation soon pursued, with the British Empire and Canada levying alike tariffs on American imports, terminating in a massive worsening in the world system of trade.

Terms-of-trade gains can only be obtained at the cost of one’s partners’ wellbeing; trading partners’ reactions more than counterweight the potential benefits of such protectionist policies. Evading such negative-sum games is one of the necessary motivations of the many-sided trading system, based on common commitments. Retaliation in reaction to non-cooperative behavior by restraining market access can also function as a disciplining device, and this is a significant principle for the WTO’s DSS, as previously stated. As a substance of fact, countries that use the DSS more regularly follow on average more open trade policies.

Measuring the long-run effects of protectionist outbreaks.

Since trade protection includes alterations on wages, prices, employment, outputs and incomes, its results are compound and can only be measured based on a number of assumptions. For a while, an ordinary way to do this has been to make use of computable general equilibrium (CGE) models. CGE models use a neoclassical framework based on micro founded descriptions of the behaviors of agents (namely, firms, households and governments). They take into consideration comprehensive data on of the economy’s structure, comprising trade flows, input-output relationships and budget restraints, together with econometric estimations of behavioral parameters to define how exogenous shocks are conveyed throughout an economy. Their strength relies in their capability to put numbers on the economy-wide influence of well-identified microeconomic mechanisms. Since

these models are neoclassical in nature, they integrally feature economic effectiveness in the distribution of production factors, which is beneficial for analyzing long run consequences. Yet, this may not be desired if one deliberates externalities and other non-neoclassical forces. Their main flaw comes from the requirement to combine real data with tractability. Their theoretical framework needs to remain rather simple, relying, for example, on representative firms and representative consumers, and on schematic specification of competitive interactions. Meanwhile, their large scale makes it hard to trace the core reasons for their results, both in terms of theoretical background and of data.

Replications of the influence of all WTO member countries increasing their tariff charges up to the maximum level permitted by their commitments gives orders of magnitude of the consistent impacts. In 2013, such a shock resembled to increasing the international average level of tariff charges from 3.6% to 12.9%. Bureau et al. (2013) models suggest global trade would diminish by 11.7%, with an average decline in real income by 0.8%. It should be highlighted again, though, that these outcomes do not comprise a quantity of dimensions of trade impact of those linked to the nature of competition and to the innovation.

Another way to evaluate quantitatively the outcomes of changes in trade protection count on so-called structural gravity models, whereby a simplified aggregate model is used as a base for an econometric examination of the past relationships between trade, trade protection and real income. A widespread literature has shown the capability of such model to analyze the determinants of trade and their outcomes. Yet, these models have not been applied to a thought examination comparable to the one mentioned to above.



More newly, so-called new numerical trade models have been advanced as a new method for assessing the outcomes of trade and trade policies. Their strength lies in the chance to trace more evidently the results down to data and theory. The counterpart is the lack of experimental detail and occasionally of robustness, exemplified in the difficulty to represent suitably inter-industry input-output relationships. However, taking into account input-output relationships, Caliendo et al. (2016) estimate that the Uruguay Round of multilateral trade liberalization resulted in an average 1.4% increase in real income. Such assessments should be viewed as figures put on well-identified mechanisms, in a context which is necessarily slender and simplified, compared to the variety of trade consequences. Generally, none of the valuation tools described here can substitute a suitable multi-layered policy analysis.

## **Chapter 2. Foreign trade policy and trade barriers in Azerbaijan.**

### **2.1 Foreign trade policy and trade barriers in Azerbaijan.**

The end of the bipolar system has led to significant changes in the political ground of the world, bringing about different political realities. The central and most noticeable political reality was that, with the collapse of the USSR, new independent members were joined the system of international relations. Independent states that formed in the post-Soviet space have solely defined their foreign political policies through their own state interests. This has led to a quantitatively and qualitatively new mutual connection in the contemporary international relations system. One of the young countries that began to join into the international community as a completely independent actor after the dissolution of the USSR was the Republic of Azerbaijan.

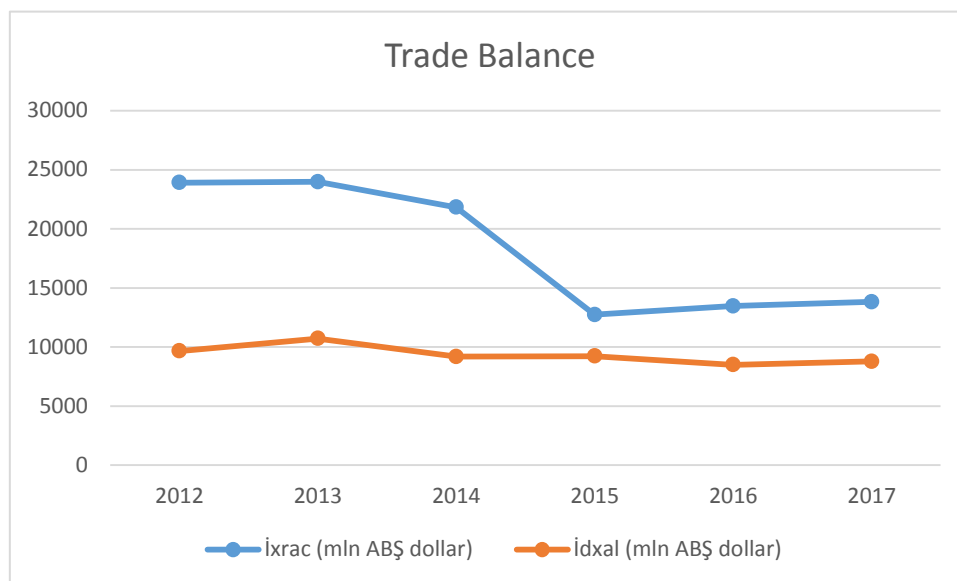
Effective integration into the international arena for the Republic of Azerbaijan, which declared its independence in October 1991, was of vital

status. The favorable geopolitical location of country, as well as the fact that the interests of the superpowers intertwined in the region, required the preparation and execution of a sustainable foreign policy strategy that would aid independence, national statehood principles and sovereignty. The national leader Heydar Aliyev's foreign policy strategy, taking into account the most minor elements, thought-provoking and new political realities, has led the young Azerbaijani state to take a worthy place in the system of international relations

There are main principles of the foreign policy of the Republic of Azerbaijan. These principles, as a rule, are formed under the influence of internal-political realities. We have already justified that foreign policy is a prolongation of domestic politics in the international system of relations. Namely, the political course that deals with the political processes in the country's internal life and the tasks to be implemented defines the principles and directions of the state's position and foreign policy in the international arena. In this sense, foreign policy should be viewed as a purposeful type of activity that serves to create a coordinated system of relations based on the basic tasks of the internal development of the state, based on the national co-ordination rules and norms of the national interests of the country and the foreign world.

From the beginning of its independency, Azerbaijan have started to create trading relationship with many countries. The main partners of Azerbaijan in trade are neighboring countries and CIS countries. Figures are showing imports from CIS and other neighbor countries between 2012 and 2017.

Figure 12. Trade balance of Azerbaijan



Source: stat.gov.az

Table 3. Import from CIS and other neighbor states.

Foreign Trade						
Import from CIS and other neighbor countries (in thousand USA dollars)						
	2012	2013	2014	2015	2016	2017
<b>Belarus</b>	68028.3	87334.8	83937.6	83630.5	76295.6	130214.3
<b>Khazakstan</b>	340557.1	306763.3	221056.1	98925.6	98117.1	107827.4
<b>Kyrgyzstan</b>	2240.7	1767.1	1702.7	1604.2	1087.4	1156.8
<b>Moldova</b>	8785.9	4015.5	5433	3559.6	3963.6	6752.3
<b>Ozbekistan</b>	8027.4	10769.4	23611.9	6168.7	11910.4	26041.3
<b>Russia</b>	1378416.5	1505178.4	1314480.4	1437937.2	1641694.7	1554257.9
<b>Tajikistan</b>	159.6	42.9	188	0	238.5	47.4

<b>Turkmenistan</b>	32714.2	48300.3	13198.4	19619	38488.9	110024.1
<b>Ukraina</b>	539089.7	589071.3	419579.7	309652.5	286811	459914.4
<b>Iran</b>	176444.8	207682.3	147156.2	90455.4	171525.3	240273.5
<b>Turkey</b>	1520405.1	1463804.9	1286641.4	1171385.4	1181578.4	1273709.1

The government of Azerbaijan has long been following a policy of protectionism. Since October 2011 Azerbaijan started to apply new protectionism policy. Beside some of the existing barriers to import, subsidies in the different spheres of economy and grants preference in some government purchases is given to local producers (of course, if the product quality is good). It should be noted that more than 90% of products, equipment and services currently in the implementation of state orders are based on external sources. Thus, directing state orders to domestic producers is a crucial factor in strengthening state protectionism.

There are numerous non-tariff barriers that can make importing difficult. These non-tariff barriers comprise a feeble and unpredictable legitimate regime, arbitrary customs management (while AmCham members have stated that customs has developed significantly and the government of Azerbaijan has taken steps in 2016 to develop customs management and collection), clear struggles of interest in commercial and regulatory matters often leading to import/export monopolies, and corruption. The government's insufficient enforcement of IPR defenses also creates a substantial trade barrier.

The Azerbaijani government must certify, approve, or license import or exports of military equipment, weapons, explosives, special kinds of technical and scientific information for manufacture of weapons, radioactive or nuclear

materials and technologies, psychotropic and narcotic substances, unprocessed diamonds, and blood and blood components. Furthermore, it controls the export of strategic merchandises manufactured in Azerbaijan.

Import/export of the subsequent products also necessitate government endorsement: information on the natural recourses and thermal energy location; wild animals and plants, and raw resources from them; antiques and work of art; outcomes of scientific and other research, creations; regulated psychotropic materials; insecticides; medical equipment; and veterinary substances and drugs.

Average tariff rate in Azerbaijan is 4.5 percent. Even though the state is working to develop its customs procedures, inadequacies with its governing system still considerably undermine investment and trade. Trade financing is functioned through banks that hold about ninety five percent of total financial sector assets. Non-tariff barriers have considerably bigger time and cost of trade. Circumstances vary from year to year, largely speaking, more trade barriers also influence people's well-being through, inflation, employment and spill-over effects. Giving to the Doing Business report for Azerbaijan (2015), exporting a normal container of goods on average:

a) necessitates 9 documents

b) lasts 27.0 days

c) costs \$3460

Importing the similar container of products to the country usually:

a) necessitates 11 documents

b) lasts 25.0 days

c) costs \$3450

In 2015 Azerbaijan was on the place 166 out of 189 economies on its performance in ease of trading across borders. However according to Doing Business report 2018 Azerbaijan stands at 83 out of 190 countries by ease of trading across borders. The ranks for comparator countries and the regional average ranking give other useful information for evaluating how easy it is for a commercial in Azerbaijan to import and export goods. World Bank gathered information on the obligatory documents, associated cost and time to complete import and export from local cargo forwarders, customs brokers, shipping lines, banks and port officials. In comparison with its neighboring countries, the related cost for exchange standard shipment of products are relatively great in Azerbaijan.

However, in recent year's Azerbaijan shows a great improvement in customs regulations, terms of importing and exporting goods, tariff regulations and other related spheres. According to Doing Business report 2018 the distance to frontier in Azerbaijan is 73.56 out of maximum 100 points (trading across borders). Table below shows cost to trade in Azerbaijan.

Table 4. Cost to trade in Azerbaijan

	Time to Complete (hours)		Associated Costs (USD)	
	Export	Import	Export	Import
Clearance and inspections required by customs authorities	24	26	177	300
Clearance and inspections required by agencies other than	2.4	0	37.1	0

customs				
Port or border handling	3	4.1	0	0
Documentary compliance	33	38	300	200
Total	62.4	68.1	514.1	500

Source: World Bank Doing Business report 2018

Systematic analysis of relevant countries' experience shows that import tariffs reduce country's economic prosperity, increase tax burden on producers, lead to trade wars, reduce employment levels, and so on. It is noteworthy that import tariffs are often inevitably led to reallocation of revenues from consumers to local producers who can not leave competitive products and to the state budget. In most countries, only part of imports are fully liberalized to some extent in priority sectors . Import policy, as in export policy, is mainly based on investment, competition, currency, credit, customs, etc. have policies.

Since January 2018, Azerbaijan introduced a new system of customs. The main aim of new custom duties is the provision of budget revenues as well as the control of local production. The necessary support will be rendered to the development of the non-oil sector and the expansion of domestic production as a result of the application of the new customs and tariff system.

During the groundwork of the new system, the import tariffs for raw supplies and products used in manufacture and the production of which was not reputable in Azerbaijan, were diminished to zero percent, whereas rates for raw supplies and goods the manufacture of which is at an inadequate level - from 15 and 10 percent to 5 percent.

Altogether, I would like to remind that in relation to the goods having the manufacture potential within Azerbaijan, all-out customs duties have been set, while for an amount of products, the customs duties rates have been kept in

Azerbaijan switched to a new system of customs duties on Jan. 1, 2018. The new duties are regulated by the “Goods Nomenclature of Foreign Economic Activity, Customs Rates for Import and Export.”

Since 2001, the duties rates of 0, 0.5, 1, 3, 5, 10 and 15 percent were used in the country. Since the beginning of this year, only rates of 0, 5 and 15 percent are applied in Azerbaijan on imported raw materials and products.

A zero rate is imposed on the majority of the products (equipment and raw materials) beginning from this year, comprising even those from which a impost duty of 0.5 percent was previously imposed.

This relates to those types of product groups (precisely, 84 and 85 groups), which, up on the order of the Ministers’ Cabinet, are already based on VAT at rate of zero when importing.

The five percent custom rate is imposed on semi-finished goods. As for the finished goods, the rate on them raised up to 15 percent.

For instance, a 15 percent rate is levied on imports of numerous silver and golden products. The rate for the import of magazines, books, brochures, newspapers and other printed substances has raised from three percent to five percent. Simultaneously, papers import which is used for the issue of newspapers is exempt from import charges. A quantity of plastic products, helicopters, parts of musical instruments, airplanes, a quantity of variations of live fish are also exempt from import charges. Import duties have been cut down for some goods, such as baby food.



## Subsidies in Azerbaijan

Agricultural subsidies, such as the form of support from the state budget to agriculture, include both diesel fuel and mineral fertilizers. In recent years, the payment of some of the expenditures through the state budget has made positive results to improve the supply of agricultural products by mineral fertilizers. Thus, according to the Ministry of Agriculture, the volume of imported mineral fertilizers increased by almost 2 times in 2005-2015. At the same time, the total volume of fertilizers sold by Agroleasing JSC to farmers on a preferential basis in 2008-2015 has reached 68,600 tons to 124,600 tons. The support policy for farmers in each form is intended to serve the agrarian sector more efficiently.

Agrarian subsidies, such as support from the state budget to agriculture, include mineral fibers, along with diesel fuel. In recent years, the payment of some of the expenditures through the state budget has made positive results to improve the supply of agricultural products by mineral fertilizers. Thus, according to the Ministry of Agriculture, the volume of imported mineral fertilizers increased by almost 2 times in 2005-2015. At the same time, the total volume of fertilizers sold by Agroleasing JSC to farmers on a preferential basis in 2008-2015 has reached 68,600 tons to 124,600 tons. The support policy for farmers in each form is intended to serve the agrarian sector more efficiently.

In the Strategic Roadmap for the production and processing of agricultural products in the Republic of Azerbaijan, the substitution of agricultural subsidy with other financial sources was prioritized. In this document, weight is built on more efficient access to more specific financial sources. Our analysis has shown that agricultural support policy is in two stages: the first stage is driven mainly by the extraordinary financial assistance allocated from the state

budget, and the second stage is dominated by the expansion of access to more diverse sources of funding. Thus, the official policy will be that the private financial resources of the state will be interested in directing funds to agriculture without the financial resources of the state. As we know, in the previous years, credit investments in the agrarian sector were less realized, but in the following years this dynamics has changed to rise. According to the Central Bank, the loan portfolio in this sector was 97.6 million manat in 2005, while in 2015 this figure was 508.1 million manat. Thus, the resources of the state have been spent in this direction, which has increased the special importance of funding the state budget and extra-budgetary funds. In the Strategic Roadmap, a more predictable approach to agrarian sector subsidy will be to encourage agricultural investments to be attractive to the private sector in terms of its profitability and effectiveness. In this sense, the Strategic Road Map does not include the subsidy from the state budget to the agrarian sector. Instead, measures were taken to facilitate access to finance. If these measures have serious consequences, subsidies from the state budget will be minimized. One of the main objectives of this is that the dependence of the farmer on the state budget is eliminated and additional financial resources are obtained from the use of more rational resources than private financial resources.

**Subsidies:** In the context of membership in the WTO

Another objective of this step is that it is in line with the fact that in the coming years, Azerbaijan will become a member of the World Trade Organization, in connection with the availability of restrictive ("baskets") measures for agrarian subsidies. Because, within the Criteria of the WTO, the use of state subsidy restrictions will depend on the level of development of countries. It will be

difficult for our farmers to compete on subsidies for a long time. Preventive measures in this regard will lead to less adaptation decline if our country is a member of the WTO.

Therefore, we are in the interest of bringing agricultural products to the European market so that we can diversify exports. We do not have the opportunity to export one direction. We know that the export geography of primary agricultural products is very limited. So 90 percent of these products are exported to former Soviet Union countries (except Baltic countries), especially to Russia. Thus, we need to diversify exports to access broader markets. At that time, we have a better quality, branding and adequate standardized production of consumers' tastes. Then we will not only produce products that are in line with the tastes of our domestic consumers, but also easily build our export potential in the regional and global markets. All the reform steps on the agrarian sector are calculated.

## 2.2 WTO accession advantages and disadvantages.

The general advantages and disadvantages of the Azerbaijan association to WTO may be assessed from various view points and the consistent attitude on this matter is not considered only by computing the benefits circle of the country and the arrangement of these benefits on numerous sectors are very vital. In the present situations, the a problem of dispute has not taken place around the bipolar methods concerning the WTO membership, but also realize ways securing the more benefits of Azerbaijan from assent to WTO. The matters of spreading the coverage geography of WTO different by its activity and important role in the international economy globalized quickly within the last time are among the most definite subjects, which disturbing and connecting both the practical persons and researchers in the numerous

level's scientific debates. The WTO making each effort in the field of extreme liberalization of the world trade, making favorable conditions for free competition, avoiding the quantitative restrictions, making trade policy transparent and clear serves the operative organization of the trade throughput in the base of national regimes application based on the free entree to the markets, comprising through averting the quantitative restrictions employed on importation, in addition to the securing the transparency and publicity in the member states foreign trade regime.

The entry of Azerbaijan into the WTO is directly connected with improvement of the legislation. Now there are such laws in the field of regulation, investments and intellectual property, they don't meet the necessities of the international standards and necessities of the WTO. Accession to the WTO will allow the country to predict a trade policy of the country which will increase transparency, the international trade partners' number will be increased and economic arguments will become more efficient. It should be noted that the highlights discussed within agricultural agreements framework include definition of the top limit of the tariffs and subsidies brought in this area.

Considering that the agriculture is the major field of employment in Azerbaijan and the peoples employed in this area have made economic units to accommodate their individual needs, but not for profitmaking purpose, we can predict as concerns the extension gage of the risk. In this case, it is known in advance that the agriculture sector will face problems during WTO membership. In general, the field to be exposed to the alteration decay in this setting will not be limited only with the agricultural sector. The situation of the insurance, banking, financial and other service sectors controlled within many years warning of the foreign capital has not been outdoor the attention. At all versions, our problems will hold the industrial dispensation field and it is

outside any doubts, as, this field is regulated by the well-ordered commercial rules. We have to take into account that the inclination of price increase of energy carriers within the last time would limit the prospects of the industrial and agrarian fields both in the value and the price rivalry. In assembly with the WTO assent we may be disadvantaged from the provisions support transported to a state where we cannot interfere. But this ban will not be applied to the organizations, such the UNO and World Bank.

The advantages inherent in membership in the World Trade Organization arise mainly in three ways. The first advantage is correction of mechanisms of pricing in WTO member countries in the conditions of the WTO, and also recognized worldwide standards. Evidently, economic systems' of western countries are based on rules and effective activity of the formations responsible for application of these laws. The laws established in the western countries continuously improve depending on necessities of social life, do everything possible to have good impact on society's all sectors. As for the CIS states operated by methodical planning in the long term, they can be considered by absence of laws and operative mechanisms of use of these laws. And it is straight connected with lack and shortcomings of execution of laws. Evidently, WTO membership is assessed as the factor developing laws and the emerging realization mechanisms. The second advantage provided by WTO membership is linked with acquisition of entree to the markets of other nations. Member states of the WTO have to put on cheap customs rates on the products imported from other member states of the WTO according to settings of the WTO. This base rate is set at the end of the many-sided negotiations held inside the WTO and to put an end to the impervious obstacles employed to foreign trade. Member states of the WTO don't set these conditions if they import products from the countries which aren't members. The third and most significant advantage guaranteed by WTO

membership is chance to use the approval mechanisms covered by WTO membership about trade disputes. As these mechanisms of settlement aren't provided to non members of the WTO.

In order to be the member of WTO firstly our economy has to be ready for this process, to mobilize chances of diplomacy and to present a right approach to the matter. There are additional facts to be taken into consideration that the membership to WTO is not a goal, but a means. Through WTO we may upsurge our potentials to liberalize our foreign trade, become integrated to the world economy, as well as avoid the technical and quantitative restrictions, simplify the customs control procedures, to rise transparency, speed up the participation of progressive technologies and techniques, patents, know-how and other leading novelties to our republic, adjust our laws to the worldwide recognized standards and to defend our copyrights. Then again, we pin our hopes on the point that after the WTO membership the world's leading insurance companies and banks will invest moneys in the economy of the member state and finally there will be shaped standard financial system, long term credits and big moneys will solve the capital difficulties of the non-oil sector of the nationwide economy.

As the membership problem of Azerbaijan in connection with assembly the WTO, the disadvantages and advantages of membership are deliberating in different level in our society. The advancing by the emerging countries from the WTO participation is not met even among the advocate of the globalization. Whenever, and the passionate opponents of the globalization reflect the accession to WTO unavoidable: Terminating of any state in the world as regards global economic integration will not be attended at any case with this republic's advantages. Joining immediate the economic integration, the state will have a chance to upsurge the size of advantages.



## Conclusion

Protectionism policies are employed by governments for several reasons:

- Employment - a business that has not been preparing for rivalry, international or domestic, loses market share and jobs are lost. Protections decrease imports and secure jobs.
- Infant industries is another reason of protectionism. A newly established company cannot resist competition with rivals who have developed products and innovative technologies. Therefore, government should protect infant industries from international competition.
- Antidumping. Some companies sell goods in foreign markets at a price under the cost of production to hold the market share and destroy rivals in export markets. Antidumping policy protects local market from imports with such low prices.
- Balance of payment. When trade deficit continues and grows, politicians begin to apply protectionism to fight the perceived inequality in the state's trade relations.
- Fair trade. Supporters of this argument propose that government should execute protection measures against foreign companies if their governments use protections of their local industries.

If protectionism is used for short term as a protective measure it can be beneficial. However, in long term usually it has negative impact.

## Rise in import costs

Tariffs increase the rates importers pay for apparatus and intermediate products. In the short term, even prices for similar goods produced domestically should go up, because of a sudden rise in demand. The increase in input prices could cause a decline in business investment or drop in corporate profits.



## Growth in consumer prices

In the short term, higher import prices would lead to a rise in consumer prices, either directly or indirectly due to influence on input costs. The rise in price would decrease households' real disposable earnings. We can then see a rise in tariffs or limit on the imported goods supply as a consumption tax paid by the whole population. The effect on inflation also has consequences for monetary policy, as it cuts the leeway of central banks that are fighting with an artificial increase of price.

## Reduced economic efficiency

Protectionism has a damaging effect on an economic output by discouraging specialization, competition, knowledge transfer and innovation. Therefore adaptation of economy to technological changes and cyclical downturns appears difficult.

## Currency impact

This is possibly the most undervalued effect. The tariff increase reduces imports and triggers the expectation of better trade balance. However, to balance this alteration with a stable level of external investment, the currency will rise. The higher exchange rate will play in contradiction of exports in external markets and support imports in the home market. In the end, it generally annihilates the initial goal: correcting the trade balance.

## Reprisals and trade wars

Given that globalization was a fairly extensive source of affluence, an international trade war can only be damaging to the worldwide economy and would, of course, affect the country that executes protectionism. A trade war activated by the protectionist goals of the U.S. government or another country is presently one of the key risks to the financial markets and global economy.

The rise in protectionism began as a result of the financial crisis and is already damaging for growth by global trade. The trade in goods rushed during the crisis, of course, due to a drop in economic activity and tighter financial conditions, especially for export financing products. However, from the time of recovery, global trade progress has been fairly slow, both a symptom and cause of the international economy's weak advance. According to OECD evaluations, if trade liberalization has remained the peace as it was in the 1990s, global trade would have been increased by 1% to 2% per year.

If the rise in protectionism continues, and especially if it spreads, it would have a bigger effect on the global economy. According to the OECD, "trade, and the related enlargement of global value chains, boosts growth through increased productivity by rising specialization and scale, boosting innovation activities, facilitating knowledge transfer, advancing resource allocation, supporting the growth of more effective firms and the exit of the least effective firms."

The decrease in disposable income formed by higher prices is shared by a large part of the population. The drop in business effectiveness generally becomes obvious over the longer term, and has a bigger influence on the economy's capability than on near-term real GDP surge.

However, the harms caused by free trade or globalization are often more evident. The closing of unable to compete company, or the drop of an entire sector of industry can simply be represented by economic and social difficulties in one community, region, or category of workers.

It is therefore important to permit the communities and sectors influenced by free markets to adapt. Globalization's poor reputation and the comeback by protectionism could no doubt have been evaded if the government had paid more attention to possible problems and strived to solve them. It would be

decent for the worldwide economy to maintain development through more free markets, while helping those who will unavoidably be influenced.

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