

Economic Theory of Optimum Intervention in Trading System

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Abstract

A brief analysis of optimal intervention in trading systems seems to indicate that it is an important determinant for entrepreneurial activities in an international economy. Undoubtedly all the turbulent changes on the global scene, as most vividly expressed in such areas as mobility of financial capital or labour force resources, direct both entrepreneurs and their respective governments to take a particular approach towards their management and effective competitiveness in the international market. The new trade economies thus created transform information management into knowledge management, which then becomes indispensable to the existence and evolution of each organization. Therefore it is most important that both national states and single enterprises are aware of the consequences of unconscious or unconsidered interventionism, both now and in the future.

Uncertainty referring regarding the destabilization of the world economy, in addition to the uncertain macroeconomic forecasts during the financial crisis, which started in July 2007, and reached its peak in the second half of 2008, forces the governments of particular countries to revise their policies and functioning mechanisms. This situation also force entrepreneurs, particularly at international level, with regard to widely defined management².

The breakdown of the credits market resulting from credit crunch and increasing rates of interest obliges many companies and corporations to curtail current investment plans, which may cause destabilization of the trade exchange, consequently affecting the long term perspective.

It is apparent that public expenditure, the shaping of economic policies, lack of reform introduced in some countries and ties such as: trade, economic cycle, herd behaviour among investors and monetary supremacy may strongly impact economic systems in certain countries³.

A difficult situation in the American real-estate market in the first quarter of 2008 and related consequences, led to a decreasing evaluation of the value of world economic growth during 2008 from 3.4% to 1.8% (or in the pessimistic version 0.8%) estimated by the UN Economic and Social Council. A majority of experts agreed that the world was on the verge of a serious economic crisis. This situation was heralded by the historic decisions of Fed (Federal Reserve System, the so-called Central Bank of the United States) enabling direct cash loans for investment companies as well as the introduction of auctions of monetary loans to financial institutions⁴.

Currently there is no unanimous prediction of how deep the crisis will be and to what extent it will influence the global economy. For this reason it is necessary to review the possibility and effect of state intervention in trade, from the perspective of the governing

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² Introduction of new management models based among other precepts on knowledge, especially trust; which has been heavily strained in recent years (in particular by global relations) and seems to be a challenge for the future. Undoubtedly the possession of key competences by the employees of a given organization (as well as of the country as the structure) in building internal and external credibility may provoke a search for these ways to promote knowledge and intellectual resources management. see W.M. Grudzewski, I.K. Hejduk, A. Sankowska

³ Lowell J., Neu C.R., Tong D., *Financial Crises and Contagion In Emerging Market Countries*, RAND, Santa Monica 1998.

⁴ A review of strategic information analyses from the Warsaw Stock Exchange (WSE), Warsaw 2008, p.4

administration (including Customs Service), in future as an institutionalized set of silent and formal principles, standards, rules and procedures for decision making commonly expected and shared in a given field of international relations.⁵

Exclusiveness of Trade Intervention in Economic System

Is state interventionism necessary in trade policy, meaning the economic system and to what extent should it apply? Superficially this question appears to be simple, however following a deeper analysis it arouses contradictory convictions among representatives of various economic schools. A trend regarding appreciation role of the state in the economy appeared in the 1920's. A theory of state intervention in economic development, promulgated at that time by J.M. Keynes, was for an exceedingly long time reflected in the policies of states that believed in reduced public sector susceptibility to economic cycles. This had many effects, among which was a dramatic increase in public expenditures from 1960 to 1984 and reaching the level of almost 50% of the GDP⁶ (gross domestic product) in countries such as: Austria, Belgium, Denmark, France, Germany, Ireland, Italy and Sweden⁷. In retrospect it is obvious that the recession-depression collapse of the US economy in 1929 reinforced the practice of state protectionism. With the approval of the US Congress, the Smooth-Hawley Tariff Act of 1930 (and Revenue Act of 1932) raised most import tariffs from 39% to 52%. Instigated by this act, the drastic remedial measures of the US's trade partners brought about a series of national currency devaluations which further influenced other interventionism-protection practices. Within the next few years, this situation became dangerous for the US itself; as the dominant state of the economic market began a process of controlled liberalization of trade by removing interior protection restrictions⁸. A side effect of the unsuccessful attempts to found an International Trade Organization (ITO) was the introduction of GATT (General Agreement of Tariffs and Trade) which lasted until 1st January 1995, the inaugural date of the WTO (World Trade Organization) in Marrakech, which took over the role of a non-institutionalized guardian of international trade exchange.

In contemporary times each intervention of the state is correlated substantially with particular policies shaped within a given economic system. So each activity of the government (including international, shaped within multilateral or bilateral agreements) may have an effect on trade. System solutions worked out within GATT/WTO remain to be a regulator in this area, establishing as a rule, a trade policy accepted by its member states, emphasizing creating the least disturbance. The following rules serve the goal:

- **non-discrimination** – expressed in the “most-favoured-nation principle” (MFN); treating a product produced in one of the member states with equal rights (facilities), as analogical goods coming from any other member state,
- **national** with respect to fees and interior regulation; entitles each side to treat citizens, legal entities, goods and ships of the other side as their own,
- **reciprocity** (real reciprocity, equality and advantage of concessions)⁹; setting a reduction of customs duties and granting any concessions without

⁵ Krasner S., *Structural Causes and Regime Consequences, Regimes as Intervening Variables*, [w:] Krasner S. (red.), *International Regimes*, New York 1983, p. 2.

⁶ GDP is defined as a value of all final goods and services produced in a country by its nationals as well as legal persons having domicile on the territory of the given country [regardless of place where economic activity is conducted]. In the GNP measure, income obtained by foreigners within a given country is excluded and the total sum constitutes the following values: consumption, investment, government expenditure, net exports (that is export-import) and net income of citizens domiciled abroad. see Working papers of the National Bank of Poland dealing with macroeconomic indicators for Poland, NBP, Warsaw 2008, p.12.

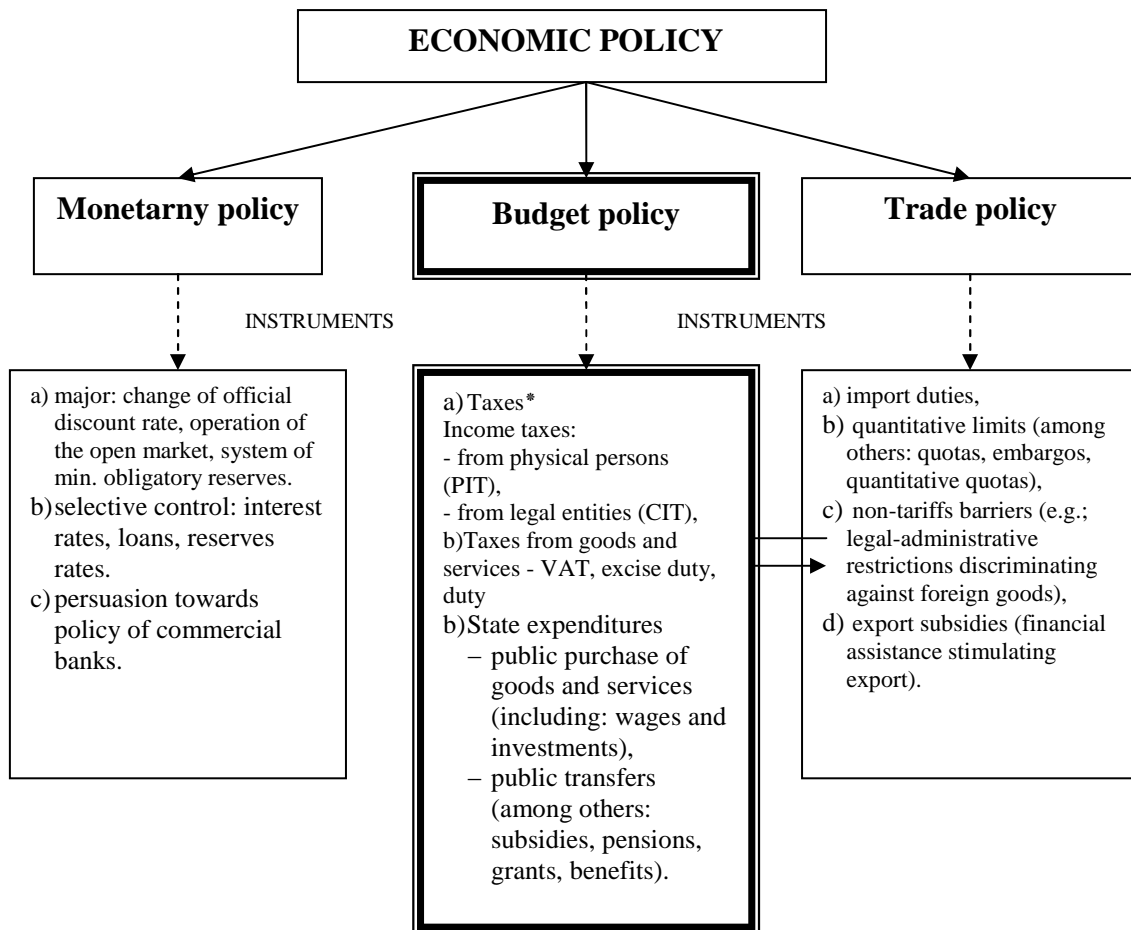
⁷ Tanzi V., *Economic Role of the Government in the 21st century*, PiR 1/2006.

⁸ Handlich P., *System of Customs Duties Preferences in European Union*, Ars boni et aequi, Poznań 2008, p.30.

⁹ Bartoszewicz T., *Customs Duty in International Economic Relations*, Ostrowiec Świętokrzyski 2002, p. 74.

- receiving proportional concessions from the partner side does not constitute commitment for members of the system,
- **exclusiveness** of trade intervention through customs tariffs and other fees of similar character (constituting the main topic of deliberation in this study),
 - **transparency** of the GATT/WTO system (consultations and information) ; establishing in this way the basis (aside from the principle of “most-favoured-nation”) of the World Trade Organization as defined by legal obligations GATT Art. X and GATS Art. III.

Though the GATT/WTO system is assumed to be unequivocally based on the application of a superior liberalization policy of trade exchange, it is hard not to have the impression that it is after all not cohesive (compare multilateralism with regionalism) and still shaped by the biggest economy potentates. Also state interventionism is permissible in this respect, however in a precisely defined way (customs duties, tariffs and other sources). At this point a **theory of optimal intervention** is exposed, constituting that policy aimed directly at the disturbance sources is the most effective policy for counteracting market disturbances¹⁰. It involves appropriate shaping of interior policy, through the crucial influence of a budget policy (especially in the area of income taxes) and monetary policy, interrelated with mutual relations in a further budget-trade phase. (draw 1).



* Taxes have been classified according to OECD standardization. A complete classification includes additionally: a) obligatory insurance premium, b) taxation of ownership – property tax (agriculture, forest), - gift and inheritance tax, c) others: means of transport tax and tax on civil law transactions See: The OECD Classification of taxes and interpretative guide, [w:] Revenue Statistics 1956-2005, OECD, Paris 2007.

Draw 1. Scheme presenting possibilities for eliminating macroeconomic disturbances through effective economic policy. Source: own study.

¹⁰ Hanclich P., *System of Customs Duties Preferences in European Union*, Ars boni et aequi, Poznań 2008, p. 133.

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From this point of view it seems that a direct policy of trade interventionism as a chief activity is not an effective method of solving economic problems, or increasing the competitiveness of enterprises. Certainly in a further phase of deploying customs duties and other fees of similar nature may result in the enhancement of economic status of the given state through increasing the domestic price of imported commodities in a non-discriminating way¹¹. However, according to experience of global economic crisis, such measures need to be reasonably applied. Undoubtedly W.M Grudzewski's and I.K. Hejduk's postulate proves to be correct that *collected and applied knowledge is currently the propelling force for developing non-material investments, which together with material ventures, offer an effective synergy; that is they reinforce each other*¹². Such completion in optimization of management processes together with usage of knowledge may bring added value to the whole economic system, which would have been unable to function without efficiently run enterprises served by effective state structures.

A Condition and Perspectives of Regional Development of Integration Groups as Intervention Determinants

Contemporary economic theory conceives that if international trade from one side promotes multilateralism and constitutional most favoured nation clause, from the other side they create regional economic systems actually contradicting the liberalization of world trade. The fact is that regional agreements (excluding ancient ones) and attempts to set up customs union that existed in French provinces as early as 1664. Yet their real development took place in the 1920's. Such activities within GATT/WTO system were made possible due to appropriate legal regulations contained in art. XXIV GATT (as a main legal basis of free-trade contracts) and art. V GATS (enabling the establishment of customs unions, free-trade areas etc.). Regionalism in this respect makes use of a so-called second best solution, enabling the creation of local agreements in a situation when it is impossible to set up world commodity exchange from a political or economic point of view. It is difficult to predict where such an assumption may lead as in 2005, some 330 agreements of this kind were ratified. This indicates that many countries decided to reduce 'red-tape' and protracted procedures, during rounds of the GATT/WTO negotiation conference to the benefit of easy and quick local pacts, serving as a peculiar intervention mechanism for those countries.

Currently, excluding the EU (the biggest political-economical pact combining 497 million inhabitants), functioning agreements of global standing in regional integration and international enterprise are as follows (draw 2):

- **MERCOSUR** – as a customs union set up in 1991. It gathers Latin American countries (Argentina, Brazil, Paraguay, Uruguay, Venezuela) and associate states (outside union): Chile, Bolivia, Peru, Ecuador, Columbia,
- **ASEAN** – Association of South-East Asian Nations set up in 1967, gathering 500 million inhabitants including: Philippines, Indonesia, Malaysia, Singapore, Thailand, Brunei, Vietnam, Laos, Burma and Cambodia¹³ as well as Australia and New Guinea,

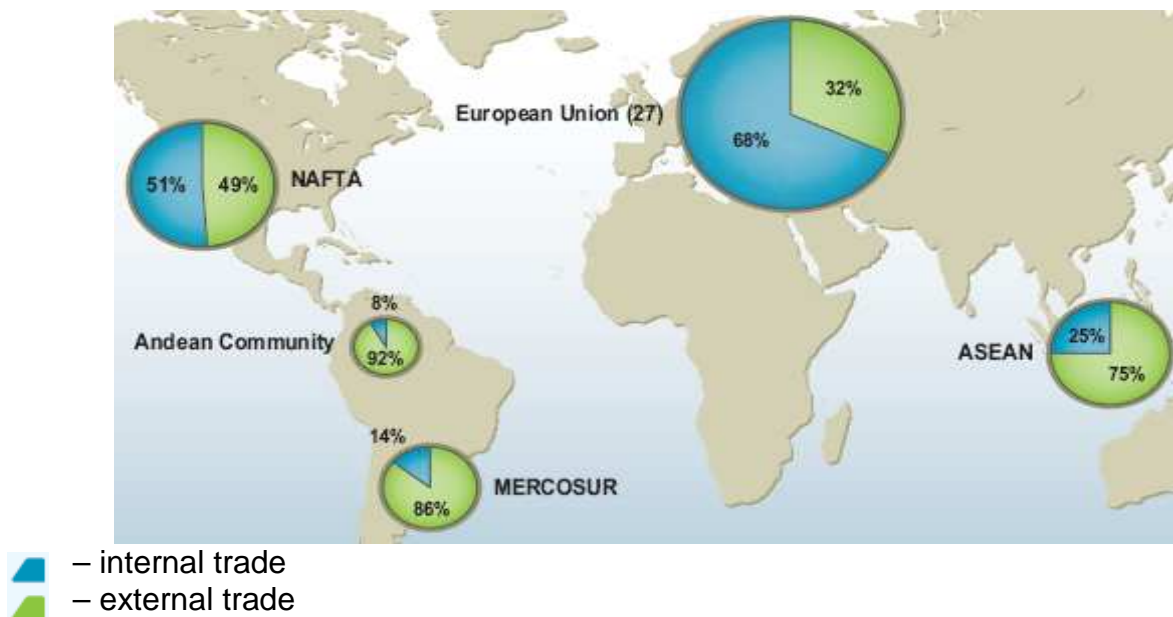
¹¹ Application of duties finds its motivation in the protection of strategic areas of economy (including international competition), protection of domestic markets and influences the reduction of balance of payments. See Drwiłło A., *Customs Law*, Arche, Gdańsk 2001, s. 21 oraz Johnson H.G., *Protection and Welfare In Modern Perspective*, Journal of World Trade Law, March-April 1976.

¹² Grudzewski W. M., Hejduk I. K., Sankowska A., Wańtuchovicz M., *Trust Management in Virtual Organizations*, Difin, Warsaw 2007, p. 24.

¹³ States gathered within ASEAN aim at strengthening cooperation with China, which should lead to a free trade area agreement. Such move would result in establishing a gigantic formation, reaching 1,8 billion people, making this region more autonomous from impact of the European Union and the United States of America. See management and help in the Asean-China Eminent Person Group, ASEAN, Djakarta 2007, p. 18.

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- **NAFTA** – North American Free Trade Agreement functioning from 1st January 1994, covering almost 364 million people from: USA, Canada and Mexico,
- **Andean Community** – trade association gathering 120 million inhabitants, formally functioning since 1996 in South American countries: Bolivia, Columbia, Ecuador and Peru.



Draw 2. Characteristic of global trade relation within regional agreements (domestic) and external multilateral in 2007. Source: International Trade Statistics, WTO 2008, p. 3.

The graphs presented unequivocally show that within regional agreements the European Union is the most united common market, representing 2/3 of the total exchange within member states. The relative rate of trade in the group of North American countries (NAFTA) changed slightly its proportions (from 56% of internal trade in 2000 up to 51% in 2007) to the benefit of extending export expansion.

Weaker regional integration is represented by countries united under ASEAN, MERCOSUR and Andean Community agreements. Domination of export increase in relation to previous years may be represented by Brazil reaching a level of 161 billion dollars, India reaching 145 billion dollars and China achieving the highest rate of export to Asia at the level of 521 billion dollars, North America – 264 billion dollars and Europe 264 billion dollars (to other countries an additional value represented 168 billion of dollars).

Conclusions

It seems that state interventionism from the perspective of historic experience has to be used reasonably, as well as within system analysis. Especially in a prognostic situation or in case of vivid signs of recession, preventative measures of ex-ante character should be mobilized. With reference to the fact that a trade system is a strong bond among economies of particular countries with the world economy, arousing comparative factors have an influence on specialization and profitability of exchange, inducing entrepreneurs to search for maximal possibilities for trade liberalization while governments of particular countries seek to protect their national economy. This aim is achieved through the previously mentioned instruments of trade policy: tariffs, contingents, embargoes, subsidies or customs duties; all of which explicitly indicate the necessity for the involvement of economic resorts (including customs duty administration) in formulating economic policy through the secondary prism of trade policy.

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It should be remembered that the biggest problem of the state (including financial institutions) is a lack of preparation within phased crisis management¹⁴, especially in the aspects of state finances, which are burdened with almost 70% fixed budget expenditures in Poland. For this reason the economical theory of optimal intervention in trade systems should be formulated by the whole economic system (especially budget and monetary policy) representing a type of liberal approach and an incentive to the possibilities of risk taking by entrepreneurs.

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¹⁴ Raczkowski K., *Management of Crisis Knowledge in Customs Duties Administration*, [w:] Scientific Notes of the University of Economics, Katowice 2008, p. 6.