Instruments of Trade Policy
Chapter IV unit 2

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Free Trade

- Buyers and sellers from separate economies voluntarily trade
- Free interplay of market forces of supply and demand
- Minimum of state interference in foreign trade
- Without tariffs, quotas, or other restrictions. **OR** With tariffs used only as a source of revenue.

Protectionism.

- A state policy aimed to protect domestic producers against foreign competition
- through the use of tariffs, quotas and non-tariff trade policy instruments

Trade liberalization

- **Opening up markets by bringing down trade barriers such as tariffs.**
- **Allows goods and services from everywhere to compete with domestic products and services.**

Trade Policy

- A government's policy controlling foreign trade
- Refers to the regulations and agreements that control imports and exports to foreign countries.

Protective tariff

- **Intended to artificially inflate prices of imports and protect domestic industries from foreign competition**

Trade Policy

- Trade policy encompasses all instruments that governments may use to promote or restrict imports and exports.
- Trade policy also includes the approach taken by countries in trade negotiations.

Broadly classified into

- Price- related measures such as tariffs
- Non-price measures or non-tariff measures (NTMS).

Tariffs

- Tariffs, also known as customs duties, are basically taxes or duties imposed on goods and services which are imported or exported.
- A financial charge in the form of a tax, imposed at the border on goods going from one customs territory to another.

Main goals of Tariff

- Raise revenue for the government
- More importantly to protect the domestic import-competing industries.

Tariffs

- **Most visible and universally used**
- **Aimed at altering the relative prices of goods and services imported, so as to**
- **Contract the domestic demand and thus regulate the volume of their imports.**

Specific Tariff

- A fixed monetary tax per physical unit of the good imported.
- Calculated on the basis of a unit of measure, such as weight, volume, etc., of the imported good.
- A tariff of Rs. 1.22/kg on cheese

Disadvantage

- Its protective value varies inversely with the price of the import.
- Customs valuation is not applicable in this case

Ad valorem tariff:

- An ad valorem tariff is levied as a constant percentage of the monetary value of one unit of the imported good.
- Eg. 12 percent of the value

- **Preserves the protective value of tariff on home producer**
- **Gives incentives to deliberately <u>undervalue</u> the good's price on invoices and bills of lading to reduce the tax burden**

Mixed Tariffs

- **For example, duty on cotton: 5 per cent ad valorem or Rs 3000/per tonne, whichever is higher**
- **Fabrics either 15 percent ad valorem or Rs. 87 per square metre, whichever is higher.**

Compound Tariff

- Include both ad valorem and a specific component
- Rs. 0.88 per litre on petroleum products plus 25 percent ad valorem.

Technical/Other Tariff

- **Calculated on the basis of the specific contents of the imported goods i.e the duties are payable by its components or related items.**
- **For example: Rs. 3000/ on each solar panel plus Rs 50/ per kg on the battery.**

Tariff rate quotas

A low tariff rate on an initial increment of imports (the within-quota quantity) and a very high tariff rate on imports entering above that initial amount.

Technical/Other Tariff

- These are calculated on the basis of the specific contents of the imported
- goods i.e the duties are payable by its components or related items. For
- example: Rs 3000/ on each solar panel plus Rs 50/ per kg on the battery.

Most-Favored Nation Tariffs

- MFN tariffs are what countries promise to impose on imports from other members of the WTO,
- unless the country is part of a preferential trade agreement (such as a free trade area or customs union)

In practice,

- MFN rates are the highest (most restrictive) that WTO members charge one another

Preferential Tariff

- Variable Tariff :
- Preferential trade agreement
- Promise lower tariffs than their MFN rate
- Reciprocal.
- 'Unilateral preferential treatment'

Bound Tariff

- A WTO member binds itself with a legal
- Commitment not to raise tariffs above a certain level
- Can only increase its level after negotiating with its trading partners
- And compensating them for possible losses of trade
- Ensures transparency and predictability.

Applied Tariffs

- An ‘applied tariff’ is the duty that is actually charged on imports on a most favoured nation (MFN) basis.

Escalated Tariff structure

- The nominal tariff rates on imports of manufactured goods are higher than the nominal tariff rates on intermediate inputs and raw materials.
- The tariff on a product increases as that product moves through the value-added chain.

Discriminatory

- As it protects manufacturing industries in importing countries and
- Dampens the attempts of developing manufacturing industries of exporting countries.

- **Prohibitive tariff**
- **A tariff that reduces imports to zero.**
- **Import subsidies**

What is distortion?

- When prices and production are higher or lower than levels that would usually exist in a competitive market.
- Trade Distortion ?
- Policy that alters the amount of trade, up or down, from what it would otherwise be.

Tariffs as Response to Trade Distortions

- ‘Unfair' foreign-trade practices which are trade distorting
- “Trigger-price" mechanisms
- Tariff responses to offset the distortion

Anti dumping duties

- Dumping – international price discrimination
- Persistent , seasonal, or cyclical
- As a predatory pricing practice
- Effect?
- Consumers –Producers /domestic industry

Dumping margin

- **Anti-dumping duties that are equal to the difference between the import price and the *normal value* of the product in the exporting country**
- **(the "dumping margin")**

Countervailing Duties

- Are tariffs that aim to offset the artificially low prices charged by exporters
- who enjoy export subsidies and tax concessions offered by the governments in their home country.

Effects of Tariffs

- Both the country exporting a product and the country importing that product.
- Create obstacles to trade
- Decrease the volume of imports and exports
- Decrease the volume of international trade
- Prospect of market access of the exporting country is worsened

Consumers

- Make imported goods more expensive
- Discourage domestic consumers from consuming
- Suffer a loss in consumer surplus
- Pay higher prices
- Now consume lesser quantity
- Shift to domestic substitutes

Producers

- Encourage production of domestically produced import substitutes
- Protect domestic industries from competition
- Price increase of their product in the domestic market
- Increase in well-being

Producers -contd

- Increases producer surplus
- Can also charge higher prices than would be possible in the case of free trade
- Foreign competition has reduced

Producers -contd

- Price increase also induces an increase in the output of the existing firms
- Possibly addition of new firms due to entry into the industry to take advantage of the new high profits
- Increase in employment in the industry.

Create trade distortions by disregarding comparative advantage

- Prevent countries from enjoying gains from trade arising from comparative advantage
- Tariffs discourage efficient production in the rest of the world
- Encourage inefficient production in the home country
- Increase government revenues

Non Tariff Measures (NTMs)

- Policy measures, other than ordinary customs tariffs
- That can potentially have an economic effect on international trade in goods, changing quantities traded, or prices or both (UNCTAD, 2010).

NTMs

- All types of measures which alter the conditions of international trade,
- including policies and regulations that restrict trade and those that facilitate it.
- Constitute the hidden or 'invisible' measures that interfere with free trade.

Note

- NTMs are not the same as non-tariff barriers (NTBs)
- NTMs consist of mandatory requirements, rules, or regulations that are legally set by the government of the exporting, importing, or transit country

In brief

- NTBs are a subset of NTMs that have a 'protectionist or discriminatory intent'.
- NTB implies a negative impact on trade.
- NTM is a neutral concept and does not necessarily imply a particular direction of impact.

There is no single, specific type of NTM.

- They form a constellation of different types of regulations
- that accompany products throughout their life cycles,
- from creation through distribution and on to final consumption

Three categories

- Those imposed on imports.
- Import quotas,
- Import prohibitions,
- Import licensing,
- Customs procedures ,and
- Administration fees.

Second category of NTMs

- Those imposed on exports.
- Export taxes
- Export subsidies
- Export quotas
- Export prohibitions
- Voluntary export restraints.

Third category of NTMs

- Those imposed internally in the domestic economy.
- Behind-the-border measures
- Domestic legislation covering health/technical/product/labour/environmental standards, internal taxes or charges, and domestic subsidies.

Sanitary and Phytosanitary (SPS) Measures

- Applied to protect human, animal or plant life from risks arising from
- additives, pests, contaminants, toxins or disease-causing organisms and to protect biodiversity

Technical Measures

- Product-specific properties
- Characteristics of the product, technical specifications and production processes

Technical Barriers To Trade (TBT)

- Are 'standards-based' measures that countries use to protect their consumers and preserve natural resources
- Mandatory 'standards and technical regulations' that define the specific characteristics that a product should have
- Conformity assessment procedures

Some examples of TBT

- Food laws
- Quality standards
- Industrial standards
- Organic certification
- Eco-labeling
- Marketing and label requirements.

Non-technical Measures

- Relate to ‘trade requirements’
- Further distinguished as
- Hard measures
- Threat measures
- Other measures such as trade-related finance and investment measures.

Non-technical Measures

- Import quotas
- Certain physical amount of the good
- Binding quota
- Non-binding quota

Tariff VS Quota

- Tariff is a tax on imports while quota is a quantity limit set on imports.

Quotas

- Do not generate revenues for the govt.
- Encourage the production of goods within the country
- Helps the nation become self-sufficient
- Decrease dependency on imports
- Protect own industries from foreign competition.

Types

Absolute quotas or quotas of a permanent nature

- Limit the quantity of imports to a specified level during a specified period of time country allocation
- Seasonal quotas
- Temporary quotas
- Tariff Rate Quota

Effects

- Government receives no revenue
- Quota rents
- Raises the domestic price of the imported good
- Consumers will be worse-off
- Producers in the importing country are better-off

Price Control Measures

- Also known as 'Para-tariff' measures
- Increase the cost of imports by a fixed percentage or by a fixed amount.
- A minimum import price

Non-automatic Licensing and Prohibitions

- Non-automatic licensing
- Discretionary license
- Total prohibitions

Financial Measures

- Foreign exchange controls
- Advance payment requirements
- Define the terms of payment
- Regulating the access to and cost of foreign exchange for imports

Measures Affecting Competition

- Granting exclusive or special preferences or privileges to one or a few limited group of economic operators
- Government imposed special import channels
- Compulsory use of national services
- Canalizing agency
- Statutory marketing board

Government Procurement Policies

- Government purchases from domestic firms
- Preference to the local tenders

Trade-Related Investment Measures

- Rules on local content requirements
- Restricting the level of imported components
- Imports related to export earnings

Distribution Restrictions

- Restriction on Post-sales Services
- Quantitative restrictions (QRs),
- A restriction on trade, usually imports, limiting the quantity of the good or service that is traded

Administrative Procedures

- Costly and time consuming administrative procedures
- Increase transaction costs and discourage imports
- Specifying particular procedures and formalities, requiring licenses, administrative delay, red-tape and corruption in customs clearing, procedural obstacles to prove compliance

Rules of origin

- Used to determine the "nationality" of goods traded in international commerce.
- Safeguard measures
- Embargos

Prevent

- Trade deflection
- Trans-shipment of goods through low tariff
- Countries

Export-related Measures

- Ban on exports
- Export Taxes

Export Subsidies and Incentives

- Duty drawback
- Duty-free access to imported intermediates export grants
- Soft loans
- Equity infusions
- Tax concessions
- Income or price support

Voluntary Export Restraints

- A type of informal quota administered by an exporting country voluntarily restraining the quantity of goods that can be exported
- Political considerations
- Based on negotiations of the importer with the exporter
- Appease the importer