Non-Tariff Barriers to Trade

Course: International Trade
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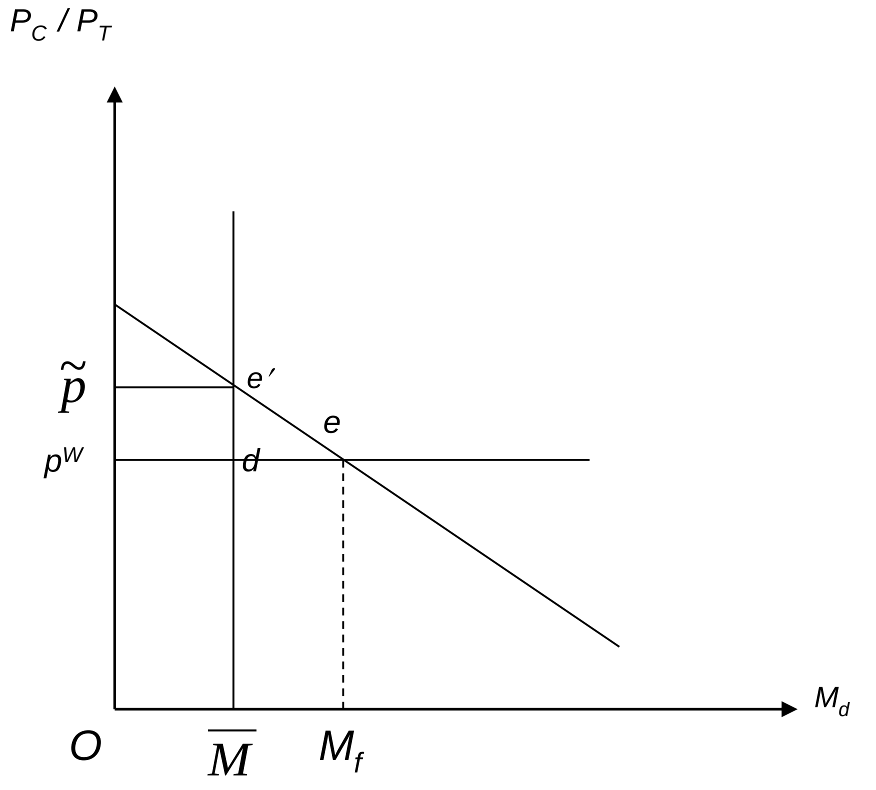
Quantitative Restrictions: Import Quota

- An import quota puts a physical restriction on the volume of imports of a country.
- Under perfect competition, similar effects like an import tariff.
- With quota domestic consumers cannot buy foreign goods more than what is permitted by quota regardless of how high price they pay.



Quota on Imports of Computers

Scarcity Rent

- Quota effectively taxes the consumers.

- The implicit tax or tariff rate is the rate by which the domestic price exceeds the world price.

$$t_q = (\tilde{p} - p^W)/p^W$$

- Scarcity rent under quota given by the rectangular area

$$p^W \tilde{p} e' d$$

Distribution of Scarcity Rent

- Home country government can extract rents from importers by auctioning import licenses so that scarcity rent now goes to government.

- Otherwise, licenses are given away on a first-cum-first-serve basis or through a lottery in which case scarcity rent accrues to the importers who obtain the import licenses.

The Economic Costs of Quota

- Production losses: quota encourages inefficient domestic producers to produce more computers;
- Consumption losses: Home consumers have to pay higher price.
- area *e′de* is the DWL

  whether licenses are auctioned off or not, in both cases scarcity rent accrues to economic agents within Home country, the government or importers.
- But if foreign supply is a monopolized, entire scarcity rent can be extracted from Home importers so that scarcity rent also constitutes a DWL.
- Additional loss: wasteful lobbying activities of potential license holders.

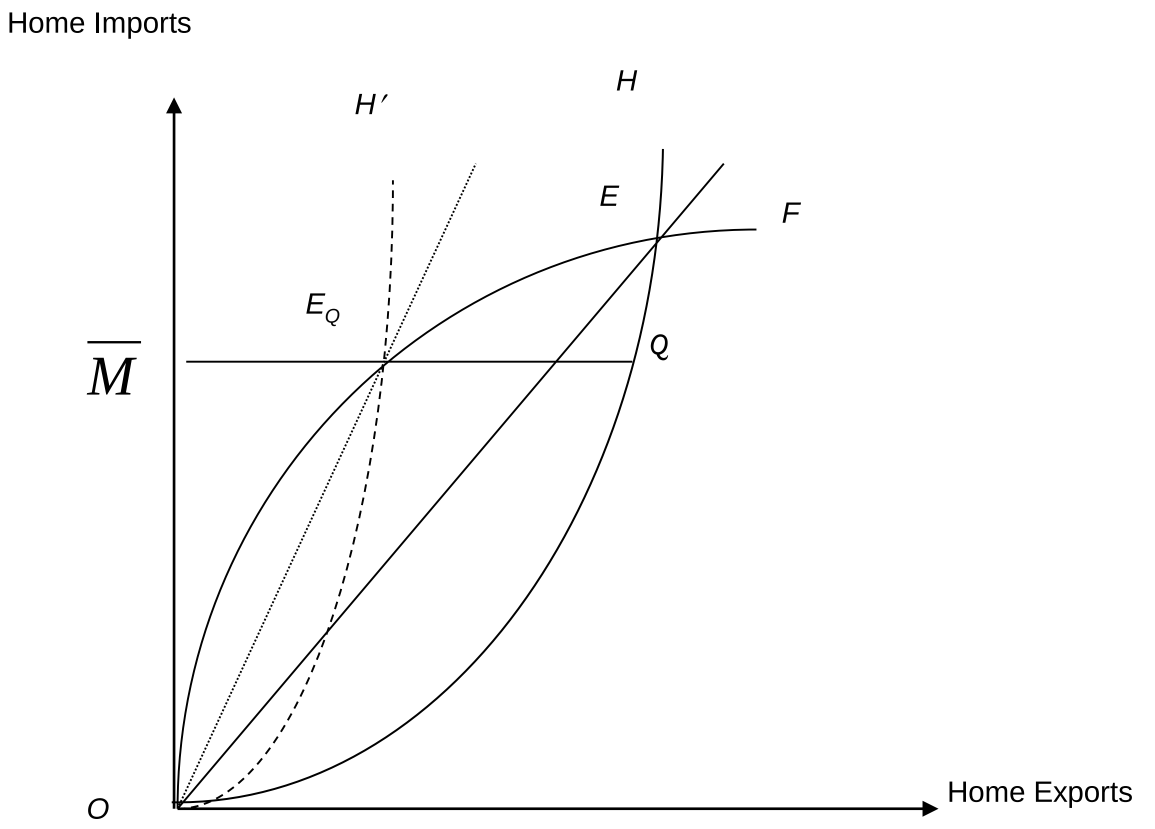
Equivalence of Quota and Tariff

- The *price-equivalence* theorem by Jagdish Bhagwati: the economic effects of quota and tariff are same.

  If a quota allowing a particular level of imports is replaced by an equal-import tariff (tariff generating same volume of imports), domestic price will be larger than world price by the same percentage point in both the cases.

- Only difference: tariff generates tariff revenue whereas import quota generates scarcity rent for import license holders.

- Part of this rent may be extracted by the government.



Tariff, Quota and TOT

- With $\overline{M}$ quota offer curve is OQ $\overline{M}$
- Home import and export fall leading to TOT improvement for HC.
- If quota is replaced by equal-import tariff, tariff rate must be such that new offer curve is OH’, new equilibrium Eq.

Comments

- Price-equivalence may not imply ***welfare equivalence*** of quota and tariff

  quota may cause larger economic losses if scarcity rent accrues to foreign supplier and when rent-seekers are engaged in wasteful lobbying activities.

- Price-equivalence extends to TOT effect: Similar to tariff, quota has both TOT effect (for large country)and VOT effect.

Import Restrictions through licenses in India

- In India import licensing was observed for almost all the imported goods.

- Goods were divided into banned, restricted, limited permissible, and subject to open general licensing (OGL).

- The OGL category was the most liberal. In 1987-88, OGL covered only 30 percent of imports.

Tariffication of QRs in India

- Important policy shift initiated in India in 1985: QRs were replaced by tariff, but not by equal-import tariff criterion (higher in many cases).

- *Tariffication of QRs*: In April 2001 as part of the structural adjustment programmes, the QRs on most of the goods including consumer goods were replaced by *equivalent* tariffs.

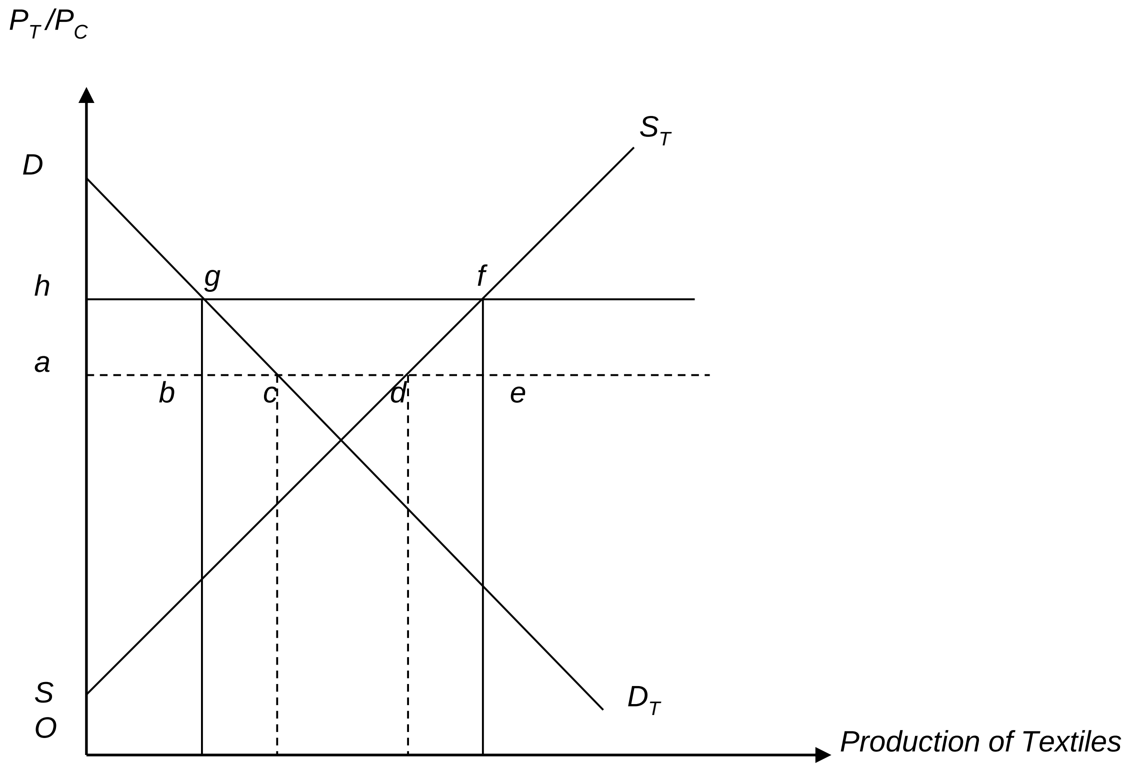
Export Subsidy

- Payment made to an exporter for its sales abroad, over and above the price the exporter gets in a Foreign country.

- Export subsidy makes sales abroad more *profitable* so export rises which creates excess demand in domestic market and domestic price of export good rises.

- Exporters export up to the volume for which domestic price exceeds the price abroad by per unit amount of the subsidy.

Welfare Implications: Both Large & Small Country



Ad-Valorem Subsidy on Textiles Exports

- Welfare loss: fall in CS by area acgh, rise in PS by area adfh, but subsidy given is a loss by area gbef.
- Deadweight loss: *area (bcg+ edf)*

Welfare Implications: Only for Large Country

- Welfare loss for both small & large countries
- Additional loss: TOT deterioration

  Export subsidy raises export offer creating excess supply in world market for textiles, and lowers its relative price worsening TOT.

- In a perfectly competitive world export subsidy lowers welfare of a country, irrespective of *small* or *large*.

Export Subsidy: Reality

- In oligopoly market, national governments have strategic incentives to provide export subsidy.
- Agricultural and dairy products are provided export subsidies.
- Export Enhancement Program (EEP) in US covering products like wheat, rice, frozen poultry, frozen pork, barley, vegetable oil and the like.
- East Asian countries provide export subsidies mostly on cotton.
- Indirect export subsidy schemes like duty drawback on imported raw materials and inputs for export production in the18th century UK and during 1970s and 1980s in India.

WTO Rules on Subsidy

- *Prohibited* subsidies: directly linked to exports;
- *Actionable* subsidies: not directly linked to exports but still have an impact on exports;
- *Non-actionable* subsidies: assistance to disadvantaged regions and meeting environmental regulation.

Reaction of the Importing Country

- Impose *countervailing duty* against subsidized exports which brings a loss to the exporting country but world as a whole gains.

- So a combination of export subsidy and an equal countervailing duty leaves world welfare unchanged.

Voluntary Export Restraints (VER)

- **Export quotas *negotiated* by an importing country with its trading partners.**

- If negotiation is successful the trading partner, that is, the exporting country ***voluntarily*** restricts its exports.

- **Example: United States successfully negotiated VER with Japan restricting exports of Japanese automobiles to United States during mid 1980s.**

- VER worsens TOT for importing country and thereby shifts scarcity rent from importing to exporting country.

  Thus, VER *may* improve welfare of large exporting country if it is not too restrictive.

  This explains why VERs may be *voluntary*.

VER versus Quota

- When there is more than one source of supply of a country's imports, then an import quota imposed by the country may be more restrictive and protective than a VER if the country is not being able to negotiate VER with all its trading partners.

- VER is often source-specific and discriminatory whereas quota is global and non-discriminatory though more restrictive.

- DWL under VER is larger than DWL under an equal-import quota for importing country.

Other Non-tariff Barriers (NTB) to Trade

- Quality standards, environmental regulations, technical barriers to trade (TBT), local content requirement related to the nature and standards of imported goods.

Thank you