TYPES OF PROTECTIONS

UNIT 2

IEC

Types of protectionism

- Protectionism (protecting against imports) has arisen in various forms.
- These include:
- 1.Tariffs
- 2.Quotas
- 3.Exchange controls
- 4.Export subsidies
- 5. Voluntary export restraints (VER's)

Other protectionist measures:

- Countries can also use a range of other protectionist measures to restrict imports. These might include:
- **Administrative obstacles -** countries can set administrative hurdles. For example, they may require significant levels of paperwork and then deal with these processes slowly making it difficult for importers to compete on a level playing field with other firms.
- **Health and safety standards** - countries may set onerously high health and safety standards for goods that are imported, once again making life difficult for importers.
- **Environmental standards** - countries can set high environmental standards that they know only domestic firms are likely to be able to achieve, making imports difficult.

1. Tariffs:

- A tariff is a tax on imports.
- It can be >>
- i. specific Tariff (so much per unit of sale) or
- ii. ad valorem Tariff (a percentage of the price of the product).
- Tariffs raise the price of imports and thus reduce the supply. This gives domestic equivalents a comparative advantage.
- As such, tariffs distorts the market forces and may prevent consumers from gaining the benefit of all the advantages of international specialisation and trade.

Who Collects a Tariff?

- In simplest terms, a tariff is a tax.
- It adds to the cost borne by consumers of imported goods and is one of several trade policies that a country can enact to protect domestic producers.
- Tariffs are paid to the customs authority of the country imposing the tariff.

Types of Tariff : 2 types

- **Specific Tariffs :** A fixed fee levied on one unit of an imported good is referred to as a specific tariff.

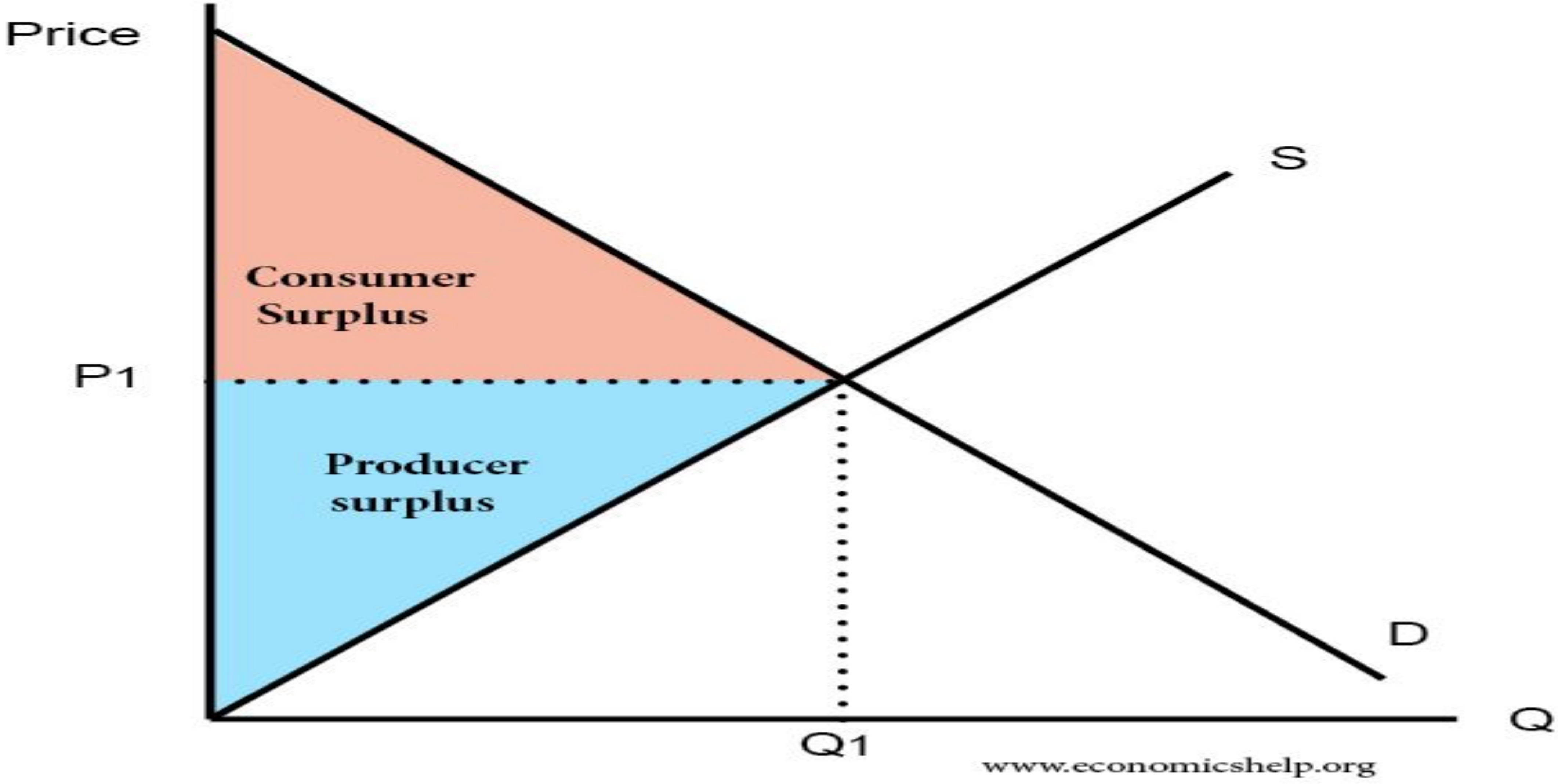
>> This tariff can vary according to the type of goods imported. For example, a country could levy a $15 tariff on each pair of shoes imported, but levy a $300 tariff on each computer imported.

Ad Valorem Tariffs :

The phrase "ad valorem" is Latin for **"according to value,"** and this type of tariff is levied on a good based on a percentage of that good's value. An example of an ad valorem tariff would be a 15% tariff levied by India on China's automobiles.

The 15% is a price increase on the value of the automobile, so a $10,000 vehicle now costs $11,500 to Indian consumers. This price increase protects domestic producers from being undercut but also keeps prices artificially high for Indian car shoppers.

Lets know a bit about>>Consumers’ and Producers’ surplus



So, They are >>

- **Consumer Surplus >>** is the difference between the price that consumers pay and the price that they are willing to pay. On a supply and demand curve, it is the area between the equilibrium price and the demand curve
- For example, if you would pay 76p for a cup of tea, but can buy it for 50p – your consumer surplus is 26p
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- AND
- **Producer Surplus >>**
- This is the difference between the price a firm receives and the price it would be willing to sell it at.
- Therefore it is the difference between the supply curve and the market price.

Effects of Tariff:

- **Price Effect:** Price rises from world price Pworld to higher tariff price Ptariff.
- **Demand Effect:** Quantity demanded by domestic consumers falls from QC1 to QC2, a movement along the demand curve due to higher price.
- **Supply Effect:** Domestic suppliers are willing to supply QS2 rather than QS1, a movement along the supply curve due to the higher price,
- **Import Effect:** so the quantity imported falls from QC1–QS1 to QC2–QS2.

Effect … Contd..

- **Effect on Consumer surplus** (the area under the demand curve but above price): shrinks by areas A+B+C+D, as domestic consumers face higher prices and consume lower quantities.
- **Effect on the Producer surplus** (the area above the supply curve but below price) : increases by area A, as domestic producers shielded from international competition can sell more of their product at a higher price.
- **Revenue Effect:** Government tax revenue is the import quantity (QC2 – QS2) times the tariff price (Pworld – Ptariff), shown as area C.

Thus Tariff has three effects on societal welfare.

- >> Consumers are made worse off because the consumer surplus becomes smaller.
- >>Producers are better off because the producer surplus is made larger.
- >>The government also has additional tax revenue .
- However, the loss to consumers is greater than the gains by producers and the government. The magnitude of this societal loss is shown by the two triangles , B and D.
- **Removing the tariff and having free trade would be a net gain for society.**

Areas B and D are **deadweight losses**, surplus formerly captured by consumers that now is lost to all parties.

- **The overall change in welfare = Change in Consumer Surplus + Change in Producer Surplus + Change in Government Revenue = (−A−B−C−D) + A + C = −B−D.**

- The final state after imposition of the tariff is an overall welfare reduction by the areas labeled "societal losses", which correspond to areas B and D.
- The losses to domestic consumers are greater than the combined benefits to domestic producers and government

For economic efficiency, free trade is often the best policy, however levying a tariff is sometimes second best.

- A tariff is called an optimal tariff if it is set to maximise the welfare of the country imposing the tariff.
- It is a tariff derived by the intersection between the trade indifference curve of that country and the offer curve of another country.
- In this case, the welfare of the other country grows worse simultaneously, thus the **policy is a kind of beggar thy neighbor policy.**

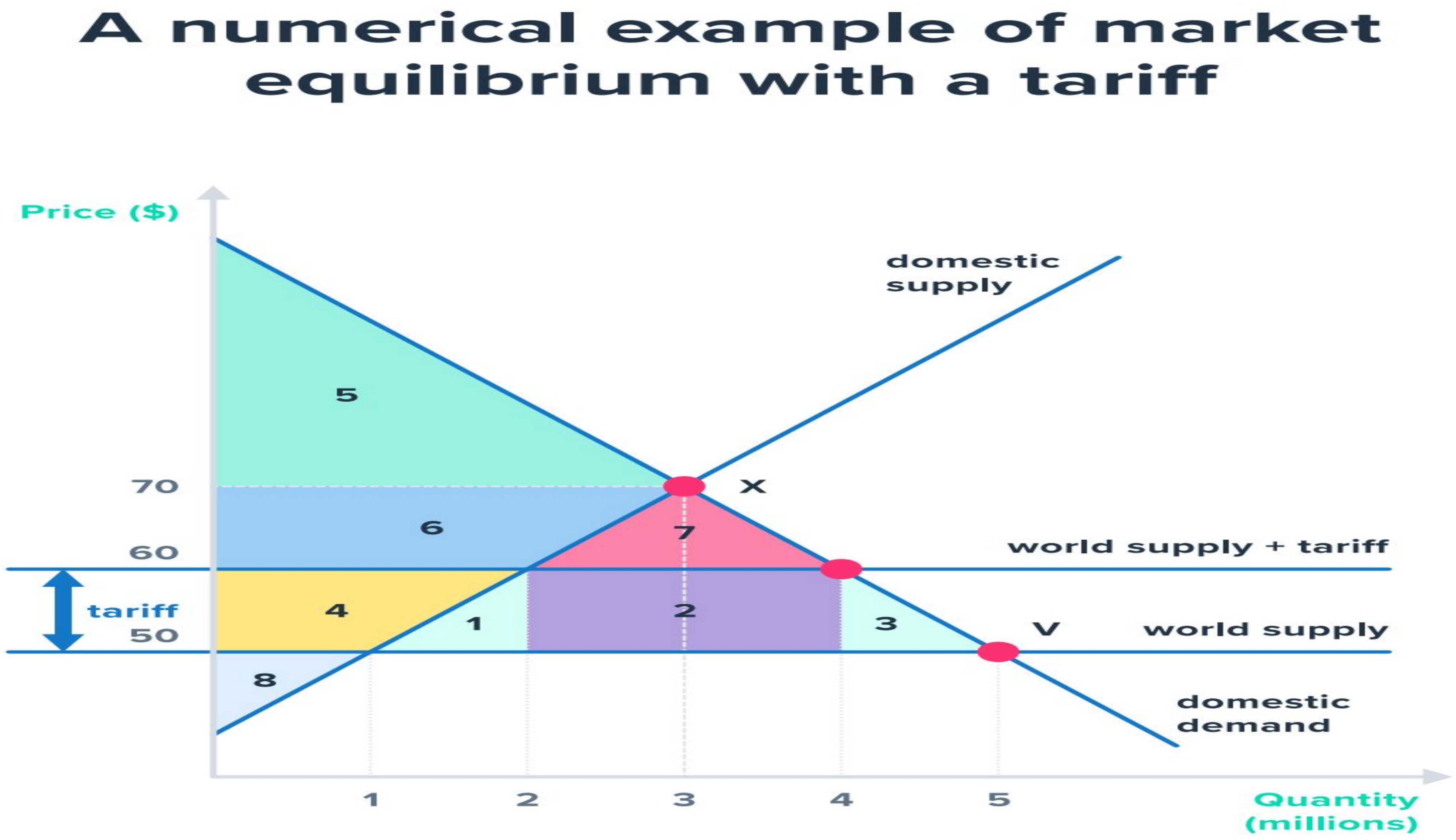
It is possible to levy a tariff as a political policy choice, and to consider a theoretical optimum tariff rate.

- However, imposing an optimal tariff will often lead to the foreign country increasing their tariffs as well, leading to a loss of welfare in both countries.
- When countries impose tariffs on each other, they will reach a position off the contract curve, meaning that both countries' **welfare could be increased by reducing tariffs.**
- **Tariff results in lowering of world's overall output.**

Thus, **two** possible consequences may follow:

- 1. >> if one country imposes a tariff which is not subject to retaliation it may gain at the expense of its trading partner.
- 2. >> If the other country retaliates and especially if this leads to counter retaliation, both countries are likely to lose as a result.

Q. Look at Fig 1 below and answer the following questions



Questions for Figure 1

- Q i. How much is the Increase in domestic producer surplus ?
- Q ii. How much is the Decrease in consumer surplus ?
- Q iii. How much is the Tariff revenue?
- Qiv. How much is the Deadweight loss ?

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- ???
- Can You Now answer what are the effects of tariff ???

THANK YOU

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