Method of Protectionism

Different Form of Protectionism

- Tariffs: Tariffs are taxes imposed on imported goods, making them more expensive for consumers and businesses.
- Quotas: Quotas set limits on the quantity of specific imported goods that can enter a country within a given period.
- Subsidies: Governments may provide financial support or subsidies to domestic industries, making their products more competitive in the global market.
- Import licensing: Import licensing involves requiring importers to obtain government approval or licenses before importing specific goods.
- Regulatory barriers: Governments may implement regulations and standards that foreign products find challenging to meet.
- Buy domestic policies: Governments may enact "buy domestic" or "buy national" policies, which require public institutions, such as government agencies, to give preference to domestic suppliers when purchasing goods and services.
- Currency manipulation: Some countries manipulate their currency exchange rates to make their exports cheaper and imports more expensive.

Tariffs

- A tariff is a tax or duty levied on the traded commodity as it crosses a national boundary.
- An **import tariff** is a duty on the imported commodity, while an **export tariff** is a duty on the exported commodity.
- Import tariffs are more important than export tariffs, and most of our discussion will deal with import tariffs.
- Example of Export Tariff:-

Chart 1 | The chart shows the trend of retail inflation (●) and food inflation (●) over time. Since food and beverages carry a 57% weightage in India's retail inflation calculation, rapid acceleration in the segment has a severe impact on the latter

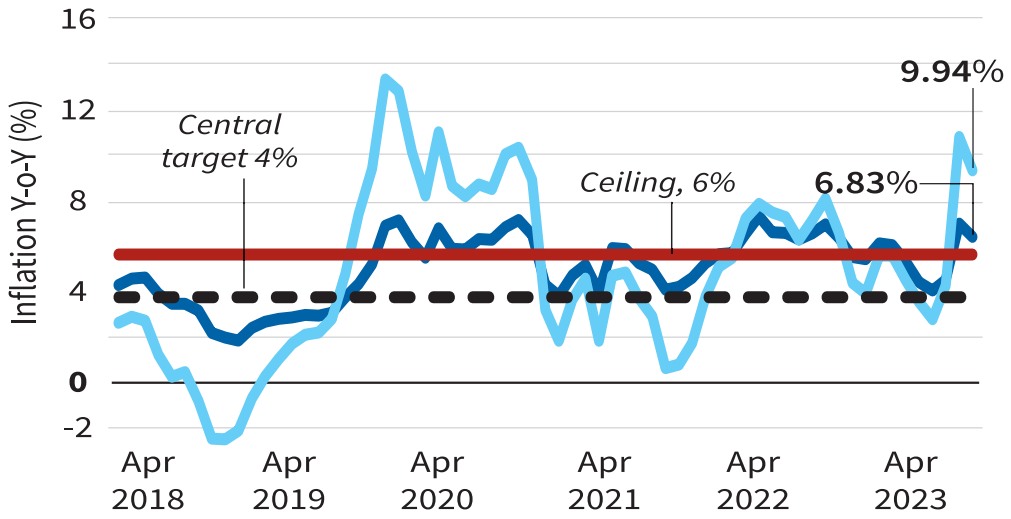


Chart 2 | The chart shows the chronology of trade and domestic stock policy to tame inflation of rice and wheat

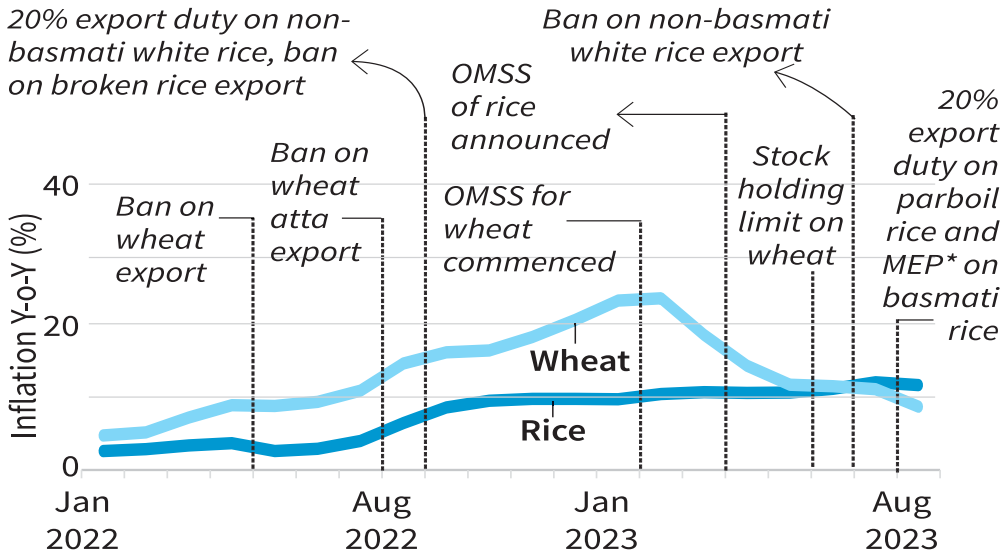


Chart 3 | The chart shows the trends in cereal exports in India. Non-basmati exports increased from 1.38 MMT in FY20 to 6.40 MMT in FY23, by 363%

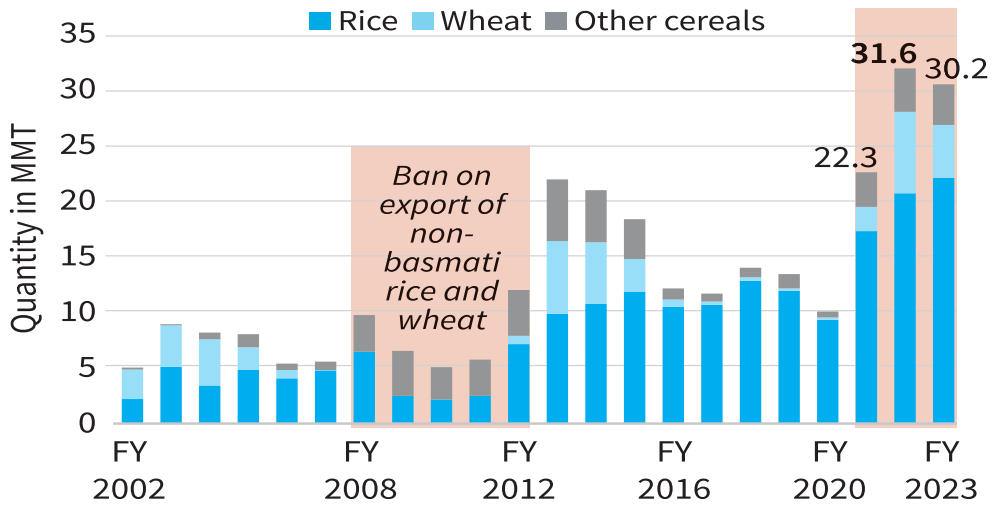
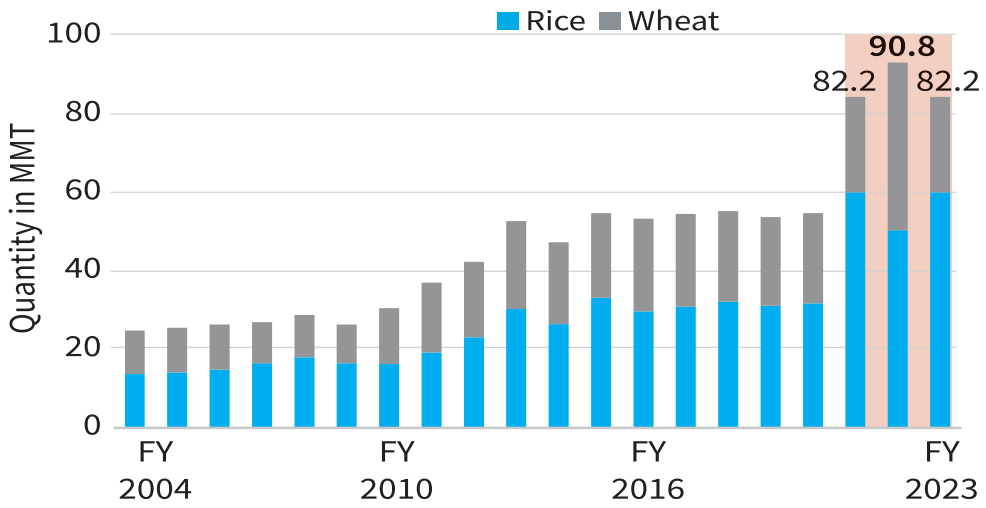


Chart 4 | The chart shows offtake of rice and wheat under NFSA and PMGKY from the central pool



*Minimum Export Price

Types of Tariffs

- The **ad valorem tariff** is expressed as a fixed *percentage* of the value of the traded commodity.
- The **specific tariff** is expressed as a fixed *sum* per physical unit of the traded commodity.
- The **compound tariff** is a combination of an ad valorem and a specific tariff.
- For example, a 10 per cent ad valorem tariff on iPhones would result in the payment to customs officials of the sum of INR 6000 on each INR 60000 imported iPhone and the sum of INR 12000 on each INR 120000 imported iPhone.
- On the other hand, a specific tariff of INR 6000 on imported iPhones means that customs officials collect a fixed sum of INR 6000 on each imported iPhone regardless of its price.
- Finally, a compound tariff of 5 per cent ad valorem and a specific tariff of INR 6000 on imported iPhones would result in the collection by customs officials of the sum of INR 9000 on each INR 60000 iPhone and INR 12000 on each INR 120000 imported iPhones.

Average Tariff on Nonagricultural Products in Major Developed Countries

	United States	European Union	Japan	Canada
Fish & fish products	0.2	11.6	5.6	0.9
Minerals & metals	1.7	2.0	1.0	1.0
Petroleum	1.8	2.5	0.7	0.9
Chemicals	2.8	4.6	2.3	0.7
Wood, paper, etc.	0.5	0.9	0.9	1.0
Textiles	7.9	6.5	5.4	2.3
Clothing	11.6	11.5	9.0	16.5
Leather, footwear, etc.	3.9	4.1	7.7	3.8
Non-electric machinery	1.2	1.8	0.0	0.4
Electric machinery	1.5	2.5	0.1	1.0
Transport equipment	2.9	4.7	0.0	5.5
Other manufactures	2.2	2.3	1.2	2.5
Average	3.1	4.2	2.5	2.1

Source: WTO Data Bank (Geneva, 2018).

- The average tariff level on all nonagricultural products is less than 5 percent. It is even less in some of the smaller developed countries.

Average Tariffs on Nonagricultural Products in Some Major Developing Countries

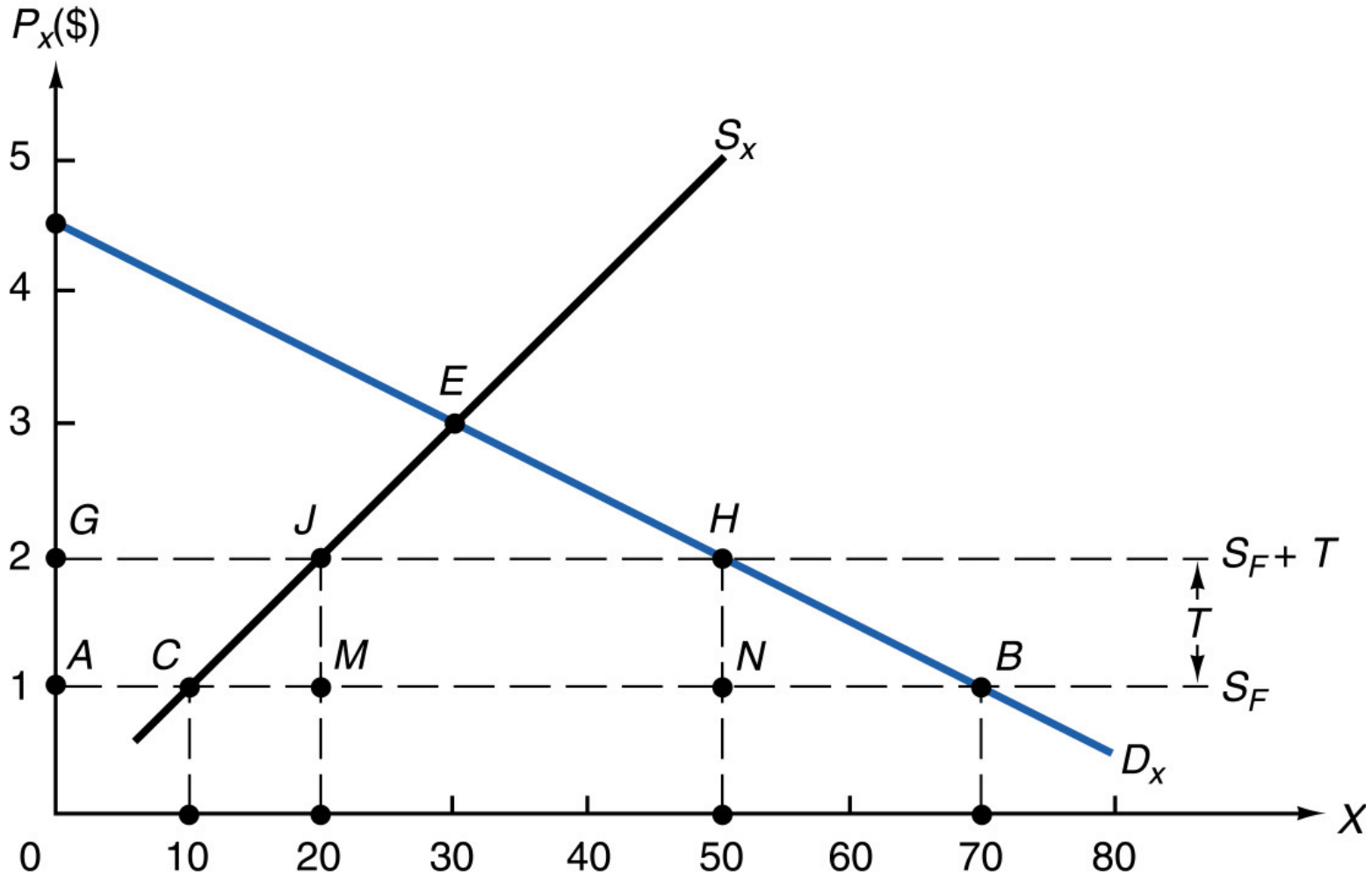
	China	India	Brazil	Russia	Korea	Mexico
Fish & fish products	10.8	29.9	10.3	7.1	16.7	14.0
Minerals & metals	7.8	8.5	10.1	7.3	4.6	3.6
Petroleum	5.3	4.2	0.4	4.4	4.5	0.1
Chemicals	6.6	8.1	8.0	4.7	5.6	2.3
Wood, paper, etc.	4.1	8.9	10.4	8.2	2.4	4.5
Textiles	9.6	11.9	23.3	7.6	9.0	9.8
Clothing	16.0	15.1	35.0	7.4	12.5	21.2
Leather, footwear, etc.	13.3	10.1	16.1	5.7	7.6	6.1
Non-electric machinery	8.1	7.2	12.8	2.6	5.9	2.8
Electric machinery	8.6	7.3	14.2	4.5	6.0	3.5
Transport equipment	12.3	24.9	19.2	8.4	5.7	8.5
Other manufactures	11.7	8.9	15.2	7.6	6.1	5.2
Average	8.8	10.7	13.9	6.2	6.8	5.8

Source: WTO Data Bank (Geneva, 2018).

- The table shows that the lowest average tariff (5.8 percent) is imposed by Mexico, with the others having average tariffs between 6.2 (Russia) and 13.9 (Brazil).
- All six countries, however, have much higher tariffs than developed countries.

Effect of Tariff

- **Consumption effect: -** Reduction in domestic consumption
- **Production effect: -** Expansion of domestic production
- **Trade effect: -** Decline in imports
- **Revenue effect: -** Revenue collected by the government


P_x($)
5
4
3
2
1
0
10
20
30
40
50
60
70
80
X
S_x
D_x
E
G
J
H
A
C
M
N
B
S_F + T
T
S_F

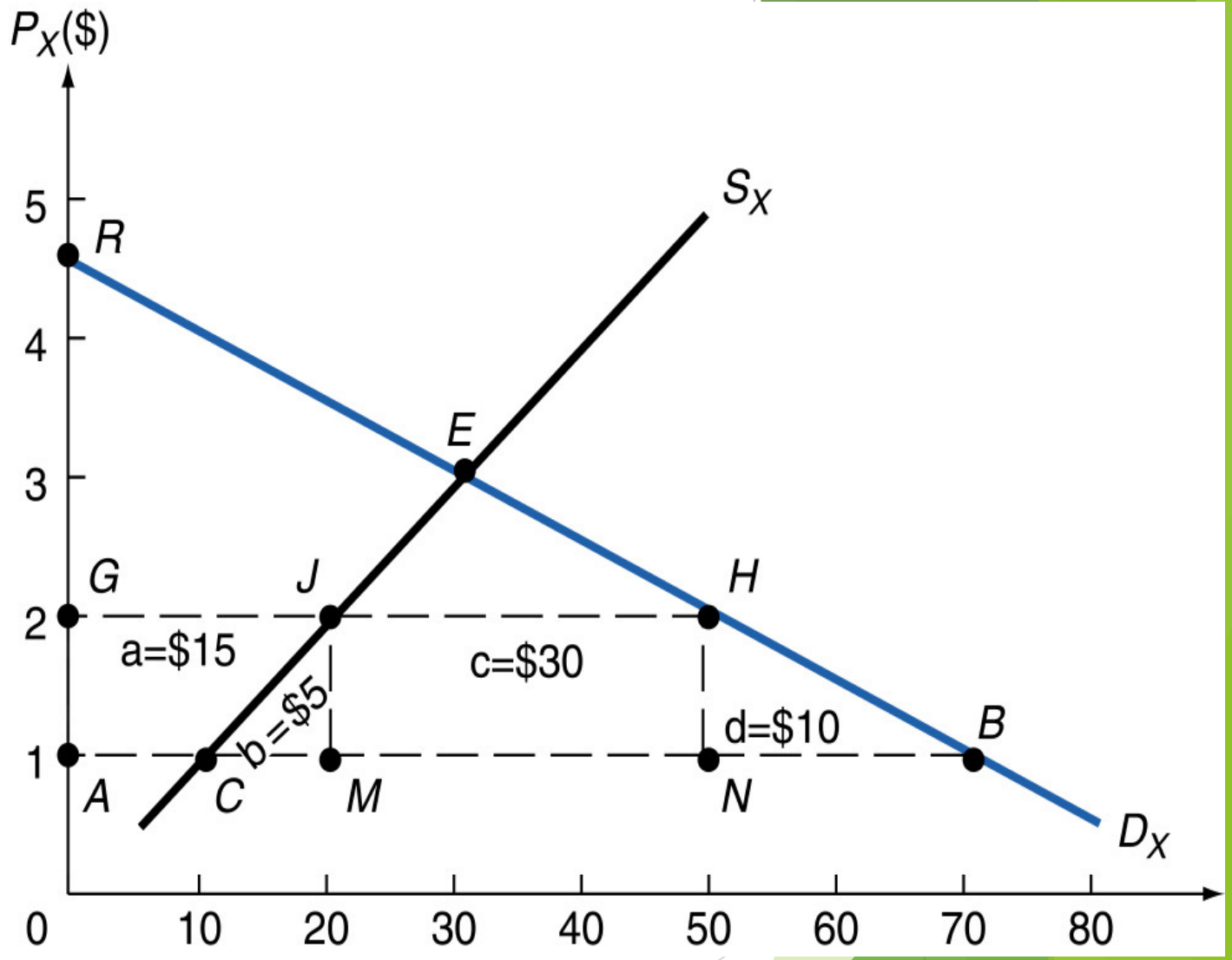
- D_X is the demand curve and S_X is the supply curve of commodity X in Nation 1.
- In the absence of trade, the intersection of D_X and S_X defines equilibrium point E, at which 30_X is demanded and supplied at P_X \$3 in Nation 1.
- With free trade at the world price of P_X \$1, Nation 1 will consume 70_X (AB), of which 10_X (AC) is produced domestically and the remainder of 60_X (CB) is imported.
- If Nation 1 now imposes a 100 per cent ad valorem tariff on the imports of commodity X, P_X in Nation 1 will rise to \$2. At P_X \$2, Nation 1 will consume 50_X (GH), of which 20X (GJ) is produced domestically and the remainder of 30X (JH) is imported.
- The horizontal dashed line $S_F + T$ represents the new tariff-inclusive foreign supply curve of commodity X to Nation 1.

- The **consumption effect of a tariff** (i.e., the reduction in domestic consumption) equals 20X (*BN*);
- The **production effect** (i.e., the expansion of domestic production resulting from the tariff) equals 10X (*CM*);
- The **trade effect** (i.e., the decline in imports) equals 30X (*BN* + *CM*);
- The **revenue effect** (i.e., the revenue collected by the government) equals $30 ($1 on each of the 30X imported, or *MJHN*).

Redistributive effect of Tariff

- From domestic consumers (who pay higher price for the commodity) to domestic producers (who receive the higher price)
- From nation's abundant factor (producing exports) to the scarce factor (producing imports).
- This leads to inefficiencies, or protection costs (*deadweight losses*).

- The reduction of the consumer surplus of $AGHB = a + b + c + d = \$60$,
- $MJHN = c = \$30$ is collected by the government as tariff revenue,
- $AGJC = a = \$15$ is redistributed to domestic producers of commodity X in the form of increased producer surplus or rent,
- while the remaining \$15 (the sum of the areas of triangles $CJM = b = \$5$ and $BHN = d = \$10$) represents the protection cost, or deadweight loss, to the economy.



Other Effect of Tariff

- Terms of Trade (TOT) effect: - The TOT effect depends on how the price changes caused by the tariff affect a country's export and import prices. If the price of imported goods rises more than the price of exported goods, it can improve a country's terms of trade.
- Balance of Payment (BoP) effect: - The Balance of Payments (BoP) is a record of all economic transactions between a country and the rest of the world over a specified period, typically a year. The tariff has a favorable effect on BoP, as it decreases imports.

Types of Quotas

1. Absolute Quota / Unilateral Quota: An absolute quota sets a specific limit on the quantity of a particular product that can be imported during a specified time period, usually annually.
2. Bilateral Quota: a quota set by the importing country through an agreement.
3. Country-Specific Quota: Country-specific quotas restrict imports from particular countries or regions. They are used to manage trade relationships- including diplomatic or economic considerations.
4. Licensing Quota: Licensing given to specific importer to import the restricted amount.

5. Tariff Rate Quota (TRQ): A tariff rate quota combines both a quota and a tariff. It allows a certain quantity of a product to be imported at a lower tariff rate, typically within the quota limit. Imports beyond the quota face a higher tariff rate. This system is often used to balance the interests of domestic producers and consumers.
6. Seasonal Quota: Seasonal quotas restrict imports of certain products during specific times of the year. They are often used to protect domestic producers during their peak production seasons.
7. Export Quota: Some countries use export quotas to limit the quantity of certain goods that can be exported. This is less common than import quotas and is often implemented to ensure adequate domestic supply or control prices.

Effects of Quotas

- S_0 is the foreign supply curve under free trade and it is perfectly elastic. S_1 is the domestic supply curve which slopes positively. D is the demand curve for the given commodity and it slopes negatively.

- The quantity demanded and supplied of the given commodity is measured along the horizontal scale and price is measured along vertical scale.

- In the conditions of free trade, the quantity supplied is OQ and the quantity demanded is OQ_1. The excess of demand over supply is met through the import from abroad QQ_1.

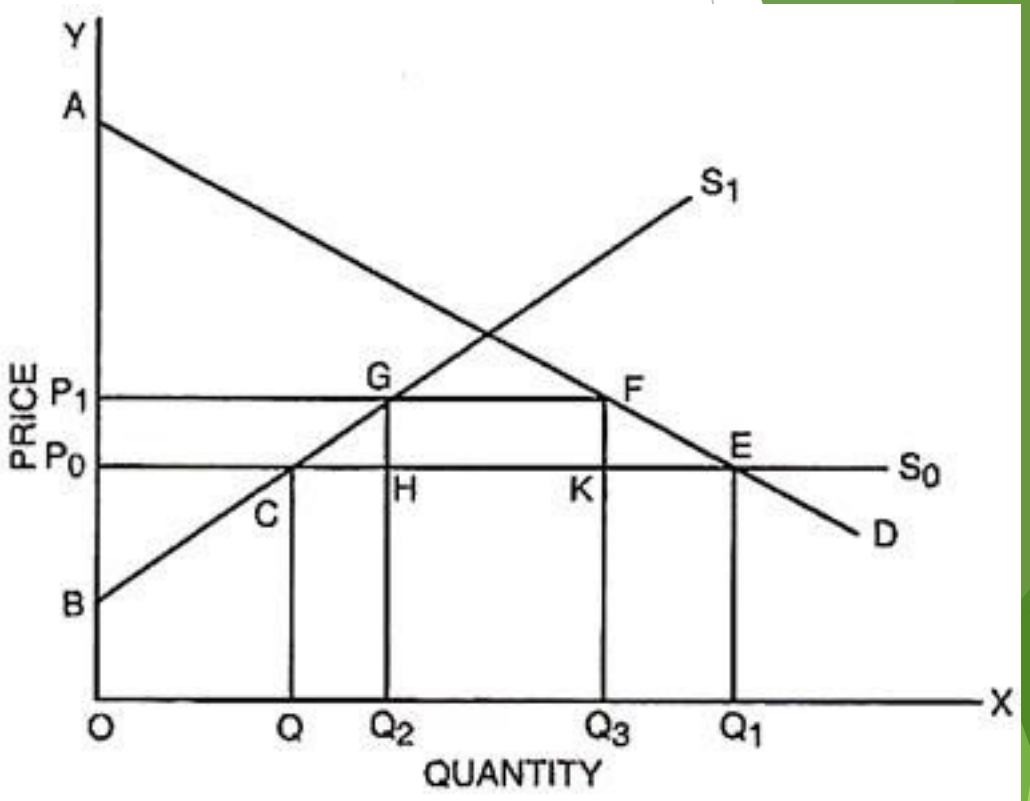


Fig. 16.1

Price Effect:

- The enforcement of import quotas restricts its availability in the home market and creates a shortage and consequent rise in its price.
- Originally, the price of the commodity was Po and the quantity imported amounted to QQ_1. The government of the home country fixes the import quota to the extent of Q_2Q_3.
- The initial total supply in the home market, OQ (Domestic Production) + QQ_1 (Imported) = OQ_1 (Total Supply).
- After the enforcement of import quota, the total supply is OQ_3 out of which domestic production is OQ_2 and import quota is Q_2Q_3 ($OQ_3 = OQ_2 + Q_2Q_3$).
- given the supply OQ_3 and demand curve D, the price rises from P_0 to P_1. This rise in the price of the commodity is the price effect of the import quota.

Protective or Production Effect:

- As it reduces the imports, the domestic producers are induced to increase the production of import substitutes. The increased domestic production due to import quota is called as the protective or production effect.
- Originally the domestic production was OQ. After the import quota is fixed at Q_2Q_3, the domestic production expands from OQ to OQ_2. Thus there is an increase in domestic production by QQ_2. This is the protective or production effect.

Consumption Effect:

- The rise in the domestic price of the given commodity due to import Quptas; the consumption of the commodity gets reduced. This is known as the consumption effect.
- The consumption under free trade situation is OQ_1. After the fixation of import quota up to Q_2Q_3, the total consumption at the higher price P_1 is reduced to OQ_3. Thus there is a reduction in consumption by $OQ_1 - OQ_3 = Q_1Q_3$

Revenue Effect:

- The revenue effect is either captured by the domestic importers or foreign exporters or shared between the domestic importers and foreign exporters in some proportion.

Redistributive Effect:

- The import quota causes a redistributive effect in the quota-enforcing country. After the fixation of the import quota, the price rises from P_0 to P_1 and the loss in consumer's surplus amounts to P_0EFP_1. The gain is producer's surplus amounts to P_0CGP_1.
- If importers are organised, an amount equal to the revenue effect GHKF will accrue to them. Consequently, the net loss to the community will be $P_0EFP_1 - (P_0CGP_1 + GHKF) = \Delta GCH + \Delta FKE$.

Balance of Payments Effect:

- One of the objectives of enforcing import quota is to reduce the balance of payments deficit (total Value of Import > total Value of Export) by restricting imports.
- That portion of national income going into imports can be utilized for investment in the import-substitution or export industries. The expansion in exports, coupled with restriction of imports is likely to bring about improvement in the balance of payments position of the country.
- The quantity imported under free trade conditions at the price P_0 is QQ_1 and the total value of imports is $QCEQ_1$. In case, the government prescribes the imports quota as Q_2Q_3.
- Since price of imported commodity rises to P_1, the value of imports is Q_2GFQ_3. There can be saving of foreign exchange of the size of GFKH and actual payment to foreign country is Q_2HKQ_3 which is less than the payment $QCEQ_1$ for imports under the free trade. Thus import quota brings about a reduction in the balance of payments deficit.

Tariff Vs Quotas: Which one is better

- Effects of Tarif and Quotas are similar but both methods are useful in different conditions.
- Quotas are more precise and certain effect on imports than tariffs.
- Quotas are more popular and less resented by the trading nation than tariffs.
- Quotas are preferable where domestic demand for importing goods is inelastic.
- Quotas are administratively more flexible instruments than tariffs.
- Quotas are more appropriate to control domestic consumers and foreign exporters.

- Quotas are more arbitrary than tariffs. It has discriminatory biases and distorted the pattern of international trade.
- Import quotas can also foster inequality among importers. Depending on how quota licenses are distributed, some importers might receive more favourable terms than others.
- Quota leads to corruption. Usually, officials charged with the allocation of import licenses are likely to be exposed to bribery. Under this situation, the tariff is preferable to the quota.
- The government suffered a loss of revenue under Quotas.

Quota

- Limits the quantity or the total values of a good imported.
- The government does not earn revenue from quotas.
- Domestic importers (or foreign producers) earn quota rents.
- Keeps domestic prices high by limiting foreign supplies in the market.

Tariff

- No limit on the quantity or the total values of goods imported.
- Revenue collected from the tariff goes to the government.
- Domestic importers and foreign producers do not profit from tariffs.
- Tariffs increase prices because the producers who have to pay the tax will transfer this burden onto consumers by raising sales prices.