9.1 Tariffs for the Long Haul

We just saw how a tariff can be used to increase producer surplus at the expense of a loss in consumer surplus. There are also many other indirect costs of tariffs: They can lead trading partners to retaliate with their own tariffs (thus hurting exporting producers in the country that first imposed the tariff); they can also be fiendishly hard to remove later on even after economic conditions have completely changed, because they help to politically organize the small group of producers that is protected from foreign competition. (We will discuss this further in Chapter 10.) Finally, large tariffs can induce producers to behave in creative— though ultimately wasteful—ways in order to avoid them.

In the case of the tariff known as the “Chicken Tax,” the tariff lasted for so long (47 years and counting) that it ended up hurting the same producers that had intensively lobbied to maintain the tariff in the first place![[1]](#footnote-1) This tariff got its name because it was a retaliation by U.S. President Lyndon Johnson’s administration against a tariff on U.S. chicken exports imposed by Western Europe in the early 1960s. The U.S. retaliation, focusing on Germany (one of the main political forces behind the original chicken tariff), imposed a 25 percent tariff on imports of light commercial truck vehicles. At the time, Volkswagen was a big producer of such vehicles and exported many of them to the United States. As time went by, many of the original tariffs were dropped, except for the ones on chickens and light commercial trucks. Volkswagen stopped producing those vehicles, but the U.S. “big three” auto and truck producers were then concerned about competition from Japanese truck producers and lobbied to keep the tariff in place. Japanese producers then responded by building those light trucks in the United States (see Chapter 8).

As a result, the latest company to be hit by the consequences of the tariff is Ford, one of those “big three” U.S. producers! Ford produces a small commercial van in Europe, the “Transit Connect,” which is designed (with its smaller capacity and ability to navigate old, narrow streets) for European cities. The recent spike in fuel prices sharply increased demand in some U.S. cities for this truck. In 2009, Ford started selling these vehicles in the United States. To get around the 25 percent tariff, Ford installs rear windows, rear seats, and seat belts prior to shipping the vehicles to the United States. These vehicles are no longer classified as commercial trucks but as passenger vehicles, which are subject to the much lower 2.5 percent tariff. Upon arrival in Baltimore, Maryland, the rear seats are promptly removed and the rear windows replaced with metal panels—before delivery to the Ford dealers.

9.2 A Voluntary Export Restraint in Practice

**Japanese Autos**

For much of the 1960s and 1970s, the U.S. auto industry was largely insulated from import competition by the difference in the kinds of cars bought by U.S. and foreign consumers. U.S. buyers, living in a large country with low gasoline taxes, preferred much larger cars than Europeans and Japanese, and, by and large, foreign firms had chosen not to challenge the United States in the large-car market.

In 1979, however, sharp oil price increases and temporary gasoline shortages caused the U.S. market to shift abruptly toward smaller cars. Japanese producers, whose costs had been falling relative to those of their U.S. competitors in any case, moved in to fill the new demand. As the Japanese market share soared and U.S. output fell, strong political forces in the United States demanded protection for the U.S. industry. Rather than act unilaterally and risk creating a trade war, the U.S. government asked the Japanese government to limit its exports. The Japanese, fearing unilateral U.S. protectionist measures if they did not do so, agreed to limit their sales. The first agreement, in 1981, limited Japanese exports to the United States to 1.68 million automobiles. A revision raised that total to 1.85 million in 1984. In 1985, the agreement was allowed to lapse.

The effects of this voluntary export restraint were complicated by several factors. First, Japanese and U.S. cars were clearly not perfect substitutes. Second, the Japanese industry to some extent responded to the quota by upgrading its quality and selling larger autos with more features. Third, the auto industry is clearly not perfectly competitive. Nonetheless, the basic results were what the discussion of voluntary export restraints earlier would have predicted: The price of Japanese cars in the United States rose, with the rent captured by Japanese firms. The U.S. government estimates the total costs to the United States to be $3.2 billion in 1984, primarily in transfers to Japan rather than efficiency losses.

**Chinese Solar Panels**

Although voluntary export restraints are no longer allowed under WTO rules, this only applies to an agreement negotiated by governments and imposed onto exporters. Recently, a European Union–China trade dispute over a surge in Chinese exports of solar panels was resolved by the Chinese producers “agreeing” to limit their exports to EU countries below 7 gigawatts-worth of solar panels per year—along with a minimum price floor for those units. EU solar panel makers were disappointed, as this agreement forestalled the imposition of 47 percent anti-dumping duties on all Chinese solar panel imports (the threat that generated those concessions by Chinese solar panel producers). However, the imposition of the anti-dumping duties would have triggered a significant retaliation from China, whose officials had already drawn up a list of European products—including luxury fashion goods and wines—that would be subjected to stiff import duties into China. Chinese producers were persuaded to agree to the export limit and price floor instead, since this would allow them to keep the higher prices charged in the European Union. The main losers are European consumers, who will pay substantially more for solar power (and the environment).

1. See Matthew Dolan, “To Outfox the Chicken Tax, Ford Strips Its Own Vans,” Wall Street Journal, September 23, 2009. [↑](#footnote-ref-1)