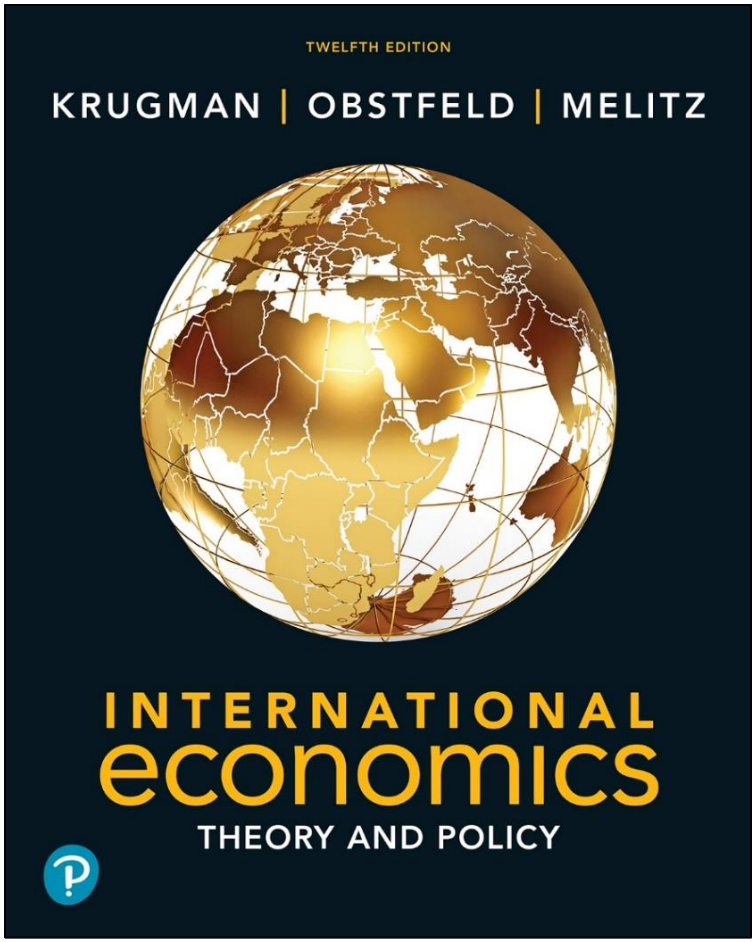
International Economics: Theory and Policy

Twelfth Edition



Chapter 9

The Instruments of Trade Policy

Preview

- Export subsidies
- Import quotas
- Voluntary export restraints

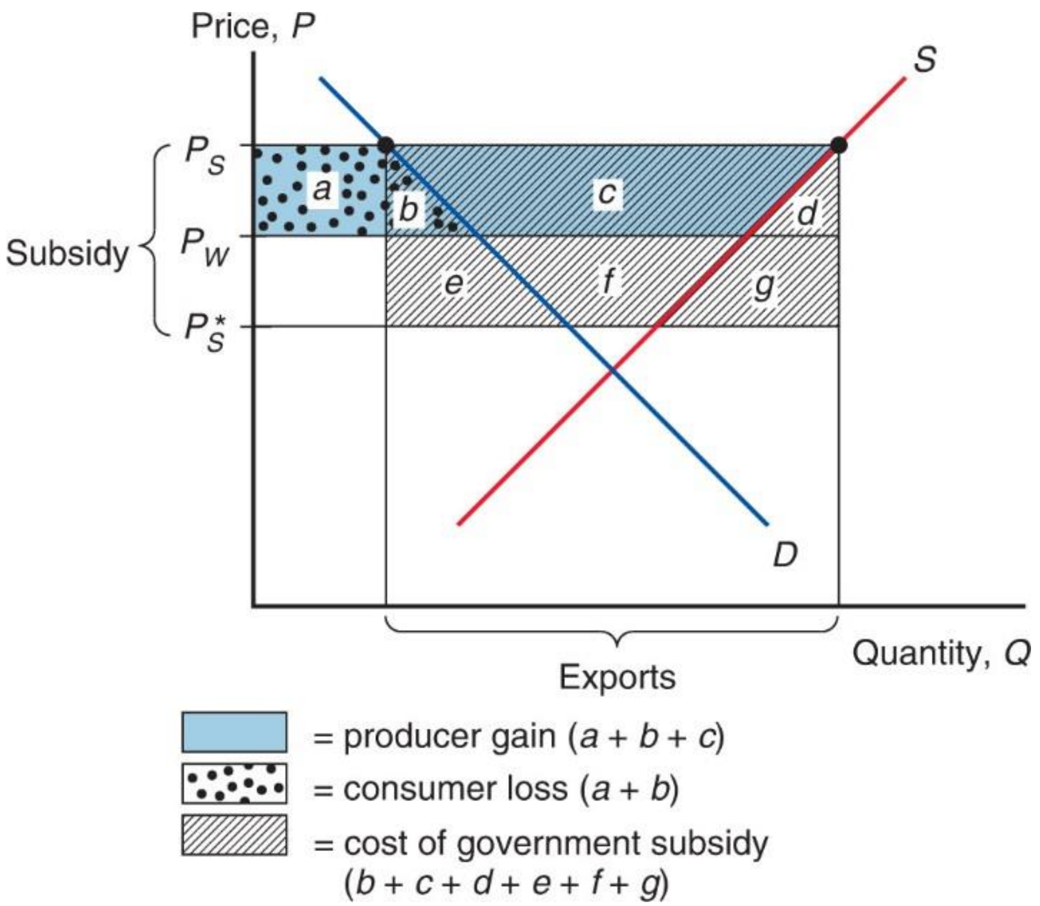
Export Subsidy (1 of 3)

- An export subsidy can also be **specific or ad valorem:**
  - A specific subsidy is a payment per unit exported.
  - An ad valorem subsidy is a payment as a proportion of the value exported.
- An export subsidy ---???--- the price in the exporting country
- consumer surplus ???
- producer surplus ???

Export Subsidy (2 of 3)

- Also, government revenue falls due to paying $S\,X_S^*$ for the export subsidy.
- An export subsidy lowers the price paid in importing countries $P_S^* = P_S - S$.
- In contrast to a tariff, an export subsidy worsens the terms of trade by lowering the price of exports in world markets.

Effects of an Export Subsidy



Export Subsidy (3 of 3)

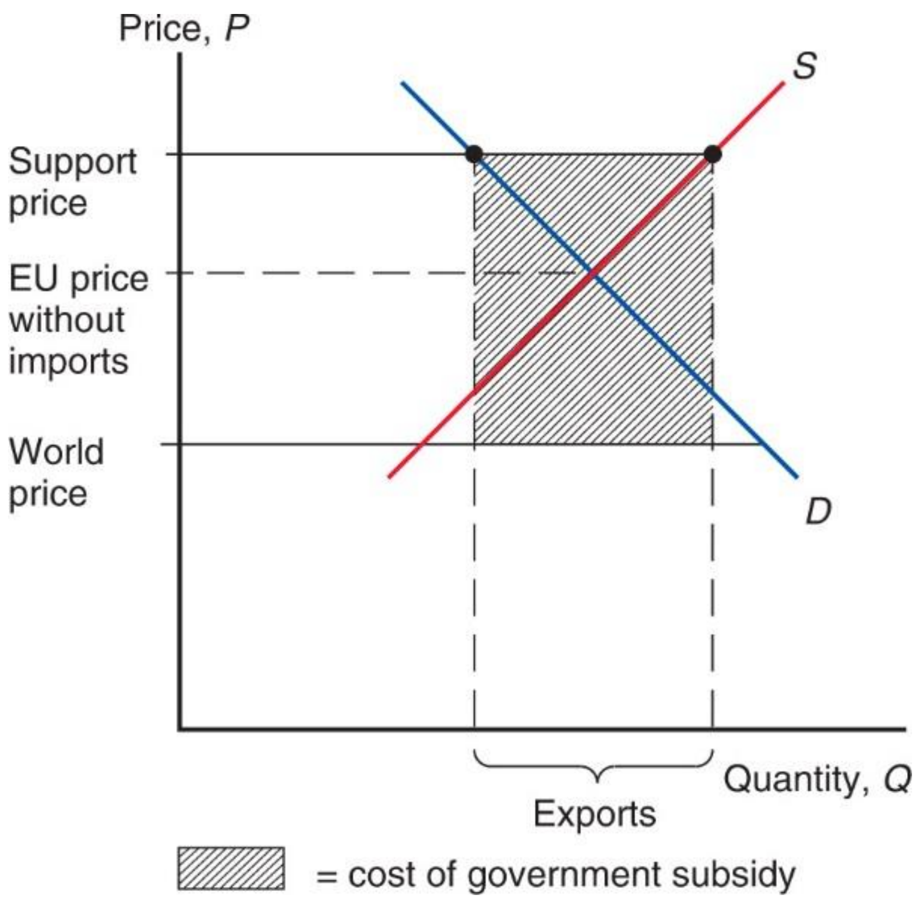
- An export subsidy damages national welfare.
- The triangles *b* and *d* represent the **efficiency loss**.
  - The export subsidy distorts production and consumption decisions: producers produce too much and consumers consume too little compared to the market outcome.
- The area *e* + *f* + *g* represents the **terms of trade loss**.
  - The terms of trade *decrease*, because the price of exports falls.

Export Subsidy in Europe

- The European Union’s Common Agricultural Policy (CAP) sets high prices for agricultural products and subsidizes exports to dispose of excess output.
  - Subsidized exports reduce world prices of agricultural products.
- The cost of this policy for European taxpayers is almost $30 billion more than its benefits (in 2007).

- https://www.youtube.com/watch?v=hvlVJUrj8tQ

Europe's Common Agricultural Policy



Import Quota (1 of 2)

- An import quota is a **restriction on the quantity** of a good that may be imported.
- This restriction is usually enforced by issuing licenses or quota rights.
- A binding import quota will push up the price of the import because the quantity demanded will exceed the quantity supplied by Home producers and from imports.

Import Quota (2 of 2)

- When a quota instead of a tariff is used to restrict imports, the government receives no revenue.
  - Instead, the revenue from selling imports at high prices goes to quota license holders.
  - These extra revenues are called **quota rents**.

An Import Quota in Practice: U.S. Sugar (1 of 4)

- Imports of sugar into the United States limited and quota rights passed out to foreign governments.
- Price of sugar in the United States has remained well above world prices.
- U.S. consumers are hurt by more than U.S. producers benefit; foreigners earn quota rents.
  - Overall effect on national welfare negative.

An Import Quota in Practice: U.S. Sugar (2 of 4)

- Under NAFTA, Mexico’s sugar exports were slowly exempted from the quota restrictions and the U.S. sugar price premium decreased to its lowest level in over 25 years.
- U.S. sugar producers complained, and the U.S. Commerce Department sharply reduced Mexican sugar imports.
  - Imposed a 64% anti-dumping tariff

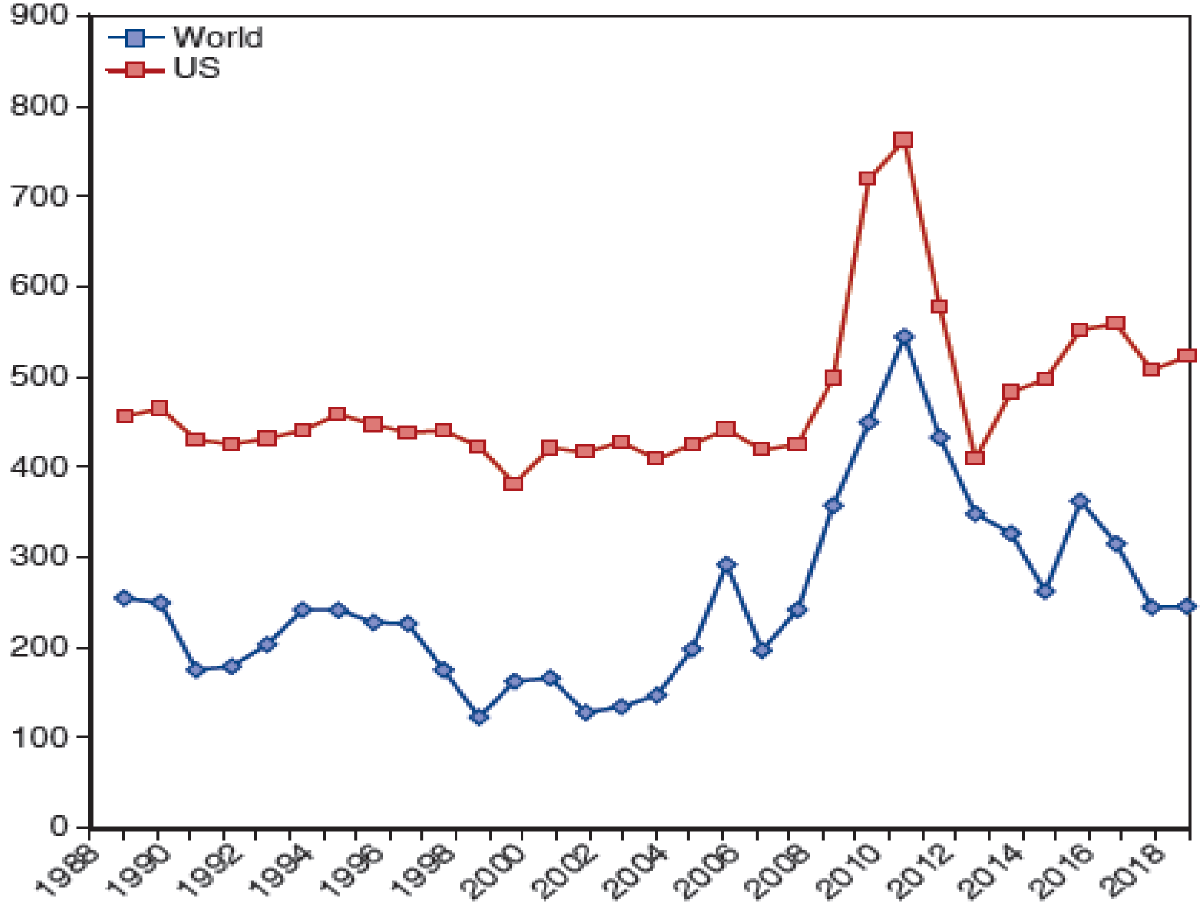
An Import Quota in Practice: U.S. Sugar (3 of 4)

- U.S. sugar prices have substantially risen again.
  – In 2015, that price was almost double the world price.
- For 2014, the sugar quota is estimated to:
  – cost consumers 3.5 billion ($11 per person or $30 for a typical household),
  – generate producer surplus losses for food producers who use refined sugar as an ingredient of $909 million
  – for a total cost estimate of $4.4 billion.
  – benefit sugar producers $3.9 billion (mostly to refiners)

An Import Quota in Practice: U.S. Sugar (4 of 4)

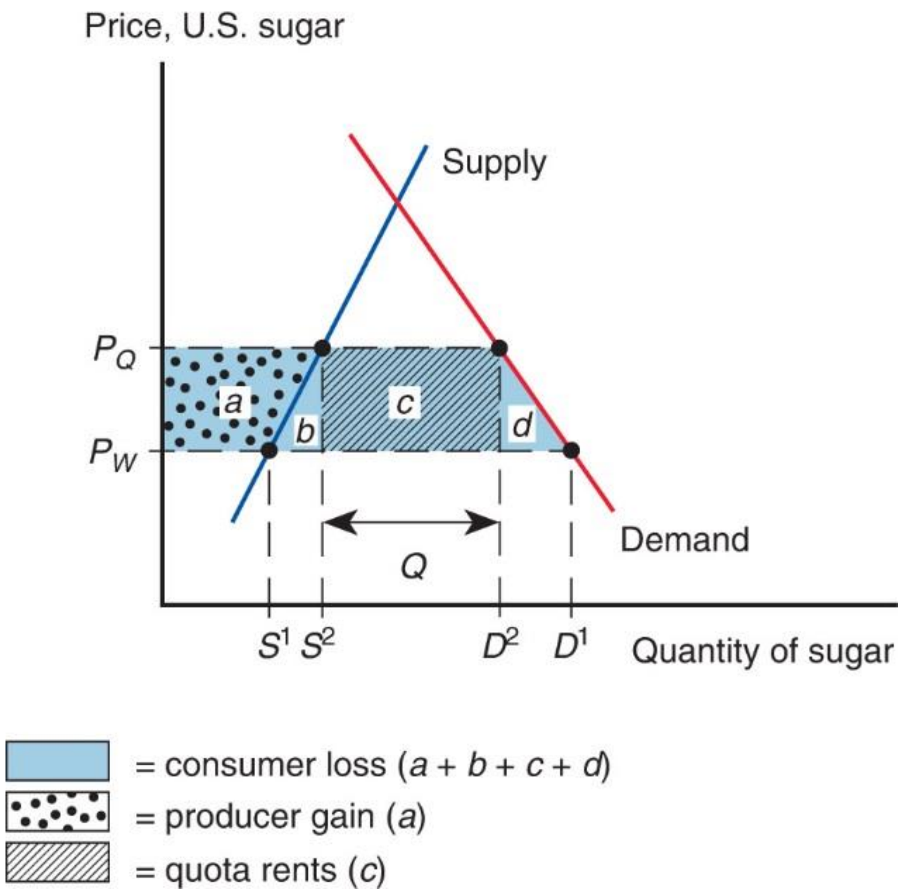
- Eliminating the sugar quota, by reducing the price of sugar in the United States, would generate 17,000–20,000 new jobs in producing foods containing sugar.
  - Far more than the 500-2,000 jobs that might be lost in the sugar industry.
  - Would turn the United States from a net importer to a net exporter of sugar-containing foods.
- The sugar producers are **better lobbyists** than the sugar-containing food sector so this protection has been extended.

U.S. and World Raw Sugar Prices 1989–2019



Source: U.S. Department of Agriculture.

Effects of the U.S. Import Quota on Sugar



Pearson

Voluntary Export Restraint

- A **voluntary export restraint** works like an import quota, except that the quota is imposed by the exporting country rather than the importing country.
- These restraints are usually requested by the importing country.
- The profits or rents from this policy are earned by foreign governments or foreign producers.
  - Foreigners sell a restricted quantity at an increased price.

A Voluntary Export Restraint in Practice

- In 1979, sharp oil price increases caused the U.S. market to shift abruptly toward smaller cars.
- Japanese producers moved in to fill the increased demand faster than U.S. auto companies could come out with smaller, more fuel-efficient models.
- Rather than act unilaterally and risk creating a trade war, the U.S. government asked the Japanese government to limit its exports.
- The price of Japanese cars in the United States rose, with the rent captured by Japanese firms.

Effects of Alternative Trade Policies

Policy	Tariff	Export Subsidy	Import Quota	Voluntary Export Restraint
Producer surplus	Increases	Increases	Increases	Increases
Consumer surplus	Falls	Falls	Falls	Falls
Government revenue	Increases	Falls (government spending rises)	No change (rents to license holders)	No change (rents to foreigners)
Overall national welfare	Ambiguous (falls for small country)	Falls	Ambiguous (falls for small country)	Falls