

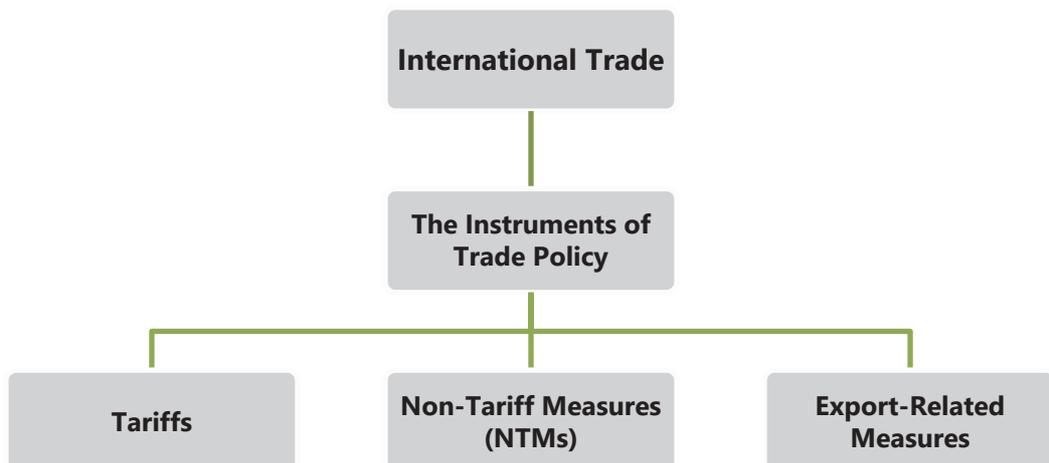
UNIT II: THE INSTRUMENTS OF TRADE POLICY

LEARNING OUTCOMES

At the end of this unit, you will be able to:

- ❑ Define trade policy and describe its objectives
- ❑ Distinguish between different types of trade policy measures
- ❑ Evaluate the use of tariffs as a trade policy instrument
- ❑ Describe the 'trigger price mechanisms' for protection of domestic industry
- ❑ Outline the different Non-Tariff Measures adopted by countries

UNIT OVERVIEW



 **2.1 INTRODUCTION**

Before we go into the subject matter of this unit, we shall take a quick look into a few recent developments in the international trade arena.

21 June 2020: China has lost a dispute to the European Union at the World Trade Organization (WTO) for a market economy status, as the former allowed the dispute to lapse. According to the EU, China subsidizes its industries to a great extent, particularly steel and aluminium, making their sales prices in the international market unfair.

21 June 2020: India argues against farm tariff concessions to ease Covid-19 woes and proposes that only a balanced, inclusive and calibrated response is needed to tackle temporary crisis.

2nd July 2020; China sees India's ban on 59 apps with Chinese links as 'discriminatory', and calls for reversal of the move as it has been discriminatory and selective, and may have violated World Trade Organization (WTO) rules.

8th July 2020: India asked Japan to lower the entry barriers in agricultural and pharmaceutical sectors.

19th July 2020: The WTO to set up dispute panels against India on request from Japan and Taiwan. The panels will look into the request against import duties on mobile phones and ICT products imposed by New Delhi.

15th September 2020: The WTO ruled that the tariffs the USA imposed on Chinese goods in 2018, triggering a trade war, were inconsistent with international trade rules.

The above vignettes are just a few of the multitudes of episodes that arise almost on a daily basis when countries engage in trade. A glance at similar newspaper reports makes it obvious that governments do not conform to free trade despite the potential efficiency and welfare outcomes it will generate; rather, they employ different devices for restricting the free flow of goods and services across their borders.

As we know, under free trade, buyers and sellers from separate economies voluntarily trade with minimum of state interference. The free interplay of market forces of supply and demand decides prices. Protectionism, on the other hand, is a state policy aimed to protect domestic producers against foreign competition through the use of tariffs, quotas and non-tariff trade policy instruments. Trade

liberalization refers to opening up of domestic markets to goods and services from the rest of the world by bringing down trade barriers.

In unit 1, we have seen that there are clear efficiency benefits from trade in terms of economic growth, job-creation and welfare. The persuasive academic arguments for open trade presuppose that fair competition, without distortions, is maintained between domestic and foreign producers. However, it is a fact that fair competition does not always exist and unobstructed international trade also brings in severe dislocation to many domestic firms and industries on account of difficult adjustment problems. Therefore, individuals and organisations continue to pressurize policy makers and regulatory authorities to restrict imports or to artificially boost up the size of exports.

Historically, as part of their protectionist measures, governments of different countries have applied many different types of policy instruments, not necessarily based on their economic merit, for restricting free flow of goods and services across national boundaries. While some such measures of government intervention are simple, widespread, and relatively transparent, others are complex, less apparent and frequently involve many types of distortions.

In this unit, we shall describe some of the most frequently used forms of interference with trade. Understanding the uses and implications of the common trade policy instruments, will enable formulation of appropriate policy responses and more balanced dialogues on trade policy issues and international trade agreements.

Trade policy encompasses all instruments that governments may use to promote or restrict imports and exports. Trade policy also includes the approach taken by countries in trade negotiations. While participating in the multilateral trading system and/or while negotiating bilateral trade agreements, countries assume obligations that shape their national trade policies. The instruments of trade policy that countries typically use to restrict imports and/ or to encourage exports can be broadly classified into price- related measures such as tariffs and non-price measures or non-tariff measures (NTMs).

In the following sections, we shall briefly touch upon the different trade policy measures adopted by countries to protect their domestic industries.



2.2 TARIFFS

Tariffs, also known as customs duties, are basically taxes or duties imposed on goods and services which are imported or exported. Different tariffs are generally applied to different commodities. It is defined as a financial charge in the form of a tax, imposed at the border on goods going from one customs territory to another. They are the most visible and universally used trade measures that determine market access for goods. Instead of a single tariff rate, countries have a tariff schedule which specifies the tariff collected on every particular good and service. Import duties being pervasive than export duties, tariffs are often identified with import duties and in this unit, the term 'tariff' would refer to import duties.

Tariffs are aimed at altering the relative prices of goods and services imported, so as to contract the domestic demand and thus regulate the volume of their imports. Tariffs leave the world market price of the goods unaffected; while raising their prices in the domestic market. The main goals of tariffs are to raise revenue for the government, and more importantly to protect the domestic import-competing industries.

2.2.1 Forms of Import Tariffs

- (i) **Specific Tariff:** Specific tariff is the fixed amount of money per physical unit or according to the weight or measurement of the commodity imported or exported. This tariff can vary according to the type of good imported. Example, a specific tariff of ₹1000/ may be charged on each imported bicycle. The disadvantage of specific tariff as an instrument for protection of domestic producers is that its protective value varies inversely with the price of the import. For example: if the price of the imported cycle is ₹5,000/- and the rate of tariff is 20%; then, if due to inflation, the price of bicycle rises to ₹10,000, the specific tariff is still only 10% of the value of the import. Since the calculation of these duties does not involve the value of merchandise, customs valuation is not applicable in this case.
- (ii) **Ad valorem tariff:** When the duty is levied as a fixed percentage of the value of the traded commodity, it is called as valorem tariff. An *ad valorem* tariff is levied as a constant percentage of the monetary value of one unit of the imported good. A 20% ad valorem tariff on any bicycle generates a ₹1000/ payment on each imported bicycle priced at ₹5,000/ in the world market; and if the price rises to ₹10,000, it generates a payment of ₹2,000/.

While *ad valorem* tariff preserves the protective value of tariff on home producer, it gives incentives to deliberately undervalue the good's price on invoices and bills of lading to reduce the tax burden. Nevertheless, *ad valorem* tariffs are widely used across the world.

There are many other variations of the above tariffs, such as:

- (a) **Mixed Tariffs:** Mixed tariffs are expressed either on the basis of the value of the imported goods (an *ad valorem* rate) or on the basis of a unit of measure of the imported goods (a specific duty) depending on which generates the most income (or least income at times) for the nation. For example, duty on cotton: 5 per cent *ad valorem* or ₹ 3000/per tonne, whichever is higher.

Compound Tariff or a Compound Duty is a combination of an *ad valorem* and a specific tariff. That is, the tariff is calculated on the basis of both the value of the imported goods (an *ad valorem* duty) and a unit of measure of the imported goods (a specific duty). It is generally calculated by adding up a specific duty to an *ad valorem* duty. Thus, on an import with quantity q and price p , a compound tariff collects a revenue equal to $t_s q + t_a p q$, where t_s is the specific tariff and t_a is the *ad valorem* tariff. For example: duty on cheese at 5 per cent *ad valorem* plus 100 per kilogram.

- (b) **Technical/Other Tariff:** These are calculated on the basis of the specific contents of the imported goods i.e. the duties are payable by its components or related items. For example: ₹3000/ on each solar panel plus ₹ 50/ per kg on the battery.
- (c) **Tariff Rate Quotas:** Tariff rate quotas (TRQs) combine two policy instruments: quotas and tariffs. Imports entering under the specified quota portion are usually subject to a lower (sometimes zero) tariff rate. Imports above the quantitative threshold of the quota face a much higher tariff.
- (d) **Most-Favoured Nation Tariffs:** MFN tariffs refer to import tariffs which countries promise to impose on imports from other members of the WTO, unless the country is part of a preferential trade agreement (such as a free trade area or customs union). This means that, in practice, MFN rates are the highest (most restrictive) that WTO members charge each other. Some countries impose higher tariffs on countries that are not part of the WTO.
- (e) **Variable Tariff:** A duty typically fixed to bring the price of an imported commodity up to level of the domestic support price for the commodity.

- (f) **Preferential Tariff:** Nearly all countries are part of at least one preferential trade agreement, under which they promise to give another country's products lower tariffs than their MFN rate. These agreements are reciprocal. A lower tariff is charged from goods imported from a country which is given preferential treatment. Examples are preferential duties in the EU region under which a good coming from one EU country to another is charged zero tariff rate. Another example is the United States - Canada - Mexico (USMCA) Agreement among Canada, Mexico and the USA where the preferential tariff rate is zero on essentially all products. Countries, especially the affluent ones also grant 'unilateral preferential treatment' to select list of products from specified developing countries. The Generalized System of Preferences (GSP) is one such system which is currently prevailing.
- (g) **Bound Tariff:** Under this, a WTO member binds itself with a legal commitment not to raise tariff rate above a certain level. By binding a tariff rate, often during negotiations, the members agree to limit their right to set tariff levels beyond a certain level. The bound rates are specific to individual products and represent the maximum level of import duty that can be levied on a product imported by that member. A member is always free to impose a tariff that is lower than the bound level. Once bound, a tariff rate becomes permanent and a member can only increase its level after negotiating with its trading partners and compensating them for possible losses of trade. A bound tariff ensures transparency and predictability.
- (h) **Applied Tariffs:** An 'applied tariff' is the duty that is actually charged on imports on a Most-Favoured Nation (MFN) basis. A WTO member can have an applied tariff for a product that differs from the bound tariff for that product as long as the applied level is not higher than the bound level.
- (i) **Escalated Tariff** structure refers to the system wherein the nominal tariff rates on imports of manufactured goods are higher than the nominal tariff rates on intermediate inputs and raw materials, i.e. the tariff on a product increases as that product moves through the value-added chain. For example, a four percent tariff on iron ore or iron ingots and twelve percent tariff on steel pipes. This type of tariff is discriminatory as it protects manufacturing industries in importing countries and dampens the attempts of developing manufacturing industries of exporting countries. This has special relevance to trade between developed countries and developing

countries. Developing countries are thus forced to continue to be suppliers of raw materials without much value addition.

- (j) **Prohibitive tariff:** A prohibitive tariff is one that is set so high that no imports can enter.
- (k) **Import subsidies:** Import subsidies also exist in some countries. An import subsidy is simply a payment per unit or as a percent of value for the importation of a good (i.e., a negative import tariff).
- (l) **Tariffs as Response to Trade Distortions:** Sometimes countries engage in 'unfair' foreign-trade practices which are trade distorting in nature and adverse to the interests of the domestic firms. The affected importing countries, upon confirmation of the distortion, respond quickly by measures in the form of tariff responses to offset the distortion. These policies are often referred to as "trigger-price" mechanisms. The following sections relate to such tariff responses to distortions related to foreign dumping and export subsidies.
- (m) **Anti-dumping Duties:** An anti-dumping duty is a protectionist tariff that a domestic government imposes on foreign imports that it believes are priced below fair market value. Dumping occurs when manufacturers sell goods in a foreign country below the sales prices in their domestic market or below their full average cost of the product. Dumping may be persistent, seasonal, or cyclical. Dumping may also be resorted to as a predatory pricing practice to drive out established domestic producers from the market and to establish monopoly position. Dumping is an international price discrimination favouring buyer of exports, but in fact, the exporters deliberately forego money in order to harm the domestic producers of the importing country.

Dumping is unfair and constitutes a threat to domestic producers and therefore when dumping is found, anti-dumping measures may be initiated as a safeguard instrument by imposing additional import duties/tariffs so as to offset the foreign firm's unfair price advantage. This is justified only if the domestic industry is seriously injured by import competition, and protection is in the national interest (that is, the associated costs to consumers would be less than the benefits that would accrue to producers). For example: In January 2017, India imposed anti-dumping duties on colour-coated or pre-painted flat steel products imported into the country from China and

European nations for a period not exceeding six months and for jute and jute products from Bangladesh and Nepal.

- (n) **Countervailing Duties:** Countervailing duties are tariffs that aim to offset the artificially low prices charged by exporters who enjoy export subsidies and tax concessions offered by the governments in their home country. If a foreign country does not have a comparative advantage in a particular good and a government subsidy allows the foreign firm to be an exporter of the product, then the subsidy generates a distortion from the free-trade allocation of resources. In such cases, CVD is charged in an importing country to negate the advantage that exporters get from subsidies to ensure fair and market-oriented pricing of imported products and thereby protecting domestic industries and firms. For example, in 2016, in order to protect its domestic industry, India imposed 12.5% countervailing duty on Gold jewellery imports from ASEAN.

2.2.2 Effects of Tariffs

A tariff levied on an imported product affects both the exporting country and the importing country.

- (i) Tariff barriers create obstacles to trade, decrease the volume of imports and exports and therefore of international trade. The prospect of market access of the exporting country is worsened when an importing country imposes a tariff.
- (ii) By making imported goods more expensive, tariffs discourage domestic consumers from consuming imported foreign goods. Domestic consumers suffer a loss in consumer surplus because they must now pay a higher price for the good and also because compared to free trade quantity, they now consume lesser quantity of the good.
- (iii) Tariffs encourage consumption and production of the domestically produced import substitutes and thus protect domestic industries.
- (iv) Producers in the importing country experience an increase in well-being as a result of imposition of tariff. The price increase of their product in the domestic market increases producer surplus in the industry. They can also charge higher prices than would be possible in the case of free trade because foreign competition has reduced.
- (v) The price increase also induces an increase in the output of the existing firms and possibly addition of new firms due to entry into the industry to

take advantage of the new high profits and consequently an increase in employment in the industry.

- (vi) Tariffs create trade distortions by disregarding comparative advantage and prevent countries from enjoying gains from trade arising from comparative advantage. Thus, tariffs discourage efficient production in the rest of the world and encourage inefficient production in the home country.
- (vii) Tariffs increase government revenues of the importing country by the value of the total tariff it charges.

Trade liberalization in recent decades, either through government policy measures or through negotiated reduction through the WTO or regional and bilateral free trade agreements, has diminished the importance of tariff as a tool of protection. Currently, trade policy is focusing increasingly on not so easily observable forms of trade barriers usually called non-tariff measures (NTMs). NTMs are thought to have important restrictive and distortionary effects on international trade. They have become so invasive that the benefits due to tariff reduction are practically offset by them.



2.3 NON – TARIFF MEASURES (NTMS)

From the discussion above, we have learnt that tariffs constitute the visible barriers to trade and have the effect of increasing the prices of imported merchandise. By contrast, the non-tariff measures which have come into greater prominence than the conventional tariff barriers, constitute the hidden or 'invisible' measures that interfere with free trade.

Non-tariff measures (NTMs) are policy measures, other than ordinary customs tariffs, that can potentially have an economic effect on international trade in goods, changing quantities traded, or prices or both (UNCTAD, 2010). Non-tariff measures comprise all types of measures which alter the conditions of international trade, including policies and regulations that restrict trade and those that facilitate it. NTMs consist of mandatory requirements, rules, or regulations that are legally set by the government of the exporting, importing, or transit country.

It should be kept in mind that NTMs are not the same as non-tariff barriers (NTBs). NTMs are sometimes used as means to circumvent free-trade rules and favour domestic industries at the expense of foreign competition. In this case they are called non-tariff barriers (NTBs). In other words, non-tariff barriers are

discriminatory non-tariff measures imposed by governments to favour domestic over foreign suppliers. NTBs are thus a subset of NTMs that have a 'protectionist or discriminatory intent'. Compared to NTBs, non-tariff measures encompass a broader set of measures.

According to WTO agreements, the use of NTMs is allowed under certain circumstances. Examples of this include the Technical Barriers to Trade (TBT) Agreement and the Sanitary and Phytosanitary Measures (SPS) Agreement, both negotiated during the Uruguay Round. However, NTMs are sometimes used as a means to circumvent free-trade rules and favour domestic industries at the expense of foreign competition. In this case they are called non-tariff barriers (NTBs). It is very difficult, and sometimes impossible, to distinguish legitimate NTMs from protectionist NTMs, especially because the same measure may be used for several reasons.

Depending on their scope and/or design NTMs are categorized as:

I. Technical Measures: Technical measures refer to product-specific properties such as characteristics of the product, technical specifications and production processes. These measures are intended for ensuring product quality, food safety, environmental protection, national security and protection of animal and plant health.

II. Non-technical Measures: Non-technical measures relate to trade requirements; for example; shipping requirements, custom formalities, trade rules, taxation policies, etc.

These are further distinguished as:

- (a) Hard measures (e.g. Price and quantity control measures),
- (b) Threat measures (e.g. Anti-dumping and safeguards) and
- (c) Other measures such as trade-related finance and investment measures.

Furthermore, the categorization also distinguishes between:

- (i) Import-related measures which relate to measures imposed by the importing country, and
- (ii) Export-related measures which relate to measures imposed by the exporting country itself.

- (iii) In addition, to these, there are procedural obstacles (PO) which are practical problems in administration, transportation, delays in testing, certification etc which may make it difficult for businesses to adhere to a given regulation.

2.3.1 Technical Measures

I Sanitary and Phytosanitary (SPS) Measures: SPS measures are applied to protect human, animal or plant life from risks arising from additives, pests, contaminants, toxins or disease-causing organisms and to protect biodiversity.

These include ban or prohibition of import of certain goods, all measures governing quality and hygienic requirements, production processes, and associated compliance assessments. For example; prohibition of import of poultry from countries affected by avian flu, meat and poultry processing standards to reduce pathogens, residue limits for pesticides in foods etc.

II Technical Barriers To Trade (TBT): Technical Barriers to Trade (TBT) which cover both food and non-food traded products refer to mandatory 'Standards and Technical Regulations' that define the specific characteristics that a product should have, such as its size, shape, design, labelling / marking / packaging, functionality or performance and production methods, excluding measures covered by the SPS Agreement. The specific procedures used to check whether a product is really conforming to these requirements (conformity assessment procedures e.g. testing, inspection and certification) are also covered in TBT. This involves compulsory quality, quantity and price control of goods before shipment from the exporting country.

Just as SPS, TBT measures are standards-based measures that countries use to protect their consumers and preserve natural resources, but these can also be used effectively as obstacles to imports or to discriminate against imports and protect domestic products. Altering products and production processes to comply with the diverse requirements in export markets may be either impossible for the exporting country or would obviously raise costs, hurting the competitiveness of the exporting country. Some examples of TBT are: food laws, quality standards, industrial standards, organic certification, eco-labelling, and marketing and label requirements.

2.3.2 Non-technical Measures

These include different types of trade protective measures which are put into operation to neutralize the possible adverse effects of imports in the market of

the importing country. Following are the most commonly practiced measures in respect of imports:

(i) Import Quotas: An import quota is a direct restriction which specifies that only a certain physical amount of the good will be allowed into the country during a given time period, usually one year. Import quotas are typically set below the free trade level of imports and are usually enforced by issuing licenses. This is referred to as a binding quota; a non-binding quota is a quota that is set at or above the free trade level of imports, thus having little effect on trade.

Import quotas are mainly of two types: absolute quotas and tariff-rate quotas. Absolute quotas or quotas of a permanent nature limit the quantity of imports to a specified level during a specified period of time and the imports can take place any time of the year. No condition is attached to the country of origin of the product. For example: 1000 tonnes of fish import which can take place any time during the year from any country. When country allocation is specified, a fixed volume or value of the product must originate in one or more countries. Example: A quota of 1000 tonnes of fish that can be imported any time during the year, but where 750 tonnes must originate in country A and 250 tonnes in country B. In addition, there are seasonal quotas and temporary quotas.

With a quota, the government, of course, receives no revenue. The profits received by the holders of such import licenses are known as 'quota rents'. While tariffs directly interfere with prices that can be charged for an imported good in the domestic market, import quota interferes with the market prices indirectly. Obviously, an import quota always raises the domestic price of the imported good. The license holders are able to buy imports and resell them at a higher price in the domestic market and they will be able to earn a 'rent' on their operations over and above the profit they would have made in a free market.

The welfare effects of quotas are similar to that of tariffs. If a quota is set below free trade level, the amount of imports will be reduced. A reduction in imports will lower the supply of the good in the domestic market and raise the domestic price. Consumers of the product in the importing country will be worse-off because the increase in the domestic price of both imported goods and the domestic substitutes reduces consumer surplus in the market. Producers in the importing country are better-off as a result of the quota. The increase in the price of their product increases producer surplus in the industry. The price increase also induces an increase in output of existing firms (and perhaps the addition of new firms), an increase in employment, and hence an increase in profit.

(ii) Price Control Measures: Price control measures (including additional taxes and charges) are steps taken to control or influence the prices of imported goods in order to support the domestic price of certain products when the import prices of these goods are lower. These are also known as 'para-tariff' measures and include measures, other than tariff measures, that increase the cost of imports in a similar manner, i.e. by a fixed percentage or by a fixed amount. Example: A minimum import price established for sulphur.

(iii) Non-automatic Licensing and Prohibitions: These measures are normally aimed at limiting the quantity of goods that can be imported, regardless of whether they originate from different sources or from one particular supplier. These measures may take the form of non-automatic licensing, or complete prohibitions. For example, textiles may be allowed only on a discretionary license by the importing country. India prohibits import/export of arms and related material from/to Iraq. Further, India also prohibits many items (mostly of animal origin) falling under 60 EXIM codes.

(iv) Financial Measures: The objective of financial measures is to increase import costs by regulating the access to and cost of foreign exchange for imports and to define the terms of payment. It includes measures such as advance payment requirements and foreign exchange controls denying the use of foreign exchange for certain types of imports or for goods imported from certain countries. For example, an importer may be required to pay a certain percentage of the value of goods imported three months before the arrival of goods or foreign exchange may not be permitted for import of newsprint.

(v) Measures Affecting Competition: These measures are aimed at granting exclusive or special preferences or privileges to one or a few limited group of economic operators. It may include government imposed special import channels or enterprises, and compulsory use of national services. For example, a statutory marketing board may be granted exclusive rights to import wheat: or a canalizing agency (like State Trading Corporation) may be given monopoly right to distribute palm oil. When a state agency or a monopoly import agency sells in the domestic market at prices above those existing in the world market, the effect will be similar to an import tariff.

(vi) Government Procurement Policies: Government procurement policies may interfere with trade if they involve mandates that the whole of a specified percentage of government purchases should be from domestic firms rather than foreign firms, despite higher prices than similar foreign suppliers. In accepting

public tenders, a government may give preference to the local tenders rather than foreign tenders.

(vii) Trade-Related Investment Measures: These measures include rules on local content requirements that mandate a specified fraction of a final good should be produced domestically.

- (a) requirement to use certain minimum levels of locally made components, (25 percent of components of automobiles to be sourced domestically)
- (b) restricting the level of imported components, and
- (c) limiting the purchase or use of imported products to an amount related to the quantity or value of local products that it exports. (A firm may import only up to 75 % of its export earnings of the previous year)

(viii) Distribution Restrictions: Distribution restrictions are limitations imposed on the distribution of goods in the importing country involving additional license or certification requirements. These may relate to geographical restrictions or restrictions as to the type of agents who may resell. For example: a restriction that imported fruits may be sold only through outlets having refrigeration facilities.

(ix) Restriction on Post-sales Services: Producers may be restricted from providing after- sales services for exported goods in the importing country. Such services may be reserved to local service companies of the importing country.

(x) Administrative Procedures: Another potential obstruction to free trade is the costly and time-consuming administrative procedures which are mandatory for import of foreign goods. These will increase transaction costs and discourage imports. The domestic import-competing industries gain by such non- tariff measures. Examples include specifying particular procedures and formalities, requiring licenses, administrative delay, red-tape and corruption in customs clearing frustrating the potential importers, procedural obstacles linked to prove compliance etc.

(xi) Rules of origin; Country of origin means the country in which a good was produced, or in the case of a traded service, the home country of the service provider. Rules of origin are the criteria needed by governments of importing countries to determine the national source of a product. Their importance is derived from the fact that duties and restrictions in several cases depend upon the source of imports. Important procedural obstacles occur in the home

countries for making available certifications regarding origin of goods, especially when different components of the product originate in different countries.

(xii) Safeguard Measures: These are initiated by countries to restrict imports of a product temporarily if its domestic industry is injured or threatened with serious injury caused by a surge in imports. Restrictions must be for a limited time and non-discriminatory.

(xiii) Embargos: An embargo is a total ban imposed by government on import or export of some or all commodities to particular country or regions for a specified or indefinite period. This may be done due to political reasons or for other reasons such as health, religious sentiments. This is the most extreme form of trade barrier.



2.4. EXPORT-RELATED MEASURES

(i) Ban on exports: Export-related measures refer to all measures applied by the government of the exporting country including both technical and non-technical measures. For example, during periods of shortages, export of agricultural products such as onion, wheat etc. may be prohibited to make them available for domestic consumption. Export restrictions have an important effect on international markets. By reducing international supply, export restrictions have been effective in increasing international prices.

(ii) Export Taxes: An export tax is a tax collected on exported goods and may be either specific or ad valorem. The effect of an export tax is to raise the price of the good and to decrease exports. Since an export tax reduces exports and increases domestic supply, it also reduces domestic prices and leads to higher domestic consumption.

(iii) Export Subsidies and Incentives: We have seen that tariffs on imports hurt exports and therefore countries have developed compensatory measures of different types for exporters like export subsidies, duty drawback, duty-free access to imported intermediates etc. Governments or government bodies also usually provide financial contribution to domestic producers in the form of grants, loans, equity infusions etc. or give some form of income or price support. If such policies on the part of governments are directed at encouraging domestic industries to sell specified products or services abroad, they can be considered as trade policy tools.

(iv) Voluntary Export Restraints: Voluntary Export Restraints (VERs) refer to a type of informal quota administered by an exporting country voluntarily restraining the quantity of goods that can be exported out of that country during a specified period of time. Such restraints originate primarily from political considerations and are imposed based on negotiations of the importer with the exporter. The inducement for the exporter to agree to a VER is mostly to appease the importing country and to avoid the effects of possible retaliatory trade restraints that may be imposed by the importer. VERs may arise when the import-competing industries seek protection from a surge of imports from particular exporting countries. VERs cause, as do tariffs and quotas, domestic prices to rise and cause loss of domestic consumer surplus.

Over the past few decades, significant transformations are happening in terms of growth as well as trends of flows and patterns of global trade. The increasing importance of developing countries has been a salient feature of the shifting global trade patterns. Fundamental changes are taking place in the way countries associate themselves for international trade and investments. Trading through regional arrangements which foster closer trade and economic relations is shaping the global trade landscape in an unprecedented way. Alongside, the trading countries also have devised ingenious policies aimed at protecting their economic interests. The discussions in this unit are in no way comprehensive considering the faster pace of discovery of such protective strategies. Students are expected to get themselves updated on such ongoing changes.

SUMMARY

- Trade policy encompasses all instruments that governments may use to promote or restrict imports and exports.
- Trade policies are broadly classified into price-related measures such as tariffs and non-price measures or non-tariff measures (NTMs).
- Tariff, also known as customs duty is defined as a financial charge in the form of a tax, imposed at the border on goods going from one customs territory to another. Tariffs are the most visible and universally used trade measures.
- A specific tariff is an import duty that assigns a fixed monetary tax per physical unit of the good imported whereas an ad valorem tariff is levied as a constant percentage of the monetary value of one unit of the imported good.

- Mixed tariffs are expressed either on the basis of the value of the imported goods (an ad valorem rate) or on the basis of a unit of measure of the imported goods (a specific duty), depending on desired yields.
- Compound Tariff or a compound duty is a combination of an ad valorem and a specific tariff and is calculated on the basis of both the value of the imported goods (an ad valorem duty) and a unit of measure of the imported goods.
- Tariff rate quotas (TRQs) combine two policy instruments namely quotas and tariffs.
- MFN tariffs are what countries promise to impose on imports from all members of the WTO, unless the country is part of a preferential trade agreement (such as a free trade area or customs union).
- Preferential tariff occurs when a country imposes tariffs lower than its MFN rate on another country's products.
- The bound tariff rate is specific to individual products and represents the maximum level of import duty that can be levied on a product imported by that member.
- An 'applied tariff' is the duty that is actually charged on imports on the most-favoured nation (MFN) basis.
- Escalated tariff structure refers to the system wherein the nominal tariff rates on imports of manufactured goods are higher than the nominal tariff rates on intermediate inputs and raw materials, i.e. the tariff on a product increases as that product moves through the value-added chain.
- A prohibitive tariff is one that is set so high that no imports will enter.
- Trigger-price mechanisms are quick responses of affected importing countries upon confirmation of trade distortion to offset the distortion. E.g. Anti-dumping duties.
- Dumping occurs when manufacturers sell goods in a foreign country below the sales prices in their domestic market or below their full average cost of the product. It hurts domestic producers.
- Anti-dumping measures are additional import duties so as to offset the foreign firm's unfair price advantage.

- Countervailing duties are tariffs to offset the artificially low prices charged by exporters who enjoy export subsidies and tax concessions offered by the governments in their home country.
- Tariff barriers create obstacles to trade, reduce the prospect of market access, make imported goods more expensive, increase consumption of domestic goods, protect domestic industries and increase government revenues
- Non-tariff measures (NTMs) are policy measures, other than ordinary customs tariffs, that can potentially have an economic effect on international trade in goods, changing quantities traded or prices or both
- Technical Barriers to Trade (TBT) are 'Standards and Technical Regulations' that define the specific characteristics that a product should have, such as its size, shape, design, labelling / marking / packaging, functionality or performance and production methods, excluding measures covered by the SPS Agreement.
- Non-technical measures relate to trade requirements; for example; shipping requirements, custom formalities, trade rules, taxation policies, etc.
- SPS measures are applied to protect human, animal or plant life from risks arising from additives, pests, contaminants, toxins or disease-causing organisms and to protect biodiversity
- An import quota is a direct restriction which specifies that only a certain physical amount of the good will be allowed into the country during a given time period, usually one year.
- The objective of financial measures is to increase import costs by regulating the access to and cost of foreign exchange for imports and to define the terms of payment.
- Government procurement policies may interfere with trade if they involve mandates that the whole of a specified percentage of purchases should be from domestic firms rather than from foreign firms
- In the case of investments, local content requirements that mandate that a specified fraction of a final good be produced domestically may act as a trade barrier.
- Rules of origin are the criteria needed by governments of importing countries to determine the national source of a product.

- Safeguard measures are initiated by countries to temporarily restrict imports of a product its domestic industry is injured by the surge in imports while an embargo is a total ban imposed by government on import or export of some or all commodities to particular country or region for a specified or indefinite period.
- An export tax is a tax collected on exported goods and may be either specific or ad valorem. An export subsidy includes financial contribution to domestic producers in the form of grants, loans, equity infusions or some form of income or price support. Both distort trade.
- Voluntary Export Restraints (VERs) refer to a type of informal quota administered by an exporting country voluntarily restraining the quantity of goods that can be exported out of that country during a specified period of time. It is imposed based on negotiations to appease the importing country and to avoid the effects of possible trade restraints.

TEST YOUR KNOWLEDGE

I Multiple Choice Type Questions

1. A specific tariff is
 - (a) a tax on a set of specified imported good
 - (b) an import tax that is common to all goods imported during a given period
 - (c) a specified fraction of the economic value of an imported good
 - (d) a tax on imports defined as an amount of currency per unit of the good
2. A tariff on imports is beneficial to domestic producers of the imported good because
 - (a) they get a part of the tariff revenue
 - (b) it raises the price for which they can sell their product in the domestic market
 - (c) it determines the quantity that can be imported to the country
 - (d) it reduces their producer surplus, making them more efficient

3. A tax applied as a percentage of the value of an imported good is known as
 - (a) preferential tariff
 - (b) ad valorem tariff
 - (c) specific tariff
 - (d) mixed or compound tariff
4. Escalated tariff refers to
 - (a) nominal tariff rates on raw materials which are greater than tariffs on manufactured products
 - (b) nominal tariff rates on manufactured products which are greater than tariffs on raw materials
 - (c) a tariff which is escalated to prohibit imports of a particular good to protect domestic industries
 - (d) none of the above
5. Voluntary export restraints involve:
 - (a) an importing country voluntarily restraining the quantity of goods that can be exported into the country during a specified period of time
 - (b) domestic firms agreeing to limit the quantity foreign products sold in their domestic markets
 - (c) an exporting country voluntarily restraining the quantity of goods that can be exported out of a country during a specified period of time
 - (d) quantitative restrictions imposed by the importing country's government.
6. Anti-dumping duties are
 - (a) additional import duties so as to offset the effects of exporting firm's unfair charging of prices in the foreign market which are lower than production costs.
 - (b) additional import duties so as to offset the effects of exporting firm's increased competitiveness due to subsidies by government
 - (c) additional import duties so as to offset the effects of exporting firm's unfair charging of lower prices in the foreign market

- (d) Both (a) and (c) above
7. A countervailing duty is
- (a) a tariff that aim to offset artificially low prices charged by exporters who enjoy export subsidies and tax concessions in their home country
 - (b) charged by importing countries to ensure fair and market-oriented pricing of imported products
 - (c) charged by importing countries to protect domestic industries and firms from unfair price advantage arising from subsidies
 - (d) All the above
8. Which of the following is an outcome of tariff?
- (a) create obstacles to trade and increase the volume of imports and exports
 - (b) domestic consumers enjoy consumer surplus because consumers must now pay only a lower price for the good
 - (c) discourage domestic consumers from consuming imported foreign goods and encourage consumption of domestically produced import substitutes
 - (d) increase government revenues of the importing country by more than value of the total tariff it charges
9. SPS measures and TBTs are
- (a) permissible under WTO to protect the interests of countries
 - (b) may result in loss of competitive advantage of developing countries
 - (c) increases the costs of compliance to the exporting countries
 - (d) All the above
10. Which of the following is not a non-tariff barrier.
- (a) Complex documentation requirements
 - (b) Import quotas on specific goods
 - (c) Countervailing duties charged by importing country
 - (d) Pre shipment product inspection and certification requirements

11. Under tariff rate quota
 - (a) countries promise to impose tariffs on imports from members other than those who are part of a preferential trade agreement
 - (b) a country permits an import of limited quantities at low rates of duty but subjects an excess amount to a much higher rate
 - (c) lower tariff is charged from goods imported from a country which is given preferential treatment
 - (d) none of the above
12. Non -tariff barriers (NTBs) include all of the following except:
 - (a) import quotas
 - (b) tariffs
 - (c) export subsidies
 - (d) technical standards of products

II Short Answer Type Questions

1. Define trade policy.
2. What is the purpose of trade policy?
3. What are the main types of trade policy instruments?
4. Define 'tariff'?
5. Outline the main goals of tariffs?
6. What is meant by 'specific tariff'?
7. Explain the term '*ad valorem* tariff'?
8. What is meant by 'mixed tariff'?
9. Define 'bound tariff'?
10. What is the purpose of binding a tariff?
11. How does 'escalated tariff structure' work?
12. Define 'dumping'?
13. What is meant by an 'Anti-dumping' measure?
14. Why are countervailing duties imposed?

15. Describe the term 'Non-Tariff measure' (NTM).
16. What is the purpose of SPS measures?
17. What do you understand by the term 'import quota'?
18. Explain the concept of 'local content requirements' in the context of trade policy.
19. What is meant by 'Voluntary Export Restraints'?
20. Outline the meaning of 'Trigger-price mechanism'.

III Long Answer Type Questions

1. Define 'trade policy'. What are the major objectives of trade policy?
2. Distinguish between different types of trade policy measures. What are the effects of each?
3. Evaluate the use of tariffs as a trade policy instrument.
4. Describe the 'trigger price mechanisms' for protection of domestic industry?
5. Outline the different non- tariff measures adopted by countries.
6. 'Governments do not conform to free trade despite the potential efficiency and welfare outcomes it will promote. Elucidate the statement. Give examples.
7. How do import tariffs influence international trade?
8. Distinguish between anti-dumping duties and countervailing duties. What purpose do they serve?
9. Describe different technical barriers to trade (TBT) and their effects on trade?
10. What are the effects of tariff on the importing and exporting countries?
11. How do import quotas affect domestic industries and consumers?
12. Explain the concept of 'Voluntary Export Restraints'. What are the circumstances under which exporters commit to voluntary export restraints?

IV Application Oriented Question

1. (i) Which of the three exporters engage in anticompetitive act in the international market while pricing its export of good X to country D?

- (ii) What would be the effect of such pricing on the domestic producers of good X? Advise remedy available for country D?

Goods X	Country A (in \$)	Country B (in \$)	Country C (in\$)
Average Cost	30.5	29.4	30.9
Price per Unit for domestic Sales	31.2	31.1	30.9
Price charged in country D	31.9	30.6	30.6

2. (i) What do you think the implications on trade will be if India pays an export subsidy of ₹ 400 / on every pair of cotton trousers exported by it to Germany.
- (ii) Suppose Germany charged an equivalent countervailing duty on every pair of cotton trousers imported from India. Do you think world welfare will be affected?

ANSWERS/HINTS

I. Multiple Choice Type Questions

1. (d) 2. (b) 3. (b) 4. (b) 5. (c) 6. (d)
7. (d) 8. (c) 9. (d) 10. (c) 11. (b) 12. (b)

II. Short Answer Type Questions

- Trade policy encompasses all instruments that governments may use to promote or restrict imports and exports.
- The instruments of trade policy are typically used by countries to restrict imports and/ or to encourage exports.
- The instruments of trade policy are broadly classified into price- related measures such as tariffs and non-price measures or non-tariff measures (NTMs).
- Tariffs, also known as customs duties, are basically taxes or duties imposed on goods and services which are imported or exported.
- The main goals of tariffs are to raise revenue for the government and more importantly to protect the domestic import-competing industries.
- A specific tariff is an import duty that assigns a fixed monetary tax per physical unit of the good imported.

7. An *ad valorem* tariff is levied as a constant percentage of the monetary value of one unit of the imported good. A 20% *ad valorem* tariff on imported car.
8. Mixed tariff is a combination of an *ad valorem* and a specific tariff. That is, the tariff is calculated on the basis of both the value of the imported goods (an *ad valorem* duty) and a unit of measure of the imported goods (a specific duty).
9. The bound tariff rate represents the maximum level of import duty/tariff that can be levied by a WTO member on a product imported by that member.
10. By binding a tariff, often during negotiations, the members agree to limit their right to set tariff levels beyond a certain level.
11. Escalated tariff structure refers to the system wherein the nominal tariff rates on imports of manufactured goods are higher than the nominal tariff rates on intermediate inputs and raw materials, i.e. the tariff on a product increases as that product moves through the value-added chain.
12. Dumping occurs when manufacturers sell goods in a foreign country below the sales prices in their domestic market or below their full average cost of the product. It hurts domestic producers.
13. Anti-dumping measures are additional import duties so as to offset the foreign firm's unfair price advantage.
14. Countervailing duties are tariffs which seek to offset artificially low prices charged by exporters who enjoy export subsidies and tax concessions offered by the Governments in their home country.
15. Non-tariff measures (NTMs) are policy measures, other than ordinary customs tariffs, that can potentially have an economic effect on international trade in goods, changing quantities traded, or prices or both.
16. SPS measures are applied to protect human, animal or plant life from risks arising from additives, pests, contaminants, toxins or disease-causing organisms and to protect biodiversity.
17. An import quota is a direct restriction which specifies that only a certain physical amount of the good will be allowed into the country during a given time period, usually one year.

18. Local content requirements mandate that a specified fraction of a final good should be produced domestically.
19. Voluntary Export Restraints (VERs) refer to a type of informal quota administered by an exporting country voluntarily restraining the quantity of goods that can be exported out of a country during a specified period of time.
20. Trigger-price mechanisms are quick responses of affected importing countries upon confirmation of trade distortion to offset the distortion. E.g. Anti-dumping duties.

III Hints to Long Answer Type Questions

- I. The length of the answer should relate to the marks allotted.
- II. The answer should be structured in three parts in the following style.
 - (a) Explain the economic fundamentals underlying the action/issue by integrating the course material in innovative ways; not necessarily confined to one unit. This part provides an opportunity for students to explain their understanding of the underlying theory. The examiner may easily discern the level of cognition of the student. This should be a compulsory component with a reasonably high proportion of marks earmarked.
 - (b) Analyse the issue at hand (given the framework and tools) and explain the policy position by applying the fundamentals as explained in (a) above.
 - (c) Substantiate with illustrations from current economic scenario

IV Application Oriented Questions

1.
 - (i) Dumping by Country B and Country C. B, because it sells at a lower price than that in domestic market; Country C because it is selling at a price which is less than the average cost of production.
 - (ii) Adverse effects on domestic industry as they will lose competitiveness in their markets due to unfair practice of dumping. Country D may prove damage to domestic industries and charge anti-dumping duties on goods imported from Country B and Country C so as to raise the price and make it at par which similar goods produced by domestic firms.

2. (i) Unfair and artificially created price advantage to trousers exporters of India – price does not reflect costs- German trousers industry lose competitiveness and market share as trousers from India are lower priced- Loss of world welfare. German industry can ask for protection by introducing countervailing duties.
- (ii) An equivalent countervailing duty will push the prices of Indian trousers and afford protection to domestic trousers industry. World welfare will be the same as before India introduced export subsidy.