Chapter -4
Unit-2
THE INSTRUMENTS OF TRADE POLICY

Some Basic Terms

Free Trade

Buyer & Sellers from separate economics voluntarily trade with min. state interference

Demand

Supply

Protectionism

State policy to protect domestic producers against foreign competition.

Tariff

Quotas

Non Tariff Tools

VIDHYODAY
VIDHYA KA UDAY

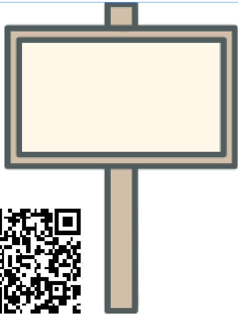
Trade Liberalization

Opening up of domestic mark to good n services from Rest of the world by bring down trade barriers.

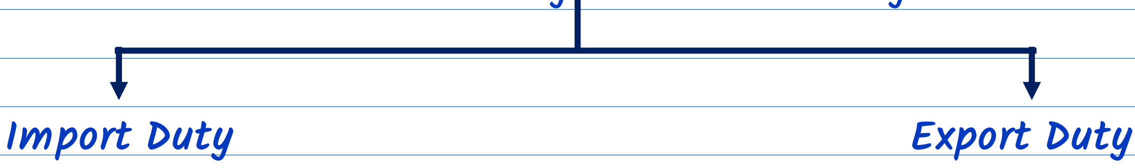
Trade Policy

All instruments that Govt. may use to
Promote or Restrict
Export & Import

Instruments



Custom duties imposed on
Goods and services
which are
Imported or Exported
↓
It is a financial charge imposed at border
on good going from
one custom territory to another territory.



Import Duty

Export Duty

note to self:

Tariff

Term tariff would refer to
Import duties.

AIM

Altering the relative price of
Goods & Services Imported
So as to contract domestic demand
&
Regulate Volume of Imports.

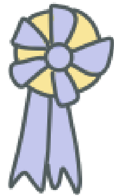
- It raising the price of good in Domestic Market
- While leave the world Market Price of the good unaffected.

VIDHYODAY

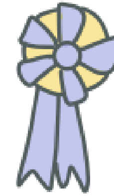
Goal of Tariff

- Raise revenue for the government
- Protect Domestic Industries

VIDHYODAY
VIDHYA KA UDAY



Forms of Import Tariff



Specific Tariff

Fixed amount of money per physical unit or according to weight or measurement of commodity imported exported.

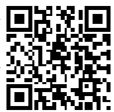
Eg: Rs. 1000 per unit of bicycle

Ad Valorem Tariff

Duty is levied as fixed % of the value of commodity
Most widely used.

Eg: 20% on value of Bicycle (5000)

20% x 5000 = 1000 Rs.



Mixed Tariff

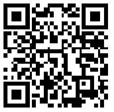
Specific Duty
or
Ad Valorem

W
E
I
H

Which ever is Higher

Eg: Duty on cotton 5% of value or Rs. 3000 which ever is higher.

Compound Tariff



Specific Duty
+
Ad Valorem

tsq + tapq

↓ Specific Teriff
↓ Advalorem Teriff

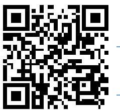
Duty on cheese
5% of advalorem
+
100 Rs. Per Kg

Technical Tariff

Duty on specific content i.e. on component or related items

Eg: Rs. 3000 on solar panel plus 50/- kg on battery

Tariff Rate Quotas



Quota

- Under Quata → Lower or Zero Tariff
- Above Quata → Higher Tariff

MFN Tariff

Tariff among members of WTO, unless country is a part of preferential trade agreement. Highest rate that MFN members charge each other.

Preferential Tariff

Lower Tariff than MFN rate Agreement

VIDHYODAY
VIDHYA KA UDAY

- **Reciprocal**
  - **NAFTA**
  - North American Free Trad Agreement
  - among Canada Mexico & USA Where Preferential Rate = 0
- **Unilateral**
  - **GSP**
  - Generalized System of Preferences between USA & 119 beneficiary countries

Bound Tariff

A WTO Member binds itself with legal commitment not to raise tariff above a certain level.

↓

Specific to Individual Product & represent Max. level Import duty.

↓

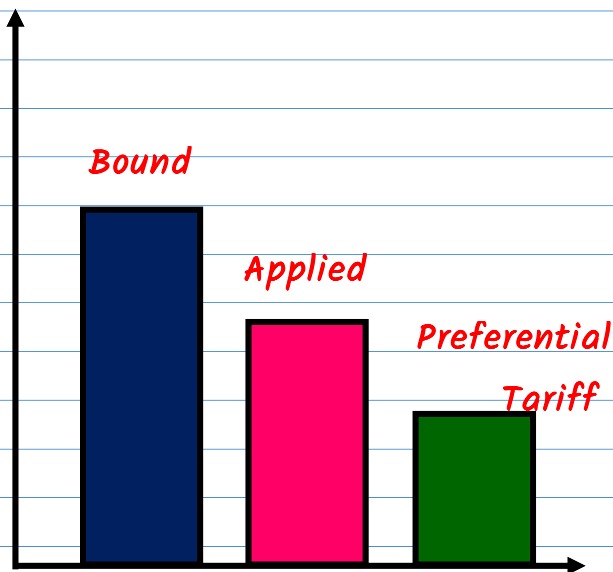
Member can free to impose lower than Bound Tariff.

↓

Increased only after Negotiation with trading partners & compensating for possible loss of trade

↓

Ensure Transparency & Predictability.



Technical Tariff

Duty that actually charged on MFN basis. It can differ from bound tariff but not higher than bound tariff.

Tariff Rate Quotas

A Duty fixed to bring the price of an imported good up to level of domestic support price.

Example

On X Good

Bound Tariff	Applied Tariff
28%	18%

Bound Tariff > Applied Tariff

Price of y = 1000 Rs. Fixed

Case-1

Imported Price = 800 Rs.

Than Tariff will be = 200 Rs.

Rs. 1000

Case-2

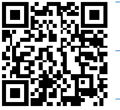
Imported Price = 700 Rs.

Than Tariff will be = 200 Rs.

Rs. 1000

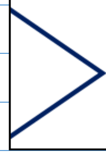
When Tariff will vary is called variable tariff.

Escalated Tariff



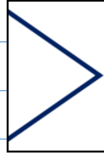
System where

Tariff on Mfg. Good

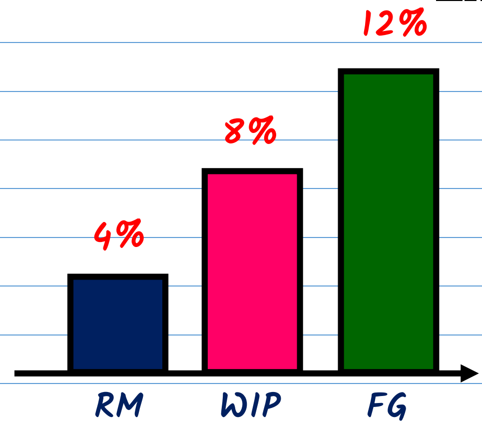


Tariff on Inputs & RM

For Eg: 12% Import duty on stell pipes



4% Import duty on iron ore or ingots



Prohibitive Tariff

One that is set so high that no imports can enter.

Import Subsidies

Negative import tariff it is a payment per unit or as a % of value for imported good.

Tariff as Response

When countries engage in "Unfair Foreign Trade" practice, which are trade distorting in nature & adverse to interests of domestic firms.

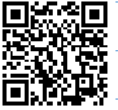
Affected importing countries respond quickly in the form of "Tariff as Response".

They also known as "Trigger-Price" mechanism.

(Aagainst Foreign Dumping)

(Aagainst Export Subsidies)

Anti-Dumping Duty



- 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.

VIDHYODAY VIDHYA KA UDAY

- This is justified only if the domestic industry is seriously injured by import competition, and protection is in the national interest.
- 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.

Countervailing Duty

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.

Effect of Tariff

- 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.
- 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 consumer lesser quantity of the good.

VIDHYODAY
VIDHYA KA UDAY

- Tariffs encourage consumption and production of the domestically produced import substitutes and thus protect domestic industries.
- 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.
- The price increase also induces on 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.
- 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.
- Tariffs increase government revenues of the importing country by the value of the total tariff

VIDHYODAY
VIDHYA KA UDAY

Non-Tariff Measures

Conventional or Hidden or Invisible Measures that interfere with free trade.

They have effect on
by
Changing
or

Quantities

Price

Both

They consist of mandatory requirements, rules, regulations that are legally set by govt. of exporting, importing or transist country.

note to self

NTMs v/s NTBs

NTMs are not the same as NTBs NTBs are discriminatory Non-tariff measures imposed by Govt. to favour Domestic over foreign suppliers. Thus NTBs are subset of NTMs

Classification of NTMs

Technical Measures

Measures refer to Product specific properties such as characteristics of product technical & specifications production processes.

They ensure product quality food safety environmental protection, National Security & Protection of animal & plant.

SPS TBT

Non-Technical Measures

Measures related to trade requirements such as-

Shipping requirements, custom formalities trade rules, Taxation policies etc.

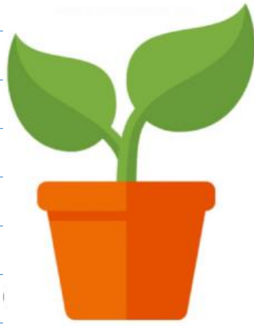
Hard Threat

NTMs

Import related
imposed by
importing countries

Export related
imposed by
Exporting countries

(PO)
Procedural obstacles
Problems in Adm.
Transportation, delay in
testing, certification etc.



Technical 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.

- 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.
- 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.

Non -Technical Measures

Import Quotas

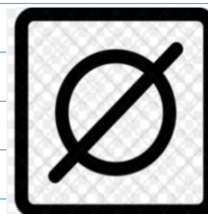
An import quota is a direct restriction which specifies that only a certain physical amount of the good will be allowed into the country during a given time period, usually one year.

Non-binding Quota (Sets at/above)

Free Trade Level

Binding Quota (Sets Below)

Absolute 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.
- In addition, there are seasonal tariff rate quotas and temporary quotas.

Quota Rent

- ✓ 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.
- ✓ An import quota always raises the domestic price of the imported good. With a quota, the government, receives no revenue. The profits received by the holders of such import licenses are known as **'quota rents'**.
- ✓ 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.

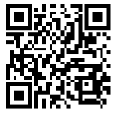
Welfare Effect of Quotas

- It is 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.

Price Control Measures

(Para-Tariff 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.



Non Autometic Licensing and Prohibition

- 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.
- 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 falling under 60 EXIM codes mostly of animal origin.

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.

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.

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.

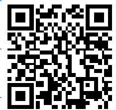
(a) requirement to use certain minimum levels of locally made components, (25 percent of components of automobiles to be sourced domestically)

(b) restricting the level of imported components, and

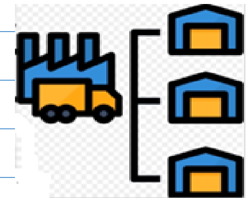
(c) limiting the purchase or use of imported products to an amount related to the quantity or value of local products that it exports. (A firm may import only up to 75% of its export earnings to the previous year)

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.

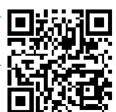


Distribution Restriction



- Distribution restrictions are limitations imposed on the distribution of goods in the importing country involving additional lincense 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.

VIDHYODAY
VIDHYA KA UDAY



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.

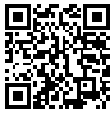
Administrative Procedures

- 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.

Rules of Origin

- Country of origin means the country in which a good was produced, or in he case of a trade 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.

VIDHYODAY
VIDHYA KA UDAY



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.

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.

VIDHYODAY
VIDHYA KA UDAY

Export Related Measures

Ban on exports

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 Taxes

- An export tax is a tax collected on exported goods and may be either specific or ad valorem.
- The effect of 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.

Export Subsidies and Incentives

- 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.

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.

VIDHYODAY
VIDHYA KA UDAY

- 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.

FEW RECENT DEVELOPMENTS IN INDIA'S INTERNATIONAL TRADE STARTEGY

- ✓ The Free Trade Agreement rush began with an agreement with Mauritius on 1 April, 2021, followed by fast-track negotiations with the United Arab Emirates (UAE). Australia, the United Kingdom (UK), Canada and the European Union (EU).
- ✓ On 18 February 2022, a comprehensive economic partnership agreement (CEPA) with the UAE was concluded within 90 days of the commencement of negotiations and has been in force since 1, May 2022.
- ✓ In addition, on Economic Cooperation and Trade Agreement (ECTA) with Australia also concluded on 2, April 2022.
- ✓ The next highly-anticipated Free Trade Agreement in the works is with the UK, which is expected to conclude by Diwali in October 2022.
- ✓ Free Trade Agreement discussions are also on the fast track with Canada, the EU, as well as with the Gulf Cooperation Council (GCC – Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE) and Israel.