CHAPTER 8

THE INSTRUMENTS OF TRADE POLICY: NON-TARIFF BARRIERS

(Chapter 9 of the textbook)

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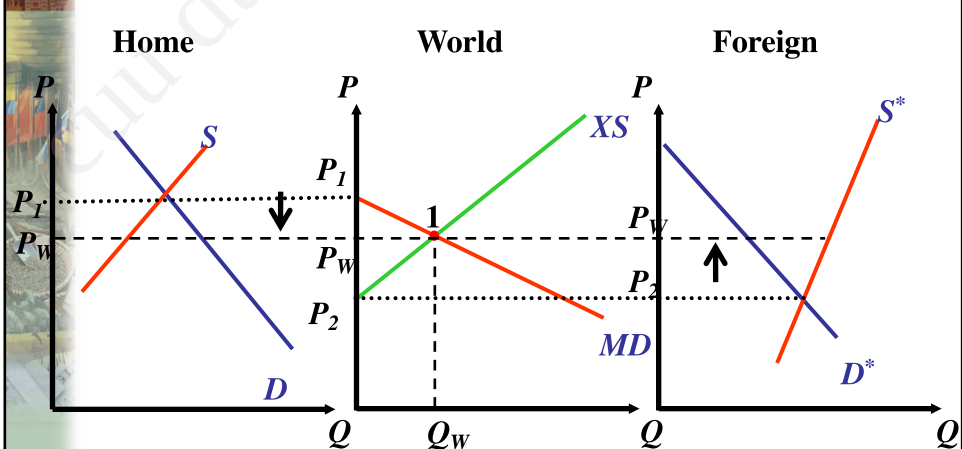
Preview

- Export subsidies
- Import quotas
- Voluntary export restraints
- Local content requirements
- Other trade policy instruments

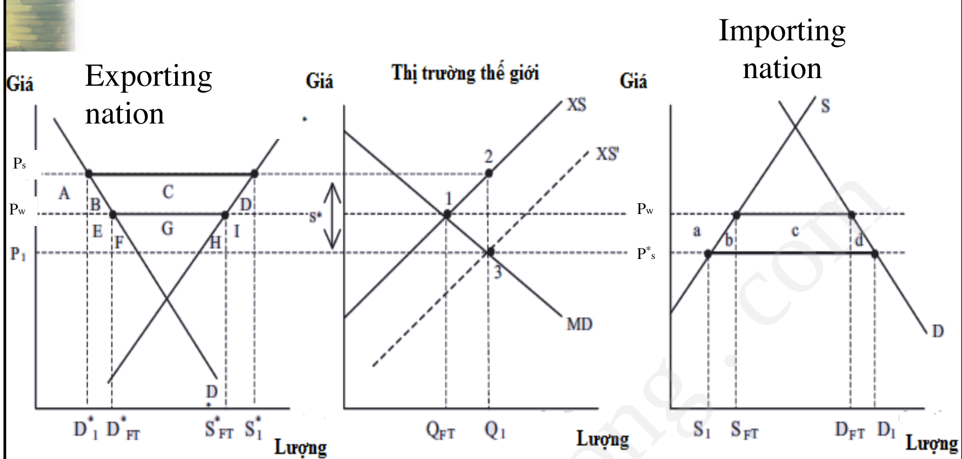
Effects of Export Subsidies

- The effects of an export subsidy are the reverse of those of a tariff.
- Shipper will export the good up to the point where the domestic price exceeds the foreign price by the amount of subsidy.
  - The difference between the domestic price in the exporting countries and the foreign price is exactly the subsidy
- Examine effects of export subsidies in two cases
  - Small exporting country case
  - Large exporting country case

The equilibrium in free trade



Effects of Export Subsidies in a large country case



Effects of Export Subsidies in a large country case (cont.)

- In the importing country:
  - An export subsidy raises the price of a good in the exporting country, while lowering it in foreign countries (the world price) from P_W to $P_{S'}$.
  - Consumers: better off
  - Producer: worse off

Effects of Export Subsidies in a large country case (cont.)

- In the exporting country: an export subsidy
  - Raises the domestic price from P_W to P_S
  - The price rise is less than the subsidy per unit of product
  - Consumers are worse off
  - Producers are better off
  - Government loses
  - Worsens the terms of trade by lowering the price of domestic products in world market (lower the world price).

Effects of Export Subsidies in a large country case (cont.)

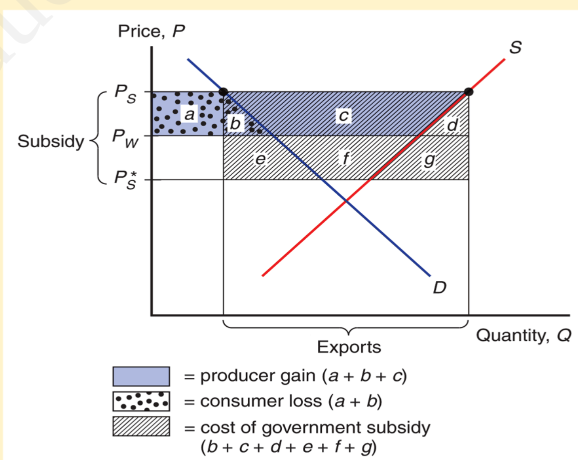
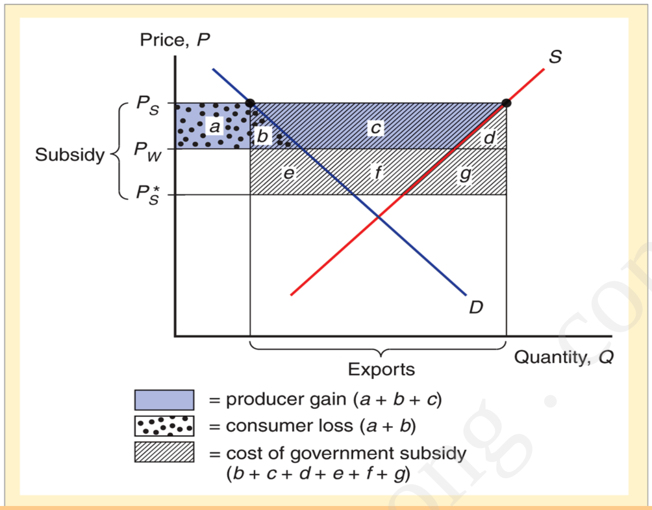


Figure 9 11

Effects of an Export Subsidy

An export subsidy raises prices in the exporting country while lowering them in the importing country.

Costs and benefit of Export Subsidies in a large country case

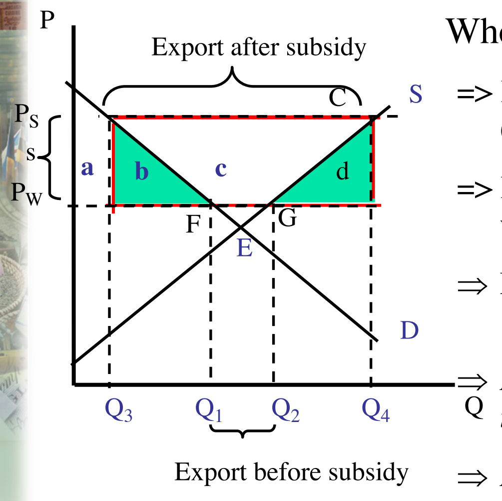


Cost of a subsidy = - (b+d) – (e+f+g)

Effects of Export Subsidies in a large country case (cont.)

- The triangles *b* and *d* represent the **efficiency loss**.
  - The tariff distorts production and consumption decisions: producers produce too much and consumers consume too little compared to the market outcome.
- The area *b* + *c* + *d* + *f* + *g* represents the **cost of government subsidy**.
  - In addition, the terms of trade *decreases*, because the price of exports falls in foreign markets from P_W to P^*_s.

The effects of export subsidies in a small country case



When a country is "small"

=> Has no effect on the foreign (world) price.

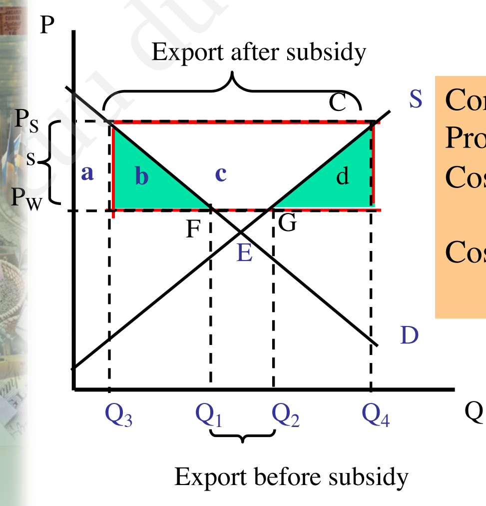
=> Foreign price will not fall, but will remain at P_w

⇒ Home price will rise to $P_s = P_w + s$

⇒ *Does not lead to change in terms of trade*

⇒ *Difference between Home and Foreign pirce is still subsidy*

The effects of export subsidies in a small country case



Consumer loss = a + b
Producer gain = a + b + c
Cost of government subsidy
= b + c + d
Cost of a export subsidy
= (b+d)

Case study: Europe's Common Agricultural Policy

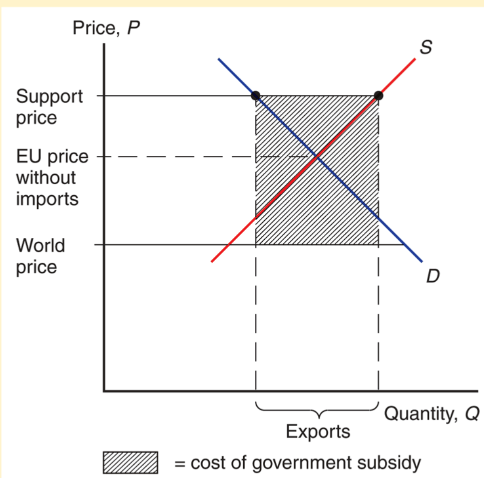
- The EU has two biggest effects on trade policy
  - Firstly, removed all tariffs within the EU
  - Secondly, the agricultural policy of the European Union has developed into a massive export subsidy program through EU's Common Agricultural Policy (CAP)
- CAP:
  - Tries to guarantee high prices to European farmers
  - Sets high prices for agricultural products
  - Whenever the prices fell below specified levels, the EU buy and store agricultural products
  - Subsidizes exports to dispose of excess production.

Case study: Europe's Common Agricultural Policy (cont.)

Figur 9 -12

Europe's Common Agricultural Program

Agricultural prices are fixed not only above world market levels but above the price that would clear the European market. An export subsidy is used to dispose of the resulting surplus.



Case study: Europe's Common Agricultural Policy (cont.)

- Effects of CAP on the EU itself:
  - The EU was producing more than consumers were willing to buy
  - The EU was obliged to buy and store huge quantities of food.
  - To avoid unlimited growth in these stockpiles, the EU turned to a policy of subsidizing exports to dispose of surplus production
  - Subsidize to offset the difference between European and world prices

Case study: Europe's Common Agricultural Policy (cont.)

- Effects of CAP on the EU itself (cont.):
  - Welfare reduces
  - The direct cost of this policy for European taxpayers is almost $US 50 billion in 2002, $US billion 76 in 2009 (does not include indirect costs to food consumers).
  - Subsidies are equal to about 36% of the value of farm output, twice the US figure.

Case study: Europe's Common Agricultural Policy (cont.)

- Effects of CAP on the world
  - EU's subsidized exports drive down world prices of agricultural products.
  - Harm the agricultural exporting nations, food exporting nations, mostly the developing countries
  - Harm the farmers in the developing countries

=> Debate in the WTO negotiation round

Case study: Europe's Common Agricultural Policy (cont.)

- Despite the considerable net costs of the CAP, the CAP is difficult to be removed
  - The strong political strength of farmers
  - Votes in elective campaign
- Recent reforms in CAP:
  - Reduce the distortion of incentives caused by price support, while continuing to provide aid to farmers.
  - farmers will increasingly receive direct payments that aren't tied to how much they produce

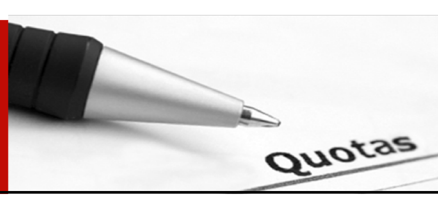
=> lower agricultural prices and reduce production.

Preview

- Export subsidies
- Import quotas
- Voluntary export restraints
- Local content requirements
- Other trade policy instruments

Concept

- An import quota:
  - A direct restriction on the quantity of a good that may be imported.
  - The role of quota decreases (WTO, FTAs)
  - Usually enforced by issuing licenses to domestic firms that import, or in some cases to foreign governments of exporting countries.



Effects of an import quota

- Import quota always raises the domestic price of imported good
  - Because at the initial price, the quantity demanded will exceed the quantity supplied by domestic producers and from imports.
  - Raise the domestic price by the same amount as a tariff that limits imports to the same level (equivalent tariff).

=> Impacts of quota is similar to impacts of an equivalent tariff.

Effects of an import quota (cont.)

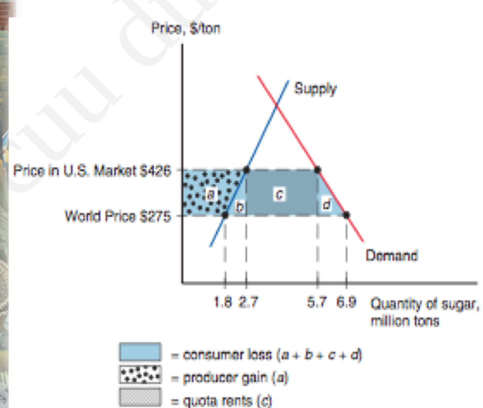
- The difference between a tariff and a quota is the government receives no revenue
  - Instead, the revenue from selling imports at high prices goes to **quota license holders** (either domestic firms or foreign governments).
  - License holders import goods and resell them at higher prices.
  - The profits received by the holders of import license are called **quota rents**.

=> With quota policy, in assessing the costs and benefits of an import quota, it is crucial to determine who gets the quota rents.

Effects of an import quota (cont.)

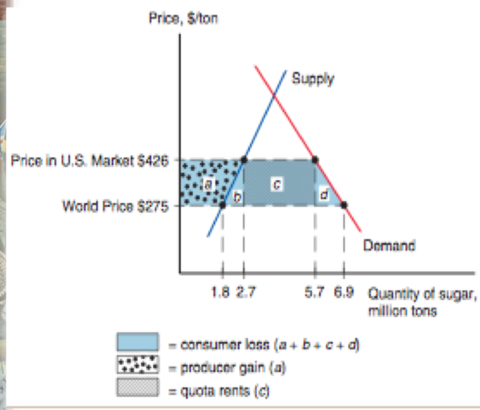
- Costs and benefits of an import quota depends on who gets the rent.
  - ♦ If license holders are domestic firms, an import quota have the similar effects as a tariff that limits imports to the same level (an equivalent tariff)
    - Cost of an import quota is (b+d)
  - ♦ If license holders are governments of exporting countries => the costs of an import quota is higher than those of the equivalent tariff.
    - Cost of an import quota is (b+d+c)

Case study: An import quota in practice - US Sugar



- Keep domestic prices at the target level above world market level with an import quota
- Allocate import quota to the foreign governments
- Restrict imports to 3 million tons
- Price in the US: 35% above the world price
- Quota rents accrue to foreigners
- Net loss to the US: a + b + c

Case study:
An import quota in practice - US Sugar



- Net loss to the US: a + b + c (612 million USD per year)
- Who gets benefits: a small group domestic sugar producers (farmers and processors). Quota equivalent to a subsidy of $ 42,000 per employee.

⇒ the quota is a life-or-death issue => defense of the quota.

- Who gets loss: consumers

But: only USD 3/capita

⇒ American voter is unaware that sugar quota exits, and so there is little effective opposition

⇒ Who gets loss: confectionary manufacturing sector

Import quota issues

-These regulations are <u>random and costly</u> to administer.

-Rules restricting trade result in firms going to unusual lengths- & incurring expenses - to get around rules.

-Trade war: war between Boeing and Airbus, Kodak and Fuji, steel war, banana war, catfish war…

-Bribery, corruption

=> Why use????

TARIFF RATE QUOTA (TRQ)

Tariff rate quota

- Combination of tariff and quota
  - ♦ Two level tariffs
    - Low tariff for in-quota imports
    - High tariff for out-of-quota imports
  - ♦ Common in agricultural trade

Example of TRQ

- Vietnam started to use TRQ in 2003 for 3 commodities: salt, cotton, material tobacco

Commodities	Number of tariff lines	In-quota tariff (%)	Out-of-quota tariff (%)
Material tobacco	12	28.7	98.3
Salt	7	0	60
Cotton	5	0	16

- In 2004, TRQ were applicable to 4 additional commodities: **maize, egg, condensed milk, and uncondensed milk**

Example of tariff rate quota (cont.)

- In 2015: MOIT issued Decree 03/2015/TT-BCT on TRQ imposed on salt, egg for 2015.

TT	HS	Commodity	Unit	Quantity
1	0407 21 00 và 0407 90 11	Chicken egg	tá	46.305
	0407 29 10 và 0407 90 20	Duck egg		
	0407 29 90 và 0407 90 90	Other egg		
2	2501	Salt	tấn	102.000
3	1701	Refined and raw sugar	tấn	81.000

Vietnam's WTO commitments related to TRQ

TT	HS	Commodity	In-quota tariff rate	Out-ot-quota tariff rate
1	04070091	Chicken egg	5% (ASEAN) 30% (outside ASEAN)	80%
	04070092	Duck egg		
	04070099	Other egg		
2	2401	Salt	30% (within and outside ASEAN)	80% 90%
3	2501	Refined and raw sugar	5% (ASEAN) 10, 15, 30% (outside ASEAN)	60%: industrial 50%: pure

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Vietnam's ATIGA commitments on TRQ

- Stop TRQ
- Articles 20 ATIGA
  - Vietnam removes the existing TRQ on 4 commodities with 3 packages
  - Package 1: from 01/01/2013
  - Package 2: from 01/01/2014
  - Package 3: From 01/01/2015 with flexibility until 2018.

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Voluntary Export Restraint (VER)

- VER: a quota on trade imposed from the exporting country's side instead of the importer's.
- These restraints are usually requested by the importing country => Not voluntarily in the root sense
- Compare to quota: VER works like an import quota, except that the quota is imposed by the exporting country rather than 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.
- Compare to an equivalent tariff: VER **is always more costly to the importing country than the equivalent tariff** (VER is exactly like a quota where the licences are assigned to foreign governments)

Voluntary Export Restraint (VER) (cont.)

- Examples of VER or Orderly Marketing Arrangements (OMA) are:
  - Japan automobile exports to USA (1981)
  - The Multi-fibre agreement which restricted garment imports from 22 countries to developed countries until the beginning of 2005.
- A VER in practice: Japanese Autos

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Local Content Requirement

- A **local content requirement** is a regulation that requires a specified fraction of a final imported good to be produced domestically.
- It may be
  - ♦ specified in value terms, by requiring that some minimum share of the value of a good represent domestic valued added
  - ♦ in physical units.
  - ♦ Widely used by developing countries to shift their manufacturing base from assembly back into intermediate goods.

Local Content Requirement (cont.)

- For domestic producers of inputs
  - ♦ Provides protection in the same way that an import quota would.
- For firms that must buy inputs
  - ♦ Does not place a strict limit on imports, but allows firms to import more provided they also buy more domestic parts.
- For government
  - ♦ Provides no government revenue (as a tariff would).

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Technical Barriers to Trade (TBTs)

- Standards, conformity assessment, technical regulations

SPSs: Sanitary and Phytosanitary Measures

- Measures to protect life and health of human, animals and plants.

Technical regulations

- *Safety regulations on cars, electric products…*
- *Food safety regulations*
- *Trademark regulations*

Most → **Rational objectives**

Some → **Disguised**

Regulations on trademark

REACH

COMPLIANCE

Regulations on trademark (cont.)

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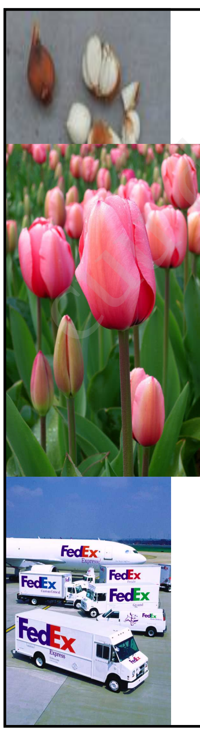
Administrative regulations



- E.g:
  - Tulip bubs
  - Federal Express

Bureaucratic regulations (Red-tap barriers)

- http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm9_e.htm
- Safety, health, quality or customs regulations can act as a form of protection and trade restriction.
- In 1982, all Japanese videocassette recorders must pass through the tiny customs house at Poiters

Bureaucratic regulations (Red-tap barriers) (cont.)

- From 1/6/2011, mobile phones, cosmetics and wine are only imported into Vietnam through 3 ports: Hai Phong, Da Nang and HCM city (Before, import through airway and road are allowed)
  - Quantity of smart phone imported each delivery is low
  - The low quantity: not enough to loan in a container. But enterprises must hire a whole container => high cost
  - Shipping: takes times, at least 30-45 days while airway takes 1 week at longest, risky

Export credit subsidies

- A subsidized loan to exporters or foreign importers
- US Export-Import Bank subsidizes loans to US exporters.
- Vietnam:
  - Decision 75/2011/NĐ-CP and Circular 35/2011/TT-BTC.
  - Decision 75
  - A subsidized loan to exporters or foreign importers
  - Loan to exporters before and after the delivery of commodity
  - Conditions to be granted export credits:
    - some eligible commodities
    - The maximum eligible loan: 85% of contract value.
    - Lending duration: not exceed 12 months

Government procurement

- Government agencies are obligated to purchase from domestic suppliers, even when they charge higher prices (or have inferior quality) compared to foreign suppliers.
- EU telecommunication industry: EU telecoms compelled to buy high cost EU inputs, equipment

Import and export prohibition

- Decree 12/2006/NĐ-CP dated 23/1/2006, effect from 1/5/2006
- Decree 12/2006
- Decree No. 187/2013/NĐ-CP dated 20/11/2013, effect from 20/2/2014
- Decree 187

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Import discouragement

- Decision No. 1380/QĐ-BTC dated 25/3/2011
- Decision 1380

Export discouragement

- Vietnam: Ore, minerals, metal (iron and steel), lumber, chemicals, leather

Rules of origin (RoO)

- What are American cars?
- Same questions: Vietnamese rice, EU goods dish washing machine…

=> has become more complicated due to evolving production systems, supply chain, and business models

- RoO:
  - Rules of origin are the criteria used to determine the national source (origin) of a product.

RoO (cont.)

- RoO is important because duties and restrictions in a lot of cases, especially in FTAs, depend upon the source of imports.
- E.g: MFN tariff rate vs. EVFTA tariff rates

  25-40% 0-10%

⇒ To get EVFTA tariff rates, goods traded between Vietnam and EU must originate from Vietnam or EU, in other words must meet RoO criteria.

⇒ EVFTA: RoO criteria is that Regional Value Content is at least 40%. It means that at least 40% of the products must originate from EU and Vietnam.

RoO (cont.)

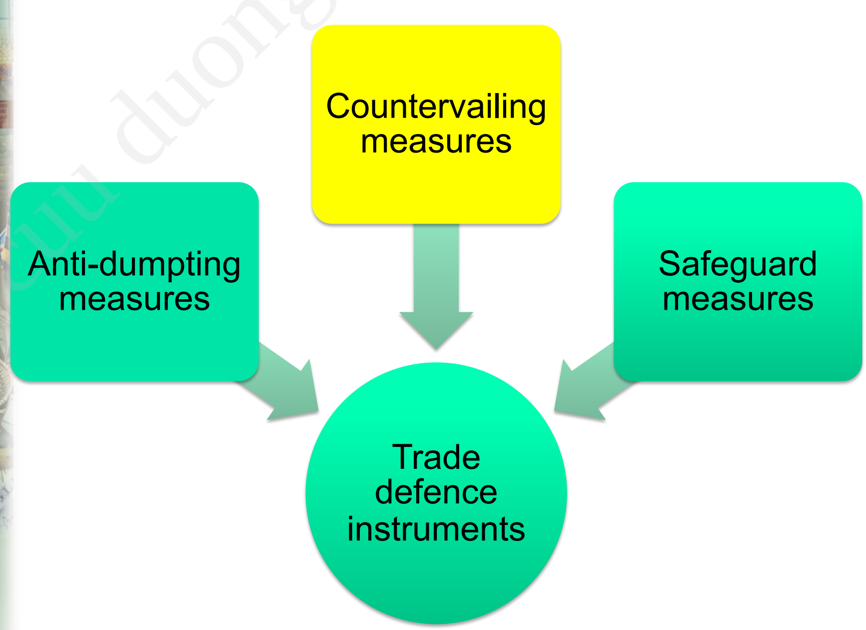
- E.g: Under ATIGA (ASEAN Trade in Goods Agreement), a product is eligible to get 0% tariff rate if at least 40% of the products are made by ASEAN nations (Regional Value Content is 40%).
  - AANZFTA, AKFTA : RVC is 40%
  - AIFTA: RVC 35%
  - VJEPA: RVC 40%

RoO (Cont.)

- If a nation participates in many FTAs and RoO is different among FTAs => leads to “noodle bowl effects”.
  - Enterprises should meet different RoO when trading with different partners
  - High cost for enterprises to meet different RoO => FTA in force but cannot be used in reality.
  - Government: complicated in designing a system to calculate RVC and follow RoO regulations.

RoO (Cont.)

- Harmonization of RoO is very important.
  - ♦ Harmonization of RoO: the definition of RoO will be applied by all countries
  - ⇒ Facilitate international trade flows, reduce implementation costs, reduce the number of origin disputes.



Summary

	Tariff	Export subsidy	Import quota	Voluntary export restraint
Producer surplus	Increases	Increases	Increases	Increases
Consumer surplus	Decreases	Decreases	Decreases	Decreases
Government net revenue	Increases	Decreases	No change: rents to license holders	No change: rents to foreigners
National welfare	Ambiguous, falls for small country	Decreases	Ambiguous, falls for small country	Decreases

Summary (cont.)

1. A tariff decreases the world price of the imported good when a country is “large”, increases the domestic price of the imported good and reduces the quantity traded. A quota does the same.
2. An export subsidy decreases the world price of the exported good when a country is “large”, increases the domestic price of the exported good and increases the quantity produced.

Summary (cont.)

3. The welfare effect of a tariff, quota and export subsidy can be measured by:
   - Efficiency loss from consumers and producers
   - Terms of trade gain or loss
4. With import quotas, voluntary export restraints and local content requirements, the government of the importing country receives no revenue.
5. With voluntary export restraints and occasionally import quotas, quota rents go to foreigners.

END OF CHAPTER 8