Chapter Seven Outline

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9. How can we measure Nontariff Barriers?
Nontariff barriers (NTBs) include quotas, voluntary export restraints, export subsidies, and other regulations and restrictions of international trade.

- Economists have become increasingly concerned.
  - NTBs have not been reduced as much as tariffs.
  - WTO does not discipline many NTBs as effectively as it does tariffs.
    - New protectionism: tendency to circumvent WTO rules by using loopholes in agreements and imposing types of barriers over which negotiations have failed.
– Countries often apply NTBs in a discriminatory way.

• Exports from developing countries appear especially vulnerable to restriction through nontariff barriers.
• **Quotas** are the simplest and most direct of nontariff trade barrier.
  – Direct quantitative restriction on the number of units of a good imposed during a specified period.

• Why do countries impose quotas?
  – Same reasons as for tariffs:
    • Protect a domestic industry from foreign competition.
    • Cut imports to reduce a balance-of-trade deficit.
Quotas

• **Two major developments from Uruguay Round talks:**
  
  – Countries are required to convert their quotas to equivalent tariffs, which then are subject to phased-in tariff reductions.
  
  – Countries agreed to establish minimum market access for markets, mostly agriculture.
  
  – Analysis of an import quota’s effects closely resemble that for a tariff – analyzed in Figure 7.1.

See Figure 7.1
Figure 7.1 illustrates that by restricting imports, a quota increases domestic production from $Y^1$ to $Y^3$ and decreases consumption from $Y^0$ to $Y^2$.

- The net welfare loss from the quota is shown as the sum of the areas of triangles $c$ and $g$.
- Area $c$ represents a transfer from domestic consumers to producers.
- Area $f$ represents the rents from the quota.
  - Rents: for each unit of good $Y$ imported under the quota, consumers now pay a higher price.
    - Rents could go to importers, exporters, foreign producers, the quota-imposing government, or they may become an additional deadweight loss.
Figure 7.1: What Are the Effects of an Import Quota on Good Y?
Voluntary export restraints (VERs)

- Importing and exporting countries negotiate agreements for the exporter to “voluntarily” restrict exports.
  - Autos, steel, textiles/apparel.
- Has effects similar to a quota.
  - Major difference is in the administration:
    - Quota: importing country handles the administration.
    - VER: exporting country handles the administration.
    - Increases likelihood that foreign producers or exporters will capture a large share of the rents.
- Tendency is for exporters to raise the average quality of their exported goods.
Comparison of Tariffs and Quotas

• Revenue from tariff goes to the tariff-imposing government.
  – Unclear who receives the quota rent.

• Domestic firms seeking protection typically prefer a quota to other forms of restriction.
  – Quota assures domestic industry a ceiling on imports regardless of changing market conditions.
  • Under a quota, domestic consumers do not have the option of switching to the imported good.
  • However, under a tariff, domestic firms could raise prices too much – consumers could switch to the imported good even though they have to pay the tariff.
• **Equivalence of tariffs and quotas**
  – It is possible to define a quota with precisely the same effects on prices, production, consumption, and trade at any moment (and vice versa with tariffs).

• **Figure 7.2 illustrates this for a large country.**
  – An import quota is more restrictive than an equivalent tariff in the face of an increase in demand.
Comparison of Tariffs and Quotas

- **Under a tariff, imports cover a portion of the increased demand.**
  - In panel (a), increased demand causes a larger increase in consumption than in domestic production.
  - A quota forces all increased demand to be matched by increases in (inefficient) domestic production, as panel (b) illustrates.
  - An equal increase in demand causes a larger price increase under a quota than under a tariff.
Figure 7.2: What Happens in Response to Increased Demand under a Tariff and under a Quota?

(a) Import Tariff

(b) Import Quota
• Export subsidy
  – A financial contribution from a government to a firm for export of a commodity.
  • Firm receives the subsidy along with the price paid by foreign consumers.
  • These subsidies create incentives for firms to export larger shares of their production and sell smaller shares domestically.
• The Importing-Country View
  – Because a subsidy is just a negative tax, it lowers the price at which the importing-country consumers can buy the good.
  – In Figure 7.3, an export subsidy of $s$ per unit increases domestic consumption from $Y^0$ to $Y^2$ and reduces domestic production from $Y^1$ to $Y^3$.
    • Difference is made up by increased imports now available at a lower price.
Export Subsidies and Countervailing Duties

- Importing-country producers are harmed (area e), but by less than the gains to importing-country consumers (area e+f+g+h) in the form of lower prices and increased availability of imports.
  - WTO rules allow for countervailing duties (area c) (CVDs), or import taxes designed specifically to offset the competitive advantage provided by trading partners’ export subsidies.
    - CVDs will not eliminate a transfer (area g) from exporting-country to importing-country taxpayers.
- Figure 7.3 makes it clear that the importing country as a whole loses from a countervailing duty.
Figure 7.3: What Are the Effects of an Export Subsidy? Importing-Country Perspective

\[ S^d + w = S^{d+w} - s + c \]
• More complex reason for export subsidies involves the possibility that temporary export subsidies in markets with certain characteristics may allow a country to capture a larger share of the world market that it can exploit by charging monopoly prices for the good.

• Figure 7.4 in the text offers a look at the countries that initiated countervailing-duty claims to the WTO in 1996 and those countries which were the subject of those claims.
• **The Exporting-Country View**
  - Subsidized producers gain at the expense of consumers and/or taxpayers, depending on how many countries in the market subsidize exports.
  - In Figure 7.5, if the small country is the only exporter subsidizing (scenario 1), export firms receive the world price plus the subsidy.
  - Net welfare effect on exporting country is loss equal to areas $j$ and $k$. 
• The Exporting-Country View
  – If all exporters subsidize (scenario 2), the world price is bid down by the amount of the subsidy.
    • The net welfare loss to the exporting country is area TZCV.

See Figure 7.5
Figure 7.5: What Are the Effects of an Export Subsidy? Exporting-Country Perspective
Controversy over export subsidies

- Why would any country choose to subsidize its exports, thereby providing artificially low-priced imports to foreign consumers?
  
  - One reason: redistribution of income that subsidies generate in the exporting country.
  - Clustering of export subsidies in agricultural product markets provides a second motivation for subsidies.
    
    - Most industrial economies have agricultural price-support systems that keep prices for those products and farmers’ incomes artificially high.
• “Price-based” definition
  – Dumping occurs when whenever a firm sells a good in a foreign market at a price below that for which the same good would sell in the domestic market.

• “Cost-based” definition
  – Sale of a good in a foreign market at a price below its production cost constitutes dumping.
Economists divide dumping into three categories:

1. Sporadic Dumping
   - Involves sale of a good in a foreign market for a short time at a price below either the domestic price or the cost of production.
   - Resembles an international “sale” if it happens for only a short period.
   - May disrupt domestic market due to uncertainty generated when foreign supply changes suddenly.
   - However, damage is usually not permanent.
2. Persistent Dumping

- Continued sale of a good in a foreign market at a price below either the domestic price or production cost, a practice that provides the basis for many calls for protection.

- Major cause of persistent dumping is international price discrimination (according to price-based definition).
  - Any firm able to separate its customers into two or more groups with different elasticities of demand for its product and to prevent resale of the good among them can increase profit by charging the groups different prices.
• Figure 7.6 shows that if a firm can prevent resale of its product between domestic and foreign customers, price discrimination based on different elasticities of demand by the two groups will increase the firm’s profits.
  – Because of the greater number of competitors in export markets, the firm will generally charge a higher price in the home market rather than in the export market.
• Dumping by price-based definition.
Figure 7.6: Persistent Dumping as International Price Discrimination

(a) Home Market

(b) Export Market
• **Predatory Dumping**
  
  – Selling in the foreign market at prices below production cost to drive domestic firms from the industry.

  • After eliminating competitors, the firm can then exploit the newly created monopoly power by raising prices.

  – **Several difficulties with this strategy:**

    • Dumping firm would suffer economic losses while dumping.
    • Domestic firms would know this dumping would only be temporary and could borrow funds to weather the attack.
    • Once prices were raised, nothing would prevent domestic firms from re-entering the industry and benefiting from the new price levels.
    • Dumping firm would be subject to filing of dumping charges by competitors.
Policy responses to dumping

- Normal course: U.S. firm charges its foreign counterpart with dumping – Commerce Department and International Trade Commission conduct investigation.
  - They must determine if dumping is really occurring; and
  - Whether it materially injures the domestic industry.

- If answer to both questions is “Yes,” then the government imposes an Antidumping Duty, a tariff equal to the dumping margin.
Voluntary Import Expansions (VIEs)

- Requires a country to import a specified quantity of foreign goods in a given industry.
  - The mandated imports are typically stated as a minimum market share.
  - Can act as powerful tools of protection.
    - Ignore the possibility that the observed outcome in a particular industry simply reflects comparative advantage rather than foreign trade barriers.
    - VIEs often allocate the required foreign market share to the country powerful enough to force the import country to negotiate the VIE.
      - Competition is restricted rather than encouraged.
• Many regulatory international trade standards are protectionist by design.
  – **Domestic-Content Requirements**
    • Mandate that a specified percentage of a product’s inputs and/or assembly have domestic origins in order for the good to be sold domestically.
    – UAW has pressured the U.S. government to pass domestic-content legislation.
      • Would require 90% value-added produced in the U.S. or Canada for all manufacturers selling more than 500,000 cars in the U.S.
      • Would also limit *outsourcing* – in which U.S.-based auto producers buy inputs and perform assembly functions abroad.
• **Rules of Origin**
  - Similar to domestic-content rules.
  - Agreements such as NAFTA would have to contain provisions that limit duty-free access to goods “originating” in the member countries.

• **Government-Procurement Policies**
  - Two areas: governments actually buy and sell many goods and services in international markets; and
  - Government-owned industries and government-run monopolies make purchases and sales.
Buy-Domestic Requirements

- Either legally or informally require governments to purchase domestically made goods on a preferred basis.

Technical, Administrative, and Regulatory Standards

- Governments regulate various aspects of activity within their economies and carefully guard their rights to do so.

  - Regulations may include health, safety, and product-labeling requirements, as well as controls over entry into certain professions and access to certain types of mass media.
How Can We Measure Nontariff Barriers?

• **Difficult to measure - At least four different measures can be used:**

  1. **Coverage ratio**
     - Value of imports subject to NTBs, divided by total imports.

  2. **Implicit tariff**
     - Calculate the tariff rate that would have the same effect on trade as the existing quota/other NTB.
3. **Producer-subsidy equivalent (PSE)**
   - Measures the difference between the income industry producers receive with their NTBs and the income producers would receive with no such barriers, and expresses that difference as a percentage of the income-without-barriers figure.

4. **Consumer-subsidy equivalent (CSE)**
   - Performs the same exercise for an industry’s consumers.
Key Terms in Chapter 7

• Nontariff barrier (NTB)
• New protectionism
• Quota
• Quota rents
• Voluntary export restraint (VER)
• Equivalence of tariffs and quotas
• Export subsidy
Key Terms in Chapter 7

- Countervailing duty (CVD)
- Dumping
- Sporadic dumping
- Persistent dumping
- Price discrimination
- Dumping margin
- Predatory dumping
Key Terms in Chapter 7

- Antidumping duty
- Voluntary import expansion (VIE)
- Domestic-content requirements
- Outsourcing
- Rules of origin
- Government-procurement policies
- Buy-domestic requirements
- Technical barriers to trade
Key Terms in Chapter 7

- Coverage ratio
- Implicit tariff
- Producer-subsidy equivalent (PSE)
- Consumer-subsidy equivalent (CSE)