Part IV　Trade Policy

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Part IV Trade Policy

Part IV provides a general background for understanding the issues associated with trade policy. Chapter 13 provides an overview of the various instruments of trade policy available to government policymakers, followed by a discussion of welfare implications in Chapter 14. An analysis of the arguments for the intervention in international trade is presented in Chapter 15, “Traditional Arguments for Protection,” followed by several “new” arguments in Chapter 16, “Strategic Approaches to Trade Policy Intervention.” Chapter 17, “Political Economy and Recent U.S. Trade Policy”, covers that subject and the GATT rounds of trade liberalization. Chapter 18, “Economic Integration”, examines issues surrounding economic coalitions of countries and takes a brief look at recent developments in Europe and North America. Chapter 19, examines trade and trade policy issues facing developing countries.

Preview

The Instruments of Trade Policy

The Impact of Trade Policies

The Instruments of Trade Policy

Tariffs

A specific tariff is levied as a fixed charge for each unit of imported goods.

An ad valorem tariff is levied as a fraction of the value of imported goods.

Finally, import subsidies also exist in some countries. An import subsidy is simply a payment per unit or as percent of value for the importation of a good.

The Instruments of Trade Policy

Export taxes and subsidies

Nontariff barriers to free trade:

- Import quotas, differs from an import tariff in that the interference with prices that can be charged on the domestic market for an imported good is indirect, not direct.

- “Voluntary” export restraints (VER), it originates primarily from political considerations. There are also some possible direct benefits to the exporter from the VER. (See Chapter 14)
- Government procurement provision, in general, these provisions restrict the purchasing of foreign products by home government agencies.
- Domestic content provision, attempt to reserve some of the value added and some of the sales of product components for domestic suppliers.
- European border taxes
- Administrative classification

The Instruments of Trade Policy

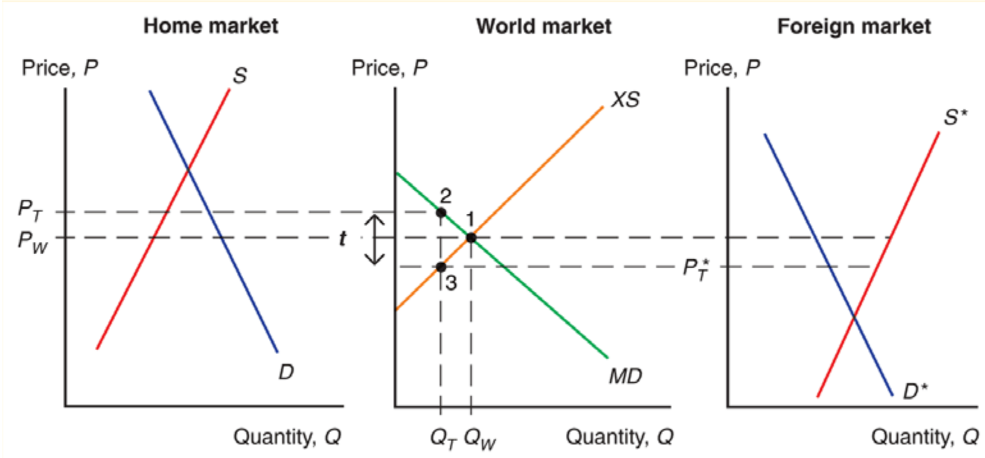
Nontariff barriers to free trade:

- Restrictions on services trade
- Trade-related investment measures
- Additional restrictions
- Additional domestic policies that affect trade

The Impact of Trade Policies

It looks at the winners and losers when trade-distorting measures are undertaken and the net effects on the country.

The initial or direct impact of a trade restriction takes place in the market of the commodity that is the focus of the specific instrument. When the analysis of a policy effect is confined to only one market and the subsequent effects on related markets are ignored, a partial equilibrium analysis is being conducted. Since these secondary effects are often important, economists try to examine the effects of economic policy in a general equilibrium model.



The Effects of a Tariff

A tariff acts as an added cost of transportation, making shippers unwilling to ship goods unless the price difference between the domestic and foreign markets exceeds the tariff.

If shippers are unwilling to ship wheat, there is *excess demand* for wheat in the domestic market and *excess supply* in the foreign market.

- The price of wheat will tend to rise in the domestic market.
- The price of wheat will tend to fall in the foreign market.

Thus, a tariff will make the price of a good rise in the domestic market and will make the price of a good fall in the foreign market, until the price difference equals the tariff.

- $P_T - P^*_T = t$
- $P_T = P^*_T + t$

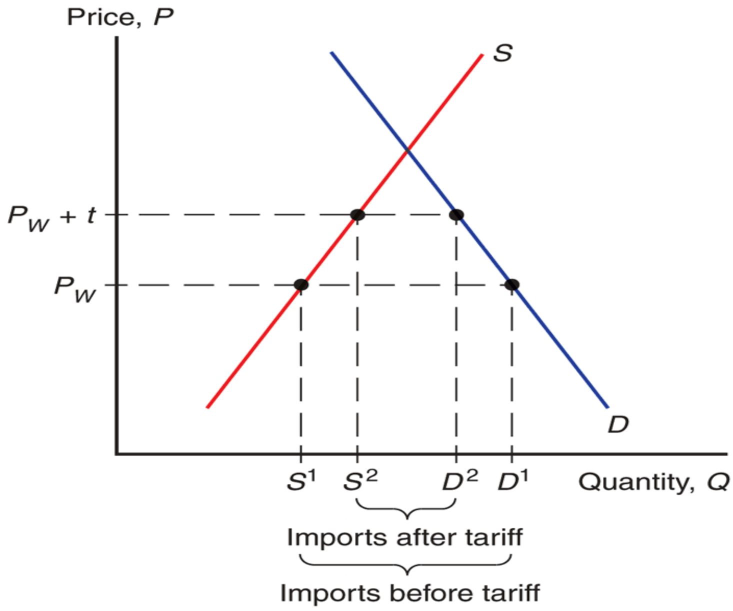
The price of the good in foreign (world) markets should fall if there is a *significant* drop in the quantity demanded of the good caused by the domestic tariff.

The Effects of a Tariff in a Small Country

When a country is "small", it has no effect on the foreign (world) price of a good, because its demand for the good is an insignificant part of world demand.

Therefore, the foreign price will not fall, but will remain at P_w

The price in the domestic market, however, will rise to $P_T = P_w + t$



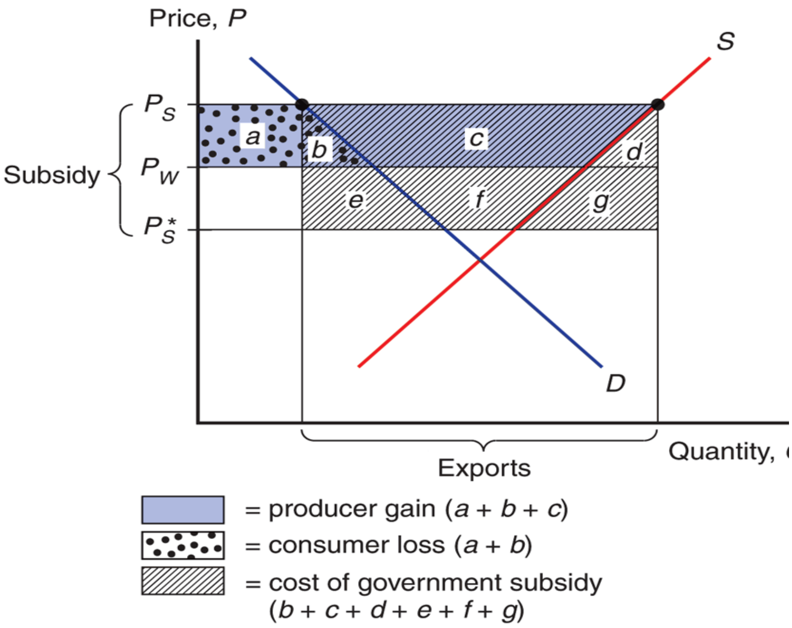
Export Subsidy

An export subsidy can also be *specific* or *ad valorem*

❑A specific subsidy is a payment per unit exported.

❑An ad valorem subsidy is a payment as a proportion of the value exported.

An export subsidy raises the price of a good in the exporting country, making its consumer surplus decrease (making its consumers worse off) and making its producer surplus increase (making its producers better off).



Import Quota

An import quota is a restriction on the quantity of a good that may be imported. This restriction is usually enforced by issuing licenses to domestic firms that import, or in some cases to foreign governments of exporting countries.

Voluntary Export Restraint

A voluntary export restraint works like an import quota, except that the quota is imposed by the exporting country rather than the importing country.
However, these restraints are usually requested by the importing country.

Local Content Requirement

A local content requirement is a regulation that requires a specified fraction of a final 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, or in physical units.

Other Trade Policies

- Export credit subsidies
- A subsidized loan to exporters
- US Export-Import Bank subsidizes loans to US exporters.
- 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.
- Bureaucratic regulations
- Safety, health, quality or customs regulations can act as
  a form of protection and trade restriction.