Econ 340

Lecture 6
Nontariff Barriers
News: Jan 23-29

• Donald Trump limits immigration -- NYT: 1/28 | Proquest
  – Donald Trump issued an executive order immediately limiting immigration. Immigration of any sort from Syria is stopped indefinitely, and immigration from another six countries is stopped for 90 days: Iran, Iraq, Libya, Somalia, Sudan, and Yemen. In addition, admission of refugees from any country is suspended for 120 days.
  – During these periods of suspension, the intent is to improve the process for vetting immigrants.
  – The action prompted protests at airports where immigrants were being detained or turned back. It also prompted a federal court judge to block implementation of a part of the order.

• Trump formally withdraws from the TPP -- NYT: 1/24 | Proquest
  – The Trans-Pacific Partnership, a free trade agreement among 12 countries including the US but not China, had been a signature achievement of the Obama administration, though it had not been approved by Congress.
  – On Monday, Trump signed the order formally ending US participation in the agreement. This was not a surprise, as the TPP had been presumed dead ever since his election, and was very uncertain of being approved by Congress even if Clinton, who said she opposed it, had been elected.
  – Nonetheless, this was a strong signal that the Trump administration plans to pursue a different path on trade than all prior administrations of the last half century, both Democratic and Republican.

• UK Supreme Court rules that Brexit must be voted on by Parliament -- WSJ: 1/25 | Proquest | NYT: 1/25 | Proquest
  – After UK voters in the referendum in June 2016 chose to exit from the European Union, the new Prime Minister Teresa May announced her intention to invoke the EU's Article 50 by the end of March 2017, starting the two-year process of negotiating the terms of exit. A lawsuit was then filed saying that membership in the EU could only be ended with the consent of Parliament, and that lawsuit was finally decided on Tuesday by the UK Supreme Court, confirming that.
  – PM May will now hurry to submit legislation to Parliament, asking it to approve the Brexit action. The Parliament is expected to approve it, even though a majority of members opposed Brexit. They are likely, however, to try to dictate the terms of any agreement.
  – The decision was expected. It had not been known, however, whether the court would insist that regional governments of Scotland, Wales, and Northern Ireland must be consulted, which would have at least prolonged the process since each was likely to be opposed. The court ruled, however, that Mrs. May does not need to consult them.

Lecture 6: NTBs
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Outline: Nontariff Barriers

• What Are NTBs?
• Quotas
  – Effects Equivalent to Tariffs
  – Who Gets the Rents
• Other NTBs
  – Tariff-Rate Quotas
  – Voluntary Export Restraints (VERs)
  – Variable Levies
  – Government Procurement Regulations
  – Customs Procedures
  – Standards
  – Unfair Trade Laws
  – Export taxes
• Subsidies
What Are NTBs?

• What Are They?
  – Any institutional or policy arrangement that interferes with trade, other than tariffs
  – Term NTB is also used more broadly to include policies that artificially expand trade
    • e.g., Export subsidy
  – Sometimes called “Nontariff Measures” (NTMs)

• Main Types of NTB
  – See outline above
Outline: Nontariff Barriers

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We’ll go through some of these individually.
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Quotas

• Definition: An import quota is a direct restriction on the quantity of an import
  – E.g., US might limit the imports of steel to some number of tons per year
  – Until Jan 1, 2005, US and EU had elaborate import quotas on many textile and apparel products from developing countries
  – We still have quotas on many agricultural products, e.g., sugar, cheddar cheese, dried milk, etc
Quotas

• Effects of a quota
  – If permitted quantity is above what would be imported anyway, then no effect at all. (True only with perfect competition)
  – Otherwise, quota creates scarcity and raises price
  – Quota raises domestic price above world price
  • For market to clear, domestic price must rise to the point that desired imports equal the quota
  • See this with supply and demand
  • First note example of US quota on sugar..
• Note that US price stayed mostly above the world price, and was more stable
• But when world price spiked, then US price was
  – just equal to the world price,
  – not above as it would have been with a tariff

http://public.wsu.edu/~hallagan/EconS327/weeks/week5/Sugar/Sugarquota301.html
Effects of a Quota: Small Country

Suppose quota limits imports to this amount.
Effects of a Quota: Small Country

Suppose quota limits imports to this amount, which is less than initial imports.
Effects of a Quota: Small Country

Then price must rise until D-S=Quota.
Effects of a Quota: Small Country

Thus price is…

“Tariff Equivalent”
Effects of a Quota: Small Country

...and quantities are

Tariff Equivalent

Quota

Lecture 6: NTBs
Effects of a Quota: Small Country

Effects on Welfare
Same as tariff, except c

Tariff Equivalent

P
P_a
P_Q
P_W

D

Effects on Welfare
Same as tariff, except c

Quota

Q_S^0
Q_S^1
Q_D^1
Q_D^0

Lecture 6: NTBs
Effects of a Quota: Small Country

• Results
  – Suppliers gain area +a
  – Demanders lose area \(-(a+b+c+d)\)
  – Somebody gets area c, but who?

• Area c is called “quota rents”
  – It is the profit from buying at world price, \(P_W\), and selling at higher domestic price, \(P_Q\)
Effects of a Quota: Small Country

• Who gets quota rents?
• Depends on how quota is administered:
  – First-come, first-served: Rents go to whoever gets there before quota is exhausted
  – Sell (or “auction”) import licenses: Rents go to government as revenue from sale of licenses
  – Give away import licenses to domestic people or firms: those people or firms then get the rents
  – Give away licenses to foreign firms or governments: foreigners get the rents
• Most common is the last: Give away to foreigners in proportion to their historical exports
Effects of a Quota: Rent Seeking

• “Rent Seeking”
  – Defined as the use of resources in effort to get rents
  – Examples
    • Faster (thus more costly) transport to win race to border for 1\textsuperscript{st}-come-1\textsuperscript{st}-served quota
    • Lobbying legislators to get quota allocations
    • Inefficient production intended to get quota allocations based on market shares
Effects of a Quota

• Effects of quota compared to tariff
  – Effects on price and quantity at a given time are the same
    • hence “tariff equivalent”
  – Effect on welfare is different if quota rents are lost to rent seeking and/or accrue to foreigners:
    • In that case, importing country loses more from quota than from equivalent tariff

• What if country is large?
  – Picture is also same as for tariff
  – But if quota rent is lost or goes to foreigners, importing country cannot gain
Effects of Quota: Large Country
(if Rent given to foreigners)

Summary:

Domestic Country:
- Suppliers gain $+a'$
- Demanders lose $-(a'+b'+c'+d')$
- Net effect on country = $-(b'+c'+d')$

Foreign Country:
- License holders gain $+(c'+e')$
- (Supplier/Demanders also lose)

Lecture 6: NTBs
Effects of a Quota

• Other effects of a quota
  – Quality upgrading
    • Limited to a fixed quantity, foreign exporters seek higher value by improving quality
  – Like a tariff, quota may induce foreign firms to produce here
  – Unlike a tariff, the quota becomes more restrictive if foreign supply increases or world price drops
Effects of a Fall in World Price

With Tariff, Domestic Price Would Fall to $P_T'$

Tariff Equivalent Grows

Quota

Lecture 6: NTBs
Effects of a Fall in World Price

• Many things do **not** change:
  – Domestic price
  – Domestic quantity supplied
  – Domestic quantity demanded
  – Quantity of imports (fixed by quota)

• What **does** change?
  – Tariff equivalent increases
  – Rents from quota increase
Effects of a Rise in World Price

• If the rise is small, this is just the reverse of what happened with a fall in world price
• But if the rise in world price is large enough, then
  – The quota ceases to be binding
  – Tariff equivalent of quota becomes, and stays, zero
  – Domestic price becomes
    • Equal to world price, and
    • Rises with it
• This last is what we saw in the graph of the price of sugar
Effects of a Rise in World Price

\[ P_Q' = P_W' \]

Quota
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Other NTBs: Tariff-Rate Quota (TRQ)

• This is **two** tariffs, separated by a quota
  – Low (or zero) tariff applies to imports below the quota
  – High tariff applies to imports above the quota

• Used by US on many agricultural products

• Effect is like
  – a low tariff,
  – a quota,
  – or a high tariff,

depending on levels of supply and demand
Other NTBs: Voluntary Export Restraint (VER)

- Restriction of exports
  - At request of importing country
  - Usually specified as maximum quantity

- This was the major form of protection for the US auto industry in the 1980s: US persuaded Japan to limit exports of cars to US

- Illegal since 1995 under WTO rules
  - But how to enforce
  - Examples in 2012 that look like VERs

- Effect is exactly like a quota allocated to foreigners
Other NTBs: Variable Levies

- A tariff that is changed as necessary to keep domestic price at a specified level
- These are used extensively by the European Union as part of its Common Agricultural Policy (CAP)
- Effects are same as a tariff, except for behavior over time
Other NTBs: Government Procurement Regulations

- Government favors domestic suppliers in buying goods and services
  - Buys only from domestic firms,
  or
  - Buys from domestic firms unless imports are, say, 10% cheaper

- US used to have a “Buy American” law
  - Some say we need it again, but would violate WTO

- Effect is like a tariff, except that loss to demander is now loss to government and thus taxpayer
Other NTBs: Government Procurement Regulations

• “Buy American” was part of the Stimulus Package of the US in 2009
  – Congress would have imposed broad restrictions
  – Obama got them to restrict only when not contrary to US commitments under trade agreements
  – Even so, result was broadly restrictive, because purchasers were not sure of rules, so avoided imports
  – Result was also that other countries included similar provisions in their stimulus packages
  – See reading by Hufbauer and Schott.

• “Buy American” was said in President Trump’s Inauguration Speech, Jan 20
Other NTBs: Customs Procedures

• All countries have customs procedures for maintaining border security and collecting tariffs

• They become NTBs when
  – Excessive difficulty, or red tape, limits imports
  – Rules impose artificially high valuation for *ad valorem* tariffs
Other NTBs: Standards

• All countries also have standards, for
  – Health and safety (e.g., no lead paint)
  – Compatibility (e.g., 110 volt appliances)

• They become NTBs when biased against imports in
  – Substance of the requirement
  – Procedures for certifying compliance
Other NTBs: Unfair Trade Laws

- The (legal) threat and use of
  - Anti-Dumping Duties
  - Countervailing Duties

- We’ll say more about this later, in lecture about U.S. Trade Policies

- These are NTBs if
  - “Unfair trade” is actually normal trade (it usually is)
  - The threat of action discourages trade, even when duties are not levied (the “chilling effect”)

Lecture 6: NTBs
Other NTBs: Unfair Trade Laws

• Use of these laws is increasing rapidly by other countries. See Lindsey and Ikenson
  – In 1990s, antidumping use increased 50% over the ‘80s.
  – Developing country AD cases:
    • 7 in 1980-87
    • Over 700 in 1995-2000
    • US (323), EU (143) (out of 976 total)
  – Targets of AD cases (1995-2000, per year):
    • Leading: China (179), Japan (78), US (65)
    • Developed countries 355; Developing countries 656
Other NTBs: Unfair Trade Laws

- Somewhat more recently:
- Newly Initiated Antidumping Investigations, 1Q 2007–3Q 2009

*Source: Global Antidumping Database.*
Other NTBs: Export Taxes

• Simply a tax on exports, analogous to tariff on imports
  – Effects are similar
  – Not common, until recently, because countries think exports are good
  – Became common in mid-2008, as high world prices for agriculture led food exporters to protect their own consumers
  – Also used recently by China on certain minerals used in high-tech devices
Other NTBs:
Effects of Export Tax – Small Country

\[ P \]
\[ P_w \]
\[ P_w-t \]

\( Q \)
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Subsidies

• Government assistance to producers
  – Export subsidy: paid only for exports
  – Domestic subsidy: paid for all production (but still increases exports or reduces imports)

• Effect on the subsidizing country
  – In competitive industries, country loses
  – Subsidies usually are intended to benefit producers, not country
  – In non-competitive industries, result may be different (recall Boeing-Airbus example)
Effects of a Subsidy on Foreign Countries

- Effect, if country is large, is to reduce the world price of the exported good.
- Subsidy expands supply in subsidizing country (which is part of $S_W^0$).

![World Market Diagram]

- $P_W^0$ to $P_W^1$ indicates the decrease in world price due to subsidy.
- $Q_W$ and $D_W$ represent quantity demanded and supplied in the world market.
- $S_W^0$ and $S_W^1$ show the expanded supply due to subsidy.
Effects of a Subsidy on Foreign Countries

- Effects on other countries depend on the direction of their trade:
  - If they import the good, they gain
  - If they export the good, they lose

See this in the following figures...
Effects of Export Subsidy:
on Foreign Importer

- Suppliers lose
- Demanders gain
- Country gains

\[ + (b+c+d) \]
Effects of Export Subsidy:

on Foreign Exporter

- Suppliers lose
- Demanders gain
- Country loses $-c$

Effects on Welfare
Effects of a Subsidy on Foreign Countries

• In both cases
  – Foreign suppliers lose
  – Foreign demanders gain
  – Net effect on countries depends on
    • Whether they are net importers or exporters
    • Thus whether price change is improvement or worsening of their terms of trade

• Optimal policy response for foreign countries
  – Importers: Write “thank-you note” (Krugman)
  – Exporters: Not much they can do
Subsidies: Are They Used?

• YES!!
• US, EU, Japan all have large subsidies on many agricultural products
• These reduce world prices and hurt producers of these products in developing countries
• Examples of US subsidies and whom they hurt:
  – Corn: Mexico
  – Sugar: Caribbean countries
  – Cotton: Certain African countries
Next Time

• Reasons for Protection

    If tariffs are such a bad idea, why are they used?