Topic 4. International trade policy.

1. The concept of a free trade. Modern protectionism.
2. Tariff methods of international trade regulation. A small-nation model. The impact of import tariff on the prosperity of a big country: a big-nation model. Export duty.
3. Advantages and disadvantages of tariffs.
4. Nontariff limits of international trade:
4.1 Quota system and licensing in international trade. Tariff-rate quota. Export quota effects.
4.2 Domestic content requirements.
4.3 Domestic subsidy. Export subsidy. Forms of dumping. International price discrimination.
4.4 Government procurement policies. Sea transport and freight restrictions

Key Concepts and Terms

Tariff, terms of trade effects, net welfare loss, domestic-allocated quota, foreign-allocated quota, autarky, basis for trade, commodity terms of trade, community indifference curve, complete specialization, constant opportunity costs, increasing opportunity costs, consumption gains, dynamic gains from international trade, exit barriers, free trade, gains from international trade, no-trade boundary, partial specialization, trading possibilities line, domestic revenue effect, effective tariff rate, foreign-trade zone (FTZ), free-trade argument, free-trade-biased sector, infant-industry argument, large nation, small nation, level playing field, nominal tariff rate, offshore-assembly provision (OAP), optimum tariff, protective effect, redistributive effect, revenue effect, terms-of-trade effect, efficiency loss of a tariff.

?Study questions?

1. For a given T, what would be the impact of an increase in supply (a shift of the supply curve to the right) on government revenue? What would be the impact of an increase in demand (a shift of the demand curve to the right)?
2. Suppose the government reduced the quota to below J quota Z. What would happen to the quota premium? Can you say with certainty what would happen to the total quota rent? What would this depend on?
3. Trade protection is often used to maintain employment in a sector. Given our analysis, what do you think of this approach to maintaining employment? Can you think of any other measures that might also maintain employment in a sector?
4. Explain how tariffs and quotas are (a) similar and (b) different.
5. Explain why oil-producing nations often tax oil exports.
6. Use the endogenous tariff model to explain why there will always be some positive level of protection even though free trade is the income-maximizing policy.
7. Identify the basic questions with which modern trade theory is concerned.
8. Describe a specific tariff, an ad valorem tariff, and a compound tariff. What are the

advantages and disadvantages of each?
9. What are the methods that customs appraisers use to determine the values of commodity imports?
10. Under what conditions does a nominal tariff applied to an import product overstate or understate the actual, or effective, protection afforded by the nominal tariff?
11. Less-developed nations sometimes argue that the industrialized nations' tariff structures discourage the less-developed nations from undergoing industrialization. Explain.
12. Distinguish between consumer surplus and producer surplus. How do these concepts relate to a country's economic welfare?
13. When a nation imposes a tariff on the importation of a commodity, economic inefficiencies develop that detract from the national welfare. Explain.
14. What factors influence the size of the revenue, protective, consumption, and redistributive effects of a tariff?
15. A nation that imposes tariffs on imported goods may find its welfare improving should the tariff result in a favourable shift in the terms of trade. Explain.
16. Which of the arguments for tariffs do you feel are most relevant in today's world?
17. Although tariffs may improve the welfare of a single nation, the world's welfare may decline. Under what conditions would this be true?
18. What impact does the imposition of a tariff normally have on a nation's terms of trade and volume of trade?
12. Would a tariff imposed on U.S. oil imports promote energy development and conservation for the United States?
13. What is meant by the terms bonded warehouse and foreign-trade zone? How does each of these help importers mitigate the effects of domestic import duties?
14. In the past two decades, nontariff trade barriers have gained in importance as protectionist devices. What are the major nontariff trade barriers?
15. How does the revenue effect of an import quota differ from that of a tariff?
16. What are the major forms of subsidies that governments grant to domestic producers?
17. What is meant by voluntary export restraints, and how do they differ from other protective barriers?
18. Which is a more restrictive trade barrier-an import tariff or an equivalent import quota?
19. Differentiate among sporadic, persistent, and predatory dumping.
20. A subsidy may provide import-competing producers the same degree of protection as tariffs or quotas but at a lower cost in terms of national welfare. Explain.

?Multiple-Choice Questions?

1. A tariff is defined as:
a. a fee for performing a service;
b. a tax on exports;
c. a tax on any type of economic activity;

d. all of the above;
e. none of the above.
2. Ad valorem tariffs are preferable to specific tariffs because:
a. ad valorem tariffs raise more revenue;
b. ad valorem tariffs can be more easily changed as trade flows change;
c. ad valorem tariffs reward low-cost foreign suppliers by in effect charging a lower absolute tax on their products than is charged on more expensive products in the same category;
d. specific tariffs become more restrictive when inflation occurs.
3. An ad valorem tariff of 30 percent on a widget that costs $300 is equivalent to a specific tariff on widgets of:
a. $30;
b. $300;
c. $60;
d. $90;
e. none of the above.
4. A specific tariff would be preferred over an ad valorem tariff by:
a. a high price foreign supplier;
b. a low cost foreign supplier;
c. a government in a high inflation world;
d. import-competing firms whose foreign competitors produce higher-priced, better-quality products.
5. According to the two-country partial equilibrium model of trade, the imposition of a tariff on imports by the importing country:
a. definitely raises net welfare in the importing country;
b. definitely raises net welfare in the exporting country;
c. definitely reduces net welfare in the world as a whole;
d. definitely reduces net welfare in the importing country but raises net welfare in the exporting country.
6. The two-country model of a tariff shows that a tariff causes:
a. a transfer of welfare from domestic producers to domestic consumers in the importing country;
b. a transfer of welfare from consumers to producers in the exporting country;
c. a transfer of consumer surplus in the importing country to the government in the form of tariff revenue;
d. all of the above;
e. none of the above.
7. Who effectively pays at least part of a tariff:
a. domestic producers;
b. foreign producers;
c. domestic consumers;
d. none of the above;
e. b and c only.
8. The Lerner symmetry theorem says that:
a. any restraint on imports also effectively acts as a stimulus for exports;

b. any promotion of exports will cause a decrease in imports as well;
c. any restraint on imports also causes exports to decrease;
d. none of the above;
e. both a and b above.
9. An effective tariff is:
a. always larger than the ad valorem tariff officially charged by the government on the good in question;
b. the percentage that a tariff raises the price of a good relative to the value added of the industry that produced the good on which the tariff is levied;
c. always less than the rate actually levied on the good in question;
d. the portion of the tariff effectively paid by foreigners.
10. The two-country partial equilibrium model shows that, in the importing country, the elimination of an import quota:
a. reduces producer surplus;
b. reduces consumer surplus;
c. reduces government revenue;
d. all of the above;
e. none of the above.
11. The difference between a tariff and an "equivalent" VER is that the equivalent VER:
a. results in a higher domestic price;
b. generates rent instead of government revenue;
c. is an export tax;
d. causes larger deadweight losses.
12. An import quota is most similar to:
a. a VER;
b. a tariff;
c. an import tax;
d. an export tax.
13. Economists often favour tariffs over quotas as the lesser of two evils because:
a. quotas can never be "equivalent" to tariffs;
b. quotas tend to become less restrictive of trade than tariffs as demand grows;
c. quotas are less efficient in allocating restricted trade among those who stand to gain the most from trade;
d. quotas provide government revenue while tariffs do not.
14. Antidumping duties:
a. were permitted by the GATT after 1947, but they were banned by the WTO in1994;
b. were sanctioned by the GATT and continue to be allowed by the WTO;
c. have never been used as other trade barriers have been erected in their place;
d. are nearly impossible to apply given the current GATT/WTO rules.
15. Under WTO regulations, dumping is defined as:
a. selling a product overseas at a price higher than that product sells for in the home market;
b. selling a product below cost;
c. selling a product below the price of competing products in the foreign market;

d. all of the above;
e. none of the above.
16. The political economy model that states that the policy favoured by slightly more than half the voters will be the one enacted regardless of the intensity of each voter's preferences is known as the:
a. majority model;
b. uninformed voter model;
c. endogenous tariff model;
d. median voter model.
17. The political economy model that shows trade policies reflect the number of people that are directly affected by the policy is known as the:
a. adding machine model;
b. median voter model;
c. uninformed voter model;
d. endogenous tariff model.
18. The political economy model suggesting that there can be a positive level of protectionism even when trade restrictions always cause more harm than good is known as the:
a. adding machine model;
b. median voter model;
c. uninformed voter model;
d. endogenous tariff model.
19. The United States government has protected the U.S. sugar industry:
a. only in the last ten years;
b. nearly every year since independence in 1776;
c. during periods of wartime only;
d. since the Great Depression.
20. Rent seeking activities:
a. are only carried out by producers that face import competition;
b. can greatly increase the welfare losses associated with trade policies;
c. are unlikely to have any effect on the costs of protection;
d. are not wasteful because they merely bring about a redistribution of existing output.

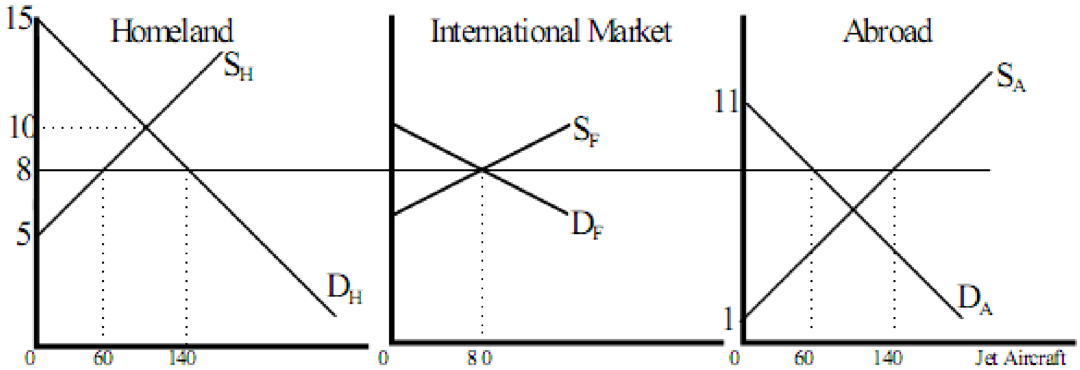
?True-false questions?

1. A quota restricts the imports of a product to a certain quantitative level.
2. Between 10 and 20% of the tariffs lines of the EU, Japan, and the U.S. are affected by nontariff barriers to trade.
3. Tariffs over the last two decades have increased as foreign competition has increased.
4. While tariffs have been falling over the past several decades, nontariff barriers have increased.
5. The U.S. currently has no quotas on imported products.
6. Quotas are not a legal method of restricting imports under GATT and the WTO.
7. The net loss to a country as a result of a quota is smaller than the net loss of an equivalent tariff.

8. A quota or a VER is usually applied so that a specific number of units can be imported without regard to the price of the product.
9. A country that is a member of the WTO by definition does not use quotas as a form of protection.
10. Some countries, such as the U.S., maintain quotas in defiance of WTO rules.
11. The Multifibre Arrangement (MFA) is a fair system and minimizes welfare losses by allocating quotas based on traditional market shares.
12. The EU and the U.S. severely limit the exports of apparel from developed countries through the use of quotas.
13. The practical difference between a quota and a VER is the name.
14. Tariffs and quotas are essentially identical in their effects.
15. Quotas redistribute income from consumers to domestic producers.
16. When a country voluntary agrees to limit its exports to another country, it is called a voluntary export restraint.
17. Quotas redistribute consumer surplus to domestic and foreign firms.
18. Like tariffs, quotas tend to increase the government's tax revenue.
19. A quota is a form of commercial policy.
20. Quotas tend to increase producers surplus.

Exercises

1. The following diagram illustrates the world market for jet aircraft, which consists of the Homeland and Abroad markets (the prices are in millions of dollars). In the case of free trade, Homeland imports 80 jets from Abroad, and the world price settles at $8 million per airplane. Suppose that Homeland producers of aircraft lobby their government and convince it to impose an import tariff of $2 million per aircraft. Use the two-country partial equilibrium model shown below to illustrate exactly what are the consequences of such a tariff on imported jet aircraft.



The Welfare Effects of a Tariff

2. In each of the following cases, calculate the effective rate of protection of the final product, assuming that markets are competitive and all other things remain the same:
a. A tariff on intermediate inputs raises the price of intermediate inputs by 10 percent in a market where, prior to the tariff, intermediate inputs accounted for 50 percent of the total cost of the final product.

b. A quota on intermediate inputs raises the price of intermediate inputs by 50 percent in a market where, prior to the quota, intermediate inputs accounted for 20 percent of the total cost of the final product.

3. Explain why a shift to free trade necessarily implies “injury” to some industries.

4. The effects of trade sanctions often seem to fall on countries that are not the targets of the sanctions. Explain how this can happen.

5. List and explain the fundamental principles of the GATT. Has the GATT been successful in satisfying its stated principles?

6. Explain the gradual progression of import controls on clothing and textiles from the initial VER with Japan to the elaborate Multi-Fiber Arrangement. Why do you think the protection grew in steps?

7. Using the political economy models, explain why the United States adopted mostly protectionist policies during the 1800s.

8. Explain the U.S. procedure for handling dumping petitions. Are these procedures sufficient to prevent biased rulings? Discuss.

9. Explain the legal difference between dumping in international markets and predatory dumping in the domestic U.S. market. Why are they interpreted differently?

10. Suppose that the production of $1 million worth of steel in Canada requires $100,000 worth of taconite. Canada's nominal tariff rates for importing these goods are 20 percent for steel and 10 percent for taconite. Given this information, calculate the effective rate of protection for Canada's steel industry.