IOSR Journal of Business and Management (IOSR-JBM)
e-ISSN: 2278-487X, p-ISSN: 2319-7668. Volume 20, Issue 4. Ver. I (April. 2018), PP 76-81
www.iosrjournals.org

An Appraisal of the Instruments of Trade Policy

Dr. Satyajeet S Deshpande
Associate Professor, Department Of Economics, New L J Commerce College, Ahmedabad, India

Abstract: *The current paper reviews various instruments of trade policy available at the disposal of the government to influence imports and exports. In the context of growing inclination of many countries towards adopting protectionist policies, the paper describes various methods adopted by modern countries to discourage imports. The paper has been divided into three parts. The first section introduces the need and importance of the topic. The second section illustrates various tariff and non-tariff instruments of trade policy which can be adopted to discourage imports. The last section concludes the paper with a word of caution while using protectionist policies.*

Keywords: *Trade policies, Tariff Measures, Non- Tariff Measures*

Date of Submission: 23-03-2018 Date of acceptance: 07-04-2018

I. Introduction:

Unemployment has been one of the biggest economic problems faced by the nations around the world. The political leadership in every country is getting severely criticized for not being able to create jobs.

As a result, many of the countries have started firmly believing that allowing low cost imports under the free trade policy has been one of the reasons for unemployment and under-development. This belief has encouraged countries to adopt protectionist policies. With WTO agreements in place, countries are searching for new methods and instruments for protecting the domestic industries. In this context, the paper explores various instruments of trade policy which are available to the countries for protecting their domestic industries, although most of them are prohibited by WTO or are to be used under prescribed conditions only.

Instruments Of Trade Policy:

Trade policy is defined as all measures taken by the government to influence the imports and exports of the country.

1. Tariffs:

Tariffs, also known as customs duties, are basically taxes or duties imposed on goods and services which are imported or exported. Import duties being pervasive than export duties, tariffs are often identified with import duties. The main goals of tariffs are to raise revenue for the government and more importantly to protect the domestic import competing industries.

Forms of Imports Tariffs:

1.1 **Specific tariff:** A specific tariff is an import duty that assigns a fixed monetary tax for physical unit of goods imported. It is calculated on the basis of a unit of measure such as weight, volume etc. of the imported good. A specific tariff of Rs.1000 may be charged on each imported bicycle. The disadvantage of specific tariff as an instrument for protection of domestic producers is that its protective value varies inversely with the price of the import.

1.2. **Ad valorem tariff:** Ad valorem tariff is levied as a constant percentage of the monetary value of 1 unit of imported good. A 20% ad valorem tariff on any bicycle generates a Rs. 1000 payment on each imported bicycle priced at Rs. 5000 in the world market; and if the price rises to Rs. 10000 it generates a payment of Rs. 2000. While ad valorem tariff preserves the protective value of tariff for home producer, it gives incentive to deliberately undervalue the good's price on invoices and bills leading to reduction in the tax burden. Nevertheless ad valorem tariff are widely used the world over.

1.3. **Mixed tariffs**: Mixed tariffs are expressed either on the basis of the value of the imported goods (an ad valorem rate) or on the basis of a unit of measure of the imported goods (a specific duty) depending on which generates the most income (or least income at times) for the nation. For example duty on iron is 5% ad-valorem or rupees 10,000 per tonne whichever is higher.

1.4. **Compound Tariff:** Compound tariff or a compound duty is a combination of an ad-valorem and a specific tariff. That is the tariff is calculated on the basis of both the value of imported goods (an ad valorem duty) and the unit of measure of the imported goods (a specific duty). It is generally calculated by adding up a specific duty to an ad- valorem duty. For example duty on aluminum at 5% ad-valorem plus Rs. 100 per kilogram

1.5. **Technical Tariff:** These are calculated on the basis of the specific contents of the imported goods that is the duties are payable by its components. For example Rs.3000 for each solar panel plus Rs.50 per kg on the battery of each solar inverter

1.6. **Tariff Rate Quotas:** Tariff rate quotas combine two policy instruments: quotas and tariffs. Imports entering under the specific quota are usually subject to a lower, sometimes zero tariff rate. Imports above the quantitative threshold of the quota face a much higher tariff.

1.7. **Most Favoured Nation (MFN) Tariff:** MFN tariffs are what countries promise to impose on imports from other members of the WTO unless the country is part of a preferential trade agreement (such as a free trade area or customs Union). This means that in practice MFN rates are the highest (most restrictive) that WTO members charge from one another. Some countries impose higher tariffs on countries that are not part of the WTO.

1.8. **Variable Tariff:** A duty typically fixed to bring the price of an imported commodity up to the domestic support price for the commodity.

1.9. **Preferential Tariff**: Nearly all countries are part of at least one preferential trade agreement under which they promised to give another country's products lower tariffs than their MFN rate. This agreement is reciprocal. A lower tariff is charged from goods imported from a country which is given preferential treatment. Examples are preferential duties in the EU region under which a good coming into one EU country from another is charged zero tariffs. Another example is North American Free Trade agreement (NAFTA) among Canada, Mexico and the USA where the preferential tariff rate is zero on essentially all products. Countries especially the affluent ones also grant 'unilateral preferential treatment' to the select list of products from specified developing countries. The Generalized System of Preferences (GSP) is one such system which is currently prevailing.

1.10. **Bound Tariff:** A bound tariff is a tariff which a WTO member binds itself with a legal commitment not to raise it above a certain level. By binding a tariff often during negotiations the members agree to limit the right to set tariff level beyond a certain level. The bound rates are specific to individual products and represent a maximum level of import duty that can be levied on a product imported by the member. A member is always free to impose a tariff that is lower than a bound level. Once bound, a tariff rate becomes permanent and a member can only increase its level after negotiating with its trading partners and compensating them for possible losses of trade.

1.11. **Applied Tariffs:** An applied tariff is the duty that is actually charged on imports from Most Favoured Nation (MFN) basis. A WTO member can have an applied tariff for a product that differs from the bound tariff for that product as long as the applied level is not higher than the bound level.

1.12. **Escalated Tariff:** Escalated tariff structure refers to the system wherein the nominal tariff rates on imports of manufactured goods are higher than the nominal tariff rates on intermediate inputs and raw materials that is the tariff on a product increases as that product moves through the value added chain. For example a 4% tariff on raw-iron or iron slab and 12% tariff on steel pipes. This type of tariff is discriminatory as it protects manufacturing industries in importing countries and dampens the attempts of developing manufacturing industries of exporting countries. This has special relevance to trade between developed countries and developing countries. Developing countries are thus forced to continue to be suppliers of raw materials without much value addition.

1.13. **Prohibitive Tariff:** a prohibitive tariff is one that is set so high that no imports will enter.

1.14. **Tariffs as Response to Trade Distortions:** Sometimes countries engage in unfair foreign trade practices which are trade distorting in nature and adverse to the interest of the domestic firms. The affected importing countries upon confirmation of the distortion respond quickly by measures in the form of tariff responses so to offset the distortion.

a. Anti Dumping Duties: Dumping occurs when manufacturers sale goods in a foreign country below the sale prices in the domestic market or below their full average cost of the product. Dumping maybe persistent seasonal or cyclical. Dumping may also be resorted to as a predatory pricing practice to drive out established domestic producers from the market and to establish monopoly position. Dumping is international price discrimination favouring buyers of Exports but in fact the Exports deliberately forgo money in order to harm the domestic producers of the importing country. This is unfair and constitutes a threat to domestic producers and therefore when dumping is found, anti dumping measures which are tariffs to offset the effect of dumping may be initiated as a safeguard instrument by imposition of additional import duties so as to offset the foreign firm's unfair price advantage. This is justified only if the domestic industry is seriously injured by import competition and protection is in the national interest (that is the associated costs to consumers would be less than the benefits that would accrue to producers). For example, in January 2017, India imposed anti dumping duties on colour coated or pre-painted flat steel products imported into the country from China and European Nations for a period not exceeding 6 months and for jute and jute products from Bangladesh and Nepal.

b. Countervailing Duties: Countervailing duties are tariffs that aim to offset the artificially low prices charged by exporters who enjoy export subsidies and tax concessions offered by the governments in their home country. If a foreign country does not have a comparative advantage in the particular good and a government subsidy allows the following firm to be an exporter of product then the subsidy generates a distortion from the free trade allocation of resources. In such cases CVD is charged in an importing country to negate the advantage that exporters get from subsidies to ensure fair and market oriented pricing of imported products and thereby protecting domestic industries and firms. For example in 2016, in order to protect it's domestic industry India imposed 12.5% countervailing duty on gold jewellery imports from ASEAN.

Effects of Tariffs

i. Tariff barriers create obstacles to trade, decrease the volume of imports and exports and therefore of international trade. Market access of the exporting country is worsened when an importing country imposes a tariff.
ii. By making imported goods more expensive, tariffs discourage domestic consumers from consuming imported foreign goods. Domestic consumers suffer a loss in consumer surplus because they must now pay a higher price for the good.
iii. Tariffs encourage consumption and production of the domestically produced import substitutes and thus protect domestic industries.
iv. Producers in the importing country experience an increase in well being as a result of imposition of tariff. The price increase of their product in the domestic market increases producer surplus in the industry. They can also charge higher price than would be possible in the case of free trade because foreign competition has reduced.
v. The price increase also induces an increase in the output of the existing firms and possibly addition of new firms due to entry into the industry to take advantage of the new high profits and consequently an increase in employment in the industry.
vi. Tariffs create trade distortions by disregarding comparative advantage and prevent countries from enjoying gains from trade arising from comparative advantage. Tariffs discourage efficient production in the rest of the world and encourage inefficient production in the home country.
vii. Tariffs increase government revenues for the importing country by the value of the total tariff it charges.

II. Non Tariff Measures (Ntms)

The non tariff measures which have come into greater prominence than the conventional tariff barriers constitute the hidden or invisible measures that interfere with free trade.

Non Tariff Measures (NTMs) are policy measures other than honorary customs tariffs that can potentially have an economic effect on international trade in goods changing quantities traded or prices or both(UNCTAD,2010).

Compared to non tariff barriers which are simply discriminatory non tariff measures imposed by governments to favour domestic over foreign suppliers non tariff measures encompass a broader set of measures.

NTM are categorized as:

I. **Technical Measures:** Technical measures refer to product specific properties such as characteristics of the product technical specifications and production processes. These measures are intended for ensuring product quality, food safety, environmental protection, national security and protection of animals and plant health.

II. **Non Technical Measures:** Non technical measures relate to trade requirements; for example shipping requirements, custom formalities, trade rules, taxation policies, etc.

2.1. Technical Measures

I. **Sanitary and phytosanitary (SPS) Measures:** SPS measures are applied to protect human, animal or plant life from risks arising from additives, pests, contaminants, toxins or disease causing organisms and to protect biodiversity. These include ban or prohibition on import of certain goods, all measures governing quality and hygienic requirements, production processes and associated compliance assessments. For example prohibition of import of poultry from countries affected by Avian flu, meat and poultry processing standards to reduce pathogens, residue limits for pesticides in food etc.

II. **Technical Barriers to trade(TBT):** Technical barriers to trade which cover both food and non food traded products refer to mandatory standards and technical regulations that define the specific characteristics that a product should have such as its size, shape, design, labeling, marketing, packaging, functionality or performance and production methods excluding measures covered by the SPS agreement. The specific procedures used to check whether a product is really confirming to these requirements (conformity assessment procedures e.g. testing inspection and certification) are also covered in TBT.

This involves compulsory quality, quantity and price control of goods before shipment from the exporting country. Just as SPS,TBT measures as standards based measures that countries use to protect their consumers and preserve natural resources but these can also be used effectively as obstacles to imports or to discriminate against imports and protect domestic products.

Altering products and production processes to comply with the diverse requirements in export markets may be either impossible for the exporting country or would obviously raise costs hurting the competitiveness of the exporting country. Some examples of TBT are: food laws, quality standards industrial standards, organic-certifications, eco-labeling, marketing and label requirements.

2.2. Non-Technical Measures

These included different types of trade protective measures which are put into operation to neutralize the possible adverse effects of Imports in the market of the importing country. Following are the most commonly practiced measures in respect of Imports:

2.2.1. Imported Quotas: An import quota is a direct restriction which specifies that only a certain physical amount of the good will be allowed into the country during a given time period usually one year. No condition is attached to the country of origin of the product. For example 1000 tons of metal Import of which can take place anytime of the year from any country. When country allocation is specified, a fixed volume or value of the product must originate in one or more countries. Example a quota of 1000 tons of iron that can be imported any time of the year but where 750 tonnes must originate in country A and 250 tons in country B. In addition there are seasonal quotas and temporary quotas.

With a quota, the government, of course, receives no revenue. While tariffs directly interfere with prices that can be charged for an imported good in the domestic market, import quota interferes with the market prices indirectly. Obviously, an import quota at all times, raises the domestic price of the imported good.

The welfare effects of quotas are similar to that of tariffs. If a quota is set below free trade level, the amount of imports will be reduced. A reduction in imports will lower the supply of the good in the domestic market and raise the domestic price. Consumers of the product in the importing country will be worse off because the increase in the domestic price of both imported goods and the domestic substitutes reduces consumers surplus in the market. Producers in the importing country are better off as a result of the quota. The increase in the price of their product increases producer surplus in the industry. The price increase also induces an increase in output of existing firms (and perhaps the addition of new firms), an increase in employment and an increase in profit.

2.2.2. Price Control Measures: Price control measures (including additional taxes and charges) are steps taken to control or influence the prices of imported goods in order to support the domestic price of certain products when the import prices of these goods are lower. These are also known as para-tariff measures and include measures other than tariff measures that increase the cost of imports in a similar manner i.e. by a fixed percentage or buy a fixed amount. Example a minimum import price established for sulphur.

2.2.3. Non Automatic Licensing and Prohibitions: These measures are normally aimed at limiting the quantity of goods that can be imported regardless of whether they originate from different sources or from one particular supplier. Measures may take the form of non automatic licensing or through complete prohibitions. For example, textiles may be allowed only on discretionary licence by importing country. India prohibits import/export of arms and related material from/to Iraq.

2.2.4. Financial Measures: The objective of financial measures is increase import costs by regulating the access to and cost of foreign exchange for imports and to define the terms of payment. It includes measures such as advance payment requirements and foreign exchange controls denying the use of foreign exchange for certain types of imports or for goods imported from certain countries. For example, an importer may be required to pay a certain percentage of the value of goods imported three months before the arrival of goods.

2.2.5. Measures Affecting Competition: These measures are aimed at granting exclusive or special preferences or privileges to one or a few limited group of economic operators. It may include government imposed special import channels or enterprises. When a state agency or a monopoly import agency sells on the domestic market at prices above those on the world market, the effect will be similar to an import tariff.

2.2.6. Government Procurement Policies: Government procurement policies may interfere with trade if they involve mandates that the whole of a specified percentage of government purchase should be from domestic firms rather than foreign firms despite higher prices then similar foreign suppliers. In accepting public tenders, a government may give preference to the local tenders rather than foreign tenders.

2.2.7. Trade Related Investment Measures: These measures include rules on local content requirements that mandate a specified fraction of a final good should be produced domestically.
a. Requirement to use certain minimum levels of locally made components, (25 percent of components of automobiles to be sourced domestically)
b. Restricting the level of imported components and
c. Limiting the purchase or use of imported products to an amount related to the quantity or value of local products that it exports. (A firm may import only up to 75% of its export earnings of the previous year)

2.2.8. Distribution Restriction: Distribution restrictions are limitations imposed on the distribution of goods in the importing country involving additional licence or certification requirements. This may relate to geographical restrictions or restrictions as to the type of agents who may resale. For example a restrictions that imported fruits maybe sold only through outlets having refrigeration facilities

2.2.9. Restriction on Post Sales Services: Producers may be restricted from providing after sales services for exported goods in the importing country. Such services may be reserved to local service companies of the importing country.

2.2.10. Administrative Procedures: Another potential obstruction to free trade is the costly and time consuming administrative procedures which are mandatory for import of foreign goods. This will increase transaction costs and discourage imports. The domestic import competing industries gain by such non-tariff measures. Examples include specifying particular procedures and formalities, requiring licenses, administrative delay, red-tape and corruption in customs clearing frustrating the potential importers, procedural obstacles etc.

2.2.11. Rules of Origin: Rules of origin are the criteria needed by governments of importing countries to determine the national source of product. Their importance is derived from the fact that duties and restrictions in several cases depend upon the source of imports. Important procedural obstacles occur in the home countries for making available certifications regarding origin of goods especially when different components of the product originate in different countries.

2.2.12. Safeguard Measures: Safeguard Measures are initiated by countries to restrict imports of a product temporarily if its domestic industry is injured or threatened with serious injury caused by a surge in imports.

2.2.13. Embargoes: An embargo is a total ban imposed by government on import or exports of some or all commodities to particular country or regions for a specified or indefinite period. This may be done due to political reasons or for other reasons such as health, religious sentiments. This is the most extreme form of trade barrier.

III. Conclusion:

Above-mentioned are some of the instruments of trade policy available to the countries for protecting their domestic industry. Although these measures may protect the domestic businesses, they must be used with caution. The instruments of trade policy, when used, give an impression that they will result in expansion of domestic output, income and employment. However, this is not always true. So while formulating economic policies, the countries should consider the long term effects on all the groups of people (producers, labour as well as consumers) rather than taking into account only the short term effects on a particular group.

References:

[1]. James D. Gaisford, W. A. (William Alexander) Kerr, Handbook on International Trade Policy, **Edward Elgar** 2007
[2]. Elhanan Helpman, Assaf Razin (ed), International Trade and Trade Policy, The MIT Press, 1991
[3]. Robert Baldwin, Trade Policy Issues and Empirical Analysis, NBER, 1988

Dr. Satyajeet S Deshpande"An Appraisal of the Instruments of Trade Policy"IOSR Journal of Business and Management (IOSR-JBM) 20.4 (2018): 76-81.