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1. Learning Outcomes

After studying this module, you shall be able to

- Know the instruments of trade policy used by governments for trade intervention.
- Distinguish between tariff and non-tariff barriers.
- Understand the administrative barriers to trade.
- Understand the role of subsidies in world trade.
- Know about dumping and anti-dumping policies.

2. Free Trade

Free trade is a situation where the government does not stop its citizens to buy goods and services from abroad or sell goods and services in foreign countries. However, free trade is a rare phenomenon. Governments actually try to control what their citizens can buy or sell abroad through interventions in free trade with the instruments of trade policy. The instruments that governments use to intervene in trade policy can broadly be classified under the following two heads:

- Tariff barriers
- Non-tariff barriers

3. Tariff Barriers

Tariff barriers refer to the tax imposed by the government on goods that are imported into the country. Tariffs collected by the exporting country are called export tariffs; if they are collected by a country through which the goods have passed, they are transit tariffs; those collected by importing countries are called import tariffs. Since import tariffs are common of all, we discuss import tariffs in detail.

Tariff barrier increases the price of imported goods in comparison to domestic goods which makes the imported goods costlier giving the domestic goods a relative advantage over foreign goods. Thus, they help the domestic government in reducing imports. In case of India, the cheap imports of refined oil have hit the domestic vegetable oil producing industry hard with capacity utilisation of this sector dropping to 30-40 per cent. To protect the domestic producers, the Indian government levies an import duty of 10 per cent on refined edible oil to protect the domestic processing industry and farmers.

3.1 Types of Tariff

The tariff barriers can further be of three types:

3.1.1 Specific tariffs

Specific tariffs are levied as fixed charge for each unit of good imported. For example, Rs. 10 per unit of good imported.

3.1.2 Advalorem tariffs

Advalorem tariffs are levied as a percentage of the value of goods imported. For example, 10% of the value of goods. If value of goods is Rs. 1000, the ad valorem tariff would be Rs. 100.

3.1.3 Compound tariffs

Compound tariffs are assessed as both a specific tariff and an ad valorem tariff on the same product.

3.2 Rationale for Imposing Tariffs

- Tariffs help in raising revenues for the domestic government especially in case of developing countries.
- They protect domestic producers from foreign competition. This is because it increases the prices of foreign goods by restricting the quantity of imports coming into the country. Suppose the price of sugar in domestic market is Rs 60 per kilogram while the price of imported sugar is Rs 50 per kilogram. In the absence of import tariffs, imported sugar would be cheaper. Consumers would be more inclined to buy the imported sugar. Now let us suppose that the domestic government levy an import tariff of Rs 20 per kilogram, the imported sugar would become costlier as a result of which there would be a demand of domestic sugar.

4. Non-Tariff Barriers

Non-tariff barriers refer to any other government regulation, policy or procedure other than a tariff that has the impact of minimizing imports. Non-tariff barriers can be of two types, one that have direct influence on the price of the goods being imported and the other that influences or control the quantity of the goods being imported.

4.1 Direct Price Influences

4.1.1 Subsidies

Subsidies are the direct payments made by the government to domestic producers. It can take form of cash payments, low interest loans, government participation in ownership, tax incentives, etc.

Subsidies help in lowering down the cost of production of domestic goods as a result of which the prices also come down. It helps domestic producers to capture export markets by making their products cheaper in international markets. It also helps the domestic producers to compete against cheaper imported goods in domestic markets. Another consequence of such subsidies is to create surplus production. That surplus is then sold in international markets, where the extra supply depresses the prices, making it much harder for producers in the developing world to sell their output at a profit.

Agriculture is one of the greatest beneficiaries of subsidies in most countries. Many developed nations like Japan, European Union, United States, Canada and many other countries are giving huge subsidies to their farmers. Outside of agriculture, subsidies are much lower but they are still significant. However the problem with subsidies is that it requires expenditure on part of the domestic government. It is because of this reason that

developing countries find it difficult to grant subsidies to their producers as compared to their foreign counterparts because of lack of resources.

A government might have to choose between imposing a tariff on competing imports or directly subsidise the industry concerned. A tariff would raise the domestic price of imports and the domestic consumers have to pay the higher price. But if a subsidy is used, the domestic price would still be less and the subsidy received by the domestic industry would allow it to compete with foreign goods at competitive prices in global markets. Thus subsidy becomes a better choice when the governments do not want the consumers to pay more but at the same time enables its domestic producers to capture global markets.

Export subsidies, however under the WTO agreement are treated as unfair trade practice. The importing countries counter such subsidies by levying countervailing duties on imported goods so as to offset the impact of these subsidies. This helps in protecting domestic producers from unfair foreign competition.

4.2 Quantity Controls

4.2.1 Quotas

Quota is the most traditional and common method of non-tariff barriers. It refers to the direct restriction on the quantity of goods that can be imported into a country during any period of time. In other words quotas limit the quantity of imports of any particular commodity coming into a country during a certain period of time. The quotas help the government to reduce the consumption of any particular commodity in the country. This is normally done through giving of import licenses to the importers. For example, the United States has a quota on cheese imports; India has a quota on import of gold.

Sometimes, governments may use tariff rate quotas, according to which, a certain quantity of goods enter the country duty-free or at a low rate. However, there is a very high rate of tariff for subsequent imports.

Difference between quotas and tariffs

Quotas increase the prices of goods just as tariffs do. But while tariff is a source of revenue for the government, quotas do not provide any revenue. In fact, quotas generate revenue for those companies which have the licenses to import the limited quantity of goods by increasing the prices in the absence of any competition.

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4.2.2 Voluntary Export Restraints (VERs)

VERs are bilateral agreements instituted to restrain the rapid growth of exports of specific goods. Essentially, the government of country X asks the government of country Y to reduce its companies' exports to country X voluntarily to help the importing country X to protect its domestic industry. One of the most famous examples of VERs is the limitation on auto exports to the United States enforced by Japanese automobile producers in 1981. The effect of VERs is similar to that of quota whereby there is an increase in the price of imported goods for consumers because of limited supply of imported goods. In the above example, the VER increased the price of limited supply of Japanese imports. According to a study by U.S. Federal Trade Commission (FTC), the U.S. consumers had to pay 5 billion dollars extra due to this VER.

4.2.3 Local Content Requirement

A local content requirement is a requirement that some fraction of the product must be produced locally or in the domestic market. The requirement can either be expressed in physical terms (60% of the parts of the product) or in value terms (60% of the value of the product). Thus, it ensures that if any company wants a contract from the government agency, it must ensure that atleast a certain portion of the product must be produced or procured locally.

For example, The Jawaharlal Nehru National Solar Mission (JNNSM) launched by the Indian government in 2010 requires that 75% of the solar equipment for all supported projects must be locally-made. This clause has been incorporated by India to protect the domestic solar industry against imports from China and the US since both these countries offer cheaper loans to Indian projects to buy their equipment. It is important to note that solar manufacturers in China and the US receive substantial state subsidies and loan guarantees from their governments.

4.2.4 "Buy Local" Legislation

Under this form of trade policy the government makes its purchases from domestic producers only. This legislation forbids the government departments to make use of imported goods. However, the government may at times permits the use of imported products only if the price is below than that of the domestic producer. This instrument is widely used by developing countries to develop and broaden their manufacturing base. In case of developed countries this measure aims to protect local jobs and industry from foreign competition. The economic effect of local content requirement and buy local legislation is same as that of quota. It limits foreign competition thereby benefiting the domestic producers. The restrictions on imports raise the price of goods for the consumers.

	Tariff	Export subsidy	Import quota	Voluntary export restraint
Producer profits	Increases	Increases	Increases	Increases
Consumer welfare	Decreases	Decreases	Decreases	Decreases
Government net revenue	Increases	Decreases	No change	No change

Effects of Alternative Trade Policies

5. Other Non-Tariff Barriers

5.1 Labeling and Testing Standards

Some countries require that goods entering into their boundaries must meet certain requirements in terms of packaging, labeling and testing standards. Such countries allow sale of only those goods which satisfy these standards. These standards require that companies must indicate on its products the name of the country where it is made or the packaging of the goods must indicate the raw material used in its production. All these requirements add to the production cost of the company.

Testing standards require the testing of products coming from foreign countries' to be tested in domestic laboratories so as to ensure their quality. Labeling and testing standards are insisted upon for ensuring quality of goods seeking an access to into the domestic markets but many countries use them as protectionist measures. Such measures are complex and discriminatory barriers to international trade. At the same time they are one of the most difficult ones to control as compared to other barriers to trade.

5.2 Sanitary and Phytosanitary Measures

Sanitary and Phytosanitary (SPS) measures are taken to protect against risks linked to food safety, animal health and plant protection or to prevent or limit damage within the territory of a country from the entry, establishment and spread of pests from a foreign country. The SPS Agreement under the WTO seeks to lay down the minimum sanitary and phytosanitary standards that the member countries must achieve for international trade of food products. This is to ensure the safety of life and health of humans, animals and plants. However, countries actually lay down more stringent PSP norms. This at times is done to decrease the imports coming into the country. Developing countries have for long maintained that these standards can be and are being used as trade barriers against them. This practice has an adverse impact on their exports. The most common complaint is that the standards are set very high, and often unreasonably so. It is in fact contended that the standards are strategically kept at high levels so that exports from the developing countries can be banned. For example, Indian meat and poultry products faced such standards imposed by European Union and United States.

5.3 Specific Permission Requirements

This measure requires that potential importers or exporters secure permission from governmental authorities. This involves the issuing of import or export licences which may be costly and time consuming.

5.4 Countertrade

The exchange of goods with goods between countries is referred to as countertrade. This practice is common in case of aerospace and defence industries whereby the importer country may not have enough foreign currency to pay for imports.

5.5. Administrative Barriers to Trade

Administrative barriers to trade are a special category of non tariff barriers and their main sources are administrative regulations and procedures that have a restrictive effect on international trade. These trade barriers can take form of legal barriers or procedural barriers. Legal barriers are caused by different laws and administrative regulation in domestic economies. Procedural barriers are related to trade procedures and they include all activities practices and formalities involved in international movement of goods.

Delays may be made with respect to issue of licences, customs valuation, and clearance of consignment of goods and so on. These types of barriers are most difficult to monitor and eliminate as compared to other tariff and non-tariff barriers.

6. Anti-dumping

Before talking about antidumping one should know what is dumping. Dumping can be defined as selling goods in foreign market at below their fair market value or selling goods in foreign market at below their costs of production. It is a way by which companies unload their excess production in foreign markets. It can also be predatory in nature with producers using substantial profits from the home markets to subsidise prices in foreign markets with a view to drive domestic producers out of that market and later rising prices and earning huge profits.

If the export price is lower than the normal value, it constitutes dumping. Thus, there are two fundamental parameters used for determination of dumping, namely, the normal value and the export price.

Normal value: Normal value is the price at which the goods under complaint are sold, in the ordinary course of trade, in the domestic market of the exporting country.

Export price: The Export price of the goods allegedly dumped into India means the price at which it is exported to India.

Dumping Margin: The margin of dumping is the difference between the Normal value and the export price of the goods under complaint. It is generally expressed as a percentage of the export price.

Example: Normal value US$ 110 per kg.
Export price US$ 100 per kg.

There is dumping in this case as export price is lower than normal value and dumping margin in this case is US$ 10 per kg., i.e. 10% of the export price.

Dumping is an unfair trade practice (when it causes injury to the domestic industry of any country) and the antidumping policies are formulated to protect domestic producers from unfair foreign competition. Anti dumping is a measure to rectify the situation arising out of the dumping of goods and its trade distortive effect. Thus, the purpose of anti dumping duty is to rectify the trade distortive effect of dumping and re-establish fair trade. It provides relief to the domestic industry against the injury caused by dumping.

As per WTO rules, member nations are allowed to impose anti dumping duties on foreign goods being sold cheaper in foreign markets than the home market. Anti dumping duty does not normally exceed the margin of dumping which is the difference between sale price in domestic country and export price (the price at which the goods are being exported into the foreign country). The Indian law also provides that the anti dumping duty to be recommended/levied shall not exceed the dumping margin.

However in the following two situations any exporter or country is to be excluded from the scope of Anti Dumping investigation/duties:

- Individual exporter: Any exporter whose margin of dumping is less than 2 per cent of the export price shall be excluded from the purview of anti-dumping duties even if the existence of dumping is established.
- Country: Further, investigation against any country is required to be terminated if the volume of the dumped imports, actual or potential, from a particular country accounts for less than 3 per cent of the total imports of the like product. However, in such a case, the cumulative imports of the like product from all these countries who individually account for less than 3 per cent should not exceed 7 per cent of the import of the like product.

All the anti-dumping investigations and recommendations in India are carried by designated authority, Ministry of Commerce, whereas the imposition and collection of the duties is done by Ministry of Finance.

6. Summary

- Free trade is a rare phenomenon.
- Government makes use of various instruments to interfere in international trade.
- These instruments are broadly of two types, tariff and non-tariff barriers.
- Tariff barrier refers to the tax imposed by the governments on goods that are imported into the country.
- Non-tariff barriers can have direct influence on the price and the quantity of the goods being imported. Some of the non-tariff barriers are:
  - Subsidies
  - Quotas
  - Voluntary Export Restraints
  - Local Content Requirement
  - "Buy Local" Legislation
- Dumping can be defined as selling goods in foreign market at below their fair market value or selling goods in foreign market at below their costs of production.
- Anti dumping is a measure to rectify the situation arising out of the dumping of goods and its trade distortive effect.

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