Week 4: Nontariff Barriers to Imports (Ch.9)

Key points

1. Import quota: Quota versus Tariff for a small country
2. Ways to allocate import licenses
3. Voluntary import restraints
4. Other nontariff barriers

- Product standards
- Domestic content requirements

1. Types of nontariff barriers to imports

- A nontariff barrier (NTB) to imports is any policy used by the government to reduce imports, other than a simple tariff on imports.

- A NTB can reduce imports through:
  - Limiting the quantity of imports
  - Increasing the cost of getting imports into the market
  - Creating uncertainty about the conditions under which imports will be permitted.

Figure 9.1 Major Types of NTBs

Type	Description	Direct Effect(s)
Import quota	Quantitative limit on imports	Quantity
Voluntary export restraint (VER)	Quantitative limit on foreign exports (based on threat of import restriction)	Quantity
Tariff-quota	Allows imports to enter the country at a low or zero tariff up to a specified quantity; imposes a higher tariff on imports above this quantity	Quantity (if the tariff for potential imports above the specified quantity is so high that it is prohibitive, so that there are no imports above the specified quantity)
Government procurement	Laws and government rules that favor local products when the government is the buyer	Quantity (for instance, an outright prohibition) Cost of importing (for instance, special procedures for imports)
Local content and mixing requirements	Require specified use of local labor, materials, or other products	Quantity
Technical and product standards	Discriminate against imports by writing or enforcing standards in a way that adversely affects imports more than domestic products	Cost (to conform to standards or demonstrate compliance) Uncertainty (if approval procedures are unclear)
Advance deposit	Requires some of the value of intended imports to be deposited with the government, and allows the government to pay low or zero interest on these deposits	Cost (forgone interest)
Import licensing	Requires importers to apply for and receive approval for intended imports	Cost (of application procedure) Uncertainty (if basis for approval is unclear)
Other customs procedures (classification of product, valuation of product, procedures for clearing)	Affect the amount of tariff duties owed or the quota limit applied; procedures can be slow or costly	Cost Uncertainty

2. Import quota

- **Import quota** is a limit on the total quantity of imports of a product allowed into a country during a period of time.

- Government officials may favour a quota because:

  - A quota ensures that the quantity of imports is strictly limited

  - A quota gives government officials greater power

2. Import Quota: Quota v Tariff for a small country

- Consider a small country facing a given world price of $300 per bicycle (see Figure 9.2)
  - A country is small if its imports does not influence the world price of the product
- At $ 300, the country would import 1 million bicycles per year
- Suppose now that the government imposes a quota of 0.6 million

2. Import Quota: Quota v Tariff for a small country

- The quota alters the available supply of bicycles

- At the domestic price of $ 300 there would be excess demand for bicycles, pushing the price up

- The new equilibrium is at P=330, the intersection of domestic demand (D_d) and total available supply ($S_d + Q_Q$)

2. Import Quota: Quota v Tariff for a small country

- At the domestic price of $330
  - Domestic quantity supplied = 0.8 million
  - Imports (the quota)= 0.6 million
  - Domestic quantity demanded = 1.4 million
- In comparison to free trade:
  - The quota increases P and Q, so domestic producers gain area *a*.
  - With higher P and lower consumption, domestic consumers lose area *a+b+c+d*.
  - Area *b+d* is a loss to the country (DWL)

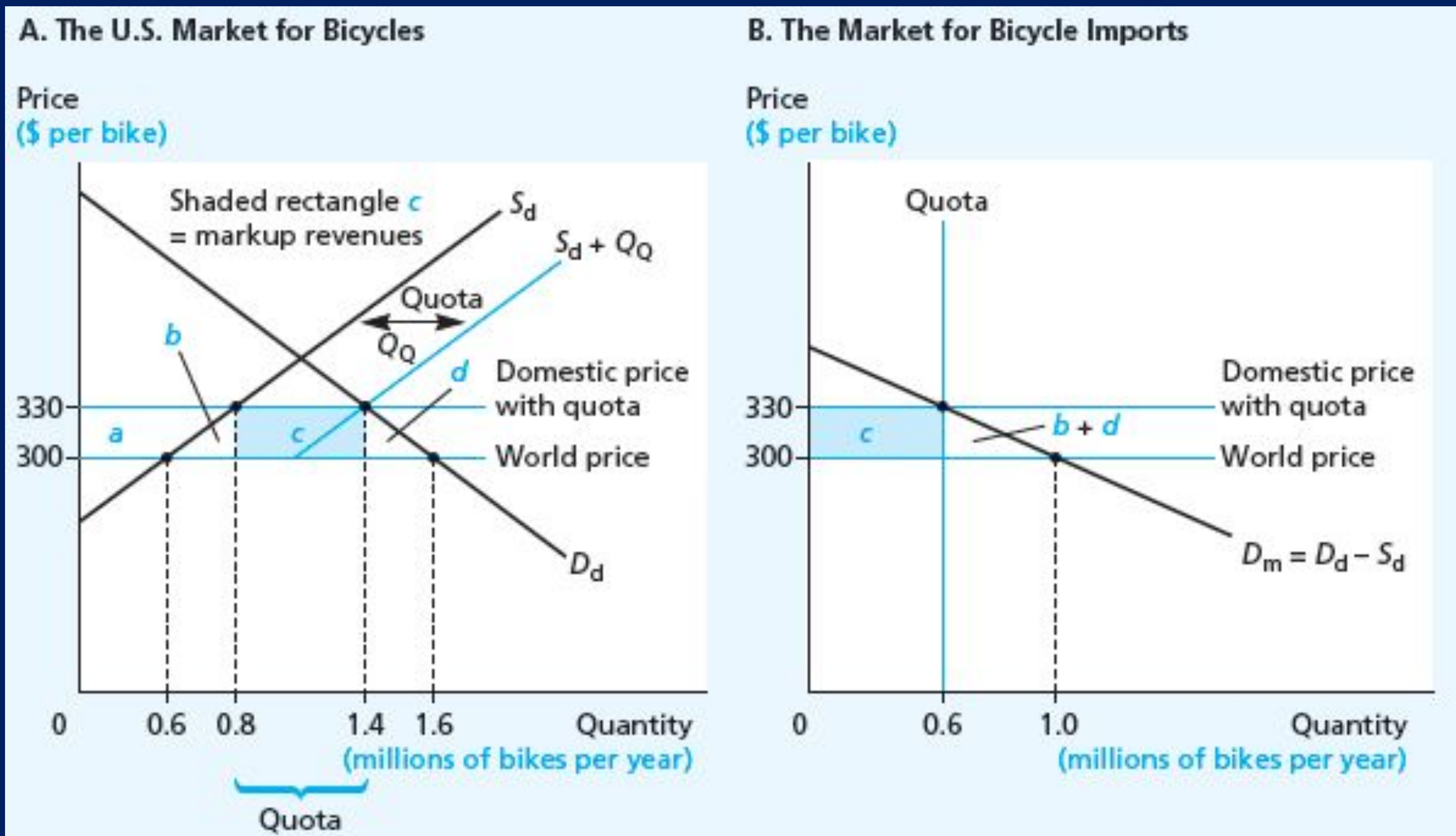
Import Quota: Quota v Tariff for a small country

- These effects are the same as the effects of a 10 per cent tariff , with one possible exception

- With a tariff, area c is government revenue.

- With a quota, who gets it? It depends on the way import licenses are allocated

9.2 The Effects of an Import Quota Under Competitive Con



3. Ways to Allocate import licenses

- **Fixed Favouritism**: the government assigns the licenses to firms without competition, applications or negotiations

- In this case, license holders will get area c.
  - Each importer buys from foreign exporters at world price, and resells at higher domestic price

- Area c is redistribution of well-being from domestic consumers to import license holders

3. Ways to Allocate import licenses

- **Import license auction**: selling import licenses to the highest bidders
- There is value in buying these licenses: buy at low world prices and sell at high domestic prices
- Firms would be willing to pay an amount very close to the price difference

3. Ways to Allocate import licenses

- If the winning bids are very close to this price difference, the government should get almost all of area c.

- There is corruption problem with selling import licenses with “under the table” deals, where whoever pays the highest bribe gets the license.

- Persistent corruption can cause talented persons to become bribe-harvesting officials instead of pursuing productive careers.

3. Ways to Allocate import licenses

- **Resource –using application procedures** include allocating licenses on a first-come , first served basis; on the basis of demonstrating need or worthiness; or on the basis of negotiations.

- An example of worthiness is awarding licenses based on the production capacity of the firm that uses these inputs

    - This approach encourages resource wastage as it encourages firms to over invest in production capacity

3. Ways to Allocate import licenses

- Resource –using procedures encourage rent seeking activities, and some or all of area *c* is turned into a loss to society.

- The inefficiency of the quota is greater than the area *b+d*, because it includes some of area *c*.

  - If all of area c is used up in rent-seeking acitivity, then the inefficiency is measured by *b+d+c*.

4. Nontariff barriers: VERs

- Voluntary export restraint (VER) occurs when the importing country government compels the foreign exporting country to agree to voluntarily to restrict its exports to this country.

- VERs have been used by large countries (i.e. US and EU) to protect their industries against a rising tide of imports.

  - The countries most often forced to restrict their exports have been Japan and Korea.

4. Nontariff barriers: VERs

- VERs avoid the problem of imposing import quotas and raising tariff barriers, as such actions violate the rules of the WTO.

4. Nontariff barriers: Product standards

- Governments can protect their domestic industries by designing product standards that:
  - Are tailored to fit local products but require costly modifications to foreign products
  - Are higher for imported products or enforced more strictly
  - The testing and certification procedures can be more costly, slower, or more uncertain for foreign products

4. Nontariff barriers: Product standards

- Example: EU cattle imports.
  - EU has banned imports of beef from cattle that have received growth hormones, claiming that it is responding to public concerns about health dangers
  - US sees this as protection of European beef producers, because scientific evidence indicates that beef from cattle that receive growth hormones is safe and poses no risk to human health

4. Nontariff barriers: domestic content requirements

- Domestic content requirements mandates that a product produced and sold in a country must have a specified minimum amount of domestic production value
  - In terms of wages paid to local workers
  - Or materials and components produced within the country

4. Nontariff barriers: domestic content requirements

- Domestic content requirements limit the import of materials and components that otherwise would have been used in domestic production.

- These requirements create the usual DWL because the protected local products are less desired and more costly to produce.

4. Nontariff barriers: Government procurement

- Government procurement practices can be a nontariff barrier to imports if the purchasing processes are biased against foreign products.

  - In the US, the buy America Act of 1933 mandates that government-funded purchases favour domestic purchases

  - The US government has complained that Japanese government has limited foreign sales of telecommunications products to government

4. The costs of protection

- For a small country, the loss of protection is equal to area b+d (Figure 9.2 d)
- The true cost of protection is probably higher than the area b+d because:
  - Foreign retaliation
  - Enforcement costs
  - Rent-seeking costs
  - Rents to foreign producers
  - Innovation

A small country imports sugar. With free trade at the world price of $0.10 per pound, the country's national market is:

Domestic production	120 million pounds per year
Domestic consumption	420 million pounds per year
Imports	300 million pounds per year

The country's government now decides to impose a quota that limits sugar imports to 240 million pounds per year. With the import quota in effect, the domestic price rises to $0.12 per pound, and domestic production increases to 160 million pounds per year. The government auctions the rights to import the 240 million pounds.

a. Calculate how much domestic producers gain or lose from the quota.

b. Calculate how much domestic consumers gain or lose from the quota.

c. Calculate how much the government receives in payment when it auctions the quota rights to import.

d. Calculate the net national gain or loss from the quota. Explain the economic reason(s) for this net gain or loss.

Suppose that the U.S. government is under heavy pressure from the Rollerblade and K2 companies to put the brakes on imports of Bauer in-line skates from Canada. The protectionists demand that the price of a $200 pair of in-line skates must be raised to $250 if their incomes are to be safe. The U.S. government has three choices: (1) free trade with no protection, (2) a special tariff on in-line skates backed by vague claims that Canada is using unfair trade practices (citing Section 301 of the Trade Act of 1974), and (3) forcing Bauer to agree to a voluntary export restraint. The three choices would lead to these prices and annual quantities:

	With Free Trade	With an $80 Tariff	With a VER
Domestic U.S. price per pair	$200	$250	$250
World price per pair	$200	$170	$170
Imports of in-line skates (millions of pairs)	10	6	6

Note that the $80 tariff reduces imports by 4 million pairs a year, the same reduction that the VER arrangement would enforce.

a. Calculate the U.S. net national gains or losses from the tariff, and the U.S. gains or losses from the VER, relative to free trade. Which of the three choices looks best for the United States as a whole? Which looks worst?

b. Calculate the net national gains or losses for Canada, the exporting country, from the tariff and the VER. Which of the three U.S. choices harms Canada most? Which harms Canada least?

c. Which of the three choices is best for the world as a whole?