PART II

INSTRUMENTS OF TRADE POLICY

Trade policy uses seven main instruments: tariffs, subsidies, import quotas, voluntary export restraints, local content requirements, administrative policies and antidumping duties.

Tariff is a tax levied on imports or exports. They are divided in two categories:

1. Specific tariffs: are levied as a fixed charge for each unit of a good imported.
2. Ad valorem tariffs: are levied as a proportion of the value of the imported good.

In most cases, tariffs are placed on imports to protect domestic producers; tariffs increases government revenues.

Specific Tariff: A specific tariff is an import duty that assigns a fixed monetary tax per physical unit of the good imported. It is calculated on the basis of a unit of measure, such as weight, volume, etc., of the imported good. Thus, a specific tariff of 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. For example: if the price of the imported cycle is 5,000/, then the rate of tariff is 20%; if due to inflation, the price of bicycle rises to 10,000, the specific tariff is only 10% of the value of the import. Since the calculation of these duties does not involve the value of merchandise, customs valuation is not applicable in this case.

Ad valorem tariff: An ad valorem tariff is levied as a constant percentage of the monetary value of one unit of the imported good. A 20% ad valorem tariff on any bicycle generates a `1000/ payment on each imported bicycle priced at `5,000/ in the world market; and if the price rises to ` 10,000, it generates a payment of `2,000/. While ad valorem tariff preserves the protective value of tariff on home producer, it gives incentives to deliberately undervalue the good's price on invoices and bills of lading to reduce the tax burden. Nevertheless, ad valorem tariffs are widely used the world over.

Subsidy is a government payment to a domestic producer. They take many forms like, cash grants, low-interest loans, tax breaks and government equity participation in domestic firms.

Subsidies help domestic producers in two ways:

(1) Competing against foreign imports and

(2) Gaining export markets

Import Quota is a direct restriction on the quantity of some good that maybe imported into a country. The restriction is usually enforced by issuing import licenses to a group of individuals or firms.

Import 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. Import quotas are typically set below the free trade level of imports and are usually enforced by issuing licenses. This is referred to as a binding quota; a non-binding quota is a quota that is set at or above the free trade level of imports, thus having little effect on trade.

Import quotas are mainly of two types: absolute quotas and tariff-rate quotas. Absolute quotas or quotas of a permanent nature limit the quantity of imports to a specified level during a specified period of time and the imports can take place any time of the year. No condition is attached to the country of origin of the product. For example: 1000 tonnes of fish import of which can take place any time 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 tonnes of fish that can be imported any time of the year, but where 750 tonnes must originate in country A and 250 tonnes in country B. In addition, there are seasonal quotas and temporary quotas

Local Content Requirement is a requirement that some specific fraction of a good needs to be produced domestically. 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)

Administrative Trade Policy: They are bureaucratic rules designed to make it difficult for imports to enter a country.

Administrative Procedures:

Another potential obstruction to free trade is the costly and time consuming administrative procedures which are mandatory for import of foreign goods. These 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 linked to prove compliance etc.

Anti-Dumping Duties: Dumping is a variously defined as selling goods in a foreign market at below their costs of producing; dumping is viewed as a method by which firms unload excess production in foreign markets.

Antidumping policies are designed to punish foreign firms that engage in dumping. Their objective is to protect domestic producers from unfair foreign competition.

Anti-dumping Measures:

Dumping occurs when manufacturers sell goods in a foreign country below the sales prices in their domestic market or below their full average cost of the product. Dumping may be 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 an international price discrimination favouring buyers of exports, but in fact, the exporters deliberately forego 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 effects 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 antidumping duties on colour-coated or pre-painted flat steel products imported into the country from China and European nations for a period not exceeding six months and for jute and jute products from Bangladesh and Nepal.

Voluntary Export Restraint is a quota on trade imposed by the exporting country, typically at the request of the importing country's government.

Voluntary Export Restraints: VERs refer to a type of informal quota administered by an exporting country voluntarily restraining the quantity of goods that can be exported out of that country during a specified period of time. Such restraints originate primarily from political considerations and are imposed based on negotiations of the importer with the exporter.

The inducement for the exporter to agree to a VER is mostly to appease the importing country and to avoid the effects of possible retaliatory trade restraints that may be imposed by the importer. VERs may arise when the import-competing industries seek protection from a surge of imports from particular exporting countries. VERs cause, as do tariffs and quotas, domestic prices to rise and cause loss of domestic consumer surplus.

A voluntary export restraint (VER) is a trade restriction on the quantity of a good that an exporting country is allowed to export to another country. This limit is self-imposed by the exporting country.

VERs came about in the 1930s and gained a lot of popularity in the 1980s when Japan used one to limit auto exports to the U.S. In 1994, World Trade Organization (WTO) members agreed not to implement any new VERs and to phase out existing ones.

How a Voluntary Export Restraint (VER) Works

Voluntary export restraints (VERs) fall under the broad category of non-tariff barriers, which are restrictive trade barriers, such as quotas, sanctions, levies, embargoes, and other restrictions. Typically, VERs are a result of requests made by the importing country to provide a measure of protection for its domestic businesses that produce competing goods, though these agreements can be reached at the industry level, as well.

VERs are often created because the exporting countries would prefer to impose their own restrictions than risk sustaining worse terms from tariffs or quotas. They've been in use since the

1930s, applied by large, developed economies to a wide range of products, from textiles to footwear, steel, and automobiles, and became a popular form of protectionism in the 1980s.

After the Uruguay Round and the updating of the General Agreement on Tariffs and Trade (GATT) in 1994, WTO members agreed not to implement any new VERs, and to phase out any existing ones within one year, with some exceptions.

Motivations Behind Voluntary Export Restraints

Typically, a country imposes a voluntary export restraint at the request of an importing country that seeks protection for its domestic producers. The exporting country establishes a VER to avoid facing trade restrictions from the importing country.

Through the use of a voluntary export restraint, the exporting country is able to exercise some degree of control over the restriction, which would otherwise be lost if it faced trade restrictions from the importing country. Hence, despite what the name suggests, VERs are rarely voluntary.

History of VERs

Voluntary export restraints have been historically used on a wide variety of traded products and have been used since the 1930s. The popularity of this particular trade restraint increased in the 1980s since it abided by the terms agreed to under the GATT (General Agreement on Trades and Tariffs). However, members of the WTO in 1994 agreed not to impose any new voluntary export restraints (VERs) and gradually ended the use of any existing ones.

Effectiveness of VERs

Studies conducted on the effectiveness of VERs suggest that they are not effective over a longer term. An example is the voluntary export restraint imposed by Japan on the export of Japanese manufactured cars into the U.S. The US government wanted to protect its automobile manufacturers since the domestic industry was threatened by the cheaper and more fuel-efficient Japanese automobiles.

The restraint proved to be ineffective since Japanese automotive producers established manufacturing plant facilities in the US. Additionally, the Japanese car manufacturers started exporting more luxurious cars in order to generate adequate funds while still adhering to the export limitation set by its government.

Balance of Payment

Meaning of Balance of Payment Account:

A Balance of Payment Account is a systematic record of all economic transactions between residents of a country and the rest of the world carried out in a specific period of time.

Briefly put, 'Balance of Payment Account is a summary of international transactions of a country for a given period' (i.e., financial year). It records a country's transactions with the rest of the world involving inflow and outflow of foreign exchange. In short BOP Account is a summary statement of transactions in foreign exchange in a year.

Simply put, BOP account is a statement of a country's sources and uses of foreign exchange in which main sources are: exports, transfers and remittances from abroad, borrowings from abroad, foreign investments whereas uses of foreign exchange are: imports, transfers to abroad, lending abroad and purchase of assets, etc.

BOP account, like a typical business account, is based on double entry system which contains two sides—Credit side and Debit side. Any transaction which brings in foreign exchange (currency) is recorded on credit side whereas any transaction that causes a country to lose foreign exchange is recorded on debit side. For example, export is credit item as it brings in foreign exchange whereas import is a debit item since it causes outflow of foreign exchange. Similarly, borrowing from rest of the world (ROW) is a credit item while lending to ROW is a debit item. main purpose of BOP Account is to know international economic position of a country and to help the government make appropriate trade and payment policies.

Features of Balance of Payment Account:

(i) It is a systematic record of all economic transactions between residents of one country and rest of the world.

(ii) It includes all transactions in goods (visible items), services (invisible) and assets (flow of capital) during a period of time.

(iii) It is constructed on double entry system of accounting. Thus, every international transaction will result in credit entry and debit entry of equal size.

(iv) All economic transactions that are carried out with the rest of world are either credited or debited.

(v) In accounting sense total debit will always be equal to total credits, i.e., balance of payments will always be in equilibrium. But in economic sense, if receipts are larger than payments, there is surplus in BOR Similarly, if payments are larger than receipts, there is deficit in BOP.

A hypothetical simplified example of a country's Balance of Payment Account is given in the following table. It has two sides—credits (receipts) on the left side and debits (payments made) on the right side.

Credits *(Inflow of foreign exchange)*			**Debits** *(Outflow of foreign exchange)*		
Row(1)	Exports of goods *(Visible items)*	550	**Row(5)**	Imports of goods	800
Row(2)	Exports of services *(Invisibles)*	150	**Row(6)**	Imports of services	50
Row(3)	Unilateral transfers *(gifts, remittances, indemnities, etc. received from foreigners)*	100	**Row(7)**	Unilateral transfers *(gifts, indemnities, etc. paid to foreigners)*	80
Row(4)	Capital receipts *(borrowings from abroad, capital repayments by, or sale of assets to to foreigners)*	200	**Row(8)**	Capital payments *(lending to, capital repayments to, or purchase of assets from foreigners)*	70
	Total Receipts	**1,000**		**Total Payments**	**1,000**

BOP account records a country's all economic transactions with ROW which Involve inflow or outflow of foreign exchange.

Visible and Invisible items:

Visible items refer to items relating to trading in goods with other countries. For example export and import of goods (like machinery, tea, etc.) are called visible items because goods are visible items and can be verified by Custom officials. Invisible items refer to items relating to trading of services with other countries and unilateral transfers. Export and import of services are called Invisible items because services are not seen crossing the border. All types of services like services of shipping, banking, tourism, investment services and unilateral transfers are invisible items.

Components of Balance of Payment Account:

The various items which make up country's Balance of Payment Account are listed in a simplified consolidated form in the above table. They are explained as under:

1. Export and import of goods (Merchandise):

The most straightforward way in which a country can acquire foreign currency is by exporting goods. These are called visible items because goods can be seen, touched and measured. This is shown by Row (1) which indicates that the country has exported goods to a value of Rs 550 crore. In an analogous (similar) way Row (5) shows that the country has imported goods to a value of Rs 800 crore. These two rows describe the country's visible trade. Movement of goods between countries is known as visible trade because the movement is open and can be verified by Customs officials.

2. Services rendered and received:

(Shipping, banking, insurance, tourism, interest, dividend etc) Under this head, following types of earnings are included.

(a) Non-factor income:

Income from shipping, banking, insurance, tourism, software services is called non-factor income. All such payments are listed under Row (2) as export of services or invisible exports.

(b) Investment income (Factor income):

Interest and dividends which citizens of a country earn on investment abroad are investment income and treated as factor income. Remember, citizens of the country own land, bonds, shares, etc. in foreign countries for which the foreigners who enjoy the services of this capital will have to pay for them. These payments will be registered under Row (2) as export of services or invisible exports.

In a completely analogous way, Row(6) covers payments which residents of the country m question make to foreigners for similar services, i.e., shipping, banking, insurance payments made by residents as tourists abroad, payments in the form of interest, dividends, profits/or capital services on foreign owned capital.

3. Unilateral transfers:

(Gifts, remittances, indemnities, etc. from foreigners) The items in Row (3) are called unrequited receipts because residents of a country receive 'for free. Nothing has to be paid in return at present or in future for these receipts. These are like transfer payments. Examples of this head are gifts received by residents from foreigners, remittances sent by emigrants to relatives, war indemnities paid by a defeated country, etc. Note: In India unrequited or unilateral transfers are treated as a part of invisible trade.

4. Capital receipts and Payments: [Borrowings, capital repayments, sale of assets, changes in foreign exchange reserve):

It records international transactions which affect assets and liabilities of domestic country with rest of the world. Items (4) and (8) of the table indicate changes in stock magnitudes and refer to capital receipts and payments .Government of a country may borrow (get loan) from another government; a firm may issue stocks abroad or a bank may float a loan in a foreign country.

In all these instances, the country in question will acquire foreign currency and these transactions will be entered as credit items in Row (4). Similarly foreigners may acquire assets in the country with whose balance of payments they are concerned.

Assets may be in the form of land, houses, plants, and shares, etc. Changes in stock of gold or reserves of foreign currency are also included in Row (4). Analogously, if residents of the country in their turn were to acquire similar foreign assets, this would give rise to outflow of foreign currency and come as a capital transfer recorded as a debit item in Row(8).

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