Trade Barriers

International Barriers to Trade

Lectures in International Business, 2004

Dr. Richard Sjolander

Why, if nation-states are better off under free trade, do they impose trade barriers?

Free trade benefits society in general.

Trade barriers benefit specific interest groups.

Four Major Categories of Trade Barriers

1. Tariffs – taxes on imports
2. Subsidies – tax breaks for domestic producers entering the market.
3. Non-tariff trade barriers – other methods used to hinder imports
4. Quotas – numeric limits on the quantities of import goods

Tariffs are Imposed for One of Two Purposes

1. Revenue Generations. Tariffs generally applied to goods not produced domestically – to generate revenue for the government.
2. Protective tariffs: Designed to shield domestic producers (at least partially) from foreign competition. This is done to offset inefficiencies in domestic production.

Who Benefits from Tariffs?

Tariffs benefit certain identifiable special interest groups in a given industry in the country imposing the Tariff.

The imposing government gains some small amount of revenue, too.
Who Pay for Tariffs?

- The masses of consumers in the importing country pay
- These are the disaggregated masses of consumers, who:
  - lack effective lobbing power
  - who may each be affected only marginally but, who in aggregate, bear total cost.

Protective Tariffs

**Defined**
Taxes imposed on imported goods and services as they enter a country market.

**Two Kinds**

- **Specific Tariffs**: taxes charged on a per unit, or weight, basis.
- **Ad Valorem Tariffs**: taxes charged as a per cent of the value of the goods or services as they pass over the border.

How is the Value of Imports Determined?

- For Specific tariffs, the weight, or number of items can be found on the shipping invoice, which will accompany the goods.
- For Ad Valorem taxes the value of the goods is generally defined as the Total value of the merchandise as it crosses the border. This normally is the CIF value.
  - Cost of the merchandise ‘C’
  - Cost of the insurance ‘I’
  - Cost of freight ‘F’

Example of Tariffs

To import an automobile to Sweden from outside the EU they charge the following:

- 500 skr. Disposal Fee.
- 2,500 skr. Environmental Tax.
- 5.7% Foreign product surtax
- 7,000 skr. Energy Tax.
- 7.4 skr. Per kilo impact fee, and
- 23.4% Percent value added tax

Example of Tariffs

To import an automobile to Sweden from outside the EU they charge the following:

- Assume a New Ford priced at: $25,000, or at 8skr = $1 200,000 skr.
- 500 skr. Disposal Fee.
- 2,500 skr. Environmental Tax.
- 7,000 skr. Energy Tax.
- 7.4 skr. Per kilo impact fee (1600kg) 11,840
- 5.7% Foreign product surtax 11,400
- 23.4% Percent value added tax 54,579

TOTAL LANDED COST INCLUDING TAXES: 287,818 skr.

Example of Tariffs

To import an automobile to Sweden from outside the EU they charge the following:

- 500 skr. Disposal Fee.
- 2,500 skr. Environmental Tax.
- 5.7% Foreign product surtax
- 7,000 skr. Energy Tax.
- 7.4 skr. Per kilo impact fee, and
- 23.4% Percent value added tax

The Mechanics of a Tariff Barrier

Now we will turn to the blackboard to analyze the effects of tariffs in an industry using graphic analysis.

1. Start with a nation without trade.
2. Add free trade.
3. Then look at the effects of imposing tariff.
Common Arguments in Favor of Tariffs

- **Domestic workers** - need protection from the effects of Cheap Foreign Labor.
- **National Defense** - This industry is vital to the national interest and is being destroyed by Cheap Imports.
- **Infant Industry** - in country must be protected from large, foreign competitors.

Non-Tariff Trade Barriers

- Non-tax measures imposed by governments to favor domestic suppliers.

Non-Tariff Trade Barriers are Popular for Several Reasons

1. The effects of these barriers may be easier to judge than tariffs.
2. They may not be perceived as negatively by trade partners.
3. They may be easier politically to enact.
4. They may get around certain WTO conditions.
5. They may have a much larger direct payoff for stakeholders.

Subsidies

- Are Tax breaks, or other incentives given to domestic producers
- They reduce the cost of production for certain producers
  - France uses them to support Airbus
  - Ireland uses them to lure businesses into the domestic market
  - Most countries use them to entice auto producers to set up shop in their countries

How Subsidies Work

- Transfer payments to the companies, or
- Reduced tax rates offered to the companies
- Lower the cost of production for affected firms, relative to other competitors in the industry.
- This allows the firms two choices:
  1. Maintain price with higher profits, or
  2. Reduce price with constant profits

Quota Barriers

- **Quotas** – are numeric limits on the quantity of goods that may be imported into a country in a specified period of time.
- Quotas rights can be sold to the highest bidder
  - raises government revenue
  - similar to government actions under Mercantilism
- Quotas can also be handled on a first come first served basis.
**The Mechanics of a Quota Trade Barrier**

Now we will turn to the blackboard to analyze the effect of quotas in an industry using graphic analysis.

1. Start with a nation without trade.
2. Add free trade.
3. Then look at the effects of imposing quota.

**Common Arguments in Favor of Quotas**

- Quotas are difficult to identify by international trade agencies, such as WTO.
- Quotas don’t actually keep foreign goods out of our market, they just keep them from flooding it.
- Other arguments are similar to those for tariffs.

**Other Non-Tariff Trade Barriers**

- **Voluntary Export Restraints**
  - Similar in their effects to quotas, but give more control over the exporter.

- **Exclusionary Product Standard**
  - Every country applies these easy to apply trade barriers.
  - They are hard to prove and may give excellent protection from the ravages of competition.

**International Trade Organizations**

- **GATT** was formed after WWII as a set of rules to insure:
  - the reduction of trade barriers
  - non-discrimination among member nations in trade,
  - transparent trade procedures,
  - settlement of trade disputes, and
  - widespread participation in trade by all nations.

**The World Trade Organization**

- The WTO (World Trade Organization) developed out of the success of the GATT in 1995.
- It expands the role of the international trade organization include:
  - Trade in Services
  - Trade in Intellectual property
  - Financial Instruments