MODULE-1 COMMERCIAL POLICY

1. TARIFF & NON TARIFF BARRIERS

Q:1 Write a short note on Commercial Policy.

(A) Commercial Policy :- The Commercial Policy plays an important role in economic growth and development of the country. The Countries Participating in the international trade are geographically and Politcally independent countries. These countries Prepare and follows their own trade Policies which help them in economic development.

(B) Types of Commercial Policies

- (1) Free Trade Policy
- (2) Protectionist Policy

(1) Free Trade Policy :- " Free Trade Policy means Liberal Trade Policy which Promote Free movement of goods and services between different countries."

In free trade, there is absence of tariffs, Quotas, exchange restrictions, taxes and subsidies on Production. Here trade takes place on the basis of market Forces of Demand and Supply.

Adam Smith has developed free trade where tariffs should be removed to get benefits of free trade. Free trade helps the countries to specialise in Production of goods in which they enjoy benefit of Comparative Cost Advantage.

② **Protectionist Policy :-** Protectionist Policy is the economic policy by restricting imports from other countries with the help of - Tariffs on imported goods
- Fixing Import Quotas and
- other government regulations.

Meaning - " Protectionist Policy is the Policy of Protecting domestic Industries against Foreign competition"

This Policy mainly focused on - **Import Substitution and Export Promotion.**

Q:2 Define Tariffs. Explain different types of Tariffs?

Ⓐ **TARIFFS :-** " A Tariff is a duty imposed on Commodities that are traded across the national border of a country "
Tariff can be imposed on both imports and exports.
It is also known as Import or Export duties or Custom duties.

Ⓑ **Main Objectives of Tariffs :-**

1) To Protect and Support domestic Industries.
2) To create more employment opportunities within Country.
3) To increase government revenue.
4) To Increase Foreign currency.
5) To reduce dependence on other countries and make the country self-sufficient.
6. To make Domestic Prices competitive with import Prices.
7. To Prevent shortages in domestic market by imposing Export tariffs.

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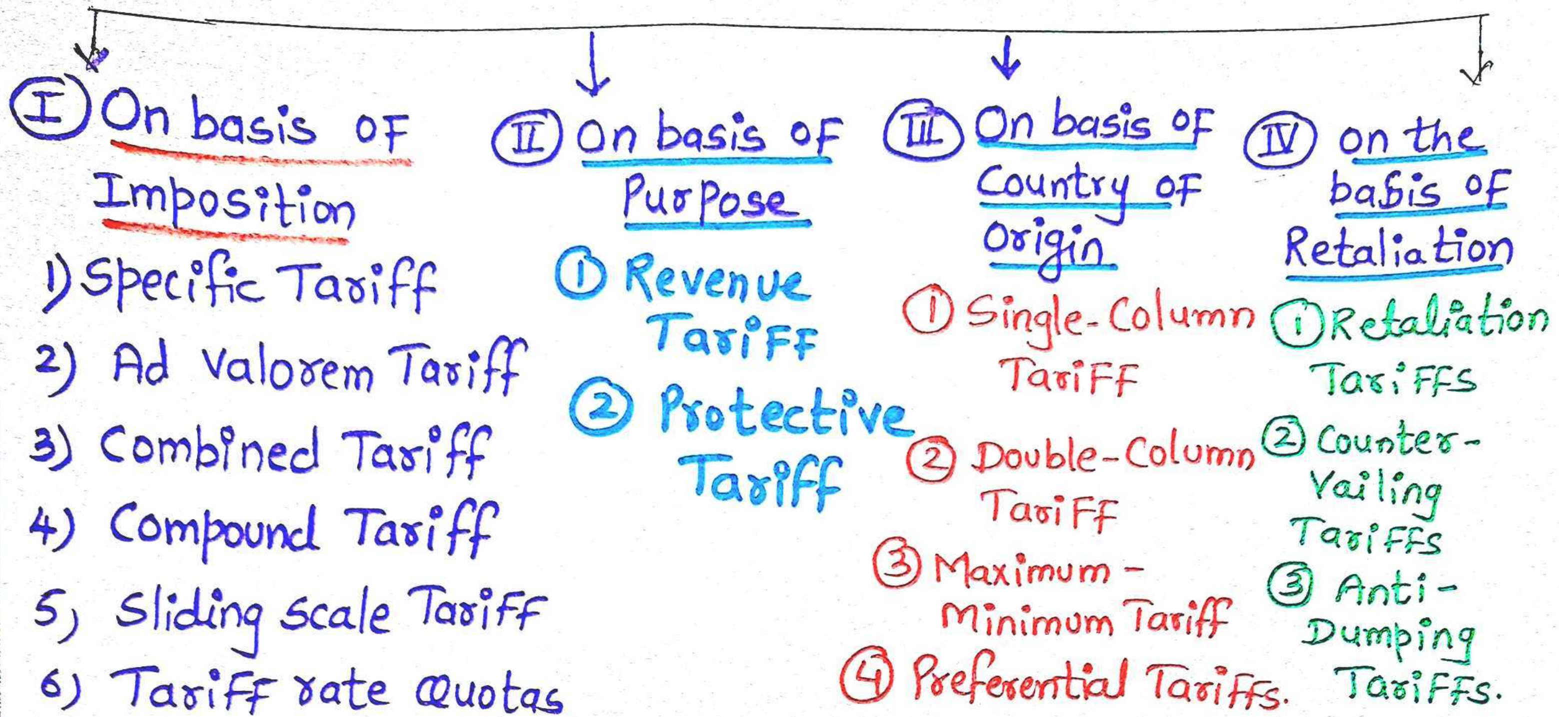
(C) Types of Tariffs :-



(I) On the basis of Imposition :-

(1) Specific Tariffs :- Specific Tariff is imposed as a fixed charge per unit of import or according to weight of commodity imported. This tariff can vary according to type of goods imported.

Example :- A country could levy of ₹ 100 tariff on each pair of shoe imported but levy ₹ 1500 tariff on each computer imported.

(2) Ad Valorem Tariff :- Ad Valorem means 'as per value'. Such tariffs are imposed at a percentage rate of value of imported or Exported commodities. These tariffs are levied on commodities whose values are proportionately higher than their physical features - like length or weight. These tariffs are more equitable.

(3) Combined / Mixed Tariffs :- Sometimes government imposed combined duties which is combination of specific and Ad Valorem Tariff.

Example :- A country may impose an import duty on car as—

Fixed specific duty = ₹ 1 lakh +
Ad Valorem duty = 20% of the Price = combined Tariff

④ **Compound Tariffs :-** Compound Tariff include- Specific Tariff on Per unit of commodity Plus a Percentage of Ad Valorem tariff. It brings greater Elasticity in revenue collection.

⑤ **Sliding Scale Duty :-** These are Taxes which vary with the Price of Commodity imported. These duties are vary with change in Seasons. These duties are generally levied on Agricultural goods.

⑥ **Tariff rate quotas :-** when quantity of imports is within quota limit them Low Tariff rates are imposed. But when quantity of import is above the quota limit then Very high tariff rates are imposed.

(II) On the basis of Purpose :-

1. **Revenue Tariffs :-** These Tariffs are imposed only with the Objective of Collecting revenues for government. Many developing countries have to depend on Indirect Taxes for revenues.

2) **Protective Tariffs :-** These tariffs are imposed to restrict import of goods. It will help to protect domestic industries.

(III) On the basis of Country of Origin :-

1. **Single Column Tariff :-** Here one duty is imposed on commodity irrespective of the country of import.

It is also called Single Column or Non-discriminatory tariff because all the Countries impose single duty only. It is very easy to impose single duty.

2) Double Column Tariff :- Here different duties are imposed on commodities by different trading countries. It is also called Double Column or multiple column or Discriminatory Tariffs.
Generally Discriminatory Tariffs are Prohibited by WTO because these taxes have adverse affect on international trade.

3. Maximum and Minimum Tariffs :- At Global market, all the Countries levy Two Tariff rates :-

i) Minimum Tariffs rates on imports when country has Commercial agreement with that country.

ii) Maximum Tariffs rates on imports when Country has no Commercial agreement with that Country.

4) Preferential Tariffs :- These Tariffs are imposed on imports from Countries that are the Part of Preferential Trade Agreement like Free Trade Area.
Example :- NAFTA - North America Free Trade Agreement
These rates of Taxes are Lower than general Tariff rates.

IV On the basis of Retaliation :-

1 Retaliation Tariffs :- It is a tax, that a government charges on import to Punish another country for Charging tax on its own exports. It is Just like - Tit for Tat Policy.

② Countervailing Tariffs :-

Countervailing duties is also called Anti-Subsidy duties. These Taxes are imposed Under WTO Rules to neutralise the negative effects of Subsidies.

Sometime Foreign Country provide Subsidies to increase exports and it will destroy domestic industries in Importing Countries. So additional Tariff is imposed on a commodity whose export Price is reduced by Foreign country due to export subsidies.

③ Anti-Dumping Tariffs :-

Dumping is a Practice where exporter sell his goods in Foreign market at Low Price. but he sell same goods in domestic market at High-Price.

Therefore Anti-Dumping is a Penality imposed on Low-Priced imports which Protect Domestic industries from Unfair Competition.

Example :- In October-2018, India imposed Anti-Dumping duties on Certain Varieties of steel to Protect domestic Producer.

Q:3 What are the Various effects of Tariffs ?

Ⓐ Effects of Tariffs :-

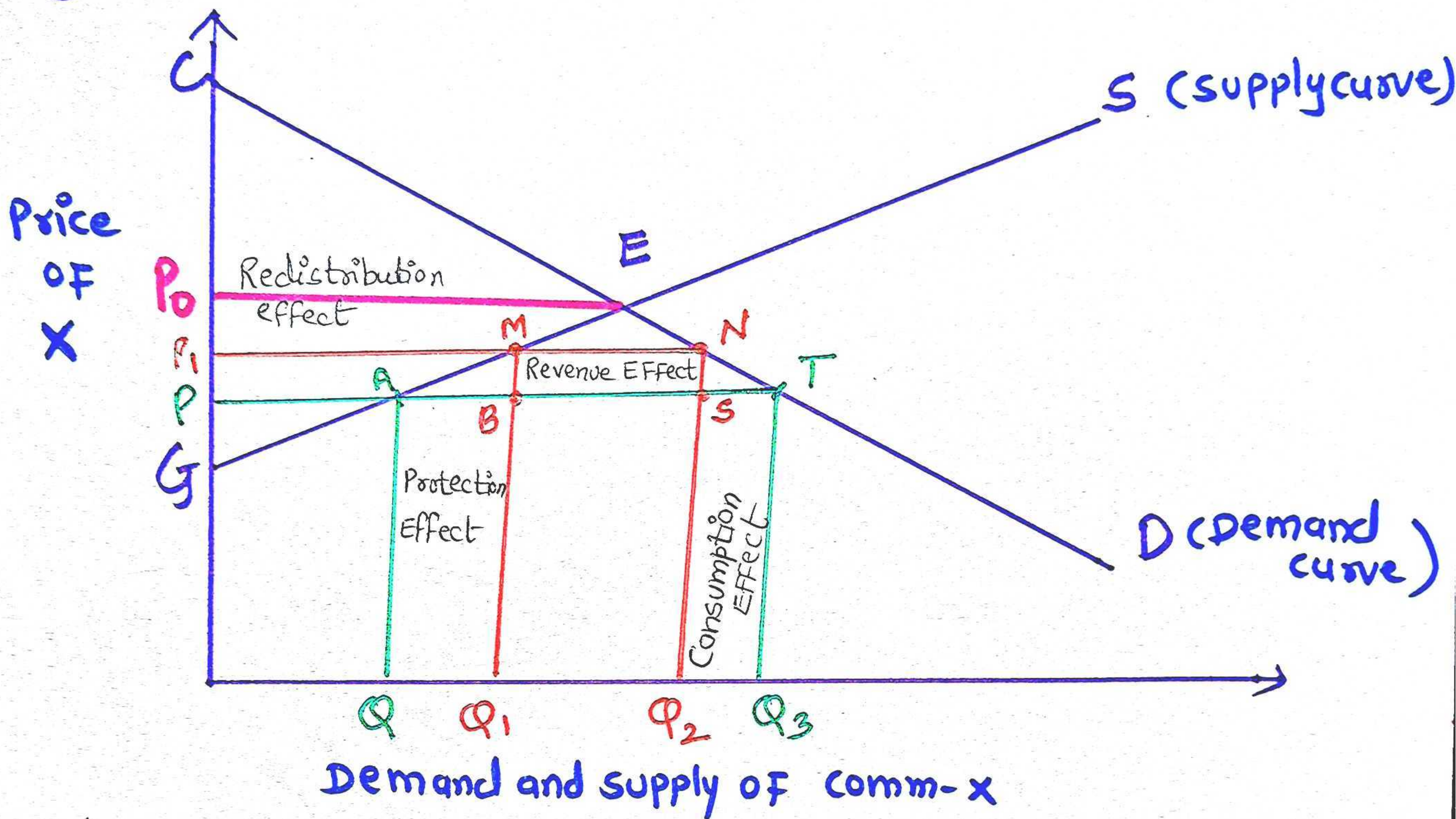
Tariff Produce multiple effects on economic life of the country.

Kindle Berger has developed and given Systematic analysis of Various effects of tariffs. This analysis is based on following assumptions—

1. There is one Country A
2. Country-A imports commodity X and export commodity-Y.

3. The effects of Tariffs are related to tariff imposing country-A
4. The effects of Tariffs on other countries are not considered.

(B) Diagram- Effects of Tariffs



In the above diagram we observe —

1) In country-A, CD is demand curve for commodity-X and GS is supply curve of commodity-X
2) The Equilibrium Price is determined at Point-E in the absence of international trade.

Before Import → The Domestic Price = OP_0
Consumer Surplus = ΔCEP_0
Producer Surplus = ΔGEP_0

3) But when country-A, import commodity-X at international Price – OP

At OP Price Country-A Produce = OQ quantity of commodity X

But at OP Price demand for commodity = OQ_3.

It means OQ_3 Quantity has to imported where—

Consumer surplus = ΔCPT (increase)

Producer surplus = ΔPGA (Decrease)

4) IF Country-A imposes a tariff on imports of Commodity-X = PP_1

Now the Price of commodity X = OP_1

At this Price supply increase to = OQ_1

But demand decrease to = OQ_2

Lets Explain Effects of Tariffs are —

1. Protective Effect :- The main aim of imposing Tariff is to Protect domestic Industries from Foreign Competition. Tariff increase Price of import which result in reduction of imports.

Before Import Country Produce → OQ quantity of X

and Country-A import → OQ_3 Quantity of X

After imposition of Tariff →

Country A Produce → OQ_1 quantity of X (increase)

Country A Import → OQ_2 Quantity of X (Decrease)

Thus Import of Tariff = PP_1 has given Protection effect to domestic industries = ABQ_1Q

2 Revenue Effect :- Due to imposition of Tariff on import goods has increased Revenue for the government.

After Tariff Demand for Commodity x = OQ_2

It increase Revenue of Government = MNSB.

3 Consumption Effect :- Imposition of Tariff results in adverse effects on Consumption.

Before Tariff Demand for commodity = OQ_3
After Tariff Demand For Commodity = OQ_2

Thus Protective effect = QQ_1 = ABQ_1Q

Consumption effect = Q_2Q_3 = STQ_3Q_2

(4) **Redistribution effect :-** Due to tariffs, income is redistributed between Producers and Consumers. The redistribution effect is in Favour of Producers

Before Tariffs - Consumer Surplus = ΔCEP_0
- Producer Surplus = ΔGEP_0

After Tariffs - Consumer Surplus = CP_1ME / ΔCP_1N
- Producer Surplus = ΔP_1GM

(5) **Terms of Trade Effect :-** When a country impose tariffs on imported commodity-X. It will increase the Price of Commodity-X, which reduce the imports and increase Domestic Production.

Due to reduction in imports, there is more supply of goods X in exporting Country. It will reduce the Price of Commodity-X in exporting Country.

Thus importing Country will import Same Commodity-X at Lower Price from exporting Countries.

Thus terms of Trade are favourable for a Country who impose tariffs on imports.

(6) **Income and Employment Effect :-** Due to imposition of Tariffs, imports of goods reduced. The Production of domestic goods increased. The money that is used for Purchasing foreign goods is now Saved. Demand for Domestic goods increase which increase the Price and Production of

goods and services.

Rising Prices will give boost to both Consumer and Capital goods. It will helps to increase income and employment in the country.

(7) Competitive Effect :- As a Protective device, tariff will reduce the competition with Foreign goods. In the absence of Competition, domestic Producer will not take more efforts to increase Production, improve Technology etc.

Imposition of Tariffs can Protect the domestic Industries but it does not bring
- Production Effeciency
- Better Technology
- Healthy Competition etc.

According to Kindleberger–
" Effects of Tariff is really Anti-Competitive but removal of Tariff will increase competitiveness "

(8) Balance of Payment effect :- Countries Facing Unfavourable balance of Payments can use tariffs as a device to correct it.

But if Countries impose retaliatory tariffs on the Country's exports and when exports reduced then Balance of Payment will become Unfavourable.

Q:4 What are Non-Tariff barriers? Explain the Classification of non-tariff barriers?

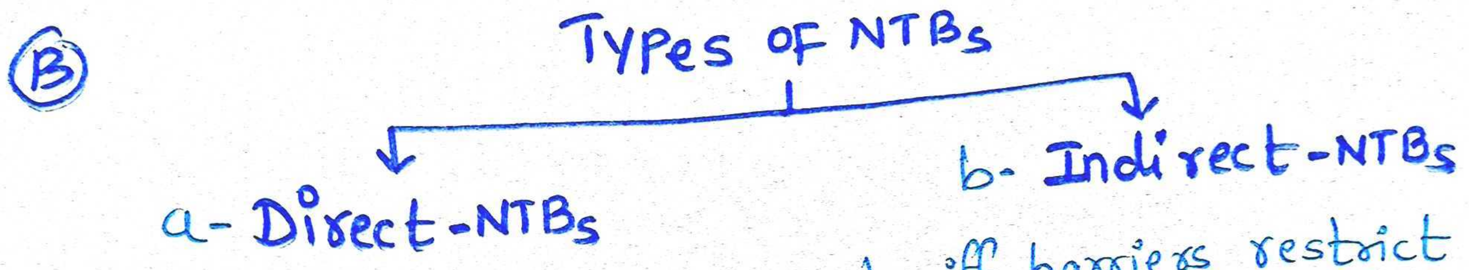
OR Give a brief account of non-tariff barriers to trade Why non-tariff barriers to trade are regarded as harmful as compared to Tariff barriers?

(A) NON-TARIFF BARRIERS (NTBs) :-

"Imports can be restricted by putting barriers other than tariffs, these restrictions are called Non-Tariff Barriers"

Example :- Quotas, import licensing, Trading blocks, state trading etc. are examples of Non-Tariff barriers.

(B)



a) Direct-NTBs :- These non-tariff barriers restrict imports directly

b) Indirect-NTBs :- Under this method imports can be restricted by encouraging Domestic Producers to produce the goods which can compete with foreign goods.

(C) Common Non-Tariff Barriers :-

① **Quotas :** Quotas means a restrictions on the value of commodity or quantity of commodity that can be imported into or exported from a country during a specific period.

Import Quotas are the maximum quantity of imports of commodities which is fixed by Government. Import Quotas are fixed to restrict import and to boost domestic production.

② **Trading blocks :-** Many countries with common interest can come together and form a Trading blocks. It is

Provide Preferential treatment to member countries and restrict the trade for non-member countries.

③ **Custom Regulations :-** Custom Rules and regulations are invisible NTBs which restrict the import of specific goods like - Drugs, chemicals, medicines, mineral etc.

④ **Preferential Agreements :-** Under this agreement, member nations gives Preferential treatments to eachother while exports and imports of goods and services.

⑤ **Consular formalities :-** Consular formalities are documents or Procedures Followed by some countries For import of goods. Sometimes, Importing countries use strict rules and regulations to reduce/control import of goods from other countries.

⑥ **Government Procurements :-** Under this method, Government involves in import and export business. The government Procurement can reduce the import of foreign goods.

⑦ **Technical and Administrative Regulations :-** Various industralised countries use NTBs to Protect local industries against foreign competition. Example - Licenses, Quotas, embargoes, foreign Exchange restriction etc. which reduce imports.

⑧ **Exchange Control :-** Foreign Exchange restrictions have been mostly used by Developing countries to maintain their balance of Payment control. Many countries impose restrictions on the use of foreign exchange which is earned through Export of goods and Services. It will helps to improve BOP Position.

9) **Unilateral Quotas :-** "When a country itself fixed the Quota of imports from abroad without any Prior negotiation with foreign Exporters is known as Unilateral Quotas"

It will also helps government to restrict imports.

10) **Bilateral Quotas :-** "When a Country fixed the Quota of import by negotiation between importing and Exporting Countries is Bilateral Quotas"

Under this system, Quotas are decided by mutual Understanding between Countries that Provide satisfaction to both countries.

11) **Voluntary Export Restraints (VERs) :-**

VERs are bilateral agreements between trading countries to Control the rapid growth of exports of certain Commodities.

It is measure taken by importing country when its domestic industries are suffering due to large imports level.

Example :- VERs have been Used by developed countries to restrict exports of steel, automobiles, Textiles etc.

12) **Domestic Subsidies :-** Subsidies are direct Payments to domestic Producers to reduce the cost of Production and encourage domestic Producers to Produce that Commodity which is imported from other Countries.

It helps in import - Substitution of goods.

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Q:5 Explain the economics of Quotas ?

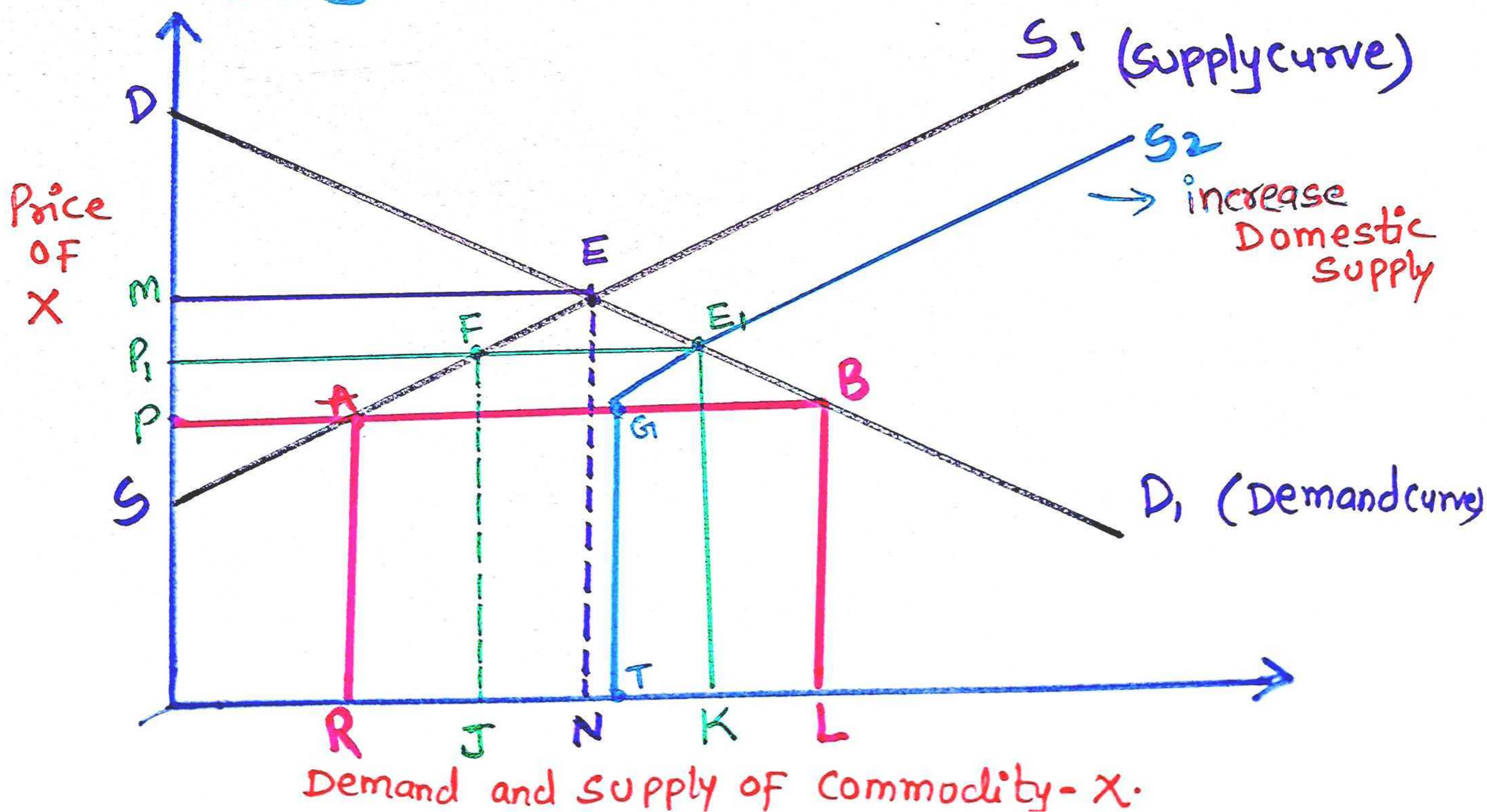
(A) Introduction :- " Import Quotas are the maximum Quantity of commodity imports is fixed by the government "

(B) Effects of Import Quotas :- As import duties on import goods will raise the Price of commodities. Similarly fixing of Import Quotas also raise the Price of commodities because Quotas reduce the supply of goods.

(C) Assumptions :-

1) There is open competition between domestic and foreign Products.
2) There is one country-A which imports commodity-X.
3) The effects of Quotas are related to country-A.
4) The effects of quotas on other countries are not considered.

(D) Diagram - Effects of Quotas :-



In above figure :-

1) DD_1 is Demand Curve and SS_1 is Supply Curve for Commodity-X in absence of international trade.
2) Country-A, enjoy equilibrium at Point E, where ON output is Produced at OM Price.
3) when Country-A, decide to import Commodity-X from Country-B at Price - OP and Domestic Demand = OL and Domestic Supply = OR
4) Due to heavy imports, Foreign Currency is drain away and it reduce Domestic Production = RN. So the government decided to fix import Quota = RT = AG

Effects of fixing Import Quota are :-

1. **Price Effect :-** Due to import Quota, import of Commodity-X is reduced. But it increase the supply of domestic Industries which shift the supply curve to right side - S_2. It also increase the Price to OP_1. Thus PP_1 is Price effect of Quota.

2. **Production Effect :-** when the import Quota is Fixed, It increase the supply of domestic industries. Here supply curve is shifted to right side - S_1 and we get New Equilibrium = E_1. Here Price increase to OP_1. Here Production increase from OR to OT.

3. **Consumption and Welfare effect :-** Due to imposition of Quota, domestic Production increases but domestic Consumption reduce from OL to OK.

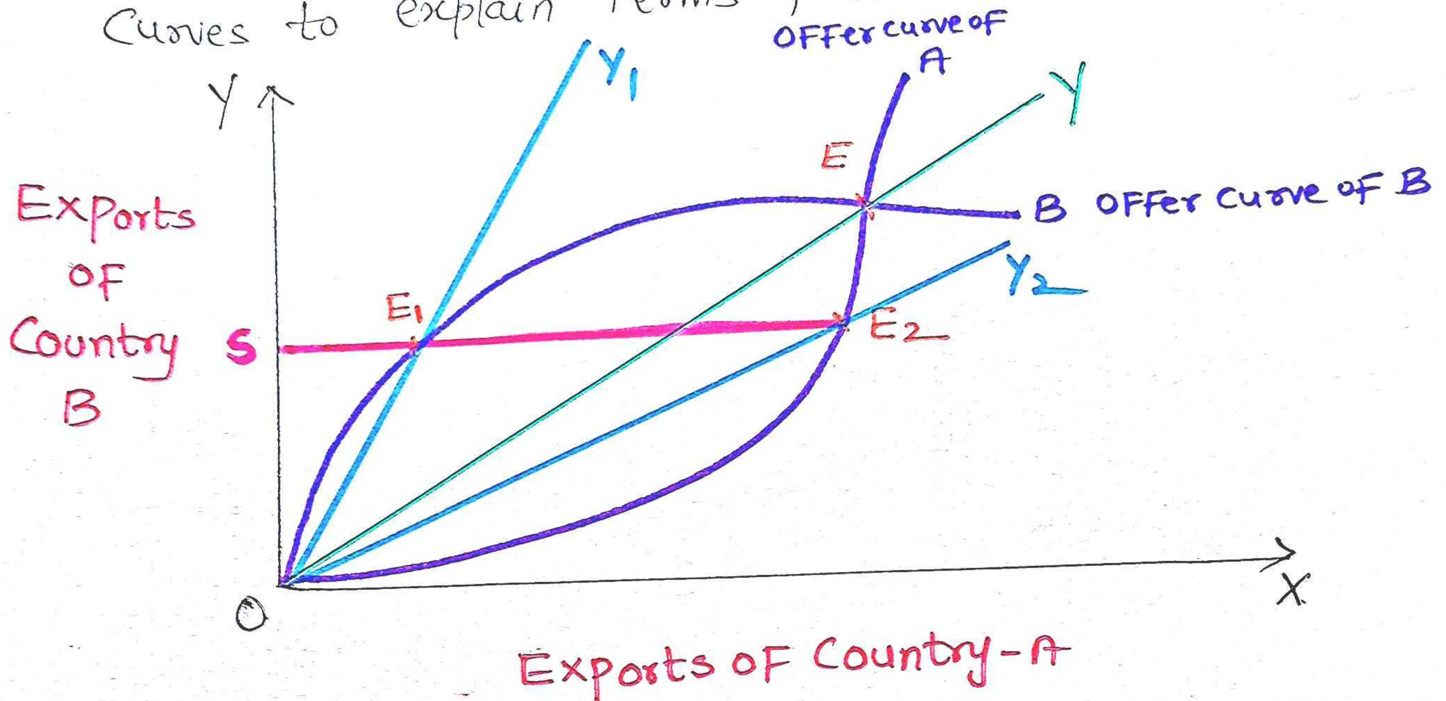
4. **Redistribution Effect :-** when import Quota

reduce the Level of domestic consumption, it shows Loss of Consumer's Welfare. This Loss of consumers welfare goes to Producers, workers and importers

This is known as redistribution effect of Quotas

5. Terms Of Trade :-

Kindleberger shows Offer Curves to explain Terms of Trade effect of Quota



In above diagram we observe ——

1) OA is Offer Curve of Country-A and OB is offer curve of Country-B.
2) E is the equilibrium Price for both countries.
3) If Country-A, determine import quota at OS level then exchange rate is Possible at E_1 or at E_2.
4) If E_1 is the exchange rate, the terms of trade is measured by the slope of Line-OY_1.
   As OY_1 is more steeper than OE,
   Here Terms of Trade are favourable for country-A.
5) If E_2 is the Exchange rate, the terms of trade is measured by the slope of Line-OY_2.

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But OY_2 is Less steeper (Flatter) than OE.
So here terms of trade are unfavourable For country-A.

6) **Revenue Effect :-** Due to import Quota, import is restricted but Production of domestic industries increase from OR to OT. It also increase the Price from OP to OP_1. Thus import Quota helps to increase Revenue of Government.

7) **Balance of Payment Effect :-** One of the main Objective of Using import Quota is to reduce the balance of Payment deficit by restricting imports. The income spent on import can be now utilised for investment in the import substitution or Promoting export industries.
Thus import Quota helps to improve BOP Position.

8) **Protective Effect :-** Import Quota helps domestic industries from foreign competition. Quotas encourage home Production and Protect Domestic industries from foreign competition.

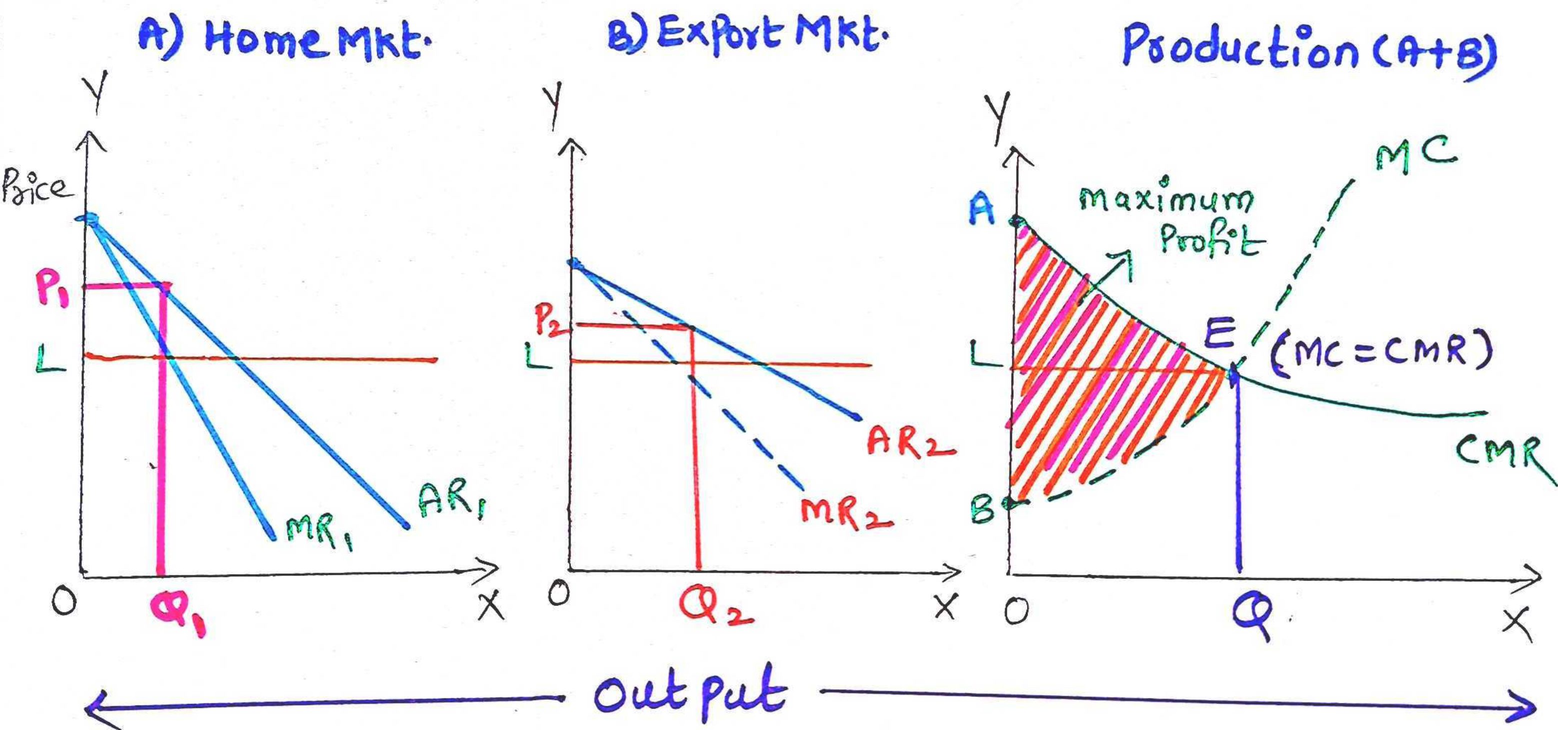
Q:6 Explain Price determination Under dumping and discuss Various Anti-Dumping measures ?

(A) **Dumping :-** Dumping is a special Kind of Price-discrimination in monopoly market. Here monopolist charge high Price for his Product in Domestic market and Less Price for his Product in Foreign market.

When firm sell its goods in foreign market at low price, sometimes producer may suffer losses but it is done to driving out rivals from market. In Dumping market, consumers enjoy a lower price initially but slowly and gradually consumers exploited by the firm when it enjoys monopoly power in foreign market.

(B) **Meaning :-** "Price Distribution in Domestic and foreign market is known as Dumping"

(C) **Price Determination Under Dumping :-**



In above figure we observe :-

1) A producer sell OQ_1 out put at high price $-OP_1$ in Home market. Here producer enjoy monopoly power.
2) A producer sell OQ_2 quantity at low price $-OP_2$ in foreign market. Here producer gets healthy competition

3) Total Output - OQ is distributed in Home Market $= OQ_1$ and Export market $= OQ_2$.

Total Output = Home market + Export market

$$OQ = OQ_1 + OQ_2$$

Here $MC = CMR$ (combined marginal Revenue)

Here Producer enjoy maximum profit = ABE - Shaded area

4) It is possible that by charging Low Price in Export market, Producer may succeed in driving out rivals from market and finally acquire monopoly and charge higher Price.

Therefore, dumpings are mostly discouraged by WTO.

D) Anti_Dumping Measures :-

1. **Subsidies to Domestic Producers :-** Domestic industries are adversely affected by Low Priced Foreign goods. So government provide subsidies to domestic Producers to reduce cost and Price of commodity.
   But subsidies put heavy burden on the government and Tax-Payers. It will also make domestic Producers to be Less-efficient. Consumers do not get benefit of Comprative Cost advantage.

2. **Tax Concession :-** Tax Concession is very Common incentive Provided to home Producers.
   Example - Tax-holiday may be given to Producers for Few years.
   It will support domestic sellers to charge Lower Price and discourage foreign Competition.

3. Local Content Requirement :- Under this rule, Producers are compelled to use local inputs even though they may be costlier. In many cases this local content requirement is fixed upto 51%.
Many developing countries impose such Non-Tariff barrier in order to protect the domestic industries.
Even advanced country like-USA also made use of this non-tariff barrier.

4. Preference to Domestic Suppliers :- Government purchase number of goods and services in many countries So to encourage domestic producers, the government Purchase these goods and services from domestic industries to reduce import.

5. Red-Tape Barriers :- Government impose many health and safety standards on Import of goods. Even Custom Procedures are made difficult to reduce imports.

6. Social Dumping :- Many developed countries do not accept the goods which are manufactured by Child labour.
Example - Carpets, match box, fire works, Garments etc.
Social dumping as a barrier can be used to Prevent Labour intensive Products.

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Q:7 Discuss Various types of Dumping?

(A) Dumping } Same from
(B) Meaning } Q:6

(C) Types OF Dumping :-

1. **Sporadic / Intermittent Dumping :-** Sporadic dumping is a exceptional Situations when the domestic Production is in Surplus even after sales. Here Producer try to sell this unsold stock of goods in foreign market at Lower Price. This is Possible only when demand for commodity is elastic in Foreign market and Producer is monopolist in Domestic market.

2. **Persistent Dumping :-** "When a monopolist Continuously sells a Portion of his Commodity at high Price in domestic market and rest output of his commodity at Lower Price in Foreign market is Called Persistent Dumping."
Thus Producer earns more Profit by selling more Quantity in foreign market.

3. **Predatory Dumping :-** "when a monopolist sells his commodity at Very Low Price in foreign market to drive out some Competitors is called Predatory Dumping."
After eliminating competition, producer increase the Price of Commodity in foreign market. Thus Producer will try to cover the Loss after enjoying monopoly Position.

Q:8 Write short note on

1. **Trade Barriers :-** Trade barriers are artifical restrictions on import and export of goods and services. Many Countries follows trade barriers to Provide maximum advantage to their countries.

Advantages of Trade barriers are —

i) To encourage New domestic industries.
ii) To Protect domestic industries from foreign Competition.
iii) To maintain Favourable BOP Position.
iv) To Save Foreign Exchange Reserve.
v) To restrict imports and Promote Exports.

Types of Trade Barriers

1) Tariff Barriers
2) Non-Tariff Barriers

1) **Tariff Barriers :-** " A tariff is duty imposed on Commodities that are traded across the national border of a Country"

Tariff Can be imposed on both imports and exports. It is also known as Import duties / Custom duties

Example

1) Import Duties
2) Export Duties
3) Transit Duties
4) Specific Duties
5) Advalorem Duties
6) Compound Duties
7) Anti-Dumping Duties
8) Consular formalities.

2) **Non-TariFF Barriers :-** "Imports Can be restricted by Putting barriers other than tariffs are Called

Non-tariff barriers."

These are Quantitative restrictions used by nation to reduce inflow of foreign goods in domestic country.

Example

i) Quotas and Licensing
ii) Trade blocks
iii) Government Procurement
iv) Custom Regulations
v) Foreign Exchange Restriction
vi) Administrative Regulation
vii) Preferential Agreements
viii) Unilateral import quota
ix) bilateral quotas
x) mixed quotas etc.

Q:9 Write short note- Effective Tariffs.

Effective Tariffs :- Tariff which is imposed on the Value of Commodity is called nominal/Advalorem tariff.

Example :- Import duty on manufactured item is 20% is a nominal tariff. This import duty is different according to type of commodity or stage of manufacturing. Generally Rate of Tariff is high for manufactured goods but for raw-materials like- cotton, leather, rubber etc. have Low rate of Tariff.

Generally advanced Countries prefer to protect their domestic industries by imposing tariffs on final goods.

Meaning :- " Effective Tariff means the Value of Protection Provided to a Particular Process OF Production by charging nominal tariff on a Product and on material inputs used in its Production"

Example:- India export shoes and leather to USA. In USA the cost of manufacturing shoes is \$25 out of which \$15 is the cost of Leather. This is the Free Trade Price of Per Pair of shoes. Suppose USA impose 30% duty on import of shoes but no duty on import of Leather, then Price of shoes in USA will be \$32.5.

	Free Trade cost Price	After Tariff cost Price (30%)
Shoe Price	\$ 25	\$ 32.5
Leather Cost	\$ 15	\$ 15
Value added.	\$ 10	\$ 17.5

$$\text{Effective Tariff Rate} = \frac{\text{Value added after Tariff} - \text{Value added before tariff}}{\text{Value added before Tariff}}$$

$$\text{Effective Tariff Rate} = \frac{\$17.5 - \$10}{\$10} = \underline{75\%}$$

Effective Tariff rate will be reduced when Tariff can be imposed on Import of inputs.

Suppose import duty on shoes = 30% and on leather = 20%

	Free Trade Cost Price	After Tariff Cost Price
Shoe Price	\$ 25	\$ 32.5 (30%)
Leather input	\$ 15	\$ 18 (20%)
Value added	\$ 10	\$ 14.5

$$\text{Effective Tariff Rate} = \frac{\text{Value added after Tariff} - \text{Value added before Tariff}}{\text{Value added before tariff}}$$

$$\text{ETR} = \frac{\$14.5 - \$10}{\$} = \underline{45\%}$$

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