V-LRN
VIRTUAL LEARNING NETWORK

International Business Environment

Block - 1

Unit – 4

Instruments of Trade Policy

Topics to be Covered

- Introduction
-  A Partial Equilibrium Theory of Trade
-  Non-Tariff Barriers to Trade
-  Quota versus Tariff
-  Exchange Control
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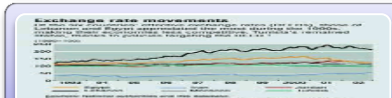
  Balance of Payments Adjustments
-  Flexible Exchange rates
-  Fixed Exchange Rates
- Summary

Introduction

- The countries that tend to restrict trade by charging an import tariff (a tax on imported goods) are said to follow a protectionist trade policy. A tariff is a price based policy to restrict trade because it changes the price of import paid by the importer. But there are other ways to restrict trade and some of these are non-price based policies. For instance an import quota will restrict the quantity of import. These non-price based policies are known as non-tariff barriers to trade. In this unit, you will learn the partial equilibrium theory of trade and various non-tariff barriers to restrict trade.

Instruments of Trade Policy

Trade policy is followed by the countries that tend to restrict trade by charging an import tariff(a tax on imported goods).

Tariff: It is a price based policy to restrict trade because it changes the price of import paid by the importer.

Non-tariff barriers: Government policies and administrative practices that regulates or restrict the foreign trade.

Partial Equilibrium Theory of Trade

Partial equilibrium is a synonym for “demand and supply” analysis

Partial equilibrium analysis is often used in trade policy because of its simplicity

Consider a competitive equilibrium in one market holding all factors other than demand and supply in that market constant

For a small, open economy the equilibrium will involve domestic demand and supply and a given world price (either foreign D or S)

Non-Tariff Barriers to Trade

Government policies and administrative practices regulates foreign trade

Major kinds of non-tariff barriers:

- Customs classification and valuation
- Subsidies
- Local content & foreign investment performance requirement
- Technical standards & health regulations
- Government procurement
- Restrictions on services

Quota versus Tariff

Quota- Quantitative measures of restrictions imposed by the government to regulate the International trade.

Tariff- It refers to a tax imposed by a government on physical goods as they move into or out of a country.

Quota versus Tariff (Contd.)

Three Reasons Why Tariffs Are Preferable to Quotas

Tariffs Generate Revenue for the Government

Import Quotas Can Lead to Administrative Corruption

Import Quotas Are More Likely to Cause Smuggling

Balance of payments adjustments

If part of the balance of payments is in deficit or surplus for a period of time, mechanisms are needed to restore equilibrium

Adjustment mechanisms can be:

- Automatic - economic processes
- Discretionary - government policies

Balance of Payments Adjustments (Contd.)

Automatic adjustment under fixed exchange rates

Key variables

- Prices
- Interest rates
- Income
- Money

Exchange Control

In India before trade liberalization in 1991 import licensing was combined with exchange control.

Only the holders of the import licenses were given permission to purchase foreign currencies from banks.

Therefore, exchange control or the control on the issue of foreign currencies was simply a part of the import licensing system.

This is what has made Rupee a non-convertible currency.

Fixed Exchange Rates

A fixed exchange rate is usually used to stabilize the value of a currency against the currency it is fixed to. Under fixed exchange rate system a deficit in the balance of payment is adjusted by money supply changes and the consequent changes in the price level.

Fixed rates provide greater certainty for exporters and importers. This also helps the government maintain low inflation, which in the long run should keep interest rates down and stimulate increased trade and investment.

Summary

- Trade policy is an important instrument to regulate the foreign trade. Government impose restrictions to protect the domestic industries. The restriction may be in the form of tariff and non-tariff barriers. A tariff is a price based policy to restrict trade.
- Non-tariff barriers may affect either price or quantity directly. The major non-tariff barriers include: customs classification and valuation, subsidies, local content and foreign investment performance requirement, Technical standards and health regulations, Government procurement, Restrictions on services, quota, etc. Exchange control and balance of payment adjustments are another means of regulating the foreign trade.


Thank you