Chapter 7

Import Tariffs and Quotas under Perfect Competition

International Economics

» After World War II, representatives of the Allied countries met on several occasions to discuss issues such as high trade barriers and unstable exchange rates.

» In 1947, the General Agreement on Tariffs and Trade (GATT) was established. Purpose was to reduce barriers to trade between nations.

WTO

Key Provisions of the GATT

- **Article I** General Most-Favored-Nation Treatment
- **Article VI** Anti-Dumping and Countervailing Duties
- **Article XI** General Elimination of Quantitative Restrictions
- **Article XVI** Subsidies
- **Article XIX** Emergency Action on Imports of Particular Products
- **Article XXIV** Territorial Application—Frontier Traffic—Customs Unions and Free-Trade Areas

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Some of the GATT's main provisions:

1. A nation must extend the same tariffs to all trading partners that are WTO members. ("most favored nation" MFN clause)
2. Tariffs may be imposed in response to unfair trade practices such as "dumping", i.e., the sale of export goods in another country at a price less than that charged at home, or alternatively, at a price less than costs of production and shipping. (To be considered later.)

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3. Countries should not limit the quantity of goods and services that they import, i.e., no quotas.
4. Countries should declare export subsidies provided to particular firms, sectors, or industries. Article XVI deals with export subsidies, and states that countries should notify each other of the extent of subsidies and discuss the possibility of eliminating them.
5. Countries can temporarily raise tariffs for certain products. Article XIX, called the **safeguard provision** or the escape clause. The importing country can temporarily raise the tariff when domestic producers are suffering due to import competition.

WTO

6. Regional trade agreements are permitted under Article XXIV of the GATT. The GATT recognizes the ability of blocs of countries to form two types of regional trade agreements:

   (i) free-trade areas: a group of countries voluntarily agrees to remove trade barriers between themselves

   (ii) **customs unions**: free-trade areas in which the countries also adopt identical tariffs between themselves and the rest of the world

WTO

- In 2002, the Bush administration imposed tariffs on steel imports following an electoral promise to help the steel industry.
- The following article of the GATT was invoked: **Article XIX** Emergency Action on Imports of Particular Products
- The following tariffs were in place from March 2002 to December 2003:

U.S. tariffs on steel

Product Category	U.S. ITC Recommendation (First Year, %)	Actual U.S. Tariff (First Year, %)
Carbon and Alloy Flat Products		
Slab	20	30
Flat products	20	30
Tin mill products	U*	30
Carbon and Alloy Long Products		
Hot-rolled bar	20	30
Cold-finished bar	20	30
Rebar	10	15
Carbon and Alloy Tubular Products		
Tubular products	?**	15
Alloy fittings and flanges	13	13
Stainless and Tool Steel Products		
Stainless steel bar	15	15
Stainless steel rod	?**	15
Stainless steel wire	U*	8

* U: Uncertain—the ITC was divided on whether a tariff should be used or not.
** ?: A specific recommendation was not made by the U.S. ITC.

U.S tariffs on steel

» Deadweight loss due to the steel tariff:

$$DWL = \frac{1}{2} \bullet t \bullet \Delta M$$

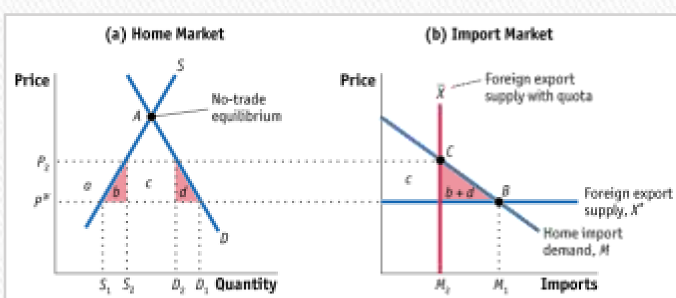
» Relative to the value of imports:

$$\frac{DWL}{P^W \bullet M} = \frac{1}{2} \bullet \frac{t \bullet \Delta M}{P^W \bullet M} = \frac{1}{2} \bullet \left(\frac{t}{P^W} \right) \bullet \% \Delta M$$

» Using a 30% tariff and following a 30% fall in imports, yields:

$$\frac{DWL}{P^W \bullet M} = \frac{1}{2}(0.3 \bullet 0.3) = 4.5\%$$

U.S tariffs on steel (small country case)



» 4.5% of an average import value of $4.1 billion implies a DWL of $185 million.
» This loss is born by U.S. consumers of steel.
» But foreign producers also lose.

U.S. tariffs on steel

» Response of European countries
- The WTO has a formal dispute settlement procedure under which countries that believe that the WTO rules have not been followed can bring their complaint and have it evaluated.
- The countries in the European Union (EU) took action by bringing the case to the WTO. The WTO ruling entitled the European Union and other countries to retaliate against the United States by imposing tariffs of their own against U.S. exports.
- The use of tariffs by an importer can easily lead to a response by exporters and a **tariff war**.

U.S. tariffs on steel

» Estimate of optimal tariff using elasticity of export supply:

Product Category	Elasticity of Export Supply	Optimal Tariff (%)	Actual Tariff (%)
Alloy steel flat-rolled products	0.27	370%	30%
Iron and steel rails and railway track	0.80	125	0
Iron and steel bars, rods, angles, shapes	0.80	125	15–30
Ferrous waste and scrap	17	6	0
Iron and steel tubes, pipes, and fittings	90	1	13–15
Iron and nonalloy steel flat-rolled product	750	0	0

US tariffs on steel: Large country case

» We cannot tell whether steel tariffs contributed to increase welfare in the US.

» In any case, possibility of retaliation by trading partners would most likely reverse any gain in the US.

» That is why the US promptly removed the tariffs.

US tariffs on steel: The large country case

- In 2009, the U.S. imposed a tariff on tires imported from China.
- This time, the tariff applied against only one country.
- The tariff was supported by workers' unions but time not by US tire producers.
- Most tire producers in the U.S. also operate in China, i.e., tire producers would lose from tariffs.

U.S. tariffs on tires

- This led to a (mild) retaliation from China followed by a counter-retaliation by the U.S.
- China filed a complaint to the WTO.
- The WTO ruled against China. NYT Dec 2010:

The imposition of the tariffs was the first time that the United States invoked a special safeguard provision that was part of its agreement to support China's entry into the W.T.O. in 2001.

Under that provision, United States companies or workers harmed by imports from China can ask the government for protection simply by demonstrating that American producers have suffered a "market disruption" or have experienced a surge in imports from China. In more traditional antidumping cases, the government would have to determine that a trading partner was competing unfairly or selling its products at less than their true cost.

U.S. tariffs on tires

» In any case, the tariff should not last more than three years.

U.S. tariffs on tires ›

- One of the founding principles of GATT was that countries should not use quotas to restrict imports.
- The Multifibre Arrangement (MFA), organized under the auspices of the GATT in 1974, was a major exception to that principle and allowed the industrial countries to restrict imports of textile and apparel products from the developing countries.
- Importing countries could join the MFA and arrange quotas bilaterally (i.e., after negotiating with exporters) or unilaterally (on their own).

China and the MFA ›

- The MFA expired on January 1, 2005. The biggest potential supplier of textile and apparel products was China. Immediately after January 1, 2005, exports of textiles and apparel from China grew rapidly.
- Given the drop in prices in 2005 from countries selling to the United States, it is possible to estimate the welfare loss due to the MFA.
- The United States did not auction the quota licenses for textiles and apparel so the quota rents were earned by foreign exporting firms.
- That means the welfare loss for the United States due to the MFA is the area (*b* + *c* + *d*). Estimated at around $11.4 billion or $100 per U.S. household.

China and the MFA

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- The European Union threatened to impose new quotas on Chinese exports, and in response, China agreed on June 11, 2005, to “voluntary” export restraints.
- Due to the worldwide recession, Chinese exports in this industry were much lower in 2009 than they had been in earlier years.
- China indicated that it would not accept any further limitation on its ability to export textile and apparel products to the United States and to Europe, and both these quotas expired.

China and the MFA