M.A. SEM II & B.A. SEM IV, ECONOMICS,

INTERNATIONAL ECONOMICS, PAPER II

Tariffs and Quotas

E-Content in PPT format prepared by
Dr. Bharti Pandey
Head, Department of Economics, SJNMPG College, Lucknow

There are two types of protection:

Tariffs

Tariff is a kind of tax, which is paid on the import of goods and services. It is used as a tool to limit trade, because, tariffs increase the price of foreign goods and services and thus it makes them more expensive for the customers. It is levied by the government to increase revenue and also to protect domestic companies against foreign competition, as the customers will get attracted by the imported goods if they are comparatively less costly. It acts as a barrier to free trade between nations.

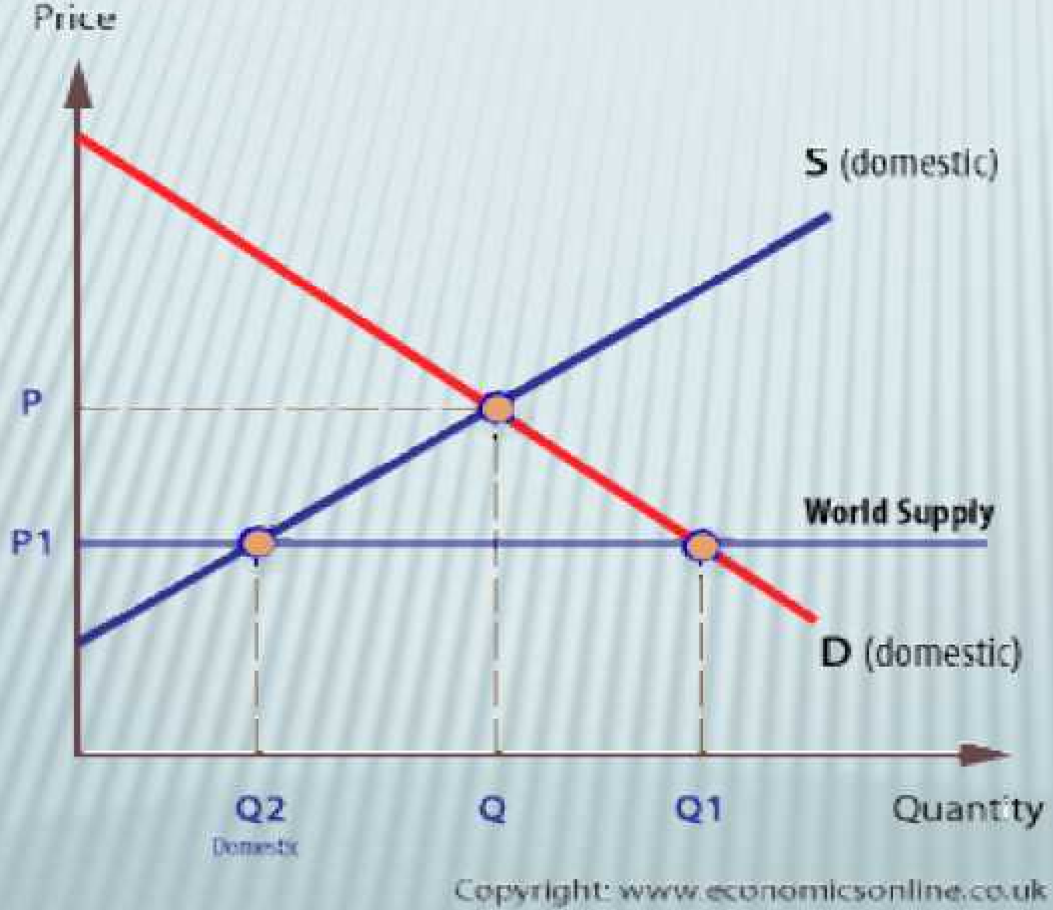
There are two kinds of tariffs, which are indicated below:
Ad valorem tariff: A certain percentage of tariff calculated on the value of imported items.
Specific tariff: A specified amount is charged depending upon the type of goods.

Quotas

Quota refers to a defined upper limit set by the government, on the number of goods or services imported or exported from/to other countries, in a particular period. It is a measure used in the regulation of trade volume between nations.
Quotas do not generate revenues for the government, but aims at encouraging the production of goods within the country; that helps the nation to become self-sufficient and decrease dependency on imports from other countries. In this way, quota helps in reducing imports and thus, protecting own industries from foreign competition.

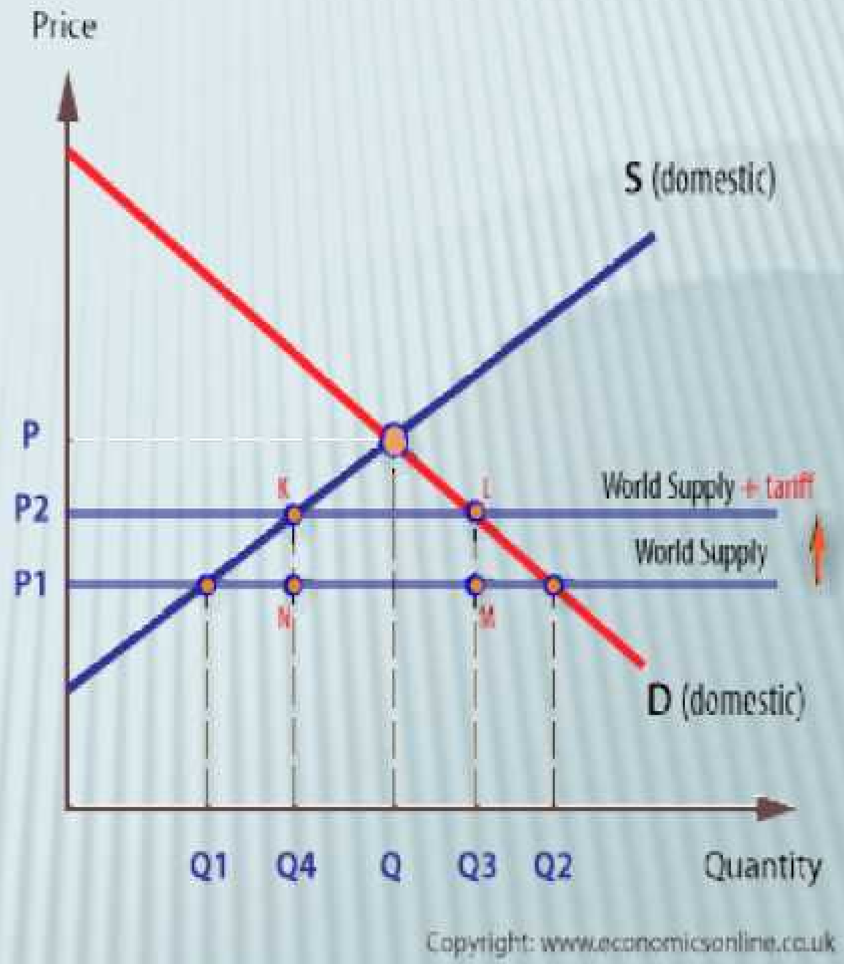
BASIS FOR COMPARISON	TARIFF	QUOTA
Meaning	Tariff refers to the tax levied on import or export of goods.	Quota refers to the restriction imposed on the quantity of goods imported.
Effect on Gross Domestic Product	Increases GDP.	No effect on GDP.
Results in	Fall in consumer's surplus and rise in producer's surplus.	Fall in consumer surplus.
Income	To government	To importers

NO TRADE CONDITION



With no trade, equilibrium market price in the country will exist at the price which equates domestic demand and domestic supply, at P, and with output at Q. However, the world price is likely to be lower, at P1, than the price in a country that does not trade. If the country is opened up to free trade from the rest of the world, the world supply curve will be perfectly elastic at the world price, P1.The new equilibrium price is P1 and output is Q1. The domestic share of output is now $Q_{2,}$ compared with Q, the self-sufficient quantity. The amount imported is the distance Q2 to Q1.

Domestic consumers face higher prices, which also means that there is a loss of consumer surplus. However, there is a gain in domestic producer surplus as producers are protected from cheap imports, and receive a higher price than they would have without the tariff. However, it is likely that there is an overall net welfare loss. Without trade, the domestic price and quantity are P & Q. If a country opens up to world supply, price falls to P1, and output increases from Q to Q2. As a result, domestic producers' share falls to Q1 and imports now dominate, with the quantity imported Q1 to Q2.



THE IMPACT OF TARIFFS

The imposition of a tariff shifts up the world supply curve to *World Supply + Tariff*. The price rises to P2, and the new output is at Q3. Domestic producers share of the market rise to Q4, and imports fall to Q4 to Q3. The result is that domestic producers have been protected from cheaper imports from the rest of the World. Given that domestic consumers face higher prices, they also suffer a loss of consumer surplus. In contrast, domestic producers increase their producer surplus as they receive a higher price than they would have without the tariff. Increased market share also means that jobs will be protected in the domestic economy.

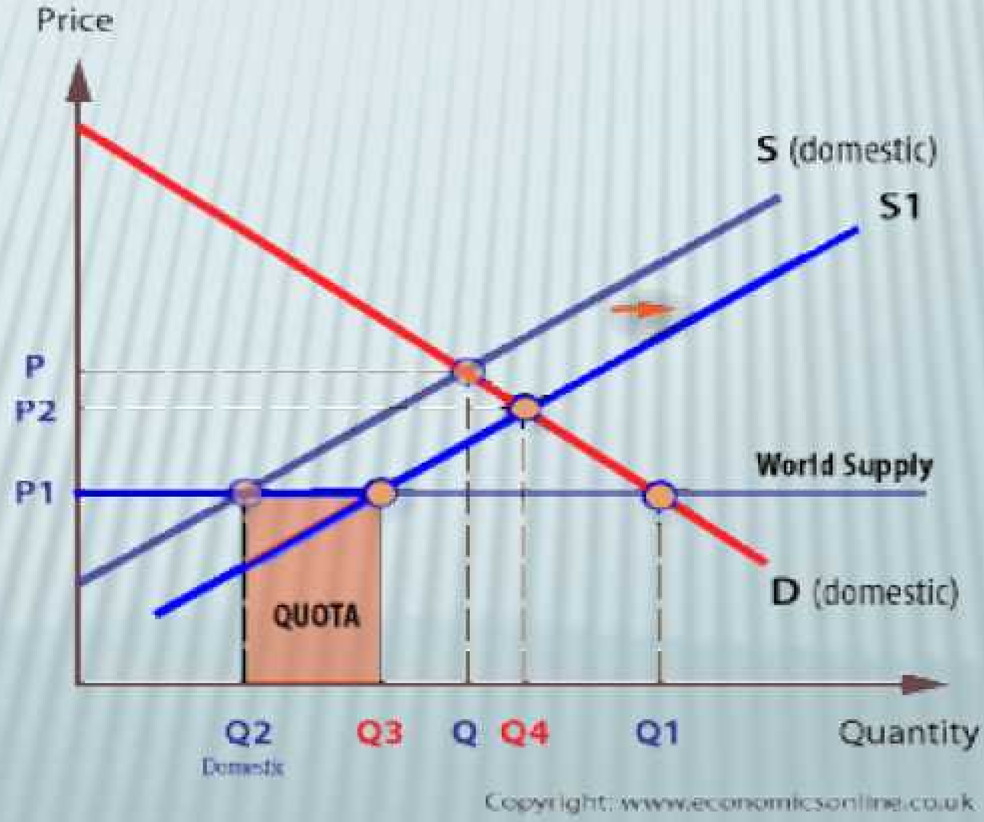
In an attempt to protect domestic producers, a quota of **Q_2 to Q_3** may be imposed on imports.

This enables the domestic share of output to rise to **0** to **Q2,** plus **Q3** to **Q4.**

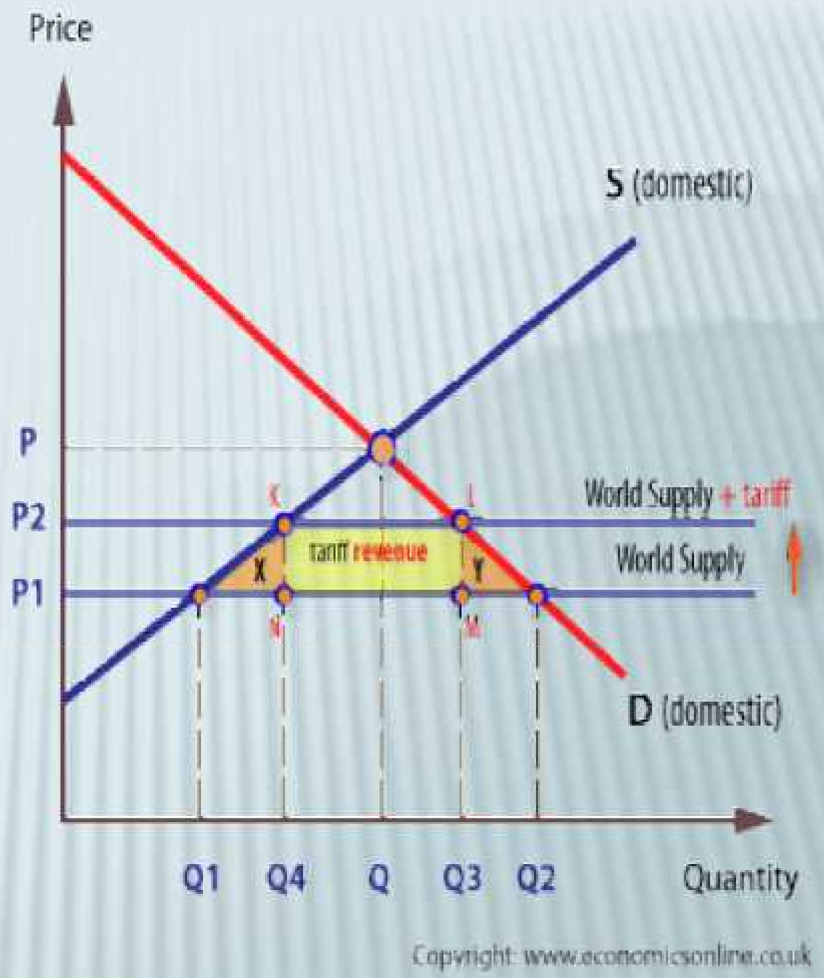
IMPOSING A QUOTA

The quota creates a *relative shortage* and drives the price up to P2, with total output falling to **Q4**. The amount imported falls to the quota level. It is this price rise that provides an incentive for less efficient domestic firms to increase their output.

One of the key differences between a tariff and a quota is that the welfare loss associated with a quota may be greater because there is no tax revenue earned by a government. Because of this, quotas are less frequently used than tariffs.



However, the reduction in consumer surplus is greater than the increase in producer surplus. Even when adding the tariff revenue (area **KLMN**) there is still a net loss. The net welfare loss is represented by the triangles X and Y.



WELFARE LOSS

Conclusion

After reviewing the above points, it is quite clear that these two terms are very different. Although there are some similarities, like they both acts as a tool that seeks to control the international trade and encourage the production within the home country, for the purpose of making it, self-sufficient.

Source of Study Material

https://www.economicsonline.co.uk/Global_economics/Tariffs_and_quotas.html

https://keydifferences.com/difference-between-tariff-and-quota.htm