

External trade

Code: 102342
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Grup 4
Fall term

Midterm Exam

(Duration: 90 minutes)

Answers are added in blue right below each question. Please consider that I am just presenting the key information your answers have to include: of course, any further appropriate discussion or details have been considered very welcome.

Problem 1 (2 points)

Provide a short description of the following concepts and their domain of application in the theory of external trade:

- 1) TARIC
- 2) Compound tariff
- 3) Passive temporary importation under bond
- 4) Customs Union
- 5) CESCE

Answer:

TARIC: It is an international code to identify the merchandise to be traded. It is string with max 16 digits. The first two digits refer to the NACE class or group and the digits 3-4 to the NACE subgroup.

COMPOUND TARIFF: It is a two-part tariff: a first part can be an ad-valorem, specific or mix tariff whereas the second part fixes a maximum or a minimum amount of tariff to be due according to an exogenous fixed limit.

PASSIVE TEMPORARY IMPORT UNDER BOND: It is a waiver for a tariff when we are importing a good that has been produced by using a piece/input previously exported by the national firms that is importing the good. Key condition: this exported piece/input has to be unique and fundamental for the production of the product to be imported.

CUSTOMS UNION: It is the second step of the integration process. It refers to a group of countries that decide to freely trade among them as well as to adopt the same trade policy versus third countries.

CESCE: It is a consortium (government, bank, insurances) granting insurances for trading with high risk countries. This insurance covers the country risk.

Problem 2 (3 points)

The government of the small country, Pontevedrina, is in trouble for the increasing trade deficit. Hence, given it is not a WTO member, it decides to introduce a tariff on the highly imported merchandise (dresses). Discuss the expected effects of this policy with a graph.

Meanwhile, the administrative officers of Pontevedrina have doubts about the way to implement this policy. They are exploring a few options:

- Imposing an ad-valorem tariff on dresses of 10%.
- Imposing a specific tariff on the imported cotton of 10€ per kg.
- Imposing the two previous tariffs jointly.

To produce a dress whose final value is 75€, a producer needs to use 2kg of cotton with an overall cost of 10 €. Assess the most convenient tariff policy to be implemented to protect national dress producers.

Answers:

The first part of the problem requires to discuss the effects of the introduction of a tariff in a small country and in a competitive economy. The tariff reduces the amount of import. This result comes from the combination of an increase in the internal production (due to the higher price that makes previously inefficient producers start producing) and a reduction of the demand of national consumers because of the increase of the price.

A graph summarizing these effects is the following:

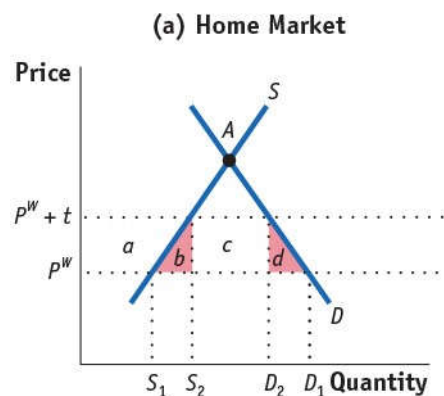


Figure 8.5
Feenstra/Taylor, *International Economics*, 4e, © 2017

The previous graph emphasizes the loss of the efficiency of producers due to the tariff (area *b*), a loss of efficiency of consumers (area *d*), whereas the area *c* is the total amount of tax that goes to the government. The initial amount of imports is given by the segment $(D_1 - S_1)$, while the total amount of imports after the tariff is $(D_2 - S_2)$ knowing that $(D_1 - S_1) > (D_2 - S_2)$.

The second part of the problem has to be solved by making reference to the concepts of

$$\text{NOMINAL RATE OF PROTECTION: } \left(\frac{P_t - P}{P} \right) * 100$$

$$\text{EFFECTIVE OR REAL RATE OF PROTECTION: } \left(\frac{VA_t - VA}{VA} \right) * 100$$

Being P_t the final price with tariff (if any) and VA_t the value added in the case of tariffs on costs and prices (if any).

a) Ad-valorem tariff: 10%

$$P_t = 75 + 0.1 * 75 = 75 + 7.5 = 82.5$$

$$P = 75$$

$$VA = 75 - 10 = 65$$

$$VA_t = 82.5 - 10 = 72.5$$

$$\text{Nominal protection rate: } \left(\frac{82.5 - 75}{75} \right) * 100 = 10\%$$

$$\text{Effective protection rate: } \left(\frac{72.5 - 65}{65} \right) * 100 = 11.5\%$$

In this case, the national dress producers are protected in an effective way (11.5 > 0)

b) Specific tariff on cotton: 10€/kg

$$P_t = P = 75$$

$$VA = 75 - 10 = 65$$

$$VA_t = 75 - 10 - 2 * 10 = 45$$

$$\text{Nominal protection rate: } \left(\frac{75 - 75}{75} \right) * 100 = 0$$

$$\text{Effective protection rate: } \left(\frac{45 - 65}{65} \right) * 100 = -30.77\%$$

In this case, the national dress producers are not protected in an effective way (-30.77 < 0)

c) Bothe the tariffs

$$P_t = 75 + 0.1 * 75 = 75 + 7.5 = 82.5$$

$$P = 75$$

$$VA = 75 - 10 = 65$$

$$VA_t = 82.5 - 10 - 2 * 10 = 52.5$$

$$\text{Nominal protection rate: } \left(\frac{85 - 75}{75} \right) * 100 = 10\%$$

$$\text{Effective protection rate: } \left(\frac{52.5 - 65}{65} \right) * 100 = -19.23\%$$

In this case, the national dress producers are not protected in an effective way (-19.23 < 0)

The most convenient tariff policy is the option a) that is the ad-valorem tariff because it is the unique option that guarantees a real (effective) protection to the dresses' producers in Pontevedrina.

Problem 3 (2.5 points)

An entrepreneur in Seville has a great business idea to create a retail shop for exotic plants from Borneo (Malaysia). However, she is aware of the trade limitation for importing plants from abroad. Hence, she thinks of creating a branch of her business in Tenerife (Canarias) in such a way to import directly from Borneo to Tenerife (Canarias) to exploit the different import rules, which are more advantageous than the ones in the EU and, then, move the merchandise from Tenerife to Seville. Having this setting in mind, discuss:

- 1) The requirements for importing plants in the EU.
- 2) The types of documents required for importing in Tenerife and in Seville according to the strategy described above.
- 3) Does this strategy make sense to overcome the EU requirements? Why? Argue your answer.

Answers:

The situation involves a double delivery:

First: Borneo to Tenerife

Second: Tenerife to Sevilla.

- 1) EU requirements for plants: CITES certificate plus other potential requirements (if any) specific to plants; but this is a free import that do not require permits
- 2) Documents required for the **delivery Borneo- Tenerife**. This operation needs to be performed using a DUA. The release of the merchandise will be done in Tenerife; hence it will be according to the quality requirements of Canarias and, if any, tariffs have to be paid over there. In addition, the merchandise will be subject to IGIC.

The second delivery is **Tenerife – Sevilla**. Once more, this operation will need a DUA; no tariff payment at the arrival because we are delivering inside a customs union; requirements for quality control according to the EU rules that is CITES certificate plus other controls if any. The release of the merchandise will be performed by a broker in Madrid (customs of import), whereas the merchandise can be stores in Madrid or in one of the customs of entry in Spain. Finally, the merchandise is also subject to TVA.

- 3) The advantages for this type of operation cannot be taken for granted since Canarias and continental Spain (including Balearic islands) adopt different quality requirements for importing merchandise from outside the European Union. Even if passing through Tenerife, at the end, the merchandise has to satisfy the EU standards of quality. In addition, this double delivery implies double costs concerning the releases of the merchandise as well as other administrative costs like the broker commission at the two customs.

Problem 4 (2.5 points)

Consider the following data referring to the Spanish ITC and its components (source: Secretaría de Estado de Comercio):

	EU-19			EU28		
	IPR	IRX	ITC	IPR	IRX	ITC
2015	98.7			98.4	99.1	
2016	98			97.7	100.3	
2017	97.4			98.0	100.8	

- 1) Compute the ITC and discuss the changes of Spanish competitiveness with respect to the two groups of countries.
- 2) Discuss the extent the changes in the ITC can be associated with changes in real competitiveness rather than depreciation of the currency.

Answers:

The problem asks for considering the competitiveness of Spain against two groups of countries:
EU19: European countries adopting euro
EU28: European Union

The table needs to be completed with missing data according to the following equation:

$$ITC = \frac{IPR * IRX}{100}$$

EU19=> IRX=100

The relative exchange rate when considering the competitiveness of Spain versus the other countries adopting euro is 100 because they all adopt the same currency. It cannot be zero, otherwise ITC would be zero as well.

Hence, the complete table is

	EU-19			EU28		
	IPR	IRX	ITC	IPR	IRX	ITC
2015	98.7	100	98.7	98.4	99.1	97.5
2016	98	100	98	97.7	100.3	98
2017	97.4	100	97.4	98.0	100.8	98.8

Discussion:

- a) Spanish competitiveness versus EU19 only depends of the relative changes in prices (IPR). It better along the whole period because of the lower relative inflation rate experienced by Spain.
- b) Spanish competitiveness versus EU28 is worsening (the magnitude of the indicator is increasing) and it depends on the combination of the effect of the relative prices and relative exchange rates. As for the effect of the relative prices (IPR) the evolution of the Spanish inflation rate with respect to the rest of EU28 is fluctuating: it is bettering from 2015 to 2016 but it is worsening from 2017 to 2018. Instead the IRX component follows a monotonic evolution indicating that the euro is permanently appreciating against the basket of currency of EU28 countries. Therefore, the worsening of the Spanish competitiveness is mostly due to the appreciation of the euro that arrives up to overcome any potential beneficial effects in prices (IPR) in the period 2015/2016.