
Restrictions on free trade

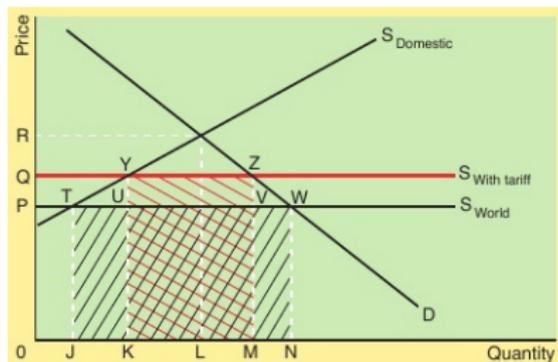
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RESTRICTIONS ON FREE TRADE

- ▶ *comparative advantage* + free trade → maximizes output
- ▶ *protectionist policies*: goal is to reduce imports
- ▶ *methods* used in protectionism:
 - ▶ tariffs
 - ▶ quotas
 - ▶ subsidies
 - ▶ exchange rate manipulation
 - ▶ administrative barriers

TARIFFS

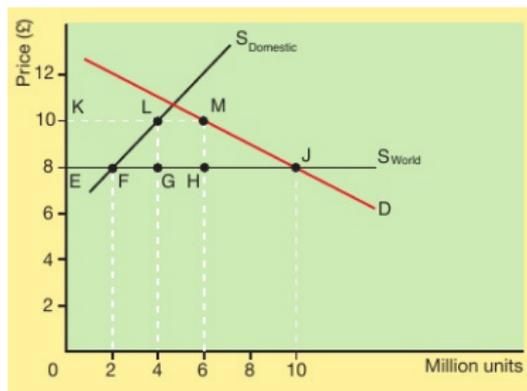
- ▶ *tariff*: tax on imported goods
- ▶ tariff is likely to increase price of the good to final consumer
- ▶ \uparrow final price of good \rightarrow
 - ▶ demand & volume of imports \downarrow
 - ▶ domestic production \uparrow



- ▶ imposing tariff \rightarrow
 - ▶ *loss* in consumer surplus (of PQZW)
 - ▶ *gain* in producer surplus (of PQYT)

QUOTAS

- *Quota*: physical limit on the quantity of a good imported



SUBSIDIES

- ▶ used to *increase exports* and *reduce imports*
- ▶ Export subsidies:
- ▶ Subsidies to reduce imports:

ADMINISTRATIVE BARRIERS

- ▶ *product standards*: will raise the costs to importers
- ▶ *bans on imports*:
- ▶ *licences to import*:
- ▶ *limitation on ports or airports* as access point:
- ▶ slowing down the *paper work*:
- ▶ delaying *shipments*:
- ▶ *bribery* of officials:

EXCHANGE RATE MANIPULATION

- ▶ ↓ exchange rate → exports will be cheaper and imports more expensive
- ▶ exchange rates are today *floating*:
- ▶ however some countries may *peg* their exchange rates

REASONS FOR RESTRICTIONS ON TRADE

- ▶ The *infant industry* argument: countries may want to protect *new industries* (i.e., Japan)
- ▶ Job protection: protect or preserve jobs (*downside*: consumers will pay more)
- ▶ Dumping: sale of goods below their cost of production (i.e., distress sale, excess capacity in short run, push out competitors)
- ▶ Cheap labour: unfair competition or source of comparative advantage?
- ▶ The terms of trade:
- ▶ Other arguments: defence industry, keep out *dangerous* products

IMPACT OF PROTECTIONIST POLICIES

- ▶ Consumers: high prices and restricted choice
- ▶ Producers: keeps out competition (*positive*); input for production may become more expensive (*negative*)
- ▶ Workers: prevents closing domestic firms (*positive*); avoids reallocation of resources (*negative*)
- ▶ Governments: gain in taxes (through tariffs or saved jobs)
- ▶ Living standards: short-run may protect living standards, in long run it may harm (inefficiency → slow growth)
- ▶ Equality: more equal distribution of income

FREE TRADE VS. PROTECTIONISM

- ▶ Argument in favour of *free trade*:
 - ▶ *specialisation*: efficient allocation of resources between countries
 - ▶ *static and dynamic efficiencies*: stimulates innovation, reduces production costs
 - ▶ *protect infant industries*
 - ▶ *protection against dumping*
- ▶ Difficulty in lowering protectionist barriers:
 - ▶ countries seek reciprocity
 - ▶ *tit-for-tat* behaviour

EXTRACT 1: AUSTRALIAN CAR INDUSTRY

- ▶ Australia wanted to *protect* its car industry → tariff and quota barriers
- ▶ Trade barriers had as consequence *inefficiencies* → high production costs
- ▶ In order to increase efficiency, Australia decided to *remove trade barriers*
- ▶ Consequence: imports *rose* → a lot of competition in the car market → competitive prices
- ▶ Australian car industry has suffered → Toyota, Ford and Holden *closed down factories* and relocated production
- ▶ Consequence: car workers loose jobs and Australian government losses on taxes
- ▶ Reallocation of workers into other industries

EXTRACT 1: AUSTRALIAN CAR INDUSTRY

- ▶ Note: other reasons for the decline of Australian car industry:
 - ▶ reductions in government assistance to the industry,
 - ▶ the volatility in exchange rates,
 - ▶ global strategic decisions by the parent companies to shift production to expanding markets in Asia,
 - ▶ and the role of industrial relations and trade unions

EXTRACT 2: SHOE AND TEXTILE TARIFFS

- ▶ US textile market is protected by tariffs
- ▶ Standards & tariffs: leather and synthetic shoes
- ▶ EU has also tariffs imposed to the US
- ▶ *Bilateral trade agreement*: EU-US

KEYTERMS

- ▶ Dumping
- ▶ Free trade
- ▶ Protectionism
- ▶ Quota
- ▶ Tariff, import duty or customs duty
- ▶ Trade barriers

KEYTERMS

REVISION (CHAPTER 1)

- ▶ *ceteris paribus*:
- ▶ law:
- ▶ normative economics:
- ▶ normative statement:
- ▶ positive economics:
- ▶ positive statement:
- ▶ scientific method:
- ▶ social science:
- ▶ theory or model:

KEYTERMS

REVISION (CHAPTER 2)

- ▶ base period:
- ▶ index number:
- ▶ nominal values:
- ▶ real values:

KEYTERMS

REVISION (CHAPTER 3)

- ▶ basic economic problem:
- ▶ capital:
- ▶ choice:
- ▶ economic goods:
- ▶ entrepreneurs:
- ▶ enterprise or entrepreneurship:
- ▶ factors of production:
- ▶ fixed capital:
- ▶ free goods:
- ▶ human capital:

KEYTERMS

REVISION (CHAPTER 3 - CONTD.)

- ▶ labour:
- ▶ land:
- ▶ needs:
- ▶ non-renewable resources:
- ▶ non-sustainable resource:
- ▶ opportunity cost:
- ▶ renewable resources:
- ▶ scarce resources:
- ▶ sustainable resource:
- ▶ wants:
- ▶ working or circulating capital:

KEYTERMS

REVISION (CHAPTER 4)

- ▶ capital goods:
- ▶ consumer goods:
- ▶ margin:
- ▶ production possibility frontier

KEYTERMS

REVISION (CHAPTER 5)

- ▶ barter:
- ▶ capital productivity:
- ▶ division of labour:
- ▶ labour productivity:
- ▶ market:
- ▶ money:
- ▶ money substitutes:
- ▶ primary:

KEYTERMS

REVISION (CHAPTER 5 CONTD.)

- ▶ private sector:
- ▶ productivity:
- ▶ public sector:
- ▶ secondary or manufacturing sector:
- ▶ specialisation:
- ▶ sub-market:
- ▶ tertiary or service sector: