Chapter 27

Restrictions of free trade

Key terms

1. Dumping: the sale of goods at less than cost price by foreign producers in the domestic market
2. Free trade: international trade without trade barriers
3. Geriatric industry: an industry which is in decline
4. Infant industry: an industry which is just staring up and in its early stages of development
5. National security: the security of nation state
6. Protectionism: government actions or policies that restrict international trade
7. Quota: a physical limit on the quantity of imported goods
8. Restriction on free trade or trade barriers: any measure which is artificially restricts international trade.
9. Tariff or import duty or custom duty: a tax on imported goods.

1. Reasons for restrictions on free trade

1.1 To protect infant and geriatric industries

- Geriatric industry: an industry which is in decline
- Infant industry: an industry which is just staring up and in its early stages of development

1.2 To protect domestic industries and employment

1.3 To protect national security

- National security: the security of nation state such as military, energy security, food security, cyber security.

1.4 To prevent dumping

- Dumping: the sale of goods at less than cost price by foreign producers in the domestic market
- Tariff can increase price of imports and prevent dumping.

1.5 To correct a deficit on the current account of the balance of payment

- Government can impose tariff to raise price imports which can reduce import expense and improve balance of payment.

1.6 To raise revenue from tariff

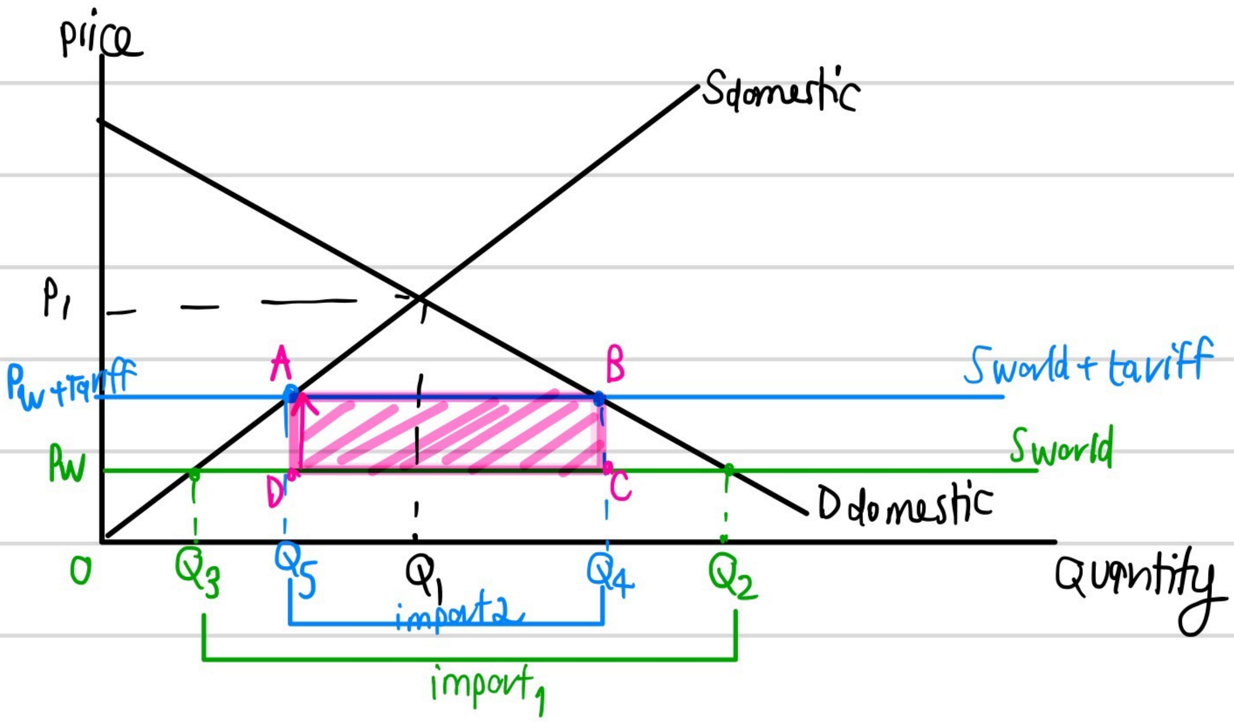
1.7 To help an economy diversify

- Protectionism can reduce over dependence on imports.

2. Types of restriction on free trade

2.1 Tariff

: is a tax on imported goods. It is sometimes called an import duty or a customs duty.



1. closed economy without international trade is at P and Q
2. Free trade => world supply is perfectly price elastic.

    => @Pw , quantity demand = Q2

    Quantity of domestic supply = Q3

    Quantity of imports = Q2 - Q3
3. With tariff => world supply shifts up to Sworld+tariff

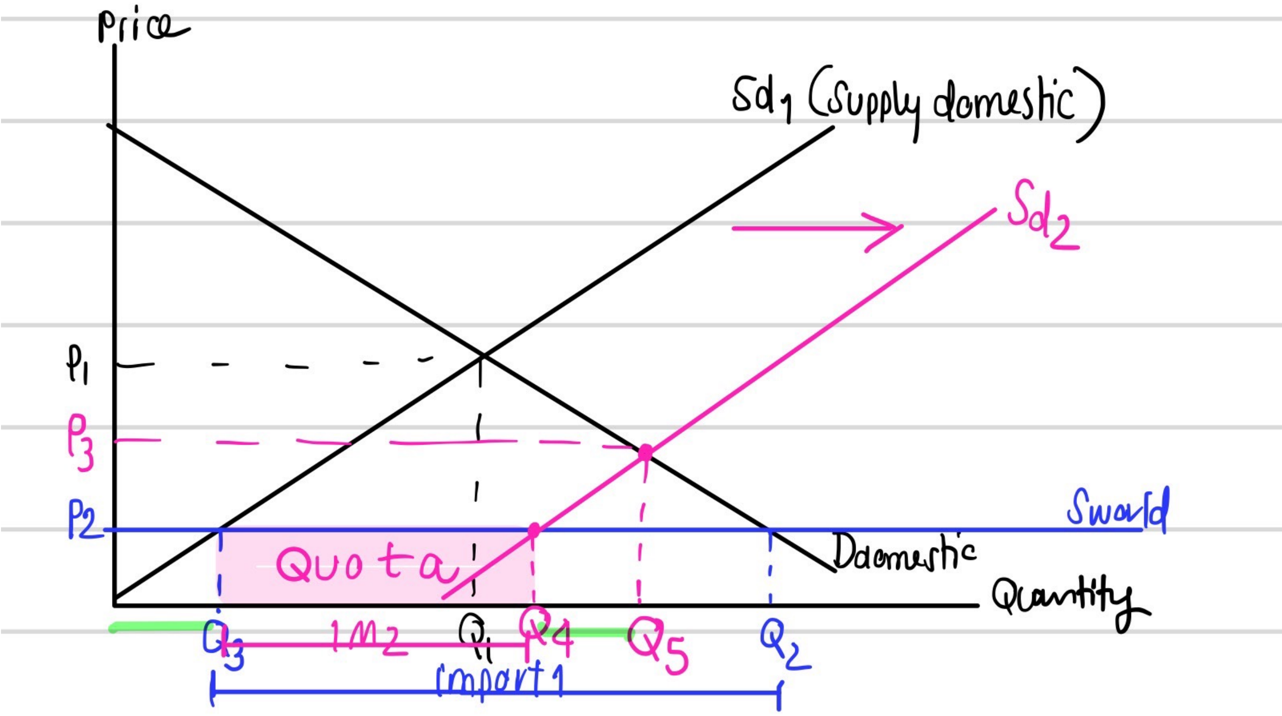
    => @Pw+tariff , quantity demand = Q4

    Quantity of domestic supply = Q5

    Quantity of mports = Q4 - Q5
4. Tax revenue = tariff per unit x Qimport = ABCD

2.2 Quota

: is a physical limit on the quantity of a good imported. It is an example of a physical control. Imposing a limit on the quantity of goods imported into a country will increase the share of the market available for domestic producers. However, it will also raise price of the protected product.



1. closed economy without international trade is at P1 and Q1
2. Free trade => world supply is perfectly price elastic.

=> @P2 , quantity demand = Q2

Quantity of domestic supply = Q3

Quantity of imports = Q2 - Q3

3. With quota=> Quantity of import quota = Q4 - Q3

=> when government limits quantity of imports, it raises price to P3

=> @P3 , It allows domestic inefficient producers to sell more products. the domestic supply curve shifts to the right to Sd2

=> @P3 , quantity demand = Q5

Quantity of domestic supply = Q3 + (Q5-Q4)

2.3 Subsidies

- Export subsidy is a form of government intervention to encourage goods to be exported rather than sold on the domestic market.
- Subsidy could allow exporters to reduce cost and become more competitive in the world market.

2.4 Administrative barriers

- A government may seek to discourage imports by requiring importers to fill out time consuming forms. It may also set high product standard to restrict foreign competition.
- This increases cost of trading goods and discourage imports. It makes difficulties in trading with a country imposing red tape, and is particularly harmful for developing countries which are unable to access these markets.

2.5 Exchange rate manipulate

- Lowering exchange rate makes price of exports become cheaper, resulting in higher export revenue.

3. Impact on protectionist policies

Parties	Impact
1. Consumers	• Tariff makes price of imports become higher. • Protectionism limits choice of imports.
2. Producers	• Domestic producers are protected by trade barriers. • Exporters have lower cost and higher profit from subsidy.
3. Workers	• Protectionism protects job for workers.
4. Government	• Government can gain tariff revenue.
5. Living standards	• Protectionism in the short term protect jobs and living standard for people in the country. • However, protectionism leads to less efficient and slow down growth in the long run.
6. Equality	• Protectionism protects jobs for domestic workers and protect unfair trade. Trade union members will benefit from these policies.

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1. In 2016 there was a significant increase in protectionist measures by many developed countries.

(A) Assess possible reasons why a developed country might restrict free trade (15 marks)

(B) Assess factors, other than increasing trade barriers, which might explain changes in a country's pattern of trade with other countries. Refer to the principle of comparative advantage in your answer. (25 marks)