Protectionism and Trade Liberalisation

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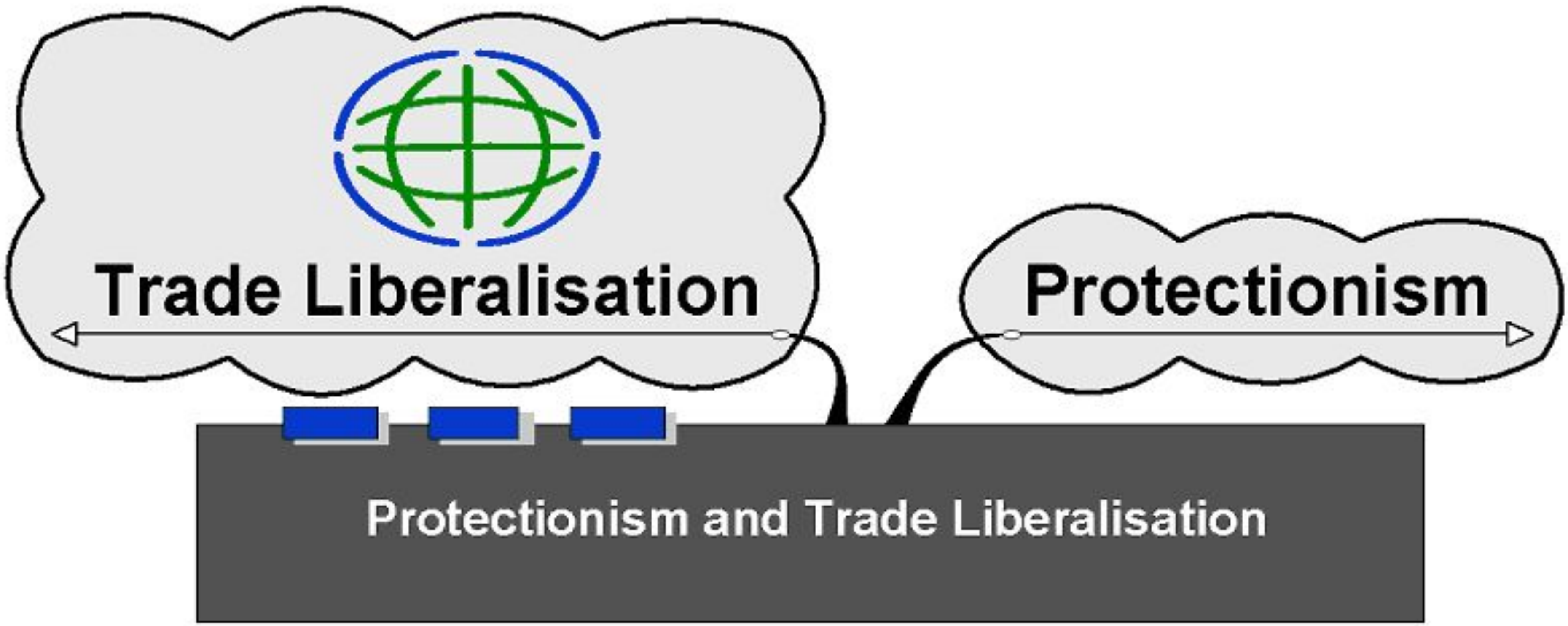


Trade and the Government

- The Govt. has the ability to influence economic relations with the rest of the world (diversification and scale of trade).
- There are two opposing ways in which they can achieve certain goals: protectionism and free trade.

Protectionism vs. Free Trade

- Free Trade: when government put in place policies that allow producers from overseas nations to freely sell their goods in our country (promote trade).
- Protectionism: when government put in place policies to stop overseas producers freely selling goods in our country (restrict trade).

Arguments for Protectionism

- **Infant Industry:**
- **New or start up industries that have not been operating for long**
  - For: new industries are given the chance to develop systems and processes to get to the stage that they are able to compete against larger international producers (‘grow up’).
  - Against: there is no incentive for these industries to become more efficient whilst continuing to gain from the protection.

- **Protecting domestic employment:**
  - **While local businesses continue to operate they provide employment.**
  - Governments will protect our domestic employment levels as this is seen as ‘desirable’ to gain political support (more jobs=more votes). While local businesses are operating they are providing employment locally.
  - ‘Import substitution’ industries: industries that produce substituti imports.

- **National interest and security:**
  - The government may see it is in our best interest to keep certain industries operating, in NZ. e.g Steel and oil production

E.g. keeping certain industries in NZ in order to maintain control of them, i.e. buying back $800 million in shares of Air NZ to prevent control shifting more so overseas.

ural industry: in times of hardship
cultural industry being protected,
le us to feed our nation.

Cheap foreign labour:

- Labour should be paid at a rate that recognises the level of productivity. If NZer's get a higher wage this should be due to higher levels of productivity, education, or skill.

- If this is not the case and the wage paid does not recognise the productivity of the worker, low wage paying countries
r advantage of being able
w cost goods (therefore
Z made products less

Protectionism

- Definition: Imposition of trade barriers in order to protect domestic producers
- By definition, protectionism is a topic that involves politics as much as “pure” economics
- But for the moment … let’s stick with economics

Types of Protectionism

- Direct
  - Embargo
  - Tariff
  - Quota
  - Subsidy
- Indirect
  - Voluntary Export Restraint (VER)
  - Exchange rate controls
  - Import licenses
  - Regulatory and administrative barriers

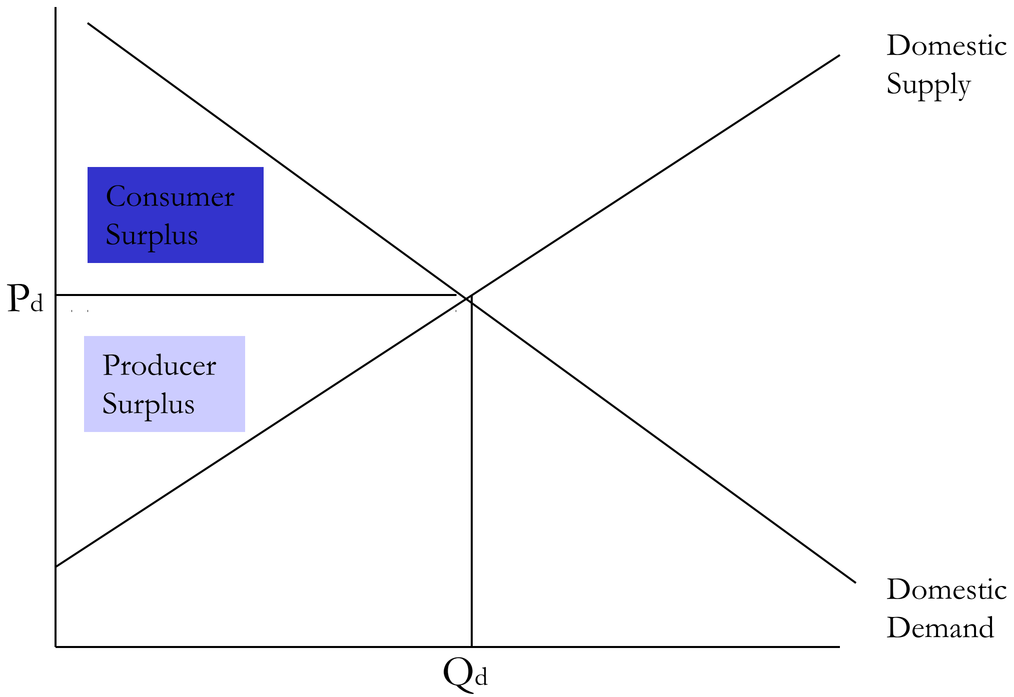
Embargo

- A total ban on trade
- Can be applied by domestic governments or imposed by foreign governments
- Examples
  - Jefferson's Embargo Act (1807)
  - U.S. embargo of Iraq post Gulf War
- Often used as an economic weapon to achieve foreign policy objectives

Implications of an Embargo

- Embargo = elimination of trade = pure domestic market
- Prices go up (consumers pay more)
- Domestic producers lose the opportunity to sell their products in foreign markets but benefit from higher prices for their goods domestically

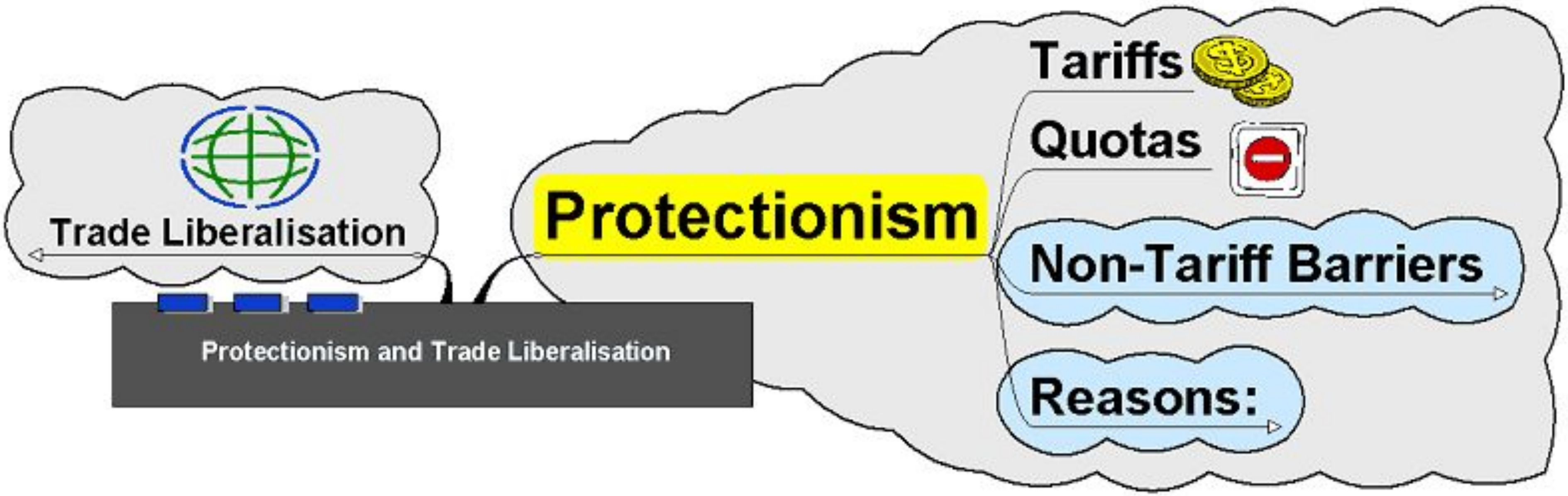
Equilibrium Without Trade



Impact of Trade

- To understand the impact of trade, you must start with an analysis of relative prices and comparative advantage
- If the domestic equilibrium price for a product is lower than the world price – the country will become an exporter of this product
- If the domestic equilibrium price is higher than the world price – the country will import the product

Protectionism



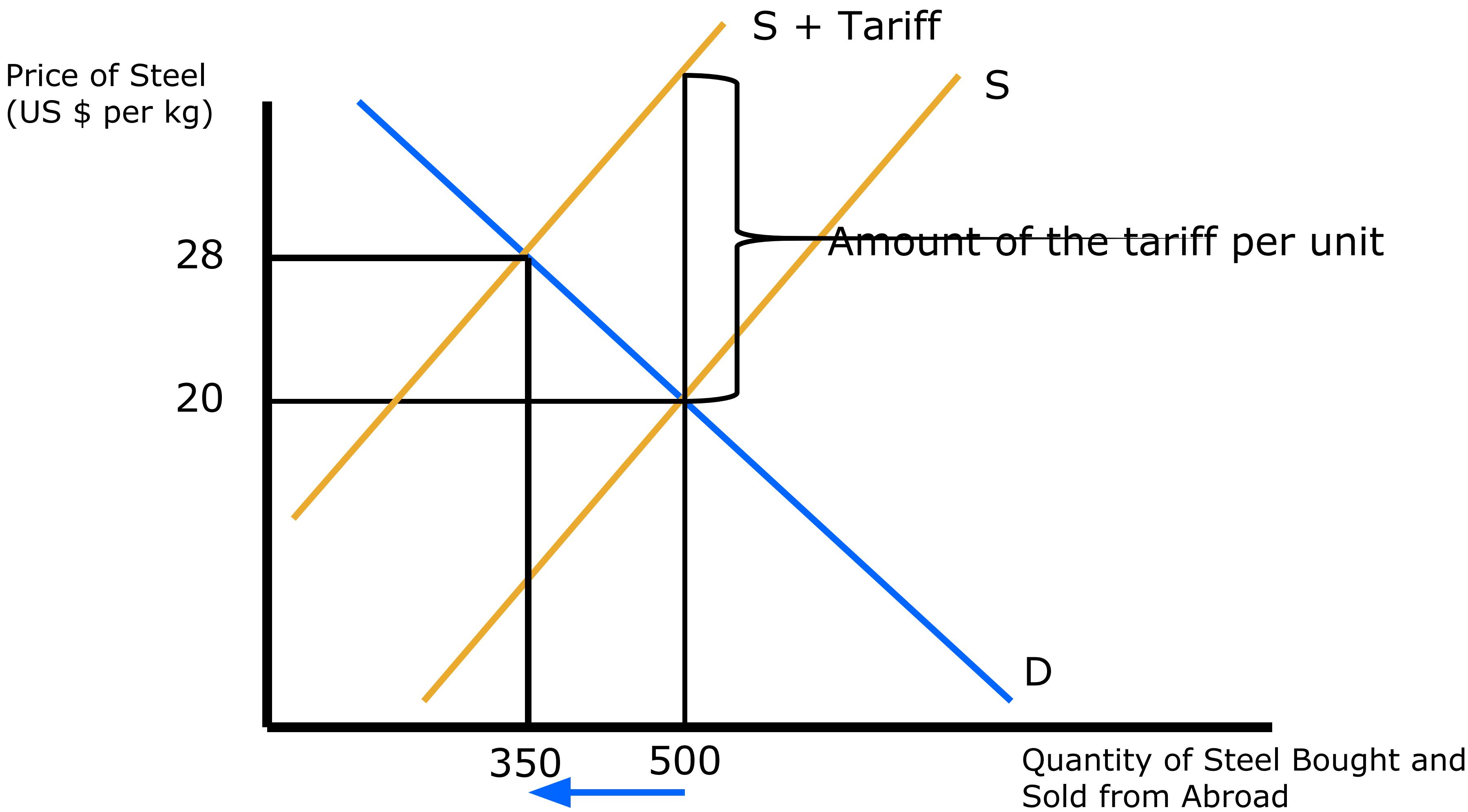
Protectionism

- Means by which trade between countries is restricted in some way – normally through measures to reduce the number of imports coming into a country
- Main means are:
  - **Tariffs**
  - **Quotas**
  - **Non-Tariff Barriers**

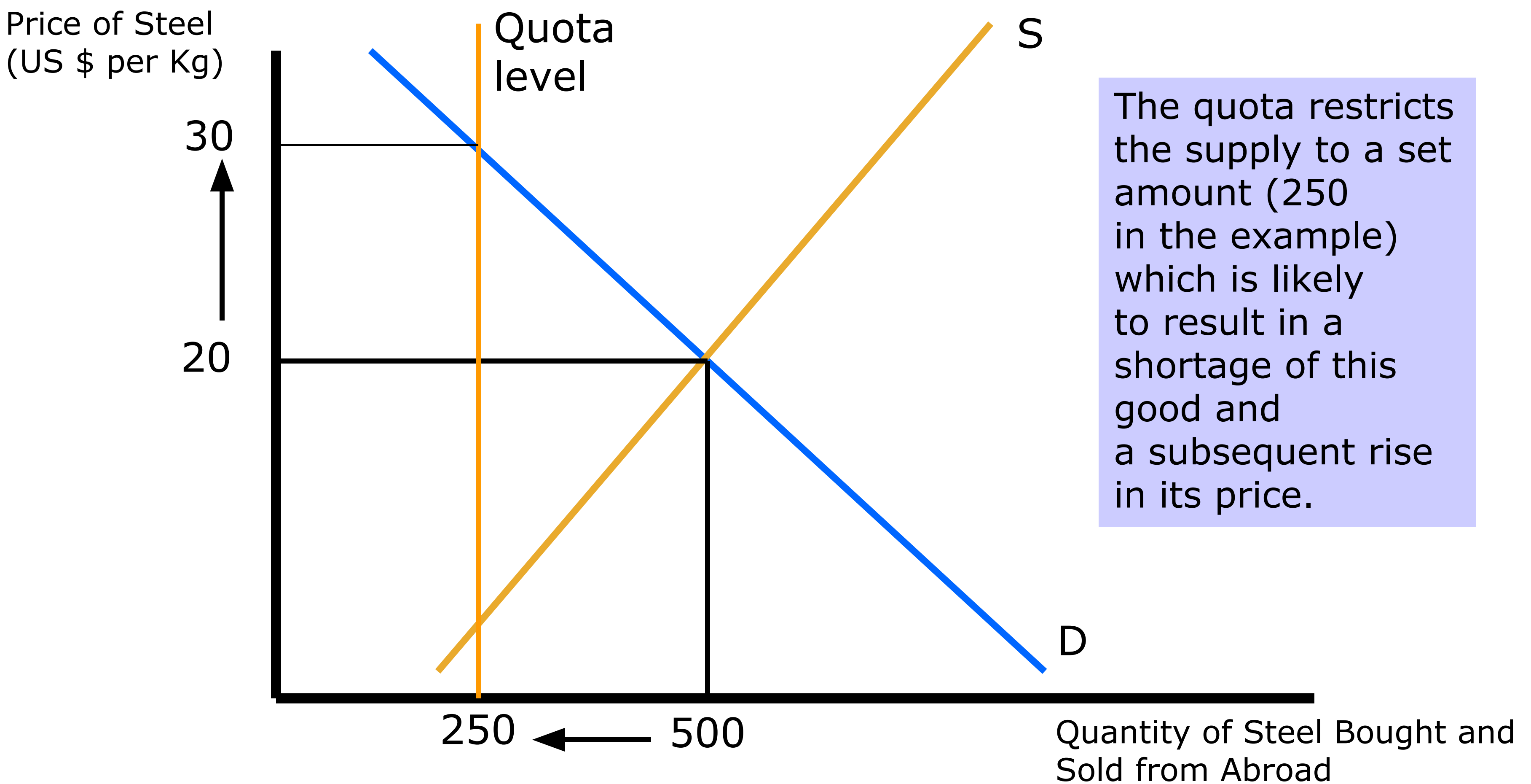
Protectionism

- **Tariff:** A tax on a good coming into a country
  - Increases the price of the good and makes it less competitive
- **Quota:** Physical restriction on the number of goods coming into a country

Impact of a Tariff on Steel



Impact of a Quota on Steel



The quota restricts the supply to a set amount (250 in the example) which is likely to result in a shortage of this good and a subsequent rise in its price.

Non-Tariff Barriers

- Any methods not covered by a tariff, most usually:
  - **Rules**
  - **Regulations**
  - **Voluntary Export Restraints (VERs)**
  - **Legislation**
  - **Exacting Standards or Specifications**

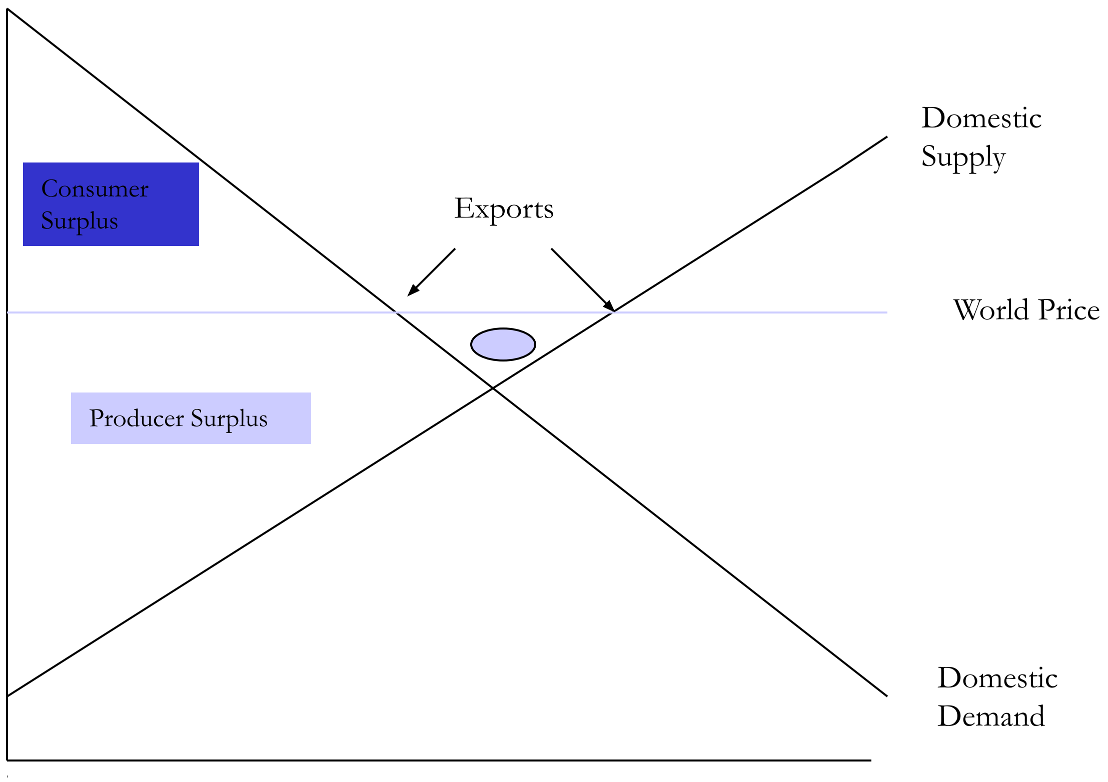
Non-Tariff Barriers

- Examples include setting exacting standards on fuel emissions from cars, the documentation required to be able to sell drugs in different countries, the ingredients in products – some of which may be banned in the destination country
- NTBs are difficult to prove – when do you accuse a country of protectionism – could be a legal or cultural issue?
- The main method involved in NTBs is not to prevent trade but to make the cost of doing so prohibitive to the potential exporter

Who Wins and Who Loses?

- To simplify our analysis, assume that the world price is a given – the actions of our small, insignificant country have no impact on the prevailing world price
- Graphically, this assumption is represented by a flat supply curve at the world price (i.e. we can import or export unlimited

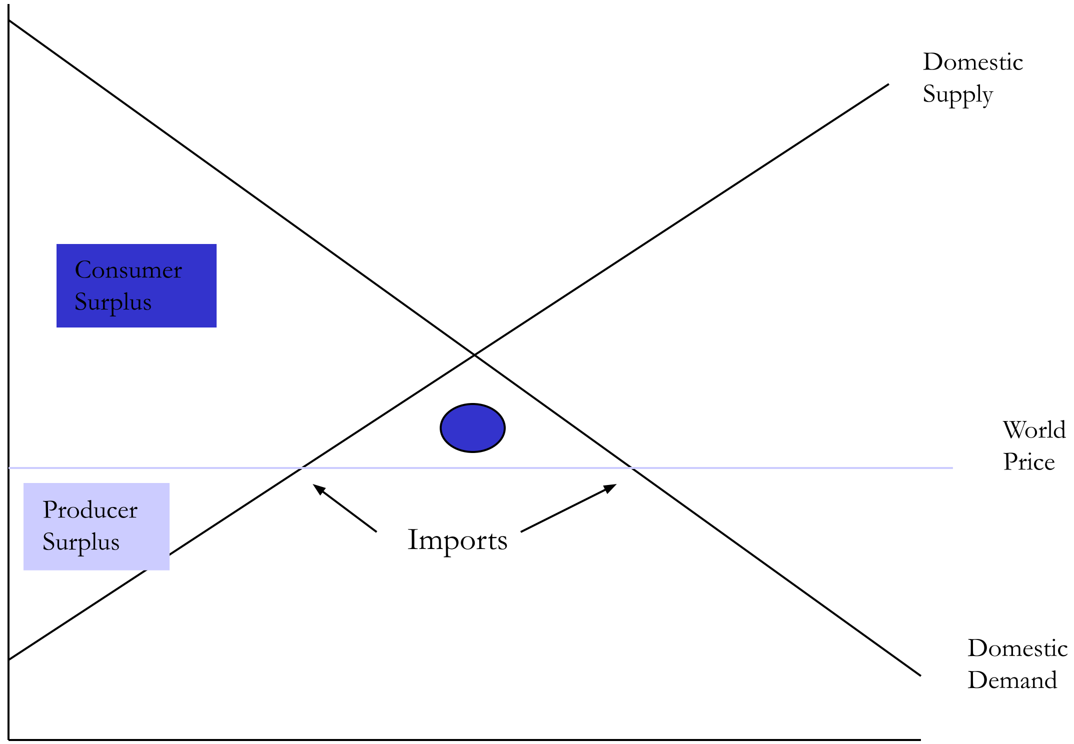
Impact on an Exporter



Impact on an Exporter

- When a country is an exporter, generally consumers lose (higher prices, reduction of consumer surplus)
- But, domestic producers gain (higher prices and increased production)
- Higher production translates into more jobs, happy constituents and reelected politicians

Impact on an Importer



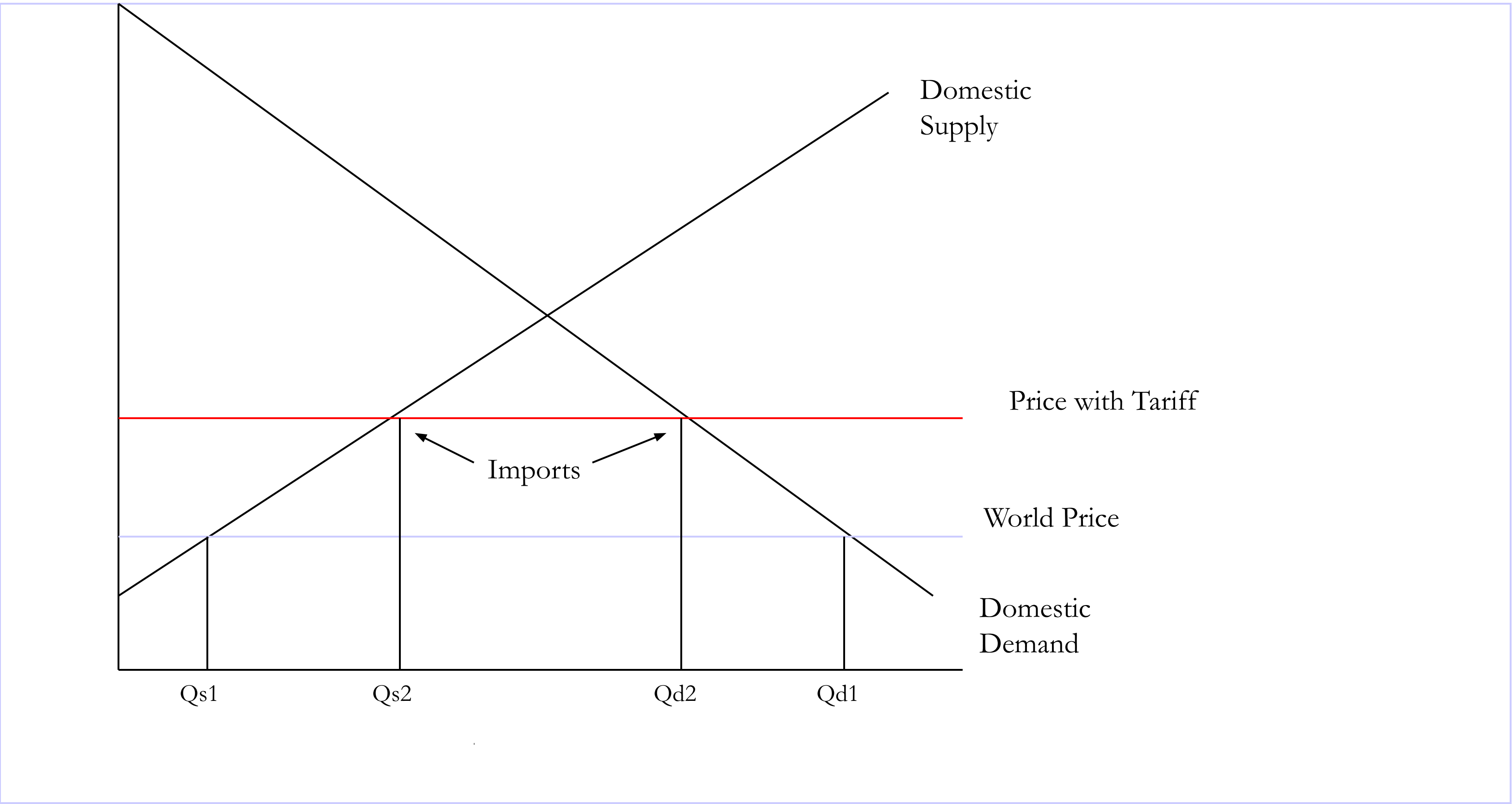
Impact on an Importer

- When a country is an importer, consumers benefit (lower prices and higher consumer surplus), but domestic producers lose (lower prices, decreased production)
- Reductions in domestic production means job losses and often an increase in political rhetoric and calls for the government to protect domestic industries from foreign competition, despite the fact the overall economy

Tariff

- The most common restriction on trade is a tariff
- Tariff = tax on imported goods
- Results of a tariff:
  - Prices go up
  - Domestic production increases
  - Government gets more revenue

Effects of a Tariff



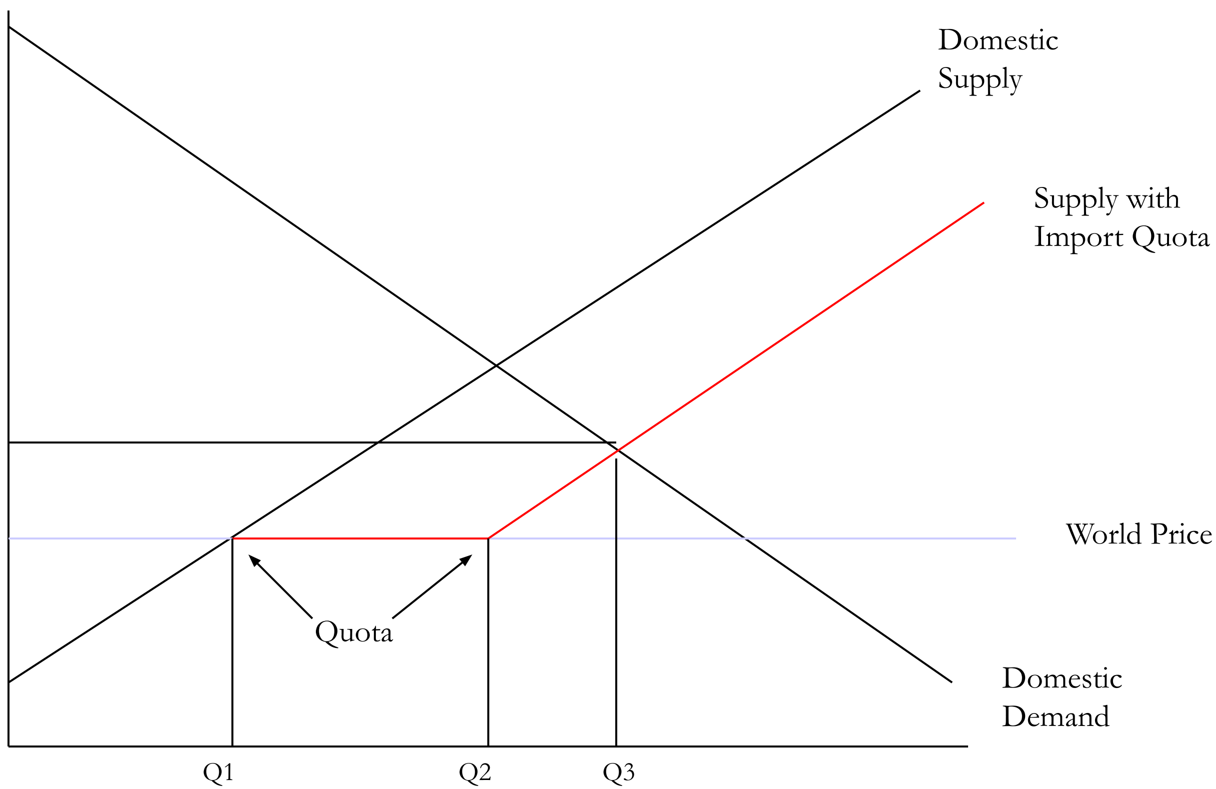
Quota

- Another very common restriction on trade is the quota
- A quota is a limitation on the quantity of a good allowed to be imported into a country
- Quotas limit the impact of international trade on the domestic market
- Usually enforced through government issued permits to

Quota (Cont'd)

- Impact of quotas:
  - Domestic prices go up (consumers pay more)
  - Domestic producers increase production
  - Government gets more revenue (import license fees)
- Let's go to the graph …

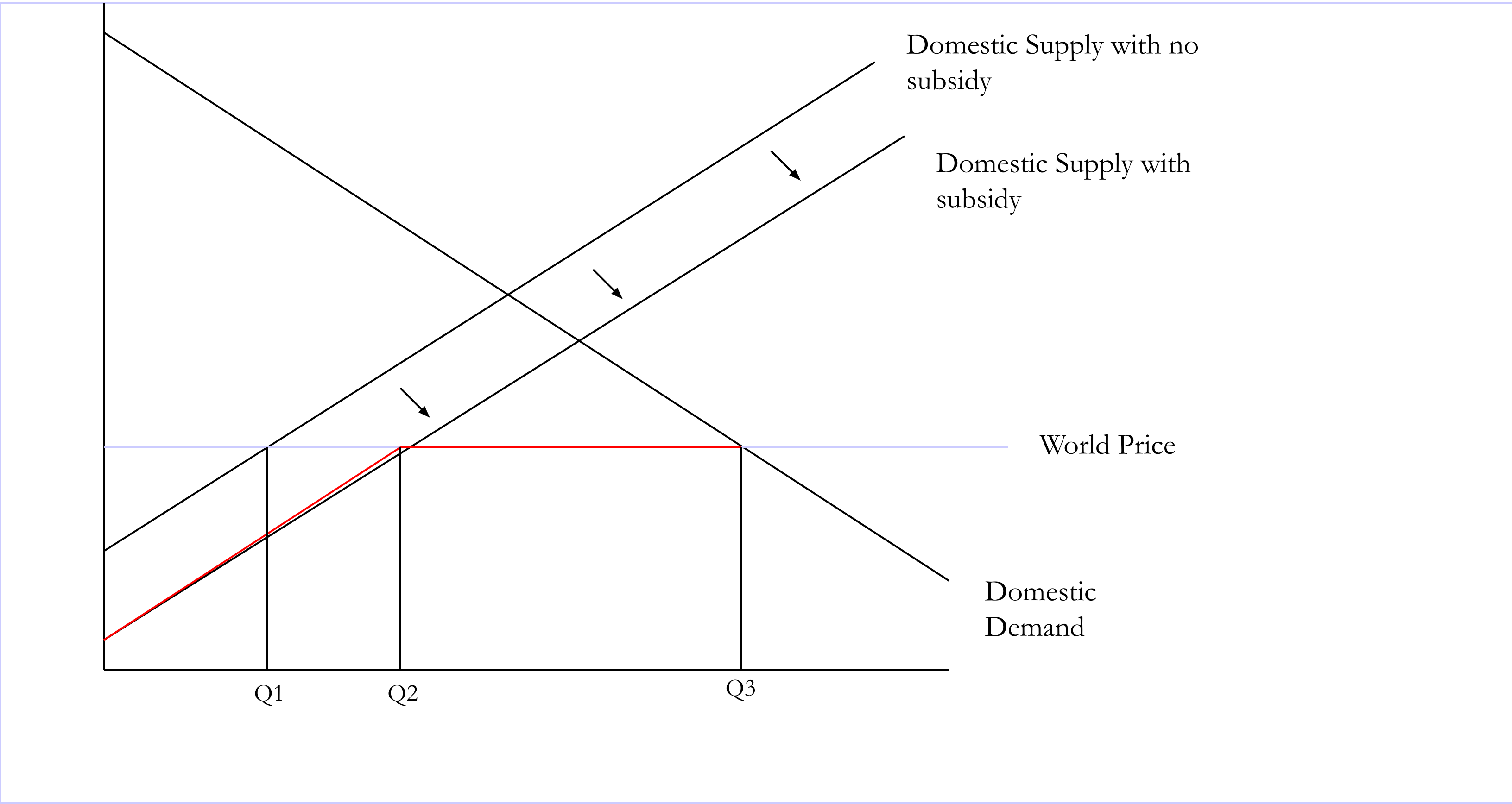
Impact of a Quota



Subsidy

- Government payment to producers in order to either reduce the impact of imports or make a country's exports more competitive
- First, let's examine the impact of an import subsidy …

Import Subsidy



Export Subsidy

- An export subsidy enables domestic producers to lower their prices in the world market below their true cost of production, and otherwise known as dumping (and a definite WTO violation)
- Export subsidies protect domestic producers from foreign competition and increase domestic production and employment – very tempting outcomes for governments
- Which leads to predictable accusations and figure pointing during international

Indirect Protectionism

- Voluntary Export Restrictions
  - Self-imposed export restrictions
  - Can be imposed on a firm upon itself, an industry upon itself, or by a domestic government over domestic producers
  - Negotiation tool to avoid trade wars and stay within WTO rules
- Exchange Rate Controls
  - Limitation on amount of foreign currency available to importers

Indirect Protectionism (Cont’d)

- Import Licensing
  - Government issued licenses required to import goods
  - In practice, works like a quota
- Regulatory and Administrative Barriers
  - Regulations that increase the cost of production for imported goods
  - Can take the form of safety standards, environmental controls,

Arguments for Protectionism

- Infant Industry Argument
  - In theory, used to provide "temporary" protection for domestic producers during their early stage of development in order to give them time to grow and develop economies of scale
  - Argument also used to justify protection for declining industries to give them time to restructure
  - In practice – "temporary" can be a

Arguments for Protectionism (Cont'd)

- The Exploitation Argument
  - Workers in developing countries are exploited by MNCs and domestic firms are forced to cut corners in order to compete
  - Activist groups push for restrictions (especially through regulation) by developed nations
  - Rebuttal – Workers in developing countries are relatively better off from trade; restrctions only make goods more expensive and force

Arguments for Protectionism (Cont'd)

- The Jobs Argument
  - Trade destroys domestic jobs
  - Rebuttal – Depends on which jobs you are talking (or care) about; trade costs some jobs and creates others; any attempt to protect domestic employment will create inefficiency and reduce long-term competitiveness

Arguments for Protectionism (Cont'd)

- National Security Argument
  - We must protect industries that are "vital to our national security"
  - Trade makes us more vulnerable to terrorism
  - Rebuttal – "Vital to national security" is very broad, tough to define, and often in the eye of the beholder; trade creates economic interdependency that builds political bridges and mutual interests

Arguments for Protectionism (Cont'd)

- Unfair Competition Argument
  - The "they don't play fair" argument
  - Foreign governments subsidize exports
  - We face a tougher regulatory environment
  - They are dumping products in our market
  - Rebuttal – Very slippery slope; we should lead by example; a shift toward protectionist policies will hurt

And Finally …

- Bargaining Chip Argument
  - Protectionism as a tool of foreign policy
  - Use threat of trade restrictions as a bargaining chip to get concessions from our trading partners
  - Rebuttal – Using trade as a political weapon has the potential to snowball with very negative consequences, so if (when) we employ this tactic – it better work

Reasons

- Protect domestic industries
- Protect domestic employment
- Strategic reasons
- Political pressures
- Protect culture?
- Prevent ‘Dumping’ – selling goods in the destination country below cost to break into that market

Trade Liberalisation

Trade Liberalisation

- Aims to free up world trade and break down the barriers to international trade
- Basic philosophy rests on the principle of comparative advantage
- Talks to achieve trade liberalisation have been ongoing for many years

Trade Liberalisation

- GATT – General Agreement on Tariffs and Trade
- First signed in 1947 – talks on-going since then!
- Uruguay Round 1994 – set up the World Trade Organisation (WTO) as well as agreements covering a range of trade liberalisation measures
- WTO provides the forum through which trade issues can be negotiated and works to help implement and police trade agreements

Trade Liberalisation

- **Potential benefits:**
  - Promotes international specialisation and increases world output
  - Promotes efficient use and allocation of world resources
  - Allows developing countries access to the heavily protected markets of the developed world thus helping promote development
  - Facilitates the working of the international market system and the working of price signals to ensure efficient allocation of resources, international competition and the associated benefits to all

WTO (World Trade Organisation)

- The only global international organisation dealing with t rules of trade between nations.
- Their goal is to help producers of goods and services, exporters and importers conduct their business through:
  - Negotiating agreements between member countries/nations aimed at reducing or eliminating obstacles to international trade (tariffs, rules and regulations, etc).
  - Monitoring the agreements, ensuring member countries are adhering to the agreements.

FACT FILE

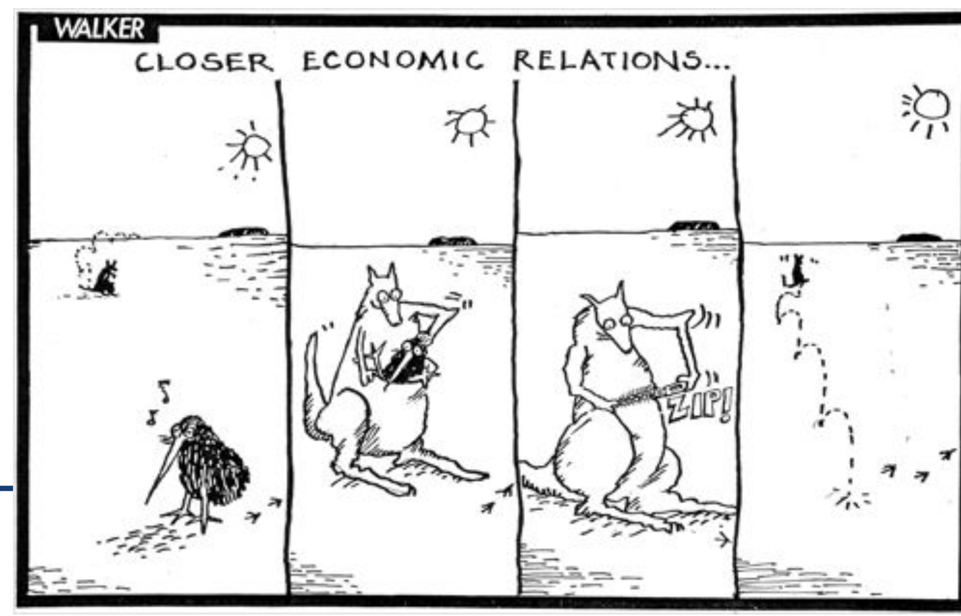
Location: Geneva, Switzerland
Established: 1 January 1995
Created by: Uruguay Round negotiations (1986-94)
Membership: 153 countries on 23 July 2008
Budget: 196 million Swiss francs for 2011
Secretariat staff: 640
Head: Pascal Lamy (Director-General)

Functions:
- Administering WTO trade agreements
- Forum for trade negotiations
- Handling trade disputes
- Monitoring national trade policies
- Technical assistance and training for developing countries
- Cooperation with other international organizations

Closer Economic Relations

- NZ's Closer Economic Relations (1983) agreement with Australia is our most important bilateral trade agreement

- Giving NZ producers a huge advantage of non-restrictive access to the large Australian markets (selling), or their goods (buying).



CER

- Main aim: break down trade barriers.
  - No tariffs or quotas placed on imports (free trade on goods and services)
  - Follows WTO rules.
  - Mutual recognition of goods and occupations (goods legal in both countries, skills/education recognised in both countries).
  - Free labour market (residents of both countries

EU (European Union)

- Free trade between union countries and a common external trade policy for non-members.

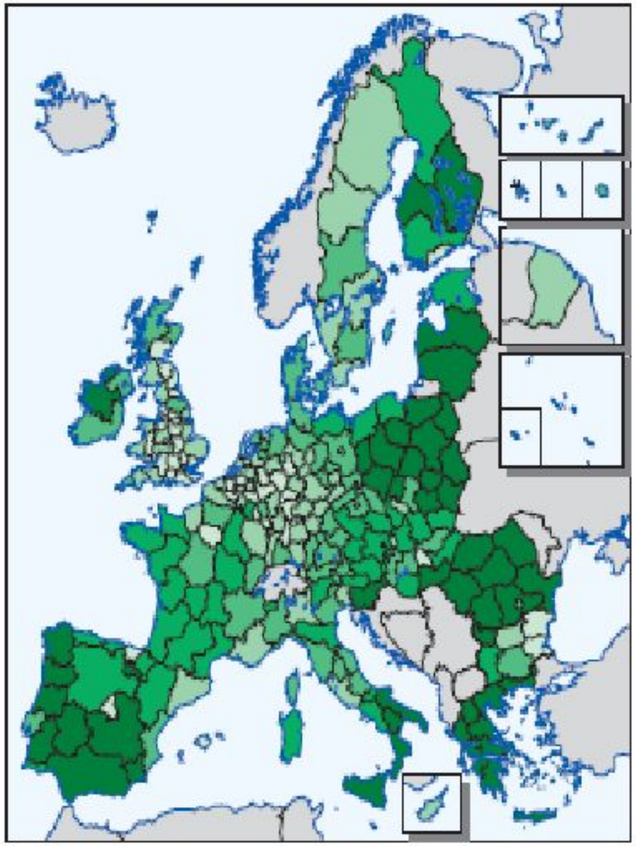
- Member Nations: (28) Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Croatia, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, The Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, United Kingdom

- Common Agriculture Policy (CAP)
  - A system of European Union Subsidies and guarantees of high prices to farmers. This includes implementing the following on certain goods
  - Tariffs
  - Minimum Prices
  - Quotas

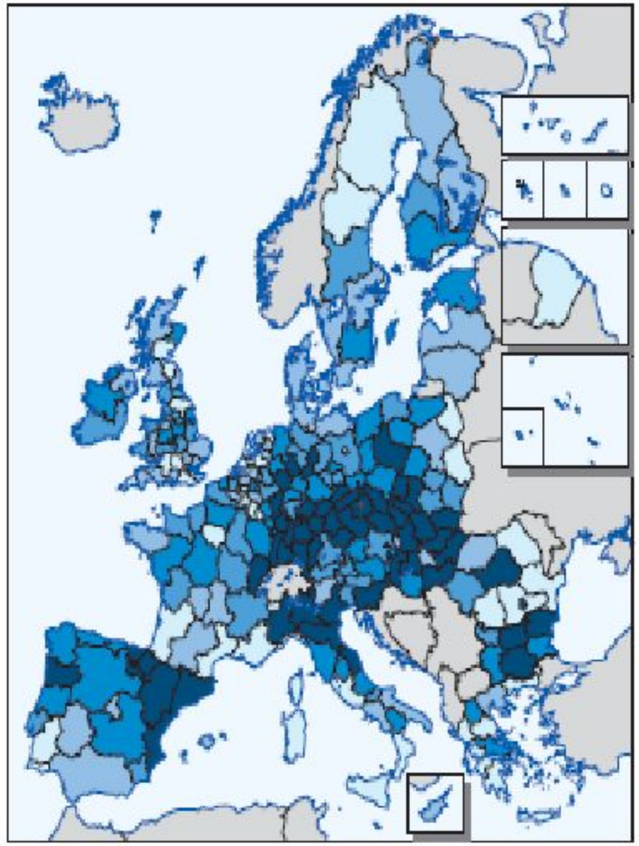
  One of NZ's priorities is to encourage further reform of the CAP.

- When Britain entered into the EU (in

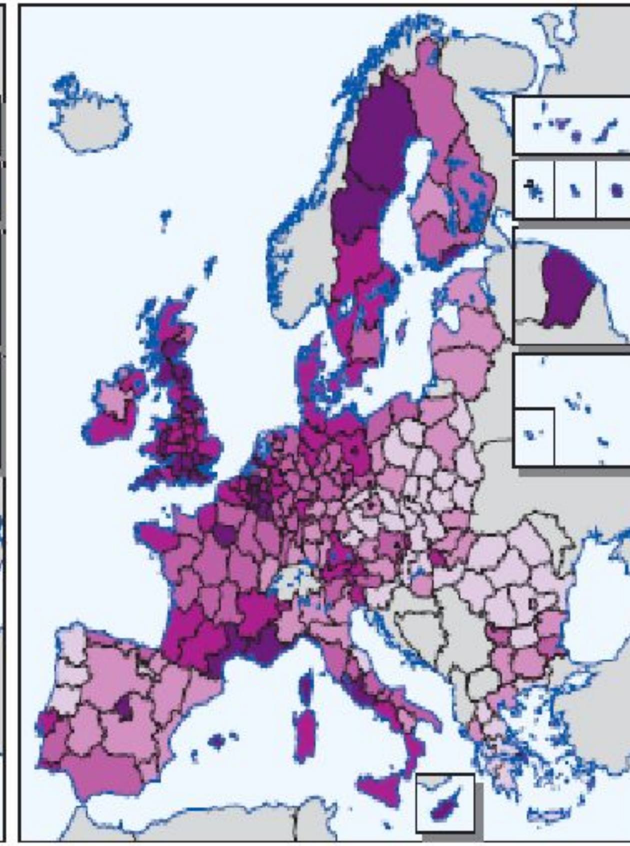
Map 6: Employment by sector, 2001



Agriculture



Industry



Services

Agriculture — % total employment

- < 1.9
- 1.9 - 3.45
- 3.45 - 5.62
- 5.62 - 9.93
- >= 9.93

EU-27 = 7.6
Standard deviation = 11.3

Sources: Eurostat and NSI

Industry — % total employment

- < 23.65
- 23.65 - 27.35
- 27.35 - 31.05
- 31.05 - 34.75
- >= 34.75

EU-27 = 29.3
Standard deviation = 7.4 7.42

Sources: Eurostat and NSI

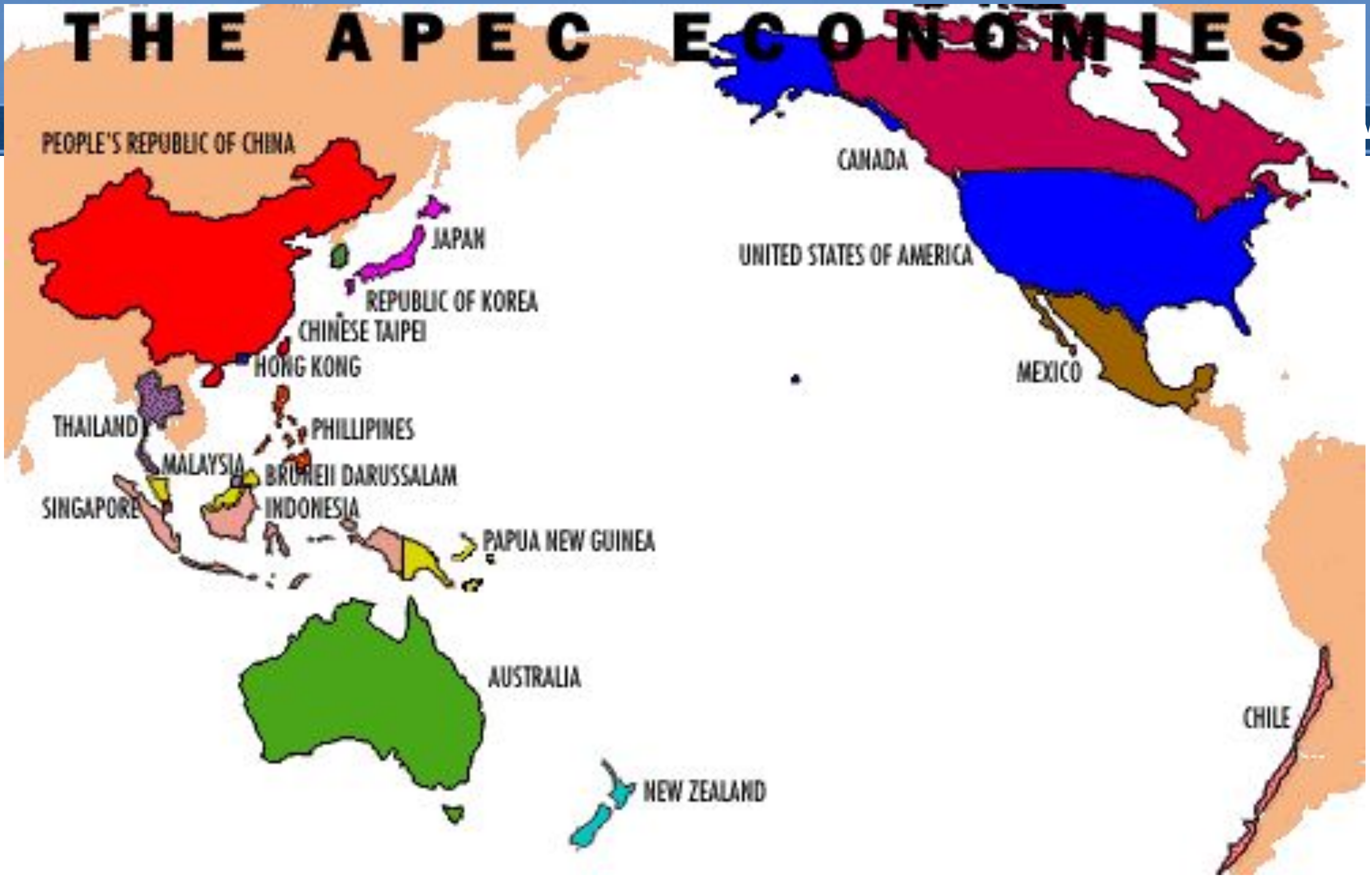
Services — % total employment

- < 53.7
- 53.7 - 59.9
- 59.9 - 66.1
- 66.1 - 72.3
- >= 72.3

EU-27 = 63.1
Standard deviation = 12.5 12.5

Sources: Eurostat and NSI

0 250 1250 km



- Member Nations include:
- Argentina, Australia, Bolivia, Brazil, Canada, Chile, China, Hong Kong, Indonesia, Japan, Malaysia, Mexico, Papua New Guinea, Peru, the Philippines, Russia, Singapore, South Korea, Thailand, US, Vietnam, NZ.

APEC (Asia-Pacific Economic Cooperation)

- Formed in 1989. APEC member nations work together to sustain economic growth via committing themselves to free trade, investment and economic reform.
- Reducing tariffs and other barriers has meant APEC member nations have become more efficient and export levels have largely increased.
- Standard of living has increased in these countries as a result of cheaper goods and services being available to consumers.

Exchange Rate Policies

- **Fixed Exchange Rates**

An exchange rate whose value is set by the official government policy.

- **Floating / Flexible Exchange Rates**

An exchange rate whose value is not officially fixed but varies according to the supply and demand for the currency in the foreign market.

Exchange rate policies

- Fixed vs. floating exchange rate.
- NZ changed from having a fixed exchange rate to a floating exchange rate in 1985.
- The government (as part of the fixed exchange rate policy) would buy and sell currencies to manipulate the price of the $NZ (i.e. exchange rate).
- Now as part of the Monetary Policy (aim of price stability by manipulating the OCR), the exchange rate is still influenced even though this isn't being targeted.

RBNZ increases the OCR

↓

Interest rates increase

↓

Encourages Foreign investment into NZ

↓

Demand for $NZ increases (they must invest in NZ banks in NZ currency).

New Zealand Trade Policy

- As a developing country, NZ has pursued the policy of free trade over the past 25 years.
- The aim of this is to promote trade between NZ and the rest of the world and having efficient producers competing in international markets in their competitive advantage production.
- We have progressively removed barriers to trade (tariffs, quotas, etc), although not completely (e.g. tariffs on some clothing and footwear still exist).
- Micro-economic policies also put in place to increase our efficiency of producers
  - e.g. electricity market reform- targeting reduced energy costs

Trade Liberalisation

- World agreements are very difficult to achieve
- Witness the issues over the removal or reduction of agricultural subsidies, tariffs on steel in the United States, the banana wars, etc!