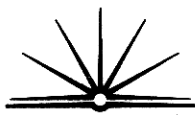


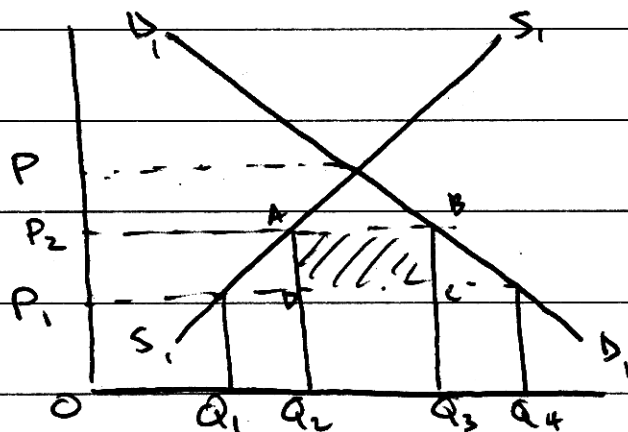
Question 28

Despite the rapid rate of Globalisation in today's world, that is the integration of world economies into one global economy characterised by increased trade, financial, capital and labour flows, Protectionist Policies by a number of regions and countries have impacted on both domestic and global economies. As a result many countries have been forced to change policies which have changed their trade flows and well being of the economy. Despite the obvious reasons for protection by governments eg. tariffs, subsidies, quotas etc. - free trade is continually encouraged on a global scale due to its greater advantages.

The most common form of protection is a tariff. Tariffs are like import taxes



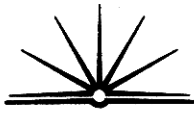
that increase the cost of imports and are a source of revenue for the government. Consider the graph below:



Above is a graph for supply and demand of a good. The domestic price is P , the world price is P_1 . In this situation domestic firms can only supply OQ_1 and foreign firms Q_1Q_4 . If a tariff is imposed, say increasing the import price to P_2 , local firms can now supply OQ_2 and foreign firms can only supply Q_2Q_3 . This has increased the domestic firms market share by Q_1Q_2 and has increased gov. revenue by $ABCD$. A reason for this protectionist policy is that it keeps employment in

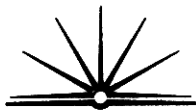
the local economy and helps infant industries grow. However, the true impact of this is higher prices paid by consumers, a decrease in innovation and efficiency as domestic firms are sheltered. This puts the domestic economy with higher inflation as input prices are greater and redistributes resources away from more efficient industries, eg. a farmer in an unprotected industry will still have to pay higher prices for a imported tractor which has a tariff on it.

Globally, foreign firms are not able to access foreign markets and hence production drops of internationally - world GDP will decrease as economies are not taking advantage of international specialisation and comparative advantage - the basis behind free trade. In the current global climate, the USA for example



has imposed tariffs as high as 30% on imported steel. This will hurt efficient steel producers in other countries such as Australia. Similarly, similar situations have arisen in agricultural commodities trade. The European union and the USA again have quotas and tariffs which again hurt commodity based economies such as Australia, and South American nations. For example, in the 1950's 82% of Australia's exports were commodity based, mainly agricultural such as wool, beef, wheat etc.

Most of this trade went to the United Kingdom (62%) due to preferential trade. However, when the UK joined the EU this ceased. Countries such as Australia ~~and~~ and New Zealand have been forced to diversify not only their exports but export markets. Today, only 21% of

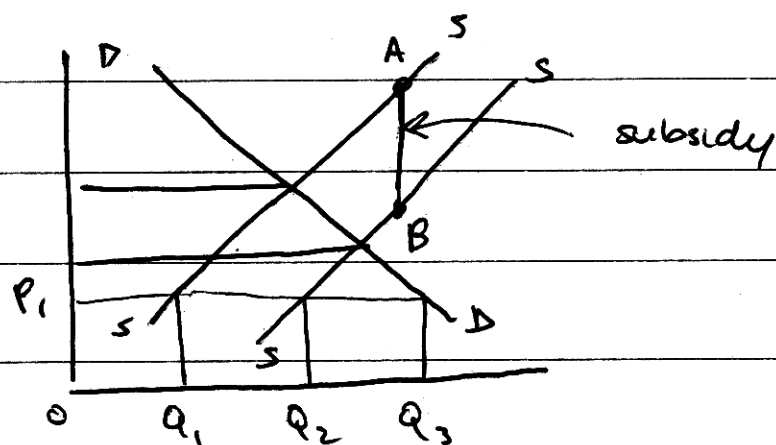


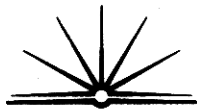
Australia's exports are agricultural, with services 23%, ~~and~~ minerals 35% and manufacturers 21%. Our export markets are also diversified, with NE Asia accounting for 40%, ASEAN 12%, USA - 10% and the EU only 12%.

Another protectionist policy is Subsidies. These are in the form of a large cash payment to assist domestic firms produce more ~~and~~ at a cheaper cost, again designed to shelter it from imports.

The USA again can be used as an example.

President Bush this year gave a subsidy of US \$800 million to American farmers. The effect of a subsidy is illustrated in the graph below.





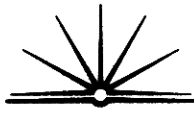
P_1 is the world price, by having a subsidy of AB , the supply line is shifted to the right, increasing domestic output from OQ_1 to OQ_2 and reducing the amount supplied by the foreign producers.

Again, like tariffs, subsidies encourage inefficiency, increase prices for consumers and lower the gross domestic product of the world as foreign firms must lower their production due to a decrease in demand. A lower GDP can also mean lower standards of living, as less needs and wants are satisfied.

Other forms of protectionist policies that have been used by some countries include voluntary exports restraints - this is usually not voluntary as threats of high tariffs are accompanied, also quotas which are a maximum legal amount that can be

imported into a country, this was used by Australia for protecting the textiles, clothing and footwear industry but was later abolished. ~~Export~~ Export incentives are another form of protection which provides assistance through tax exemptions for example for local firms to export more.

All forms of protection hurt the domestic economy as explained by low productivity and efficiency and impact on the global economy with lower ~~the~~ world GDP and a lower standard of living. For these reasons, the ~~the~~ world trade Organisation (WTO) has been established to promote and facilitate ~~the~~ free world trade. It currently has over 142 members and accounts for more than 90% of world trade. The WTO can make decisions that must be followed



during arbitration, if a country feels that another country or region is breaching free trade unlawfully and intentionally. However, the WTO has been criticised in the past as it is seen to promote the interests of wealthy powerful nations such as the USA, which protectionist policies greatly hurt the economic welfare of other small open economies such as Australia.

Protectionist policies such as tariffs, subsidies and quotas have been used widely by a number of countries to protect domestic industry. However, such policies have hurt not only their own domestic economies with decreasing productivity but the global economy as a whole.