Chapter 36

International
Trade Restrictions

Economics, 7th Edition
Boyes/Melvin

Governments and Trade

- Governments often find political reasons to favor policies that restrict trade.
- Government policy aimed at influencing international trade flows is called **commercial policy**.
- **Protection** from foreign competition generally benefits domestic producers at the expense of domestic consumers.

Arguments for Protection

- Creation of domestic jobs
- Creation of a "level playing field"
- Government Revenue Creation
- National Defense
- Infant Industries
- Strategic Trade Policy

Creation of Domestic Jobs

- Assumes that domestic producers will produce the goods that otherwise would have been produced abroad, giving jobs to domestic workers instead of foreign workers.
- Unfortunately, only the single industry involved is helped.
- Domestic consumers will pay higher prices for the good involved, thereby having less income to spend on other goods.
- Saving domestic jobs from foreign competition may ultimately cost domestic consumers more than it benefits the protected industries.

"Level Playing Field"

- Government should offset perceived advantages of foreign producers: cheaper labor, lower taxes, less stringent regulations
- **"Fair trade"** typically aimed at imposing restrictions to match those imposed by other nations.
- Elimination of the comparative advantage of another country makes domestic consumers worse off, and undermines the basis for specialization and trade.

Government Revenue Creation

- Tariffs on trade generate government revenue. In many developing countries income taxes are difficult to levy and collect, while tariffs are easy to collect.

National Defense

- Industries that are critical to the national defense (certain metals, food, transportation) should be protected from foreign competition if that is the only way to ensure their existence.
- An alternative is to store up the critical product in peacetime.

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Infant Industries

- New industries need time to:
  - Establish efficient relationships with other firms
  - Overcome Learning curves
  - Increase the scale of production until economies occur
- Countries sometimes justify protecting new industries that need time to become competitive with the rest of the world.
- An alternative is to subsidize the industry, making it possible for them to charge lower prices relative to their production costs.
- Should be temporary, but often it is hard to remove.

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Strategic Trade Policy

- **STP**: The use of trade restrictions or subsidies to allow domestic firms with decreasing costs to gain a greater share of the world market.
- **Increasing returns to scale industries:** costs of production per unit of output fall with levels of output.

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Tools of Commercial Policy

- **Tariffs:** taxes on imports or exports
- **Quotas**
  - **Quantity Quota**: a limit on the amount of a good that may be imported.
  - **Value Quota**: a limit on the monetary value of a good that may be imported.
- **Government Procurement**: laws that require the purchase of domestic goods.
- **Health and Safety Standards:** sometimes used to restrict foreign goods from domestic markets under the claim of protecting the public health and safety.

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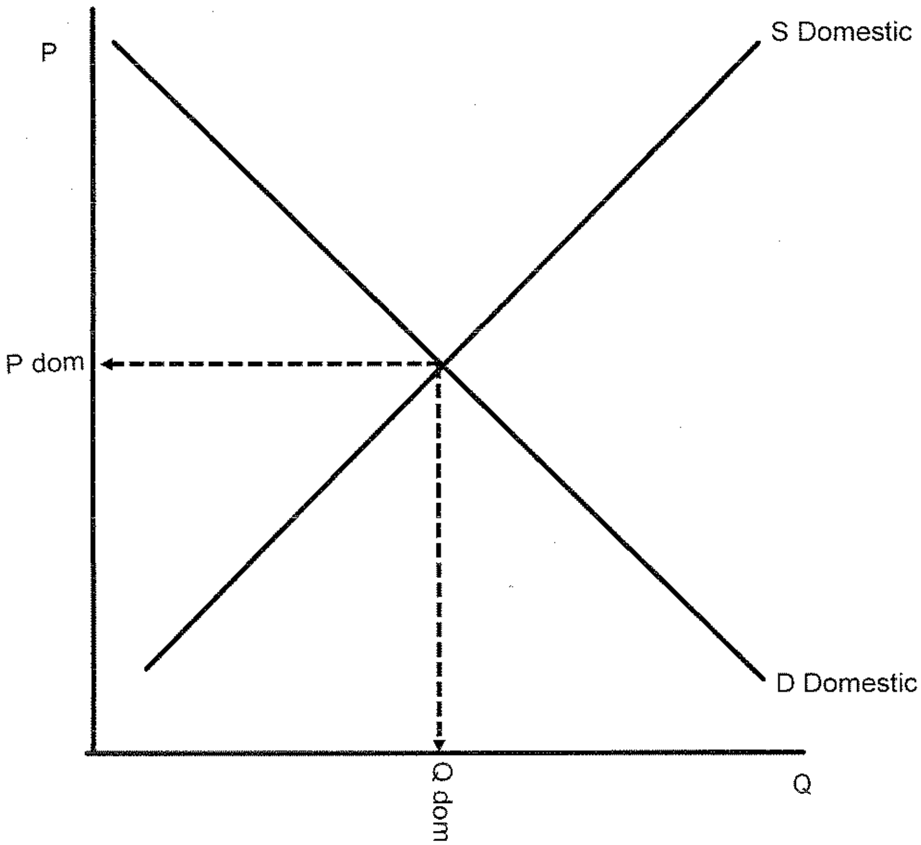
Preferential Trade Agreements

- Groups of countries sometimes enter into agreements to abolish most barriers to trade among themselves.
  - Well-known examples are the **European Union** (EU) and **NAFTA.**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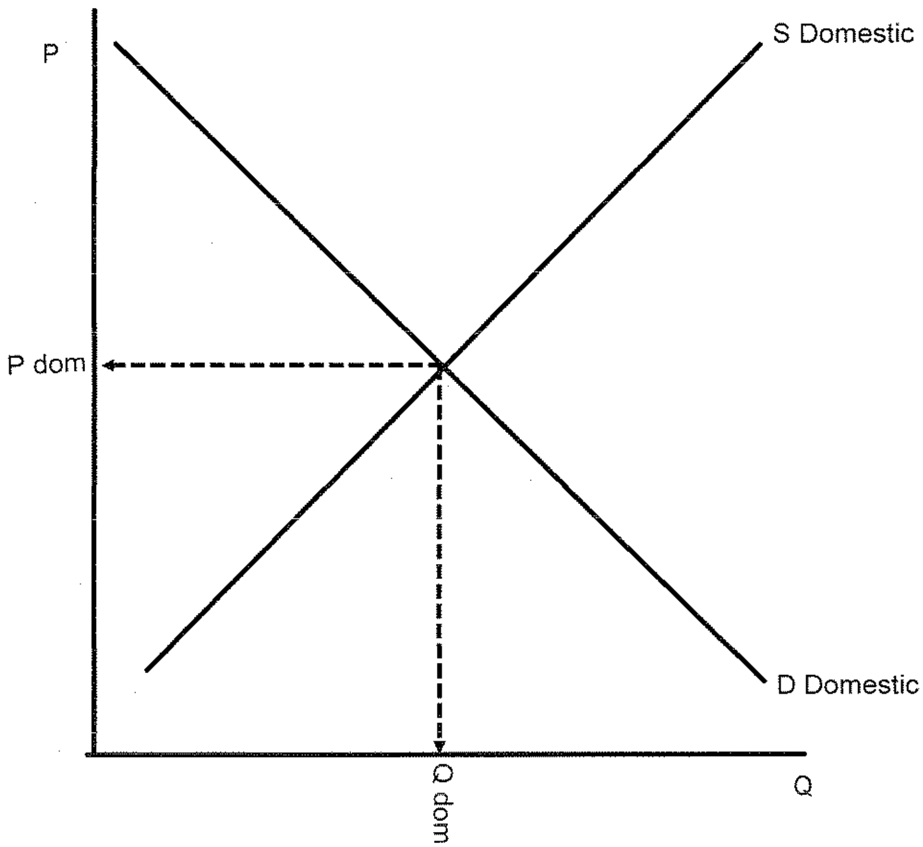
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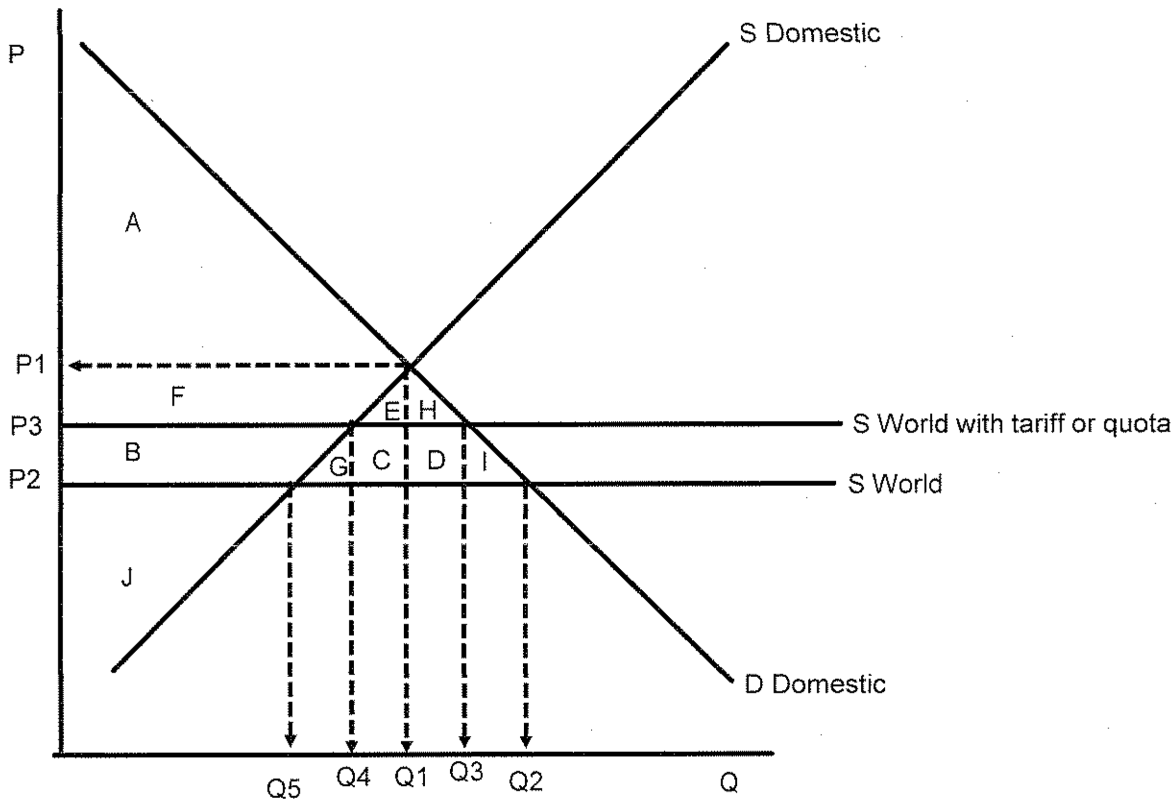
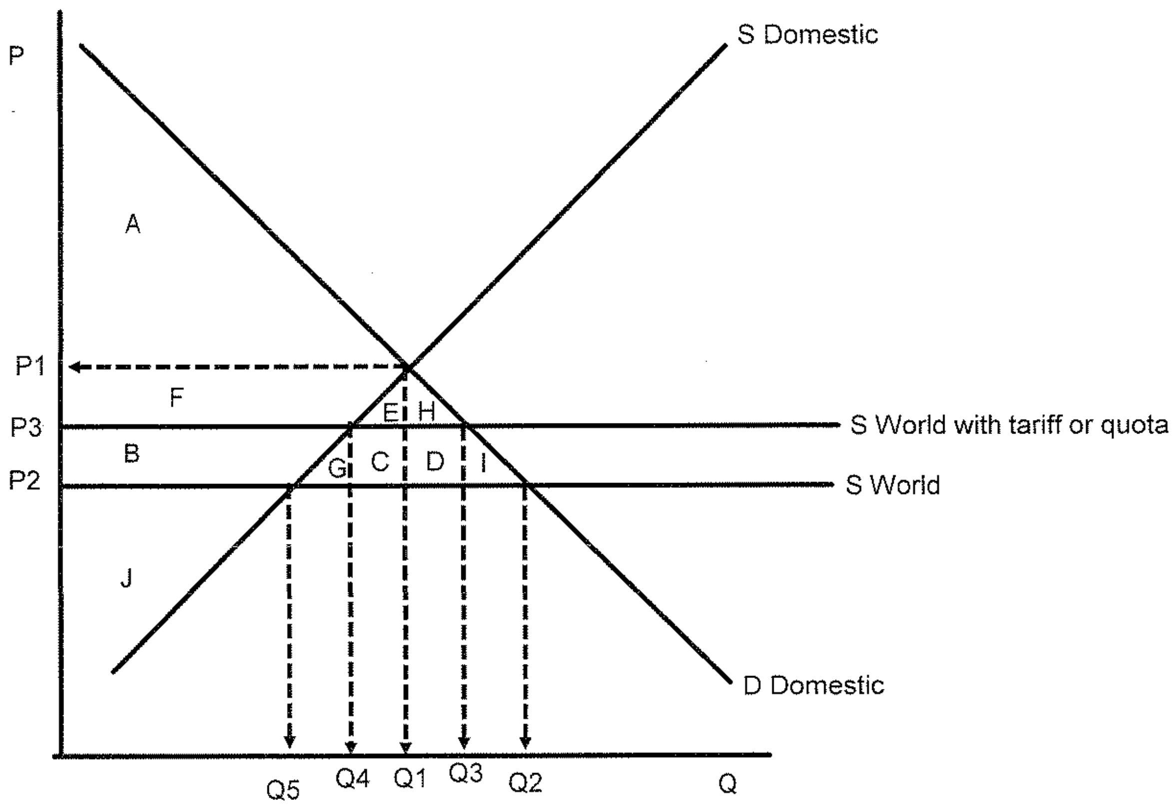


If this were a closed economy (no trade) what is EQ Price and Quantity?

What is consumer surplus?

What is producer surplus?

Where is the deadweight loss that exists due to lack of free trade?



If a quota were imposed, where is the EQ P and Q?

Where is CS?

Where is Domestic PS?

Where is DWL?

Graph the market for coffee. Illustrate the domestic supply and the total supply on the same graph.

Label the domestic equilibrium price and quantity as Pd and Qd.

Label the total equilibrium price and quantity as Pw and Qw.

At the total equilibrium, explain the amount of coffee that would be supplied by the foreign market, and the amount of coffee that would be supplied by the domestic market.

Now suppose the US government imposed a tariff on coffee. Illustrate the supply curve that would reflect the tariff. Label the new equilibrium price and quantity as Pt and Qt.

> Illustrate the amount of the tariff.
>
> Explain the amount of coffee that would be supplied by the foreign market under the tariff, and the amount of coffee that would be supplied by the domestic market.