Edexcel (B) Economics A-level

Theme 3: The Global Economy

3.1 Globalisation

3.1.4 Trade policy and trade negotiations

Notes

Protectionism:

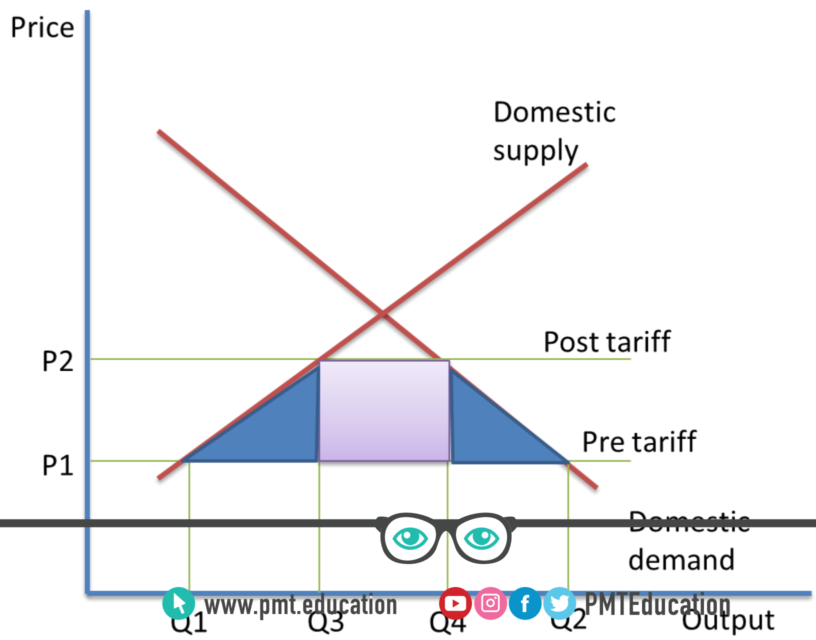
- Protectionism is the act of guarding a country’s industries from foreign competition, by imposing restrictions on free trade.
- If a country employed several protectionist measures, then a trade deficit would reduce. This is because they will be importing less due to tariffs and quotas on imports.
- Infant industries might need protecting. These are industries which are relatively new and need support. Protectionism is usually short term until the industry develops, at which point the industry can trade freely. It is based on the concept of new industries facing high start-up costs, which fall as the industry develops. In order to help the industry survive, it receives support.
- Protectionism could be used to correct market failure. It can deal with demerit goods and protect society from them.
- Governments might want to protect domestic jobs and avoid them being offshored.
- Some countries might impose trade restrictions as a form of retaliation against trade barriers imposed by other countries.

Types of restrictions on trade:

- ### Tariffs

Tariffs are taxes on imports to a country. It could lead to retaliation, so exports might decrease. The impact of tariffs is that the quantity demanded of domestic goods increases, whilst the quantity demanded of imports decreases.

Tariffs result in higher prices for consumers and a loss in consumer surplus.



The tariff diagram illustrates the effects of imposing a tariff. The original quantity of imports is Q2 – Q1, and the new quantity of imports is Q4 – Q3.

The purple shaded rectangle shows the revenue the government gains from imposing the tariff. This could help finance government expenditure.

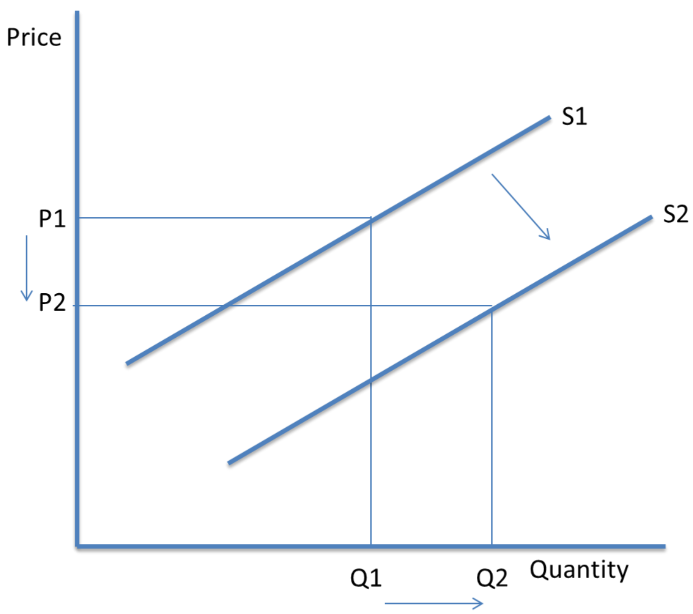
The two blue triangles show the area of deadweight loss of welfare, as a result of the tariff.

- **Quotas**

A quota limits the quantity of a foreign produced good that is sold on the domestic market. It sets a physical limit on a specific good imported in a set amount of time. It leads to a rise in the price of the good for domestic consumers, so they become worse off.

- **Subsidies to domestic producers**

This makes domestic goods relatively cheap compared to imports. It encourages domestic production to increase, as shown by a right shift in the supply curve, and the average price falls.



However, it depends how the subsidy is spent. In the EU, the Common Agricultural Policy subsidises domestic farming. This helps the UK retain some sort of primary sector. The subsidy might encourage a surplus to be produced, which could be wasteful. It also depends on government finances, and it should be considered whether the industry is worth subsidising or not.

Non-tariff barriers

Voluntary export restraints (VERs)

This is when two countries make an agreement to limit the volume of exports to one another over a period of time. They are used when governments want to protect domestic industries from competing imports.

It is usually suggested by the exporting country, to avoid even less flexible trade barriers being imposed.

Embargoes

This is the complete ban on trade with a particular country. It is usually politically motivated.

Excessive administrative burdens ('red tape')

Excessive administration increases the cost of trading, and hence discourages imports. It makes it difficult to trade with countries imposing red tape, and is particularly harmful for developing countries which are unable to access these markets. It is harder to notice this type of protectionism.

Impact of protectionist policies on consumers, producers, governments, living standards and equality:

- Protectionism could distort the market and lead to a loss of allocative efficiency. It prevents industries from competing in a competitive market and there is a loss of consumer welfare. Consumers face higher prices and less variety. By not competing in a competitive market, firms have little or no incentive to lower their costs of production.

- It imposes an extra cost on exporters, which could lower output and damage the economy.

- Tariffs are regressive and are most damaging to those on low and fixed incomes, which could increase income and wealth inequality. However, taxes could raise more revenue for the government, which could be used to redistribute income to the poor or improve public services.

- There is a risk of retaliation from other countries, so countries might become hostile.

- Protectionism could lead to government failure.

International trade negotiations:

○ Role of G20

The G20 is comprised of 20 major economies. These are the US, the UK, the EU, South Korea, Argentina, Brazil, China, France, Australia, Canada, Germany, Italy, Japan, Mexico, India, Russia, Indonesia, South Africa, Saudi Arabia and Turkey.

It was formed with the aim of promoting international financial stability and discussing important policy issues. The group accounts for 85% of gross world product and 2/3 of the global population.

However, the G20 does not include the majority of countries, and developing countries might be excluded. Moreover, there are different economic interests and situations within the countries in the G20, so it could be difficult to coordinate policies.

Nevertheless, the G20 has been able to strengthen the role of emerging economies and reform financial institutions.

○ Role of international institutions (World Trade Organisation (WTO), International Monetary Fund (IMF), World Bank)

- **The role of the WTO in promoting free trade**

The WTO promotes world trade through reducing trade barriers and policing existing agreements. It also settles trade disputes, by acting as the judge, and organises trade negotiations.

Every member of the WTO must follow the rules. Those who break the rules face trade sanctions. In addition to trade in goods, the WTO covers the trade in services and intellectual property rights.

As of 2015, there are 161 member states in the WTO.

- **The progress made and difficulties faced by the WTO, such as agricultural disputes and trade agreements**

Trading blocs might distort world trade or adversely affect those who do not belong to them. There could be an inefficient allocation of resources as a result of policies such as the EU CAP.

Conflicts between blocs could lead to a rise in protectionism. A common external tariff contradicts the WTO's principles, since although there is free trade between members, protectionist barriers are imposed on those who are not members.

Some countries might argue that the WTO is too powerful, or that it ignores the problems of developing countries. This could be since developed countries do not trade completely freely with developing countries, which limits their ability to grow.

Setting up a customs union or a free trade area could be seen to violate the WTO's principle of having all trading partners treated equally. This is especially if a common external tariff is applied. However, they can complement the trading system and the WTO strives to ensure that non-members can trade freely and easily with the members of a trade bloc.

- **The World Bank and IMF**

The World Bank and IMF are sometimes called the Bretton Woods Institutions. They aim to provide structure and stability to the world's economic and financial systems.

Almost every country is a member of both institutions. The governments of each member nations own and direct the institutions.

The World Bank mainly focuses on development. The IMF tries to keep payments and receipts between countries logical and ordered.

World Bank

The World Bank can loan funds to member countries, and its aim is to promote economic and social progress by raising productivity and reducing poverty.

The World Bank is involved in several projects globally, such as providing microcredit, supporting education, and helping the rebuilding of countries after earthquakes.

International Monetary Fund (IMF)

The IMF aims to promote monetary cooperation between nations, and monetary problems can be consulted in the institution.

It also aims to help free trade globally, so jobs are supported. The IMF promotes exchange rate stability, and tries to avoid competitive depreciations in the currency.

Members can also borrow from the IMF, such as if they need to correct an imbalance in the balance of payments.

- ### Bilateral trading agreements

A bilateral trade agreement is an agreement between two countries or groups to favour each other's goods and services. The agreement might involve a guarantee purchase quantity or the removal of protectionist barriers.

An advantage of a bilateral trading agreement is that only two parties are involved, so the process is simple.