
Protectionism

Trade barriers, tariffs and comparative advantage

MERIDIAN EDUCATION

TOPIC 3.1 | SAMPLE ESSAYS

Protectionism

Trade barriers, tariffs and comparative advantage

Coverage

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source pages

- Reduction in protectionism
- Short-run job protection versus long-run efficiency
- Tariff and subsidy evaluation

Level-7 Econ Sample essays written by Ryan Reagan
Written by Ryan Reagan- the most popular IB Econ strategist in the world
** Ryan's videos on Youtube have been watched by over 100,000 IB students world-wide*

Topic 3.1: Protectionism

Question:

USA and Australia enter trade agreement

Text 1

With the Australia-United States Free Trade Agreement coming into force on 1 January 2005, the Australian Government has officially joined much of the rest of the world in promoting the opportunities and benefits of bilateral and regional free trade agreements.

Text 2

Until recently, Australia had focused its attention on multilateral trade negotiations. In fact, prior to 2003, Australia had signed only one free trade agreement with New Zealand. Since then, Australia has signed agreements with Singapore, the US and Thailand.

As a result of this relative inactivity on the bilateral front, Australia is now facing discrimination in many key markets. For this reason, the Government is looking to Asia and investigating the possibility of forming a **free trade area** with ASEAN, China, South Korea and Japan.

Text 3

The Australian Government has signalled its on-going commitment to multilateral trade agreements. It recently played an important role in negotiating the World Trade Organization (WTO) "Doha" agreement of July 2004 that provides for a reduction in protectionism, like tariffs and **subsidies**, in controversial areas such as agriculture. The removal of barriers will, hopefully, improve the access of developing nations into the markets of developed nations.

Text 4

Australia has greatly benefited from the freer market access resulting from WTO membership, with Australian exports rising from \$93 billion to more than \$154 billion since 1995 and a strengthening of the Australian dollar. The sharp increase in trade has also significantly contributed to more than 250 000 jobs created in Australia during that time. It would be unwise for Australia to turn its back on the multilateral trading regime despite nationalistic fears of job losses, dumping and the need to raise taxes.

(Economic material from The Australian & Economic 90041)

Evaluate the effects of WTO trade negotiations aimed at reducing protectionism (8 marks)

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Suggested answer:

This article discusses the trade negotiations and agreements between Australia and the rest of the world.

There are a number of advantages of a reduction in protectionism mentioned in the article. As mentioned in the article, the removal of barriers will hopefully improve the access of developing nations to developed nations. This suggests that exports from developing nations into developed nations will rise. The increase in exports will lead to an increase in aggregate demand, which increases economic growth for developing countries. Since developed countries have higher income than developing countries, this can help generate significant increase in aggregate demand and economic growth for developing countries, leading to significant improvements in living standards. Like mentioned in paragraph 4, freer market access also helps to increase Australian exports, which will also help to increase economic growth of Australia. This increase in economic growth has also created 250, 000 jobs in Australia like mentioned in the article. Another advantage of freer is that there will be greater specialization of different countries according to comparative advantage, which will increase efficiency and also increase the total output of all countries combined.

Despite all the advantages mentioned above, reduction in protectionism also has a number of unintended consequences. Firstly, there is a greater fear of job losses like mentioned in the article. This is because more efficient importers will replace less efficient domestic producers when free trade increases. This will lead to a fall in output by less efficient domestic producers and lead to a reduction of job opportunities. Secondly, there is also greater fear of dumping. Dumping refers to the situation when a country exports goods to another country at a price below average cost. Dumping ultimately hurts domestic producers because it reduces the market price and hence, the profitability of domestic producers. More domestic firms may shut down if there are less protectionism measures to protect domestic producers from dumping. Lastly, the article also mentions a fear of the need to raise taxes. A reduction in protectionism generally means a reduction in tariffs, which reduces tax revenue for the government. To make up for this loss in tax revenue from tariffs, the government may need to increase tax on domestic firms or consumers. This will reduce the disposable income for domestic consumers and the profitability of domestic firms.

Overall, there are both winners and losers to reduction in protectionism. The winners are exporters, while the losers are inefficient domestic producers. However, over the long term, the benefits of reducing protectionism tend to outweigh the costs, because freer trade will ultimately increase economic efficiency and increase living standards of all countries.

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- ❶ The Australian government intends to reduce tariffs on foreign car imports from 10% to 5% in 2010. They say the future of the industry lies in "innovation and global integration, not industry protection with old-fashioned **quotas** and tariffs". However, its plan keeps protection for the Australian car industry through increased subsidies, doubling industry assistance to 6.2 billion Australian dollars.
- ❷ The 1.3 billion Australian dollars Green Car Innovation Fund provides some environmental respectability to an outdated industry policy. However, Australia can import as many fuel efficient cars as it wants without having to make them itself.
- ❸ Car makers are already responding to the **demand** for more fuel-efficient cars and the car industry does not need further incentives. If the government's intention is to lower carbon emissions from car use in Australia, then it should aim to provide consumers with access to low-emission cars at the cheapest possible price. Lowering tariffs on imported cars achieves this objective at a much lower cost than building cars locally.
- ❹ The government argues "only 15 countries, including Australia, can design, engineer and build a car from scratch" and says its car plan "demonstrates the government's commitment to modern manufacturing and to providing high-skill, high-wage jobs for Australians". The notion that only the car industry can provide high-skill, high-wage jobs is mistaken.
- ❺ What cost will taxpayers pay for the government's determination to maintain the capacity to build cars locally? The billions of dollars in help provided by successive Australian governments to the local car industry has come at the expense of consumers and taxpayers, destroying jobs and income in other industries. This is the real, but largely unseen, cost of industry assistance.
- ❻ The new car plan is the latest of many support packages for this industry, yet the government argues things will be different this time, with "a high level of support at the beginning, eventually falling towards zero".
- ❼ The car industry has failed to benefit from the efforts of previous Australian governments to support it, because such support limits the competitive pressures that are the best guarantee of a competitive car industry.

Evaluate whether increased protectionism in the car industry can benefit the economy

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This article discusses how Australian government is intending to reduce tariff on cars and a subsidy that is in place to support domestic Australian car producers.

There are a number of disadvantages to protectionism that may be suggested in the article. Firstly, it is mentioned in paragraph 3 that lowering tariffs on imported car achieves the objective of increasing access to low-emission cars at a much lower cost than building cars locally. This suggests that reducing tariff is a very efficient method to increase access to fuel-efficient cars by lowering price of imports and increasing imports. In fact, this will also improve economic efficiency as more efficient foreign producers replace less efficient domestic car producers. Another disadvantage of protectionism mentioned in the article is that the subsidy, which is a form of protectionism, comes at the expense of many domestic tax payers, which “destroys jobs and income in other industries”. This is because the government must increase taxes for other industries in order to raise money for subsidizing car producers. The increase in tax reduces profitability for firms in other industries and can lead to unemployment. Moreover, it is also mentioned in the article that protectionism to support domestic car producers tend to reduce competitive pressure, which is “the best guarantee of a competitive car industry.” The reduction in competitive pressure will reduce incentive for domestic producers to innovate and improve efficiency. From consumers point of view, protectionism also has a negative impact. This is because protectionism measures such as tariff and quotas tend to increase market price for cars. Furthermore, protectionism reduce the quantity of imports, which lead to a fall in consumer choice.

The main reason why Australia aims to support its car industry seem to be the fact that the car industry can help to provide high skill, high wage jobs. Hence, if the industry is not protected, it can suffer from foreign competition, leading to unemployment. However, it is also stated in the article that “the notion that only car industry can provide high skill, high wage jobs is mistaken.” This suggests that it is unnecessary to protect domestic car producers because other industries can also provide job opportunities

Protectionism can have a positive effect for workers in the short run. However, in the long run, protectionism will lead to an inefficient allocation of resources. Moreover, protecting workers in the car industry will lead to unemployment in other industries due to the need for higher taxes. Hence, in conclusion, the cost of protecting car industry outweighs the benefit and protectionism should not be adopted.

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