Free Trade and Protection

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Definitions

- Free trade refers to the exchange of goods and services in the international market place without restrictions
- Specialisation refers to the concept that nations should produce the goods that they can produce at the lowest relative opportunity cost and then trade with other nations

Comparative Advantage

- An absolute advantage refers to a position where a country can produce more of a good than another country with the same number of inputs
- A comparative advantage refers to a position where a country can produce a good at a lower opportunity cost than another
- The law of specialisation says that a country should specialise in the production of goods it holds a comparative advantage in

Sources of a Comparative Advantage

- Factor Endowment
- Climate
- Differences in technology

Exports/Imports

- Exporting and importing raise the economic welfare of countries
  - Exports allow firms to sell at the world price and thus give them a larger profit
    - Exports thus increase producer surplus
  - Imports allow consumers to buy at the world price and thus save money
    - Imports thus increase consumer surplus

Protection

- Protection occurs when the government attempts to place restrictions on free trade in order to protect domestic producers
  - Tariffs
  - Subsidies
  - Import Licensing/ Quotas
- However protection will always provide a deadweight loss to the economy as more consumer surplus is lost than producer surplus is gained

Tariffs

- A tariff refers to a tax on an import, raising its price and thus allowing domestic producers to compete
- However the gain in producer surplus and government revenue created by the tariff will not outweigh the loss in consumer surplus
- Thus a tariff is in-efficient and will distort the market

Subsidies

- A subsidy or "hidden tax" refers to a grant payed to domestic producers that allows them to artificially increase supply and lower their prices
- However this grant is payed for by taxpayers and the increased producer surplus will

not outweigh its cost

Trade Liberalisation	Protection
Lower prices for consumers	Infant Industry
Higher profit for producers	Anti-Dumping
Net exports increase	Diversification
Economic Growth	Cheap foreign labour

The World Trade Organisation

- The WTO is made of a group of 164 nations and promotes trade liberalisation worldwide
- It assists in negotiating free trade agreements and works as a dispute resolution body
- It operates on two main principles
    - Most favoured nation principle
    - National Treatment principle

Regional Trade Agreements

- A regional trade agreements refers to an agreement of free trade between specific nations
- Australia holds 9 free trade agreements

Trade Blocs

- A trade bloc refers to a group nations that all hold free trade agreements with each other but not with outside nations
- The most notable of these is the European union
- Trade blocs can be argued to be trade diverting as nations outside the bloc have little access to their markets