133. The benefits of trade

Item 133 – Grade 3

IB question

• Explain that gains from trade include lower prices for consumers, greater choice for consumers, the ability of producers to benefit from economies of scale, the ability to acquire needed resources, a more efficient allocation of resources, increased competition, and a source of foreign exchange.

Definition

- International trade → Exchange of goods and services between countries

<Gains from trade>

1. Lower price
    - Consumers are able to buy less expensive products and producers are able to purchase less expensive raw materials and semi-manufactured goods
    - Cause: Comparative advantage (HL)
2. Greater choice
    - Enables consumers to have a greater choice of products

    (Domestic + from other countries)
3. Differences in resources
    - Different countries possesses different resources
    - There are some resources that a country may need, but quite simply does not have (ex. Copper, diamonds, oil)
4. Economies of scale
    - Demand increases when producing for an international market → leading to high level of production and size of production
    - The increased levels of production should provide scope for economies of scale to be achieved and production should become more efficient.
    - Specialization is to increase when firms are large (ex. Accounting manager or marketing manager) → leading to increase in cost benefits from acquiring experience and expertise, known as moving down the "learning curve" (The long-run average cost curve)
    - Division of labour should increase (where a production process is broken down into a number of simple and basic tasks)

- International trade, and with it larger markets and production units, should enable production in a country's export industries to become more efficient in the long-run. It should also make the producers more competitive. It should lead to a reduction in long-run average costs.

5. Increased competition

- International trade may lead to increased competition, as domestic firms compete with foreign firms → leading to greater efficiency + for consumers, goods become cheaper + quality and variety of goods will increase

6. More efficient allocation of resources

- If there is no government interference, the countries that are best at producing certain goods and services will produce them; they will be able to produce these goods and services at the lowest cost and take advantage of their efficiency
- If this happens in all different trading countries, then it is fair to assume that the world's resources are being used most efficiently when free trade is taking place

7. Source of foreign exchange ★

- International trade enable countries to obtain foreign exchange

→ International trade can make a major contribution to a country's economic growth

134. Absolute and comparative advantage (HL)

Item 134 – Grade 4

- Mutually beneficial trade is based on the principle of absolute advantage according to Adam Smith. Each country should specialize in the production of the good in which it has an absolute advantage.

Ib question

- Explain the theory of absolute advantage.
- Explain, using a diagram, the gains from trade arising from a country's absolute advantage in the production of a good.

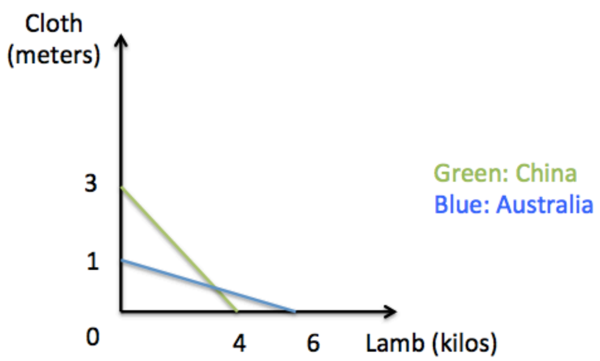
Definition

- Absolute advantage: A country is said to have an absolute advantage in the production of a good if it can produce more of it with the same resources or if it can produce a unit of it with using fewer resources than another country.

Table: Production outcomes where two countries are using the same quantities of resources to produce lamb and cloth

Country	Kilo of lamb	Meters of cloth
Australia	6	1
China	4	3
Total without trade	10	4

Production possibilities curves (PPC) to show absolute advantage



- Australia has an absolute advantage in producing lamb

  → Because it can produce 6 units with the same resources while China can only produce 4 kilos

  → Australia should specialize in the production of lamb

- China has an absolute advantage in cloth

  → Because it can produce 3 units with the same resources while China can only produce 1 kilo

  → China should specialize in the production of cloth

Definition

- Reciprocal absolute advantage: When each country has an absolute advantage in the production of one product

*Both China and Australia has a reciprocal absolute advantage

Ib question

- Explain the theory of comparative advantage.
- Describe the sources of comparative advantage, including the differences between countries in factor endowments and the levels of technology.
- Draw a diagram to show comparative advantage.
- Calculate opportunity costs from a set of data in order to identify comparative advantage.
- Draw a diagram to illustrate comparative advantage from a set of data.
- Discuss the real-world relevance and limitations of the theory of comparative advantage, considering factors including the assumptions on which it rests, and the costs and benefits of specialization (a full discussion must take into account arguments in favour and against free trade and protection—see below).

Definition

- Comparative advantage: When a country produces the good at a lower opportunity cost than another country. (Country A has to give up few units of other goods to produce the good in question than does country B)

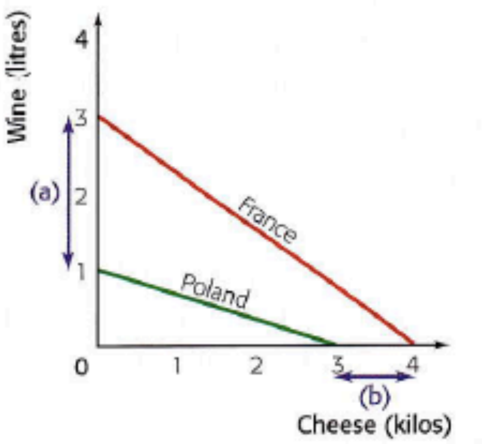
Table: Comparative advantage

Country	Liters of wine	Opportunity cost to produce 1 litre of wine	Kilos of cheese	Opportunity cost to produce 1 kilo of cheese
France	3	$\frac{4}{3}$ kilos of cheese	4	$\frac{3}{4}$ litre of wine
Poland	1	3 kilos of cheese	3	$\frac{1}{3}$ litre of wine

- France has an absolute advantage in both goods
- However, in terms of comparative advantage, France has a comparative advantage in the production of wine (since France has to give up $\frac{4}{3}$ kilos of cheese to produce 1 litre of wine while Poland has to give up 3 kilos of cheese) and Poland has comparative advantage in the production of cheese (since Poland has to give up $\frac{1}{3}$ litre of wine to produce 1 cheese while France has to give up $\frac{3}{4}$ litre of wine)

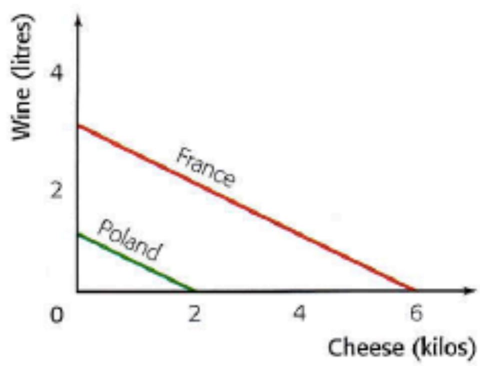
→ France should specialize in the production of wine and Poland should specialize in the production of cheese

Production possibilities curves (PPC) to show comparative advantage



- (a) The comparative advantage for the better producer is in the good where the distance between the production possibilities is greatest (→ France has a comparative advantage in wine)
- (b) The comparative advantage for the less efficient producer is in the good where the distance between the production possibilities is least (→ France does not have a comparative advantage in cheese)
- The slope of straight line PPC: constant opportunity cost
- (Theory of comparative advantage works so long as the opportunity costs faced by the two countries are different)

Production possibilities curves (PPC) to show identical opportunity costs



- If the two countries face the same opportunity costs (shown by parallel PPCs), then there would be no point in trade taking place, which is shown in the graph above
- If the slopes of the two PPCs are the same, then opportunity costs for each country will be

identical, and there will be no gains to be made by trading

Table: Identical opportunity costs

Country	Liters of wine	Opportunity cost of 1 litre of wine	Kilos of cheese	Opportunity cost of 1 kilo of cheese
France	3	2 kilos of cheese	6	$\frac{1}{2}$ litre of wine
Poland	1	2 kilos of cheese	2	$\frac{1}{2}$ litre of wine

<Real-world relevance and limitations of the comparative advantage>

1) Assuming that as in perfect competition, there is perfect knowledge
2) Assuming that there is no transport costs (which is not true)

   The existence of transport costs may erode a country's comparative advantage and not make international trading worthwhile, since it may eliminate its competitiveness
3) Assuming that there are only 2 economies

   The theory may be applied to more countries and more products and it is still possible to iscern where the comparative advantages lie.
4) Assuming that there are no economies or diseconomies of scale

   However, the existence of economies of scale would, in all probability, increase a country's comparative advantage, as relative costs of production fell even more
5) Assuming that goods being traded are identical

   However, problems arise with goods such as consumer durables

   Ex) A Toshiba television will be different from a Philips television and so it is much harder to prove that Japan has the comparative advantage in producing television
6) Assuming that f.o.p remain in the country

   However, it may be the f.o.p, rather than the goods, that move from country to country

   Ex) Developed countries rather than exporting finished goods to LDCs, may invest capital in LDCs to enable goods to be produced there. Labour may migrate from low-wage to high-wage countries
7) Assuming that there is perfectly free trade among countries

   However, in reality, there are likely to be government-imposed trade barriers in many industries

135. The World Trade Organizations (WTO)

Item 135 – Grade 3

Ib question

• Describe the objectives and functions of the WTO.

The World Trade Organization (WTO)

- An international organization that sets the rules for global trading and resolves disputes between its member countries.
- Was established on 1 January I995 and now has l53 members and 30 observer countries, the majority of whom are seeking membership.
- Is largely credited with the fact that, since 1947, average world tariffs for manufactured goods have declined from approximately 40 percent to 4 percent

Aims of the WTO

- Aims to increase international trade by lowering trade barriers and providing a forum for negotiation
- The function of the WTO are to:
  - Administer WTO trade agreements
  - Handle trade disputes among member countries
  - Monitor national trade policies
  - Provide technical assistance and training for developing countries
  - Cooperate with other international organizations
- WTO operates through a system of trade negotiations, or **rounds**.
  The current round of negotiation is called the **Doha round**
- The programme, called the Doha Development Agenda, covers many areas including agricultural tariffs, non-agricultural tariffs, trade and environment, anti-dumping, subsidies, competition policy, transparency in government procurement and intellectual property
- In July 2006, Doha round negotiations broke down and were ultimately suspended as a result of an inability to come to agreement on fundamental issues. There were two key concerns.
  1) The EU and the USA were being urged to reduce their agricultural subsidies to improve market access for developing countries' exports

2) the more-developed countries wanted the larger developing countries to lower their barrier to imports of manufactured goods

136. Types of trade protections

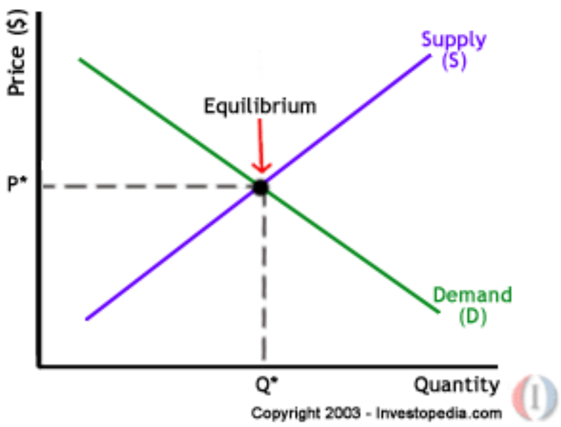
→ There are a number of different methods used to protect economies from imports

Item 136 – Grade 4

Definitions

- Free trade → It takes place between countries when there are no barriers to trade put in place by governments or international organizations. Goods and services are allowed to move freely between countries.
- Trade protectionism → Government actions and policies that restrict or restrain international trade, often done with the intent of protecting local businesses and jobs from foreign competition. Typical methods of protectionism are (import) tariffs, quotas, subsidies or tax cuts to local businesses and direct state intervention.

Domestic market without free trade



<u>Domestic market with free trade (wheat being produced domestically and imported</u>

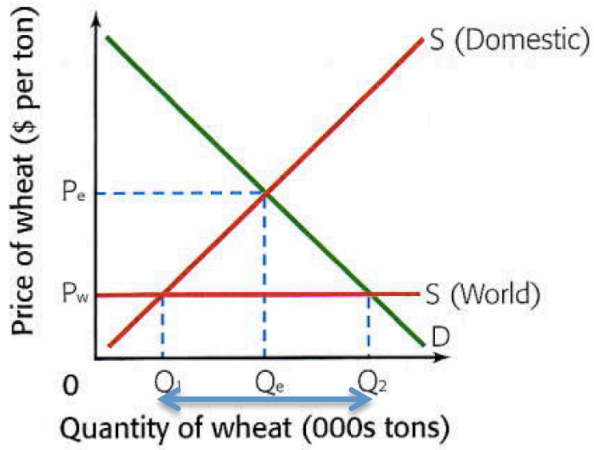


Figure 22.1 Free trade in wheat

- When there is no foreign trade: equilibrium point is, 0Qe – Pe
- When foreign trade does take place, supply curve faced by the importers, S (World), is perfectly elastic. S (World) must be below Pe or there would be no point in trading

  Equilibrium price is: S (World) or Pw
- At this price, domestic farmers will only be prepared to supply 0Q1 tons of wheat. However, the demand for wheat will be 0Q2 and so the excess demand is satisfied by imported wheat (which will fill in the gaps between Q2 and Q1 by Foreign producers). Thus domestic consumers get to consume QeQ2 more wheat at a lower price.

Winners	**Losers**
• Domestic consumers (buying lots of wheat at lower prices than before)	• Domestic producers (selling much less product than before, at a much lower price → Wages will decrease)
• Foreign producers	

Ib question

• Explain, using a tariff diagram, the effects of imposing a tariff on imported goods on different stakeholders, including domestic producers, foreign producers, consumers and the government.

Definition

- Tariff: a tax that is charged on imported goods.

A tariff on wheat imports

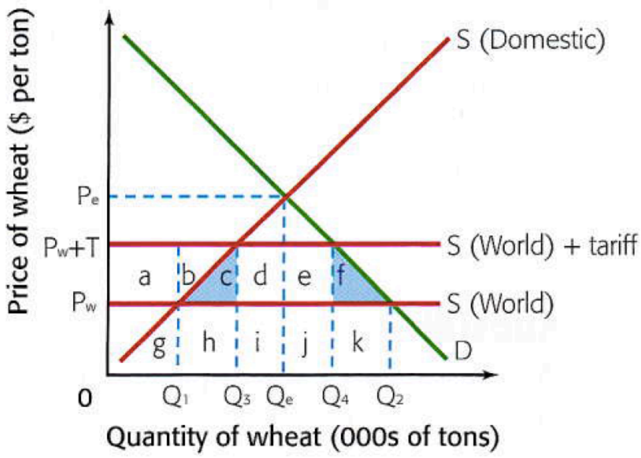


Figure 22.2 A tariff on wheat imports

- An imposed tax will shift the supply curve upwards by the amount of the tax (in the case of a tariff, it will shift the world supply curve upwards, since it is placed on the foreign producers of the good and not the domestic producers)

Before the tariff	After the tariff
• 0Q2 tons of wheat were being consumed at a price of Pw. • 0Q1 of domestic production • Imports of Q1Q2 • Total revenue of only g for domestic firm	• Market price at Pw+T • Total quantity demanded falls from 0Q2 to 0Q4 • Domestic producers' total revenue of g+a+b+c+h • Supply of foreign producers Q3Q4, receiving Pw +T, but have to pay the tariff to the government → leading to revenue falling from h+i+J+k to only i+j Government's tariff revenue of d+e (paid by foreign producers)

*In this case, the higher price will be passed on to millers and eventually to the cereal companies or bakeries that buy the refined wheat.

- Tariffs are the most common type of anti-dumping measure. If a country has been able to prove that dumping has taken place, then it can place a tariff on the imported goods to raise their prices and eliminate the cost advantages of the dumped imports

Definition

- Dumping → Exporting goods at prices lower than the home-market prices.

<Two further outcomes>

- Q4Q2 tons of wheat are now demanded. There is a loss of consumer surplus equivalent to f, because the wheat is not now purchased. → Known as a dead-weight loss of welfare, because of the loss of consumer surplus
- Q1Q3 tons of wheat are now produced by relatively inefficient domestic farmers. The foreign farmers would produce this quantity for a minimum revenue of h, whereas the domestic producers need a minimum revenue of h+c. c represents the inefficiency of the domestic producers and a loss of world efficiency, since more of the world's resources are being used to produce the wheat than are necessary → which is another dead-weight loss of welfare

Winners	Losers
• Domestic producers (More supply in the market at this higher price and it also means more jobs and better salary)	• Domestic consumers
• Government (gaining more tax revenue)	• Foreign producers

Ib question

- Explain, using a diagram, the effects of setting a quota on foreign producers on different stakeholders, including domestic producers, foreign producers, consumers and the government.

Definition

- Quota: a physical limit on the numbers or value of goods that can be imported into a country. Quantity limit or value limit.

A quota on wheat imports

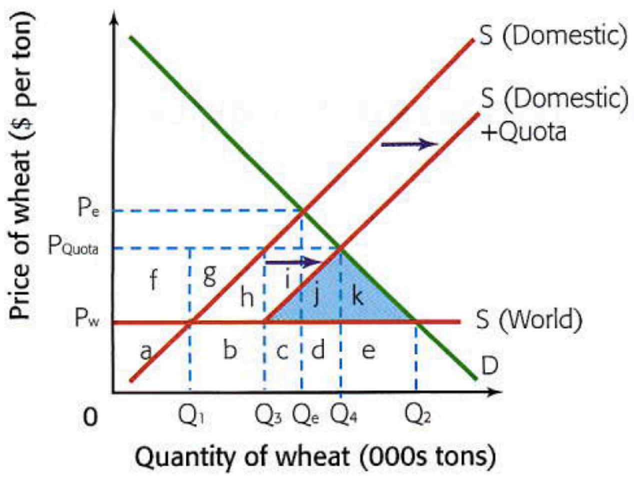


Figure 22.4 A quota on wheat imports

• Before the quota is imposed:	• After the quota (Q1Q4 tons of wheat) is imposed
• 0Q2 tons of wheat demanded at a price of Pw • 0Q1 of domestic supply • Q1Q2 of imports • Total revenue of only a for domestic firm	• 0Q1 of domestic producers' supply at a price of Pw • Q1Q3 of quotas being produced by the importers → However, there is an excess demand of Q3Q2 at the price Pw and so price begins to rise. As the price rises, importers are not allowed to supply more wheat because they have filled their quota, and domestic producers begin to enter the market, attracted by the higher price of wheat.

→ The domestic supply curve shift to the right, above Pw

→ Eventually, the price settles at PQuota (where demand =supply, and the wheat demanded falls to Q4)

- Domestic producers now supply 0Q1 and Q3Q4 tons of wheat at a price of PQuota
- Revenue rises to a+c+d+f+i+j for domestic firm
- Foreign producers now supply their quota of Q1Q3 tons of wheat and also receive a price of PQuota → thus, their income changes from b+c+d+e to b+g+h.

<Two further outcomes>

- Q4Q2 tons of wheat are now demanded. Consumers keep the amount e that they would have spent on wheat but there is a loss of consumer surplus equivalent to k, because the wheat is not now purchased → a dead-weight loss of welfare, because of the loss of consumer surplus
- Q3Q4 tons of wheat is now produced by relatively inefficient domestic farmers. The foreign farmers would produce this quantity for a minimum revenue of c+d, whereas the domestic producers need a minimum revenue of c+d+j. j represents the inefficeniby of the domestic producers and a loss of world efficiency, since more of the world's resources are being used to produce the wheat than are necessary → another dead-weight loss of welfare

Winners	Losers
• Domestic producers	• Domestic consumers
• Possibly Government if it earns revenue by selling quota licenses	• Foreign producers

Ib question

• Explain, using a diagram, the effects of giving a subsidy to domestic producers on different stakeholders, including domestic producers, foreign producers, consumers and the government.

Definition

- Subsidies: an amount of money paid by the government to a firm, per unit of output

A subsidy on wheat production

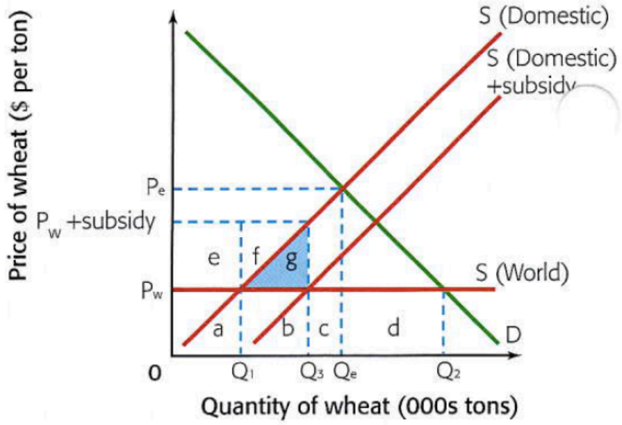


Figure 22.3 A subsidy on domestic wheat production

- In this case, the government is giving a subsidy to domestic producers to make them competitive → The effect will be to shift the domestic supply curve downwards by the amount of the subsidy

Before the subsidy:	After the subsidy:
• 0Q2 tons of wheat are being consumed at a price of Pw • Domestic production is 0Q1 and imports are Q1Q2 • Total revenue only a for domestic firm • Revenue for foreign producers is b+c+d	• S (Domestic) shifts downwards by the amount of the subsidy to S (Domestic) + subsidy • Market price staying at Pw and so demand remains at 0Q2 • However, domestic producers increase production to 0Q3 as they are now receiving Pw+subsidy per unit that they produce • Revenue increases to a+b+e+f+g for domestic firm • Foreign producers supply the rest (Q3Q2) → Thus, their revenue falls to c+d • The amount of subsidy paid by the government is e+f+g

<Two further outcomes>

- Q1Q3 tons of wheat are now produced by relatively inefficient domestic farmers, as opposed to more efficient foreign farmers. The foreign farmers would produce this quantity for a minimum revenue of b, whereas the domestic producers need minimum revenue of b+g → g represents the inefficiency of the domestic producers and a misallocation of the world's resources (since it is an excess supply of wheat) → another dead-weight loss of welfare
- There is no loss of consumer surplus, because the price of the wheat does not change. However, consumers are indirectly affected as governments will us tax revenue to fund the subsidies → higher tax payments and also opportunity cost in terms of reduced government spending on other things

Ib question

• Describe administrative barriers that may be used as a means of protection.

• Evaluate the effect of different types of trade protection.

1. "Red tape"

- Administrative processes that have to be undertaken when importing goods
- It may act as a restriction to imports if these are lengthy and complicated
- Ex) Paperwork which importers have to go through, which will slow down imports, and it is likely to result in rising cost to the importer
- Ex) Countries may designate certain ports of entry that are difficult to reach and also more expensive → may cause border delays and again raise costs

2. Health and safety standards and environmental standards

- Various restrictions may be placed on the types of goods that can be sold in the domestic market, or on the methods used in the manufacture of certain goods.
- While it is important that countries be able to guarantee the health and safety of the population by preventing the import of unhealthy or unsafe goods, it is extremely important that governments are legitimately keeping out imports rather than simply protecting their own country's workers

3. Embargoes

- It is an extreme quota
- It is a complete ban on imports and is usually put in place as a form of political punishment
- Ex) USA has a trade embargo on all products from Cuba
- Countries put in place a set of economic sanctions against an offending country. These limit the exports or imports of one or a few key products and are also used as a form of political punishment, or to achieve a desired political objective

137. Types of trade protection (HL)

Item 137 – Grade 3

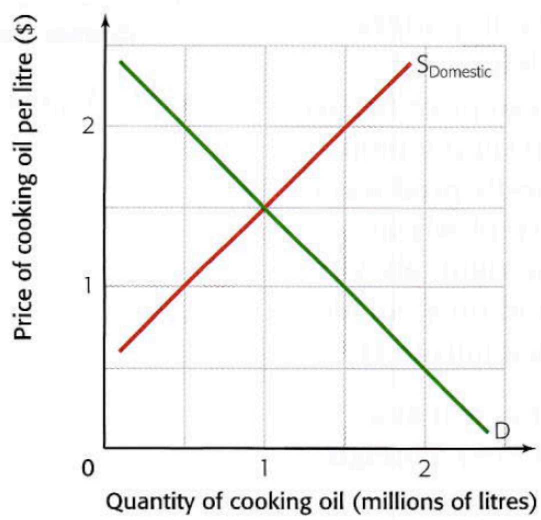
Ib question

• Calculate from diagrams the effects of imposing a tariff on imported goods on different stakeholders, including domestic producers, foreign producers, consumers and the government.

• Calculate from diagrams the effects of setting a quota on foreign producers on different stakeholders, including domestic producers, foreign producers, consumers and the government.

• Calculate from diagrams the effects of giving a subsidy to domestic producers on different stakeholders, including domestic producers, foreign producers, consumers and the government.

This graph shows the market for cooking oil in a country:

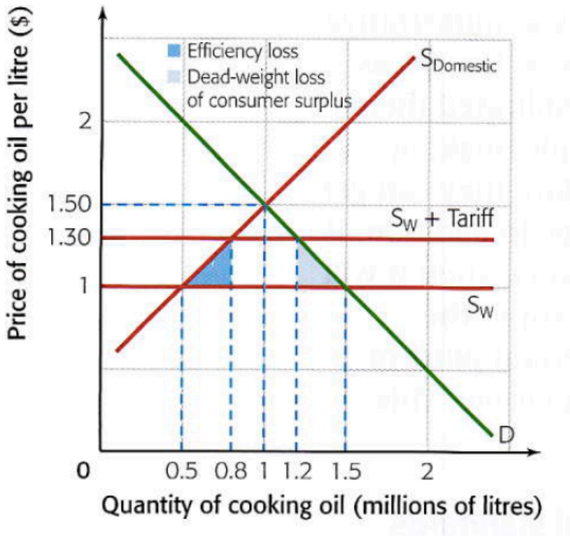


Questions

1. Indicate the domestic equilibrium price and quantity on the graph
2. Cooking oil may be imported. The world price is 1 dollar per liter. Add the world supply curve to the graph.
3. Explain how much cooking oil will be supplied by domestic suppliers and how much will be supplied by foreign producers when free trade takes place
4. The government imposes a tariff of 30 cents per liter. Show the effect of this on the graph.
5. Calculate the change in consumer spending before and after the imposition of the tariff
6. Calculate the government tax revenue after the tariff is put in place
7. Explain the imact of the tariff on any two of the stakeholders in the cooking oil market

Answers

The required diagram is shown below.



1. Equilibrium price and quantity are shown as 1.50 dollars and 1 million liters of cooking oil
2. The world supply curve has been added. It is a perfectly inelastic supply curve as 1 dollar
3. Before free trade, domestic producers supplied 1 million liters of cooking oi. After free trade, the domestic supply falls to 0.5 million liters and the quantity supplied by foreign producers is 1 million liters (1.5 million -0.5 million).
4. The effect of the tariff is shown by the upward shift of Sw from 1 dollar to 1.30 dollar i.e. Sw+tariff
5. Consumer expenditure before the tariff was 1.5 million $\times$ 1 dollar = 1.5 million dollar

   Consumer expenditure after the tariff was 1.2 million $\times$ 1.30 million dollars = 1.5 million dollars
6. The tax revenue will be 30 cents $\times$ 400,000 = 120,000.
7. The stakeholders in the market are domestic producers, foreign producers, consumers, the government, and resource allocation. An explanation of the effect on any two will be sufficient. The effects are as follows.

- *Domestic producers* are able to sell more, at a higher price, thus increasing revenue and, in all probability, profit. They will also increase employment, which should be good for the domestic economy.
- *Foreign producers* sell less, at the same price, thus reducing their revenue and, almost certainly, their profit. This will also lower employment in the foreign economies, causing damage there.

- *Consumers* get to consume less of the product, at a higher price, in this case paying more in total. They also suffer a loss of consumer surplus, some to domestic producers, some to the government and a dead-weight loss, shown by the light blue triangle in the diagram.
- *The government* will gain income from the tariff, which may then be spent. The government may also benefit from a decrease in unemployment in the economy. However, there is always the danger of retaliation from other countries for imposing the tariff.
- *Resource allocation* in this case means that production of 0.3 million liters of cooking oil shifts from efficient foreign producers to less-efficient domestic producers. This is a welfare loss and inefficient resource allocation occurs, shown by the dark blue triangle in the diagram.

138. Arguments for and against trade protection (arguments against and for free trade)

Item 138 – Grade 5

Ib question

• Discuss the arguments in favour of trade protection, including the protection of domestic jobs, national security, protection of infant industries, the maintenance of health, safety and environmental standards, anti-dumping and unfair competition, a means of overcoming a balance of payments deficit and a source of government revenue.

<Arguments for trade protectionism>

- Protection of domestic jobs

  → Governments often attempt to protect industries that are in decline (because of the inability to compete with foreign competition) in order to avoid structural unemployment.

  → However, it is likely that the industry will continue to decline and that protection will simply prolong the process. It may be better to let the resources employed in the industry move into other, expanding areas of the economy, despite the short-run social costs.

- National security

  → It is sometimes argued that certain industires need to be protected in case they are needed at times of crisis

  → Ex) Wars nned agriculture, steel and power generation. Steel industry may argue that it must be protected in order to stay competitive.

  → However, this argument is often overstated, used for an excuse for protectionism.

- Protecting the economy from low-cost labour

  → The economy should be protected from imports that are produced in countries where the costs of labour is very low because it is argued that it is the main reason for declining domestic industries.

  Ex) There have been demands in the US to protect the domestic clothing industry against cheap imports from Asia, where wages are mush lower.

  Ex) Hourly wages for ship building in China are below those in South Korea and that this accounts for the increase in demand for Chinese ships. However, this argument goes against the whole concept of comparative advantage. It would mean that domestic consumers would pay higher prices than they should and that production in the protected economy would take place at an inefficient level. The country whishing to export would lose trade and their economy would suffer.

Comparative advantage does change over time. As relative factor costs change in different countries, it is important that resources should move as freely as possible from industries where comparative advantage is waning, into industries where it is growing. Supply-side policies that focus on labour markets emphasize the importance of making labour flexible enough to adapt to changing economic circumstances. → Putting some responsibility on governments to help those workers who have lost their jobs due to increased competition from countries that have developed their comparative advantage in the production of labour-intensive goods.

- Protection of infant (sunrise) industries

→ Infant industry: industry that is just developing

→ It is thought that they do not have the economies of scale advantages compared to larger industries so it needs to be protected against imports until it achieves a size where it is able to compete on an equal footing

→ However, it is argued that most developing countries have highly efficient capital markets, which allow them to access to large amounts of financial capital so it is hard to imagine that a new industry would not set up at the most efficient size

→ Ex) Saudi Arabian government has been diversifying into petrochemical production in recent years. The plants constructed have been among sme of the largest in the world, gaining almost immediately from economies of scale

- The maintenance of health, safety and environmental standards

→ A country may wish to impose safety, health, or environmental standards on goods being imported into its domestic market in order to ensure that the imports match the standards of domestic products

→ Ex) EU banned the importing of US beef in the 1990s because t was treated with hormones

→ This is a valid argument as well as considered to be simply subtle means of protectionism

→ Another issue relating to the use of product stnadards as a trade barrier is the cost involved in meeting product standards, which is a particular concern in developing countries.

→ There is a cost to meet the standards + the cost of getting appropriate approval and documentation to prove that the standards have been met are extremely high → putting producers in developing countries at a disadvantage and may make it difficult for such countries to exploit their comparative advantage successfully

→ In order to tackle this problem, WTO has established a Standards and Trade Development facility (STDF), designed to "help developing countries improve their expertise and their capacity to analyse and implement international standards on food safety and animal ad plant health".

- Anti-dumping and unfair competition

→ Dumping: Selling by a country of large quantities of a commodity, at a price lower than its production cost, in another country

→ Ex) EU may have a surplus of butter and sell this at a very low cost to a small developing country and this may ruin the domestic producers in the developing country.

→ Where countries can prove that their industries have been severely damaged by dumping, their governments are allowed, under international trade rules, to impose anti-dumping measures to reduce the damage

→ However, it is very difficult to prove whether or not a foreign industry has actually been guilty of dumping

→ Also, a government that subsidizes a domestic industry may actually support dumping

→ Ex) Developing countries argue that when the EU exports subsidized sugar, it is actually the case of dumping because the price doesn't reflect the actual costs of the EU sugar producers

→ If dumping occur, it is more likely that there will be a need for talks between governments, rather than any form of protectionism

- A means of overcoming a balance of payments deficit

→ Governments sometimes impose protectionist measures to attempt to reduce import expenditure and thus improve a current account deficit, whereby the country is spending more on its imports of goods and services than it is earning for its exports of goods and services

→ However, this will only work in the short-run. It does not address the actual problem, since it does not rectify the actual cause of the deficit.

→ Also, if countries do this, then it is likely that other countries will retaliate with protectionist measures of their own

- A source of government revenue

→ Especially in developing countries, governments impose taxes (tariffs) on products to raise revenu

Ib question

• Discuss the arguments against trade protection, including a misallocation of resources, the danger of retaliation and "trade wars", the potential for corruption, increased costs of production due to lack of competition, higher prices for domestic consumers, increased costs of imported factors of production and reduced export competitiveness.

<Arguments against trade protectionism>

- A misallocation of resources (in the long-run)

  → Protectionism distorts comparative advantage, lending to the inefficient use of the world's resources. Specialization is reduced and this would reduce the potential level of the world's output

- The danger of retaliation and "trade wars"

  → This is where one country establishes trade barriers (measures designed to restrict trade) and then those that are affected do exactly the same in retaliation. Trade wars are not uncommon.

  → Ex) In 2009, there was a trade war between Mexico and USA. The USA banned Mexican lorries used to deliver goods in the US because they were considered unsafe. In retaliation, the Mexican government imposed tariffs of 10-45 percent on some US products such as cellphones, pears and cherries.

- The potential for corruption
- Increased costs of production due to lack of competition
- Higher prices for domestic consumers
- Increased costs of imported factors of production
- Reduced export competitiveness

  → Competition would diminish if foreign firms are kept out of a country, and so domestic firms may become inefficient without the incentive to minimize costs. Innovation may also be reduced for the same reason

Protectionism may hinder economic growth!!!