Free Trade versus Protectionism

Free Trade	Protectionism
• The idea that countries benefit from trading with other nations. • The policy of trading with other nations without restrictions, tariffs, or quotas. • The concept that a nation has an "open economy."	• Protectionism is the idea that protecting the home market is necessary because other countries take advantage of a country while trading. • The policy of using tariffs or quotas to restrict trade. • The concept of protecting domestic workers and industries in the face of foreign competition.

Introduction

In order to curb free trade and to promote the well – being of domestic markets, Government intervenes in trade policy by means of barriers. These Barriers can be :

- ❑Tariff Barriers
- ❑Non- Tariff Barriers

TARIFF BARRIERS

Tariff barriers refer to the *tax imposed* by the government on goods that are imported into the country.

Tariff barrier increases the price of imported goods in comparison to domestic goods which makes the imported goods costlier giving the domestic goods a relative advantage over foreign goods

TYPES OF TARIFF BARRIERS

- **Specific tariffs:**

Specific tariffs are levied as *fixed charge for each* unit of good imported. For example, Rs. 10 per unit of good imported.

- **Advalorem tariffs:**

Advalorem tariffs are levied as a *percentage of the value of goods imported*. For example, 10% of the value of goods. If value of goods is Rs. 1000, the ad valorem tariff would be Rs. 100.

- **Compound tariffs:**

Compound tariffs are assessed as *both* a specific tariff and an ad valorem tariff on the same product.

NON- TARIFF BARRIER

Non-tariff barriers refer to any other government regulation, policy or procedure *other than a tariff* that has the impact of minimizing imports.

Non –tariff barriers can control price as well as quantity of the imported goods

TYPES OF NON- TARIFF BARRIER

1. Direct Price Influence

✓ **Subsidies :** Subsidies are the *direct payments made by the government to domestic producers*. Subsidies help in lowering down the cost of production of domestic goods , which means cheaper products in comparison to imported goods as well as surplus production. It can take form of cash payments, low interest loans, government participation in ownership, tax incentives, etc.

TYPES OF NON- TARIFF BARRIER

2. Quantity Control influence

- ✓**Quotas:** Quota refers to the direct *restriction on the quantity of goods* that can be imported into a country during any period of time. The quotas help the government to reduce the consumption of any particular commodity in the country.
- ✓**Voluntary Export Restraints (VERs):** *VERs are bilateral agreements instituted to restrain the rapid growth of exports of specific goods.* Essentially, the government of country X asks the government of country Y to reduce its companies' exports to country X voluntarily to help the importing country X to protect its domestic industry.

- ✓**Local Content Requirement :**A local content requirement is a requirement that *some fraction of the product must be produced locally or in the domestic market*. The requirement can either be expressed in physical terms (x% of the parts of the product) or in value terms (x% of the value of the product)

- ✓**"Buy Local" Legislation:** Under this form of trade policy the government makes its purchases from domestic producers only. This legislation forbids the government departments to make use of imported goods.

Other Non-Tariff Barriers

- **Labelling and Testing Standard:** Labeling and testing standards are insisted upon for ensuring quality of goods seeking an access into the domestic markets but many countries use them as protectionist measures. Such measures are complex and discriminatory barriers to international trade.

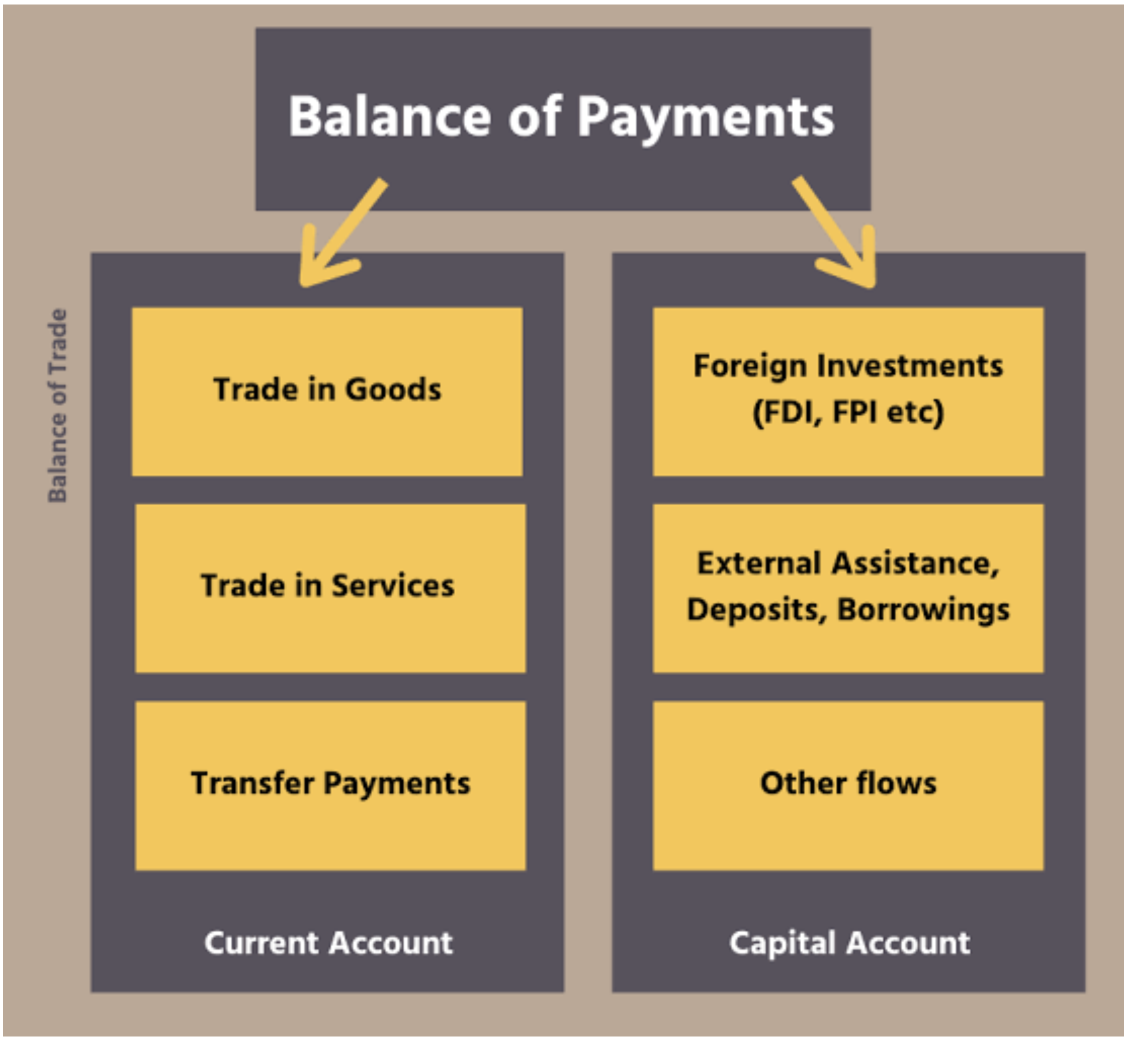
- **Sanitary and Phytosanitary Measures:** Sanitary and Phytosanitary (SPS) measures are taken to protect against risks linked to food safety, animal health and plant protection or to prevent or limit damage within the territory of a country from the entry, establishment and spread of pests from a foreign country

✓ **Specific Permission Requirements:** This measure requires that potential importers or exporters secure permission from governmental authorities. This involves the issuing of import or export licences which may be costly and time consuming.

✓ **Administrative Barriers to Trade:** Administrative barriers to trade are a special category of non tariff barriers which restrict trade using administrative regulations and procedures. *Legal barriers* are caused by different laws and administrative regulation in domestic economies and *Procedural barriers* are related to trade procedures and formalities involved in international movement of goods.

Rationale behind Trade Barriers

- Tariffs help in raising revenues for the domestic government especially in case of developing countries.
- They protect domestic producers from foreign competition.
- They promote local Research and development in domestic market.



Whether balance of payment is favourable or not, depends on the current account as follows:

(i) Balance of payment will be balanced if amount of export done by a country is equal to the import made by the country, i.e., export = import.

(ii) It is adverse if export is less than import.

(iii) It is favourable if export is greater than import.

When there is a deficit in the current account of the balance of payments, the country meets its deficit through:

(i) Drawing on the past accumulated balance of the country, which it may be keeping as a reserve in a foreign country, e.g., India holds in London.

(ii) Drawing from the International Monetary Fund.

(iii) External assistance from other countries by way of loans and grants.

DUMPING

Dumping is the sale of a good abroad at a price lower than the selling price of the same good, at the same time, and in the same circumstances at home. Dumping may be classified into two categories: (i) international dumping and (ii) persistent dumping.

(i) International dumping

It means occasional foreign sales below the home price or even below the cost of production with some specific objective. Few such objectives are mentioned below:

(a) In a market, prices are temporarily low because of a recession.

(b) To establish a foothold in a foreign market.

(c) To drive out an existing foreign competition or to force it to join a cartel.

(d) To dispose of occasional domestic surplus, which might result from optimistic production plans or from a decline in demand. The producer may prefer to sell the occasional surpluses in foreign market at comparatively lower prices rather than spoiling the regular domestic market by announcing occasional price cuts.

(e) To dispose of remnants at the end of the season, which are almost unsaleable at home. Sometimes the consignee may reject the goods or it may not be possible for him to keep up his contract. In such a case, it might be less profitable but better to sell the goods in the foreign market for whatever they fetch rather than reshipping them home.

(f) To obtain badly needed foreign exchange. It is this kind of dumping which is very disturbing for the importing countries.

(ii) Persistent dumping

It means continuous sales abroad at prices lower than those charged at home. It may be done due to difference in the demand curves for a particular commodity in different countries. If, for instance, the domestic demand curve is inelastic and the foreign demand curve is highly elastic, it will be profitable for the producer to charge a comparatively lower price and sell larger volume in the foreign market.