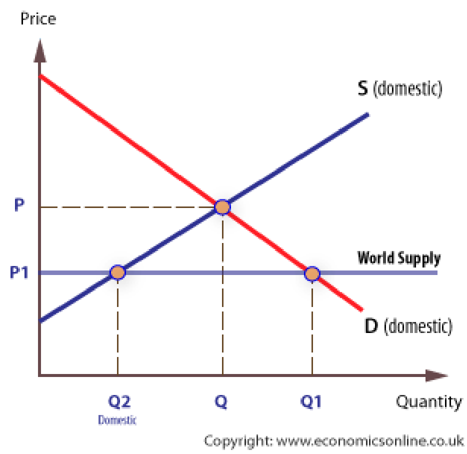
Analyse the impacts of free trade and protectionist policies on the Australian economy

Intro

Free trade is the situation when there are no government imposed artificial barriers that restrict the free exchange of goods and services between countries. There has been a global movement towards free trade in recent decades such as the cutting of tariffs, removal of subsidies and the signings of bilateral free trade agreements. Protection refers to any government policy that gives local producers an artificial advantage over foreign producers. Despite the global movements towards free trade, notable protectionist policies still exist in the global economy such as EU's Common Agricultural Policy (CAP), the recent imposition of tariffs in the China trade wars as well as smaller domestic protectionist policies of local content rules and export incentives. These policies would influence Australia's level of growth, employment, inflation and external stability.

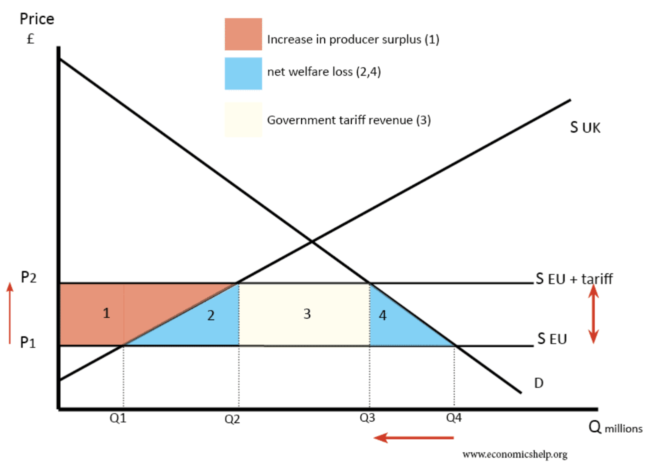
Rationale

The main rationale for protectionism is to protect infant industries, prevent dumping and short term unemployment meanwhile upholding national defence and achieving self-sufficiency. Australia used to be a major advocate for protectionism, known as 'Fortress Australia', however this changed throughout the 1970s to 1990s. The Hawke government implemented unilateral tariff cuts to 5% in the 1980s and 1990s but also exempted the PMV and TCF industries from tariff cuts under the belief that these infant industries could eventually compete on a global scale in their 1988 and 1991 Industry Statements.



By implementing a tariff on foreign PMV and TCF firms, the price of imports rose from P_1 to P, reducing supply from Q_2 - Q_1 to 0. Government revenue would also be received, given by (P - P_1) * Q.

This decision would protect the infant industries but also raise government revenue, improving the budget outcome. However, the decrease in foreign competition in these industries would lead to lower innovation and thus technical efficiency as per William Baumol's 'contestability theory' - which states that markets are able to operate and will operate more efficiently under the mere threat of competition. This would lead to lower aggregate supply and long term growth. Furthermore, with imposition of tariffs, foreign goods and services will increase in price for domestic consumers, increasing imported inflation, worsening price stability. The imposition of protectionist policies is also a direct violation of David Ricardo's theory of 'Comparative Advantage' (1817) - which envisions in an ideal world, each economy would specialise in certain industries to minimise opportunity cost and thus maximise global output, achieving allocative efficiency.



This opportunity cost can be represented by a tariff diagram, with areas 2 and 4 representing the deadweight loss, which is the fall in total surplus resulting from the imposition of a tariff.

The Productivity Commission estimated in 2018 that an increase in global tariffs by 15% would decrease Australia's GDP by 1%, resulting in 100,000 lost jobs and reduced median incomes by $1500 per annum. Conversely, the same report estimated that abolishing tariffs on manufactured goods would decrease input costs for services by $4.7 billion and mining by $217 million, leading to increased export revenue, increased aggregate demand and thus achieving higher levels of growth.

Free Trade #1
The movement towards free trade in Australia began with the Whitlam government who implemented a 25%, 'across the board' tariff cut, in 1973. Since then Australia has transformed from a highly protectionist country with an average tariff level of 36% (1968-69) to one of the least protectionist - boasting an average of just 1.3% (2017) with a mere 5% on TCF. Australia also joined the WTO in 1995, initiating the signings of bilateral and multilateral trade agreements, which subsequently fostered the growth of the services sector, representing around 70% of GDP and 75% of total employment. This would simultaneously increase economic growth and decrease unemployment, increasing disposable incomes. A DFAT report estimated that between 1988 and 2008, export revenue increased from 15.1% of GDP to 23.5%, leading to increased aggregate demand and economic growth. Trade liberalisation had boosted economic growth by 3.4% and average household incomes by $3900 per annum.

Free Trade #2
However, trade liberalisation has worsened some of Australia's weaker export industries such as manufacturing. Australia lacks comparative advantage in manufacturing which was exposed through the process of trade liberalisation, forcing Australian firms to compete with low-cost Asian competitors such as China, Japan and South Korea. Whereas, trade liberalisation has helped more efficient industries such as mining to grow their export revenue which can be seen as manufacturing as a percentage of GDP has decreased from 15% in 1991 to 10% in 2011, whilst mining has increased from 5% to 11% in the same period. This is the economic phenomenon, 'Dutch Disease' whereby due to mining/resource growth increases up to 90, during the 2000s and a 300% increase in commodity prices, the Australian dollar has risen from $0.50 USD in 200 to $1.10 USD in 2011. Due to this, manufacturing demand-price elastic exports lose international competitiveness and therefore deteriorate. Ultimately, Australia's high cost of labour and its comparative advantage in other industries would cause the closure of its PMV industry as without the tariffs implemented, the industry was unable to compete internationally.

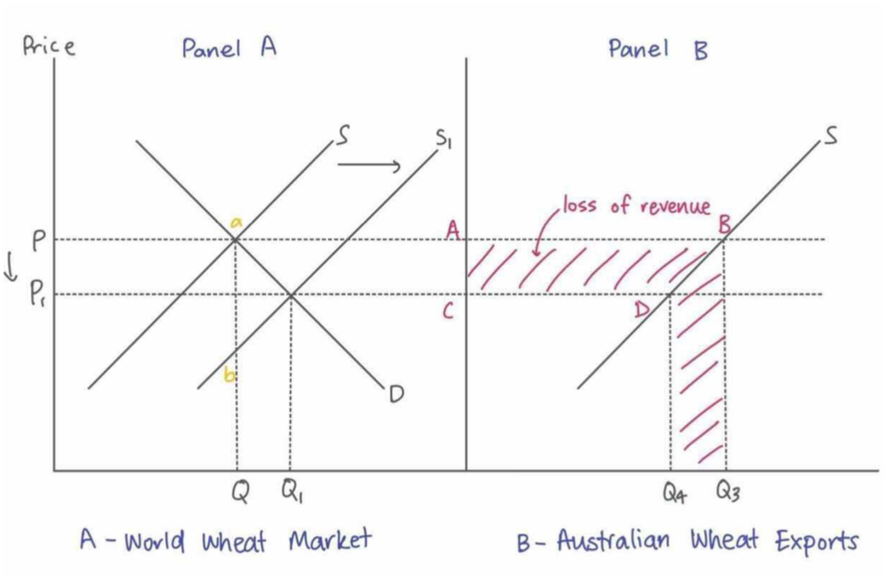
Despite $30 billion worth of tariff assistance between 1997 and 2012, Ford, Holden and Toyota have permanently closed due to high manufacturing costs, resulting in 50,000 jobs lost as a result of structural unemployment. This would see the unemployment rate rise from 5.6% in 2013 to a decade-peak of 6.1% in 2014. Removing these tariffs would also be a significant loss in government revenue, leading to the greater necessity of fiscal consolidation as seen in from 2014-17 with consecutive contractionary stances to decrease government debt obligations. Trade liberalisation would also cause the 'hollowing out' of the manufacturing industry with it currently representing 7% of GDP, much lower than its 15% in 1980.

Free Trade #3
With a global shift towards greater free trade, there have been increased trade volumes and lower inflation in the domestic economy. Free trade agreements have led to trade totalling over $150 billion annually for the Australian economy. This is because industries with comparative advantage have greater access to domestic and global markets, increasing their export revenue. Domestic industries such as mining and services have benefitted from increased

demand from other economies such as China and this increased export revenue is estimated to boost Australian GDP by 0.25-0.5% per annum between 2015-25. Australia and China signed ChAFTA (China and Australia Free Trade Agreement) in 2015, allowing 98% of exports and 95% of Chinese imports to enter their respective markets tariff free. This agreement largely supported the Australian mining and agricultural industry as $85 billion worth of tariffs were removed on Australia’s mining exports while $13 billion dollars worth of tariffs were removed on Australia’s agricultural exports. This included tariff cuts to dairy, by 20%, beef, by 13% and wine by 6%. Ultimately, this will increase export revenue and aggregate demand, leading to greater levels of economic growth. ChAFTA would lead to a $47 billion increase in GDP and an increase in household consumption by $4,500 over the 5 years since its implementation.

With lower tariffs on Chinese imports, imported inflation would fall, decreasing from 1.49% to 1.28% from 2015-2016. Furthermore, approximately 80% of Australian firms receive input in their production from overseas, leading to lower cost-push inflation. Capital intensive industries such as mining/resources require manufactured goods, which Australia lacks comparative advantage in, thus these goods must be imported. Under ChAFTA, mining production costs have significantly decreased, leading to greater export revenue, as Australia’s BOGS rose from -$27 billion in 2017 to $7.58 billion in 2018, the deficit indicating the increase in import expenditure, resulting from ChAFTA. This improvement in BOGS would lead to an improvement in the current account, increasing from -$10 billion to -$6 billion in the same time period, improving Australia’s external stability.

Protection #1
The most prominent protectionist policy still in use, globally, is the EU’s Common Agricultural Policy. The CAP is a subsidy that makes up 38% of the EU’s $158 billion euro budget and represents 21% of total farm income.



As the subsidy, size given by the vertical distance between S and S_1, increases the supply of the World Wheat Market, pushing down the price from P to P_1, Australian producers will see a contraction in revenue as Q_3 falls to Q_4. Australia has the 2nd lowest level of agricultural subsidies amongst OECD countries, at just 2% of total farm income. Thus, unable to compete with the EU, the Australian agriculture industry only makes up 10% of Australian exports and approximately 3% of Australia's GDP.

Protection #2

Another example of global protectionist policies is the US and China trade war and the more recent Australia and China trade tensions. The US and China trade war in 2016 was labelled the "largest trade war in economic history" by then-president Donald Trump, with the US imposing a 10% tariff worth $200 billion on 6000 Chinese exports. China would then retaliate with a $60 billion tariff, triggering another phase of US tariffs worth $267 billion, covering all Chinese exports. This led to China's loss of export revenue, leading to lower aggregate demand and growth as their GDP growth decreased from 6.8% to 6.4% from 2016-18. When China experiences lower growth, their derived demand for Australian exports will drop, leading to lower Australian export revenue and thus aggregate demand and growth. The Australian economy experienced a decrease of $36 billion in their mining and education exports in 2016. A KPMG study estimated that this trade war would reduce Australia's economic growth by 0.3% over five years, or 0.5% if the US tariffs escalate to 25% as planned.

More recently, China accused Australia of dumping, prompting a 200% tariff on Australian wine and a 80% tariff on Australian barley in 2020. As a result, domestic producers have seen a significant drop in revenue and disposable income, forcing some firms to close or to turn to new consumers. According to the Australian Bureau of Statistics, only 33,000 tonnes of Australian barley were exported to China in 2020, however in the same period, Saudi Arabia became the largest demanding market, taking 1.5 million tonnes. This trade diversion would open up employment opportunities in the agricultural sector as demand for agricultural goods increases, as labour is a derived demand, leading to decreased unemployment in Australia. This could be seen as despite the unemployment rate reaching a peak of 7.8% in August of 2020, through government expenditure and recovery of growth, increasing from -1.1% in 2020 to 3.4% in March quarter of 2021, the unemployment rate fell to 4.6% in July of 2021. The current estimate of NAIRU is 4.5%, set by the RBA, indicates that Australia almost operated at full employment, showing that most industries recovered, despite COVID-19 and the Chinese tariffs.

Protection #3

Domestic protectionist policies are less significant to Australia's export revenue however are still beneficial to domestic producers. The main policies in use are local content rules and export incentives. For example, 55% of television broadcast between 6am and midnight must be locally based, promoting self-sufficiency whilst simultaneously maintaining a sense of cultural identity. Export incentives include the $140 million Export Market Development Grants scheme, which reimburses 4000 Australian businesses so as to facilitate the promotion of their exports of global markets. A 2015 review suggested that this small scale policy was effective and had resulted in a net economic benefit of between $1.55 and $7.03 for each dollar spent by boosting export revenue.

Kommentiert [1]: remember a conclusion even if it is very brief

Kommentiert [2]: overall a really strong essay! could potentially tie back to the aus economy in a couple of places but otherwise really good :))