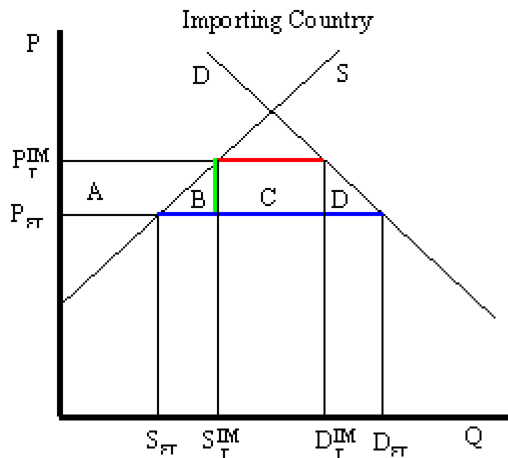
Answer on Question #48944, Economics, Other

1) a) Consider a market in a small importing country that faces an international or world price of PFT in free trade. The free trade equilibrium is depicted in the adjoining diagram where PFT is the free trade equilibrium price. At that price, domestic demand is given by DFT, domestic supply by SFT and imports by the difference DFT – SFT (the blue line in the figure).



When a specific tariff is implemented by a small country it will raise the domestic price by the full value of the tariff. Suppose the price in the importing country rises to P_T^{IM} because of the tariff. In this case the tariff rate would be $t = P_T^{IM} - P_{FT}$, equal to the length of the green line segment in the diagram.Because there are only negative elements in the national welfare change, the net national welfare effect of a tariff must be negative. This means that a tariff implemented by a "small" importing country must reduce national welfare.

b) Because the country is assumed "small," the tariff has no effect upon the price in the rest of the world, therefore there are no welfare changes for producers or consumers there. Even though imports are reduced, the related reduction in exports by the rest of the world is assumed to be too small to have a noticeable impact.

2) Trade restrictions are typically undertaken in an effort to protect companies and workers in the home economy from competition by foreign firms. A protectionist policy is one in which a country restricts the importation of goods and services produced in foreign countries. The slowdown in the U.S. economy late in 2007 and in 2008 has produced a new round of protectionist sentiment—one that became a factor in the 2008 U.S. presidential campaign.
The United States, for example, uses protectionist policies to limit the quantity of foreign-produced sugar coming into the United States. The effect of this policy is to reduce the supply of sugar in the U.S. market and increase the price of sugar in the United States. The 2008 U.S. Farm Bill sweetened things for sugar growers even more. It raised the price they are guaranteed to receive and limited imports of foreign sugar so that American growers will always have at least 85% of the domestic market. The bill for the first time set an income limit—only growers whose incomes fall below $1.5 million per year (for couples) or $750,000 for individuals will receive direct subsidies.

3) The benefits of free trade include:
1. The theory of comparative advantage
This explains that by specializing in goods where countries have a lower opportunity cost, there can be an increase in economic welfare for all countries. Free trade enables countries to specialise in those goods where they have a comparative advantage.
2. Reducing Tariff barriers leads to trade creation

Trade creation occurs when consumption switches from high cost producers to low cost producers.
3. Increased Exports.
As well as benefits for consumers importing goods, firms exporting goods where the UK has a comparative advantage will also see a big improvement in economic welfare. Lower tariffs on UK exports will enable a higher quantity of exports boosting UK jobs and economic growth.
4. Economies of Scale.
If countries can specialize in certain goods they can benefit from economies of scale and lower average costs, this is especially true in industries with high fixed costs or that require high levels of investment. The benefits of economies of scale will ultimately lead to lower prices for consumers.
5. Increased Competition.
With more trade domestic firms will face more competition from abroad therefore there will be more incentives to cut costs and increase efficiency. It may prevent domestic monopolies from charging too high prices.
6. Trade is an engine of growth.
World trade has increased by an average of 7% since the 1945, causing this to be one of the big contributors to economic growth.
7. Make use of surplus raw materials
Middle Eastern counties such as Qatar are very rich in reserves of oil but without trade there would be not much benefit in having so much oil.
Japan on the other hand has very few raw material without trade it would be very poor.
8. Tariffs may encourage inefficiency
If an economy protects its domestic industry by increasing tariffs industries may not have any incentives to cut costs.