

ECONOMICS IN THE REAL WORLD

STUDENT RESOURCES

A-LEVEL



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AQA Economics A-Level: 4.2.6.2 Trade

Edexcel Economics A-Level: 4.1.6 Restrictions on free trade, 4.3.3 Strategies influencing growth and development.

Definitions

- **Free Trade** - When goods and services can be bought and sold between countries in the absence of restrictions e.g. tariffs and quotas
- **Protectionism** - The implementation of policies which act in opposition to free trade to protect domestic industries
- **Terms of Trade** - The price of exports in relation to imports, measured by the ratio of export prices to import prices

Why countries pursue protectionism

- **Infant industries argument:** This argument states that countries should introduce protectionist policies for emerging domestic industries with high value added and income elastic demand to protect them from foreign competition. The aim is to help these domestic industries grow to the point where they become internationally competitive. Then the nation can benefit from industrial growth, employment opportunities, economies of scale, reduced trade deficits and more.
- **Strategic Industries argument:** This argument states that industries which are deemed to be very important to a country's economy or security should be protected from foreign competition through protectionist policies. A common example is an industry of military importance.
- **Public Choice Theory argument:** Protectionism is often a popular policy with the voting public. The gains from trade are often less obvious than the costs of potential unemployment and the damage to domestic producers caused by trade. Additionally, while trade makes everyone richer, it makes some comparatively better off. While this is still beneficial for all involved many people don't like the idea of others becoming richer and as such will support protectionism.

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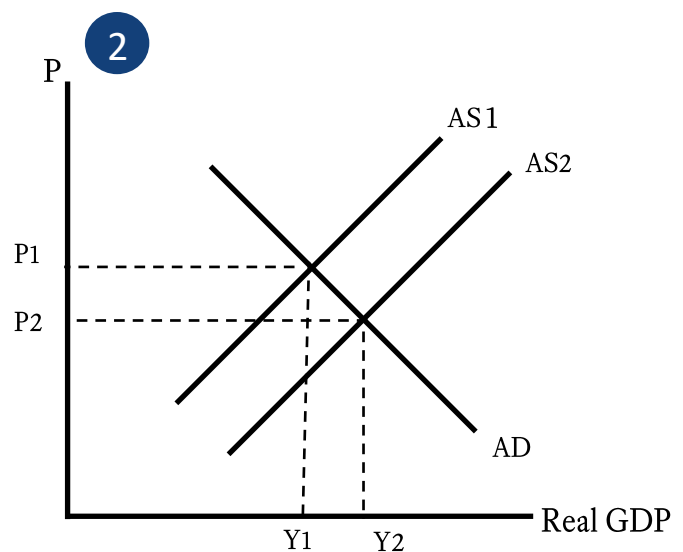
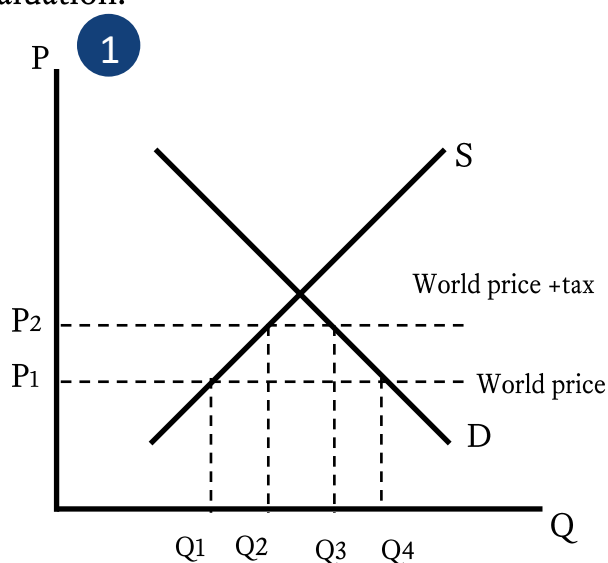
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How the Infant Industry argument works

Use this chain of analysis along with the graphs within essays to explain your point/evaluation.



The infant industry argument can be explained in many ways due to there being a variety of forms of protectionism. For example, via tariffs, production subsidies or a quota on imports. The chain of analysis below will go through the infant industry argument using a tariff.

1. The government introduces a tariff on imports. (diagram 1)
2. Before the introduction of a tariff, the free trade equilibrium is where the demand curve (D) and World price intersect. At this point, the domestic price is P_1 and the quantity imported is Q_1 - Q_4 .
3. When the government introduces a tariff, the price of the good increases by the amount of the tariff, to world price + tax. Due to the higher price, domestic demand contracts from Q_4 to Q_3 and domestic production increases from Q_1 to Q_2 .
4. Eventually, the firms may become internationally competitive. At which point, if the government removes the tariffs the companies will not be put out of business. The economy will therefore benefit from higher output as shown in diagram 2.

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Problems/Evaluation of Protectionism and the Infant Industry argument

- The implementation of protectionist policies increases costs for consumers and erodes consumer surplus.
- The argument for strategic industries, while occasionally valid is often used to justify protectionism for industries which do not require it, such as France claiming their wine industry to be strategically important.
- Often the introduction of protectionist policies results in retaliation from the nations they are introduced against. Retaliation can take various forms but typically involves imposing tariffs, quotas or other restrictions on the imports of the other country.
- Reduced international competition means that industries have weakened incentives to operate efficiently.
- The government generally fails to select the correct industries to protect and will instead protect industries which will never be internationally competitive. For example, the Saudi Arabian government invested millions into the growth of the farming industry, despite this as soon as the subsidies ended the industry collapsed. This is because the country did not have the right climate to be internationally competitive in this industry.
- While the government gains tariff revenue there is no guarantee that it will be invested back into the industry, or into the infrastructure of the country.

Exam Tips

The infant industries argument is a good opportunity to apply real-world examples and show evaluation skills in an essay. You can also work it into a lot of possible exam questions.

Because of this it is a good section to practise and have a general plan - making sure to emphasise the number of conditions that must be met for it to be successful.