ECONOMICS

Discuss the effects of reduction in protectionist policies and free trade on the domestic and global economies.

Protectionist policies have historically been barriers that prevented the process of globalisation and free trade. As a result, a reduction in protection by economies around the world would help to promote globalisation, leading to positive impacts on both the domestic and global economy. A reduction in protection would result in more efficient resource allocation, a rise in living standards, a fall in unemployment and a change in world trade and output. However, removal of protectionist policies may also result in unpleasant outcomes if not managed efficiently, including an increase in global inequality.

Protectionist policies are any form of government actions that give an artificial advantage to domestic firms over overseas producers. There are various types of protection that can be used by the government with the most commonly used being tariff and subsidies. Protectionist policies have the effect of making domestic goods and services relatively cheaper than overseas products. However, in recent decades, there has been a gradual reduction in protection in many countries around the world as they began to see the benefits of free trade, a situation where the government impose no artificial barriers to trade to restrict the exchange of goods and services between countries. Between 1968 and 2010, there has been a major reduction in the average tariff level from 36% to 1.9% and other non-tariff barriers to trade in Australia.

One of the major effects of a reduction in protection is an improvement in the allocation of resources. Resources are scare in an economy and therefore countries often seek to maximise production by minimising opportunity costs in order to increase an economy's productive capacity and economic growth. Removal of protection would allow economies to achieve comparative advantage, where they benefit from producing goods and services that they are most efficient at and with minimum opportunity costs compared to another country. Reducing protectionist policies would expose domestic industries to greater competition, forcing inefficient industries who could not compete with the lower prices to cease production or implement major structural reforms. The resources previously occupied by these inefficient industries could now be allocated to sectors where the economy has a greater comparative advantage, resulting in more efficient resource allocation.

This is observed in the shrinking of the textile industry and the industry of manufacturing of consumer electronic products in Australia. As protection became reduced gradually, these industries to find it difficult to compete with other countries where lower labour costs allow these goods and services to be produced at a much cheaper price, such as in China and Bangladesh. The resources from these industries were then allocated to other sectors in the Australian economy, especially the mining and service industry, allowing them to grow significantly in recent decade, reflecting Australia's comparative advantage in these areas. Comparative advantage is an extremely beneficial situation as it enables the domestic economy and other countries in the world to obtain goods and services they cannot produce, or in sufficient quantities due to a lack of adequate resources, effectively maximising resource allocation to a global scale. The increased efficiency resulted from a reduction of trade protection saw a rapid increase in the volume of trade, which grew fifty times its 1950 level. As a result, it can be seen that reducing protection can help to achieve a more efficient allocation of resources, resulting in higher levels of economic growth.

Reduction in protection also have a positive impact on the general aspects of an economy, including standards of living and the level of unemployment. As mentioned previously, a reduction in protection helps to improve resource allocations, effectively maximising resource use and economic growth within an economy. Increased level of economic growth result in higher real GDP per capita and hence an increase in disposable income for households, leading to greater levels of household spending and improved material living standards. The Institute of International Economics estimates that a removal of protectionist policies would result in an increase in the GWP by US$300 - $700 billion every year. Removal of protection also allows customers to obtain greater variety of goods and services through imports. Prices for goods and services would also be lowered while quality is improved, as businesses face greater competitive pressure from foreign producers. For example, the prices of motor vehicle are now 40% cheaper compared to cars in the 1990s.

Increased competition would also force local businesses to become more efficient in order to compete more readily in the global market, through improving technology and productivity. The adjustment process may see an increase in structural and short term unemployment as firms seek to minimise costs by retrenching excess staff and substituting labour with capital. However, in the long term, lower production costs by business would improve international competitiveness of Australian businesses, resulting in an increase in the level of production and export as opportunity costs are minimised, as well as contributing to an increase in aggregate demand. As a result, businesses would need to hire more workers to meet the demand, reducing unemployment in the long term. The structurally unemployed who get retrained also have more job opportunities and greater potential to earn higher wages, further improving the standards of living of the economy.

Despite the many benefits associated with achieving free trade, the reduction in protectionist policies may also result in negative impacts. A major concern resulted from a reduction in protection is the increase in inequality in the global economy. Reduced trade protection is often associated with the development of regional trading blocs, as much of the removal of trade barriers occurs as a result of negotiation between countries within their trading blocs. Trading blocs are preferential agreements where countries enter into with the exclusion of other countries. Some economists argue that trading blocs divide the global economy into separate trading areas, thereby preventing progress towards global free trade. This is especially valid against poorer developing countries of the world, who are often excluded in these trading blocs. For example, there are no trading blocs involving sub-Sahara African countries. Some trading blocs, such as the European Union reduce trade restrictions between member nations but raised tariff barriers against non-member countries, especially on agricultural products. This can have devastating effects on poorer nations as much of their export revenue is generated from agricultural exports. The situation is worsened as countries failed to reach an agreement in the Doha Round of Talks, whose main agendas include reducing agricultural protection and increasing trade concessions for developing countries. This exclude poorer nations from gaining benefits from increase exports while other countries prosper with increased trade, resulting in greater income inequality in the global economy.

As a result, a reduction in protection can have both negative and positive impacts on the global and domestic economy. Countries can benefit from improved allocation of resources from a reduction in protection, leading to higher economic growth and its associated impact of lower unemployment and increased standards of living in the long term. However, the development of discriminating regional trading blocs can disadvantage poorer nations, widening the gap in global income distribution.

Free trade can lead to pollution and other environmental problems.