

Restrictions on Free Trade

Restrictions on free trade are **protectionist policies** used by governments to limit international trade and protect the domestic economy. They include tariffs, quotas, subsidies and non-tariff barriers.

Free trade allows countries to specialise according to their **comparative advantage**, maximising global output. However, governments may restrict trade where they believe the costs of free trade outweigh these benefits.

Reasons for Restrictions on Free Trade

Protect Domestic Employment

Free trade increases competition from foreign firms. If domestic firms cannot compete with cheaper imports, they may reduce output or shut down, causing structural unemployment.

Foreign competition $\uparrow \rightarrow$ demand for domestic goods $\downarrow \rightarrow$ domestic output $\downarrow \rightarrow$ derived demand for labour $\downarrow \rightarrow$ unemployment $\uparrow$

Protectionism reduces foreign competition, helping to protect domestic firms and employment.

For example the US 50% tariff on imported steel preserved roughly **8,700 domestic steelmaking jobs**,

Infant Industries

An infant industry is a new or developing industry which may initially struggle to compete against established foreign firms.

Temporary protection gives domestic firms time to expand and exploit economies of scale, lowering average costs and allowing them to become internationally competitive.

Protection from imports $\rightarrow$ domestic demand $\uparrow \rightarrow$ output $\uparrow \rightarrow$ economies of scale $\uparrow \rightarrow$ average costs $\downarrow \rightarrow$ international competitiveness $\uparrow$

Prevent Dumping

Dumping occurs when foreign firms sell goods at excessively low prices, potentially below their cost of production, to force competitors out of the market.

Dumping $\rightarrow$ import prices $\downarrow \rightarrow$ demand for domestic goods $\downarrow \rightarrow$ domestic firms lose market share $\rightarrow$ firms may exit

For example The US imposed anti-dumping duties of **52.5%** on Samsung washing machines after finding they were sold below market value in America to undercut domestic manufacturers.

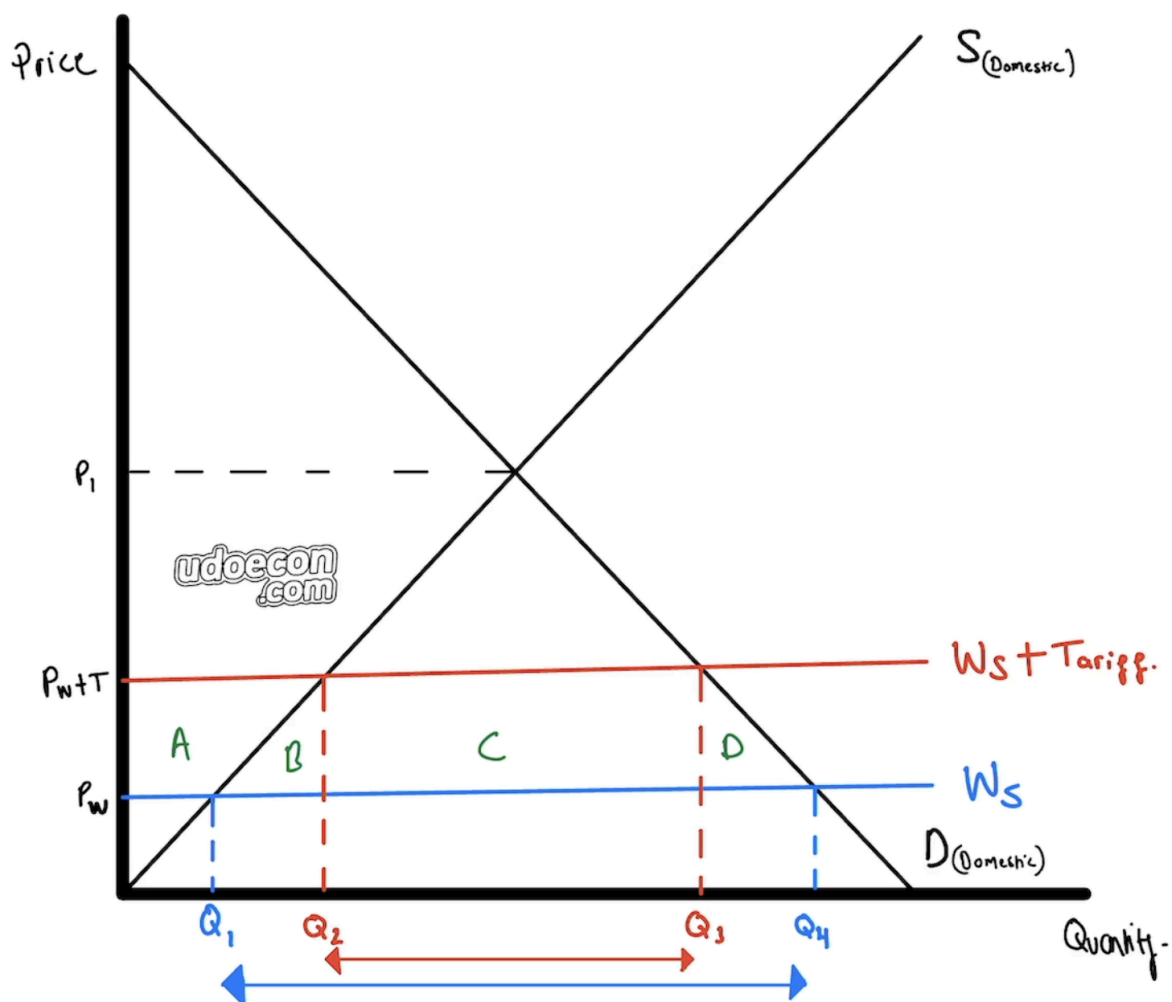
Reduce the Current Account Deficit

Protectionism can reduce expenditure on imports and therefore improve the trade balance and current account balance.

Tariffs/quotas → imports ↓ → import expenditure ↓ → net trade ($X - M$) ↑ → current account deficit ↓

Types of Restrictions on Free Trade

Tariffs



A tariff is a **tax on imports**.

A tariff increases the price of imported goods from P_w to $P_w + T$. As imports become more expensive, domestic consumer demand for imports falls from $Q_1 - Q_4$ to $Q_2 - Q_3$. This means

domestic consumers substitute away from buying goods from foreign producers to instead buying from domestic firms, keeping domestic firms demand high thus keeping derived demand for domestic labour high hence why we call these protectionist policies.

On a tariff diagram:

- Domestic production increases (Q1 to Q2)
- Imports decrease (Q1-Q4 to Q2-Q3)
- Domestic producer surplus increases (A)
- Consumer surplus decreases (Higher price due to lack of international competition)
- Government receives tariff revenue ©

For example the US imposed a **50% tariff on foreign steel**.

Quotas

A quota is a **limit on the quantity of a good that can be imported**.

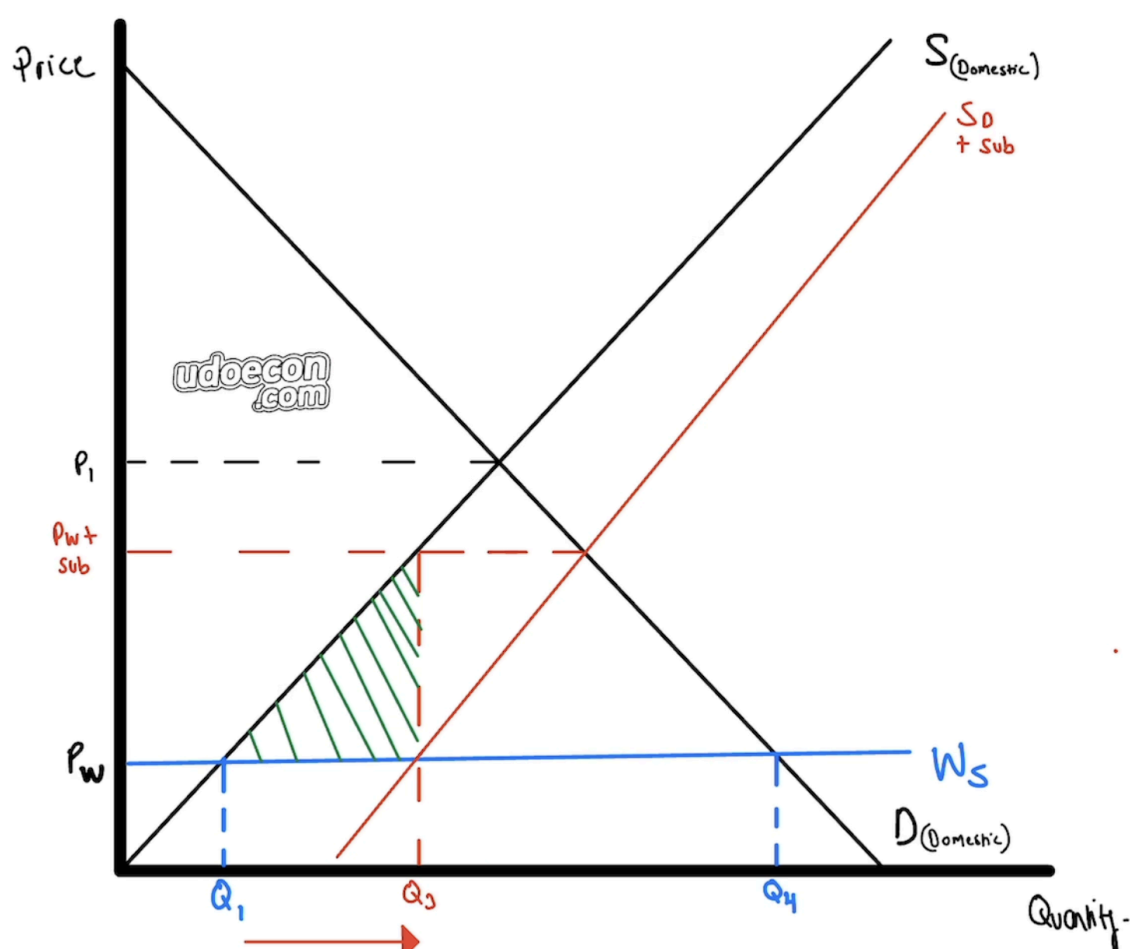
Quota imposed → supply of cheaper imports restricted → shortage at original price → market price ↑ → domestic production ↑ + consumption ↓ → imports ↓

This protects domestic producers from foreign competition and may increase domestic employment. However, unlike a tariff, a standard quota provides no direct tariff revenue to the government.

For example Algeria imposed a strict import quota capping foreign vehicles at **83,000 units annually**, causing domestic used car prices to surge by **over 100%**.

Also The US caps raw sugar imports at roughly **1.1 million tonnes**, driving domestic US sugar prices to **2x the world market rate**.

Subsidies to Domestic Producers



A subsidy is a **payment from the government to domestic producers**. It may be used to protect **infant industries**, which initially have high costs of production and struggle to compete with cheaper foreign producers.

Subsidy $\rightarrow$ effective costs of production $\downarrow \rightarrow$ domestic supply shifts from **S domestic** to **S domestic + subsidy** $\rightarrow$ domestic firms become more competitive $\rightarrow$ domestic output increases from **Q1 to Q3** $\rightarrow$ imports fall from **Q4 - Q1 to Q4 - Q3** (thus acting as a protectionist policy)

Before the subsidy, domestic producers receive the world price **Pw**. After the subsidy, consumers continue to pay **Pw**, but domestic producers effectively receive **Pw + subsidy** per unit, with the difference funded by the government.

This allows higher cost domestic firms to increase production and compete with foreign producers **without raising the price paid by consumers**.

For example, the EU allocates €386.6 billion (around 32% of its budget) to subsidise European farmers, helping them compete against non-EU producers such as Brazilian beef and sugar exporters. ([European Commission](#))

Non-Tariff Barriers

Non-tariff barriers are restrictions on trade that do not directly involve tariffs.

Examples include:

- Health and safety regulations
- Environmental regulations
- Product labelling requirements

These increase the cost and difficulty of importing, reducing foreign competition.

For example, the EU's health rules ban hormone treated beef imports, restricting US producers' access to the EU market; the WTO valued the affected trade at **\$116 million per year**. ([WTO](#))

Impacts of Protectionism

Consumers

Protectionism generally harms consumers because trade barriers reduce foreign competition and increase prices.

Trade barriers → foreign competition ↓ → import prices ↑ → domestic prices potentially ↑ → consumer surplus ↓ → purchasing power ↓ → living standards ↓

Consumers may also experience less choice and potentially lower quality because domestic firms face less competitive pressure.

Domestic Producers

Domestic producers generally benefit because they face less foreign competition.

Imports ↓ → demand for domestic substitutes ↑ → domestic output ↑ → producer surplus/profits ↑ → employment potentially ↑

Protectionism can also harm domestic firms that rely on imported raw materials e.g UK firms, as tariffs increase their costs of production.

Government

Tariffs generate additional government revenue. Higher domestic profits and employment may also increase corporation and income tax receipts.

However, subsidies require government spending and therefore have an opportunity cost, potentially increasing the budget deficit.

Living Standards

Protectionism can protect jobs and wages in domestic industries, potentially raising living standards for workers in those sectors.

However, tariffs can increase the price of imported consumer goods and inputs.

Tariffs → imported goods/inputs become more expensive → cost of living + firms' costs ↑ → inflationary pressure ↑ → real purchasing power ↓

Protectionism can also prevent countries from fully exploiting their comparative advantage, reducing specialisation and the gains from trade.

Equality

Protectionism may reduce inequality if it protects lower income workers who would otherwise lose manufacturing jobs because of foreign competition.

However, tariffs can be regressive. If tariffs increase the price of necessities, lower income households are affected more because necessities account for a larger proportion of their income.