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## FREE TRADE OR PROTECTIONISM: IMPLEMENTATION OF RATIONAL EXPECTATION POLICY IS A SOLUTION FOR TRANSITION ECONOMIES

**Abstract:** *Emerging economies is the best example for transformation of the local economies over time based on the various economic models where information, goods and services, capital freely flow. Where capital spread freely and their movement freely, stimulating the development of transition economies in recent regions. In this article it has been studied different economic policies available in the world economy imply the formation of a single (universal) international economic, legal and cultural information space. Main purpose of the article is explaining comparative analyses of economic models with different development instruments and policies. Relevance of the paper work is increasing international cooperation and partnership of transition economies in different trade unions for supporting sustainable economic prospective in regions. In other words, the phenomenon of globalization goes beyond a purely economic framework and has a noticeable effect on all the main areas of free trade and protectionism which stays controversy of the countries. Author explains theoretical point of view of the foreign trade long term prospective relations for macroeconomic stability in the country.*

**Key words:** free trade, protectionism, median, economic policy, prosperity.

**Language:** English

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### Introduction

In international economic relations, two opposing policies of the state have developed: protectionism and free trade. Protectionism is a state policy aimed at protecting domestic producers from foreign competitors. The essence of this policy is that it is necessary to restrain the import of highly competitive foreign goods into the state and to protect the export of goods of their production to other countries. In this policy, the state uses the following tools: customs duties, non-tariff barriers and export support. Customs duties are import taxes that increase the prices of these imported goods and make them difficult to sell in a given country. There are two main types of tariffs: fiscal tariffs and protectionist tariffs.

Repetition facilitates processing. Human comprehends process words, pictures, faces, and everyday environmental sounds more rapidly when

these stimuli are immediate repetitions than when they are novel (for review, see Bigand, Tillmann, Poulin-Charronnat, & Manderlier, 2005). Why do comprehends remain prepared to process a stimulus after its first presentation? We consider an adaptive, computational-level account of why such facilitation may be beneficial: priming is a consequence of expectation for repetition due to rational adaptation to the environment (Anderson, 1990; Marr, 1982). Clustering of repeated events in time, rather than uniform spacing, is pervasive in human dynamics, from economic transactions to instant messages to the occurrence of words in newspaper headlines over time (Anderson & Schooler, 1991; Vazquez et al., 2006).

In one version of the expectation–adaptation account, the effect of primes—that is, of the occurrence of instances of them in the recent history of opportunities for it—is to change the parameters

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governing the expectation. Critically, in this account, expectations for Tare “unigram” with respect to this history of opportunities: if we denote the strength of expectation as, then previous opportunities for Tare not part of Context. Rather, the effect of the prime is to update the parameters governing this expectation so that it is stronger than it was before the prime—that is, that the distribution of expectations rapidly and rationally adjusted. An analogy here would be the repeated rolling of a die that you know is loaded but whose loading you do not know: every time you see it come up six you will expect more strongly that it will come up six in the future because you gain information about the loading, even though the outcomes of consecutive rolls are not causally related in your mental model of how the die falls.

This view leads to a natural account of cumulatively effects, in which the strength of priming increases with the number of primes that a speaker is exposed to, regardless of their temporal ordering (Fine et al., 2010, 2013; Fine & Jaeger, 2013; Jaeger, 2008; Jaeger & Snider, 2013; Kaschak, Loney, & Borreggine, 2006; Reitter et al., 2011).

### METHODS

In this paper work it has been used qualitative methods with ground theory for explaining major point of view about foreign trade. Main proposals directed for the comparative analyses of three economic policies.

### RESULTS

Protectionist tariffs are used to protect national industry from foreign competition. They make foreign products more expensive than domestic products and thus force people to stop buying foreign goods. Non-

tariff barriers are restrictive or prohibitive import measures (quotas, licensing, or even direct import bans). A quota is a restriction on the quantity of goods of a certain name that can be imported into a country. Quotas reduce foreign competition in the domestic market in a particular industry. Licensing allows the import of goods only with special permits (licenses) of state bodies.

The bans completely block the import into the country of certain goods, justifying this by the fact that imported products do not meet national standards for the quality of goods.

Export support is a measure of government assistance in promoting the production of national products abroad. This may be the payment of subsidies, the provision of tax benefits, loans with a low interest rate per annum, legal and political support.

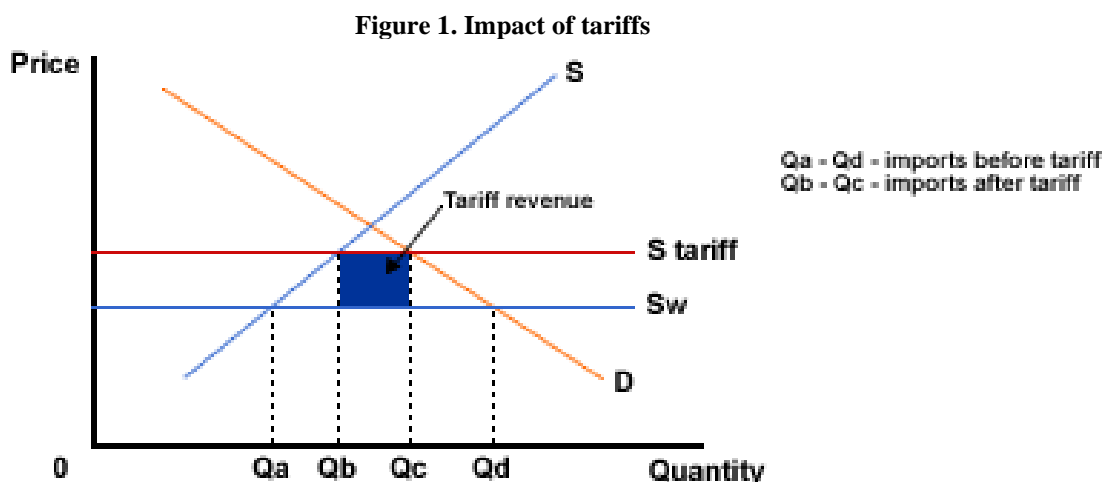
Another protectionist measure is the sale of good quality national goods at high prices, while paying subsidies to domestic buyers of these products.

Positive features of protectionism:

- 1) protection of national production from dumping sales;
- 2) containment of imports and balancing the trade balance;
- 3) protection of new sectors of the national economy;
- 4) trade barriers stimulate domestic production.

But there are also negative features of protectionism, which include:

- 1) rising prices and reducing the choice of goods;
- 2) a drop in production efficiency;
- 3) the rejection of the benefits of the international division of labor;
- 4) undermining export opportunities.



Source: [http://www.sanandres.esc.edu.ar/secondary/economics%20packs/international\\_economics/page\\_18.htm](http://www.sanandres.esc.edu.ar/secondary/economics%20packs/international_economics/page_18.htm)

Protectionism (protecting against imports) has arisen in various forms. These include:

#### Tariffs

A tariff is a tax on imports, which can either be specific (so much per unit of sale) or ad valorem (a percentage of the price of the product). Tariffs reduce supply and raise the price of imports. This gives

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domestic equivalents a comparative advantage. As such, tariffs are distorting the market forces and may prevent consumers from gaining the benefit of all the advantages of international specialization and trade. The impact of a tariff is shown in Figure 1.

### Quotas

Quotas have the effect of restricting the maximum amount of imports allowed into an economy. Once again, they reduce the amount of imports entering an economy and increase the equilibrium price within the market. The government receives no revenue from a quota, as it does with a tariff, unless it can set up a system of licenses.

### Exchange controls

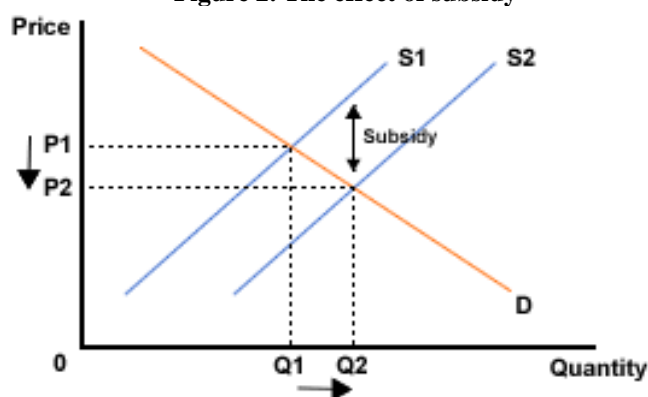
The government could limit the amount of foreign currency available for paying for imports. These are not allowed amongst member of integration

group, for example, and have become more difficult to sustain in a world of highly mobile capital.

### Export subsidies

Export subsidies allow exporters to supply the market with more product than the natural equilibrium would have allowed. Foreign consumers will enjoy increased economic welfare as the price of their purchases fall. Domestic employees might enjoy more wages and job security. But taxpayers are footing the bill for this. Domestic firms might divert trade into exports and ignore the home market. This could lead to increases in domestic prices. The impact of a subsidy is shown in Figure 2. The supply curve is shifted vertically downwards by the amount of the subsidy and this leads to a lower equilibrium price and a higher quantity being traded.

Figure 2. The effect of subsidy



Source: [www.sanandres.esc.edu.ar/secondary/economics%20packs/international\\_economics/page\\_18.htm](http://www.sanandres.esc.edu.ar/secondary/economics%20packs/international_economics/page_18.htm)

### The principle of free trade

It appeared and improved as a reaction to the protectionist measures of the state in different periods of development of the national economy, from the era of the initial accumulation of capital to the time of creation of national industry in backward countries. Naturally, along with criticism of protectionism, this principle contains evidence of the benefits of free trade.

Criticism of protectionism was conducted mainly to identify the negative aspects of the policy of protecting the national economy from foreign competition. The implications of such a policy are obvious, and they testify to the costs of protectionism.

First, protectionism in the long run undermines the foundations of national production, as it eases the pressure from the world market necessary for the development of entrepreneurial initiative. Routine takes precedence over the pursuit of progress, innovation, unwillingness to part with acquired privileges and received income by position. The determination to surround oneself with protectionist barriers is often not determined by national economic interests, but is the result of pressure from powerful

private interests that enjoy lobbying support from political and parliamentary circles.

Secondly, protectionism is harmful from the point of view of the consumer, whom he forces to overpay for the goods and services he needs, not only for imported goods subject to customs duties, but also for products of national production, the production and sale of which are associated with a non-competitive pricing system.

Thirdly, protectionism creates the risk of a chain reaction, since after protecting some industries, sooner or later protection of others will be required.

Fourth, the protection of national industries from foreign competition ultimately drives them into a protectionist trap, because if crutches were "issued" to strengthen such industries, then it would be difficult to remove them without the risk of collapse. Thus, protectionism introduced as a temporary measure can become an integral attribute of a long-term national economic policy.

The advantages of free trade are multifaceted and are proved both by theory and practice.

Firstly, free trade can improve the welfare of trading nations, as it opens up the possibility of international specialization of production and

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exchange based on the principle of comparative advantage. Growth in wealth comes from gains from international trade. Classics suggested measuring this gain by the difference between the rate of profit in the conditions of international exchange of goods and the rate of profit in its absence. A. Marshall used another method - determining the amount of surplus (profit) of producers and consumers of products.

Secondly, free trade facilitates the development of competition and maintains a spirit of innovation not only among national producers, but also in relations with other countries. This ultimately helps to improve the quality of products.

Thirdly, free trade opens up opportunities for expanding markets and, consequently, for international concentration of production and mass production of goods that benefit consumers.

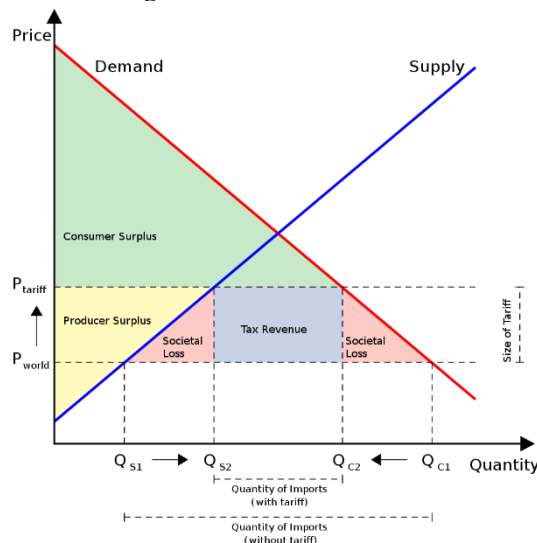
Fourth, free trade serves as the basis for optimizing the distribution of productive resources between countries and their international combination, which significantly increases the efficiency of their use.

**Free trade** is a trade policy that does not restrict imports or exports; it can also be understood as the

free market idea applied to international trade. In government, free trade is predominantly advocated by political parties that hold liberal economic positions while economically left-wing and nationalist political parties generally support protectionism, the opposite of free trade.

Most nations are today members of the World Trade Organization multilateral trade agreements. Free trade was best exemplified by the unilateral stance of Great Britain who reduced regulations and duties on imports and exports from the mid nineteenth century to the 1920s. An alternative approach, of creating free trade areas between groups of countries by agreement, such as that of the European Economic Area and the MERCOSUR open markets, creates a protectionist barrier between that free trade area and the rest of the world. Most governments still impose some protectionist policies that are intended to support local employment, such as applying tariffs to imports or subsidies to exports. Governments may also restrict free trade to limit exports of natural resources. Other barriers that may hinder trade include import quotas, taxes and non-tariff barriers, such as regulatory legislation.

**Figure 3. Free Trade model**



\*The pink regions are the net loss to society caused by the existence of the tariff

Source: [https://en.wikipedia.org/wiki/Free\\_trade](https://en.wikipedia.org/wiki/Free_trade)

The chart at the right analyzes the effect of the imposition of an import tariff on some imaginary good. Prior to the tariff, the price of the good in the world market (and hence in the domestic market) is  $P_{world}$ . The tariff increases the domestic price to  $P_{tariff}$ . The higher price causes domestic production to increase from  $Q_{S1}$  to  $Q_{S2}$  and causes domestic consumption to decline from  $Q_{C1}$  to  $Q_{C2}$  as indicated Figure 3.

### Economist opinions

The literature analyzing the economics of free trade is extremely rich with extensive work having

been done on the theoretical and empirical effects. Though it creates winners and losers, the broad consensus among economists is that free trade is a net gain for society. In a 2016 survey of American economists (83 responders), "87.5% agree that the U.S. should eliminate remaining tariffs and other barriers to trade" and "90.1% disagree with the suggestion that the U.S. should restrict employers from outsourcing work to foreign countries".

Quoting Harvard economics professor [N. Gregory Mankiw](#), "few propositions command as much consensus among professional economists as

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that open world trade increases economic growth and raises living standards". In a survey of leading economists, none disagreed with the notion that "freer trade improves productive efficiency and offers consumers better choices, and in the long run these gains are much larger than any effects on employment".

Most economists would agree that although [increasing returns to scale](#) might mean that a certain industry could settle in a particular geographical area without any strong economic reason derived from [comparative advantage](#), this is not a reason to argue against free trade because the absolute level of output enjoyed by both winner and loser will increase, with the winner gaining more than the loser, but both gaining more than before in an absolute level.

### Concept of rational expectations

The concept of rational expectations was first proposed in the 1960s. John F. out of Indiana University. He used this term to describe many economic situations in which the result partially depends on what people expect. For example, the price of an agricultural product depends on how many acres of land farmers are sowing, which in turn depends on the price that farmers rely on after they collect and sell the crop. Or another example: the value of money and the pace of its depreciation partly depend on what people expect about the pace of this depreciation. This is because people are trying to get rid of the currency, which, according to their expectations, should lose part of its value, thereby contributing to its depreciation. Similarly, the price of a stock or bond depends in part on what potential buyers and sellers expect in the future.

Using expectations in economic theory is not new. And before, many economists, such as A. Pigou, J. M. Keynes, and J. R. Hicks, assigned people's expectations for the future a central role in determining the business cycle. Keynes described this as "waves of optimism and pessimism," which determine the level of economic activity. However, proponents of the theory of rational expectations go further in their analysis and attach even greater importance to expectations.

The relationship between expectations and results is twofold. When forming expectations, people try to predict what will really happen. They have a strong incentive to use forecasting rules that work well, because higher "profits" go to those who act on the basis of better forecasts, regardless of whether it is about stock trading or buying a new car. When people have to predict a certain price again and again, they

tend to adjust their forecasting rules so as not to repeat mistakes that can be avoided. Thus, there is a constant relationship between past results and current expectations. This means that in repeated situations, the way the past moves into the future is usually stable, and people adjust their forecasts in order to align their behavior with this stable model.

The concept of rational expectations assumes that the end results do not differ systematically (i.e., regularly and predictably) from what people expect. This idea stems from the same way of thinking that led Abraham Lincoln to the statement: "you can fool some people all the time and you can fool all people for a while, but you can't fool all people all the time." From the point of view of the doctrine of rational expectations, the Lincoln statement puts everything in its place. FER does not deny that people often make mistakes in their forecasts, but it also assumes that errors will not constantly occur in one and the same thing.

### Consumption theory based on the concept of permanent income

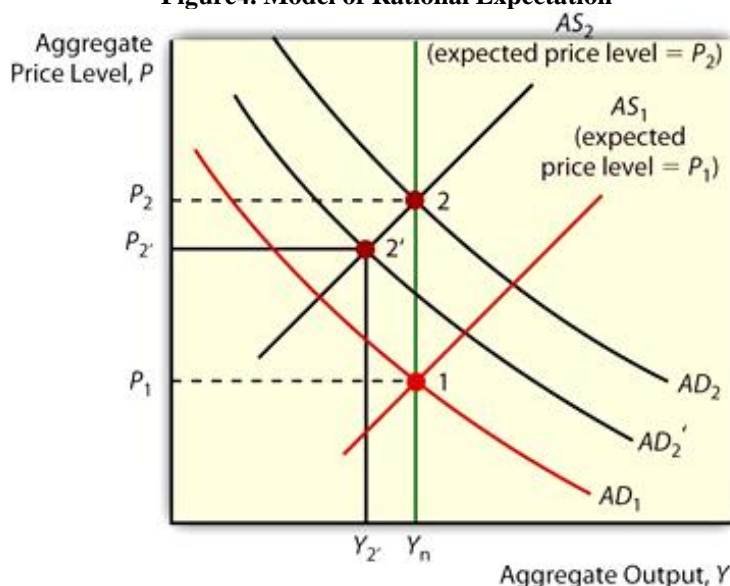
Keynesian consumer function assumes the existence of a positive relationship between the consumption of people and their income. Early empirical studies of the 1940s and 1950s revealed some deviations from the theory, which Milton Friedman subsequently explained with the help of his famous theory of permanent income. Friedman proceeded from the idea of Irving Fisher that consumption should depend not only on current income, but also on future prospects related to income. Friedman postulated that people consume on the basis of their permanent income. The latter can be defined as the level of consumption that can be maintained insofar as the level of wealth remains unchanged. In the definition of the term "wealth," Friedman included a measure of "human wealth," namely, the true value of expectations regarding future income from employment.

Keynesian cross diagrams and the IS-LM and AS-AD models did not explicitly take rational expectations into account, Lucas, Sargent, and others had to recast them in what is generally called the new classical macroeconomic model. *That new model uses the AS, ASL, and AD curves but reduces the short run of aggregate demand shocks to zero if the policy is expected.* So, for example, an anticipated EMP shifts AD right but immediately shifts AS left as workers spontaneously push for higher wages. *Y\* can actually decline if an EMP is not as expansionary as expected!*

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**Figure4. Model of Rational Expectation**



Source: [https://saylordotorg.github.io/text\\_money-and-banking-v2.0/s29-01-rational-expectations.html](https://saylordotorg.github.io/text_money-and-banking-v2.0/s29-01-rational-expectations.html)

If economic actors expect a big shift in AD, the AS curve will shift hard left to keep  $Y^*$  at  $Y_{nr}$ , as in [Figure 4 "The effect of an unexpectedly weak EMP"](#). If the AD curve does not shift as far right as expected, or indeed if it stays put, prices will rise and output will fall, as in the following graph. *This helps to explain why financial markets sometimes react badly to small decreases in the Fed's fed funds target.*

**Main outcomes from the research**

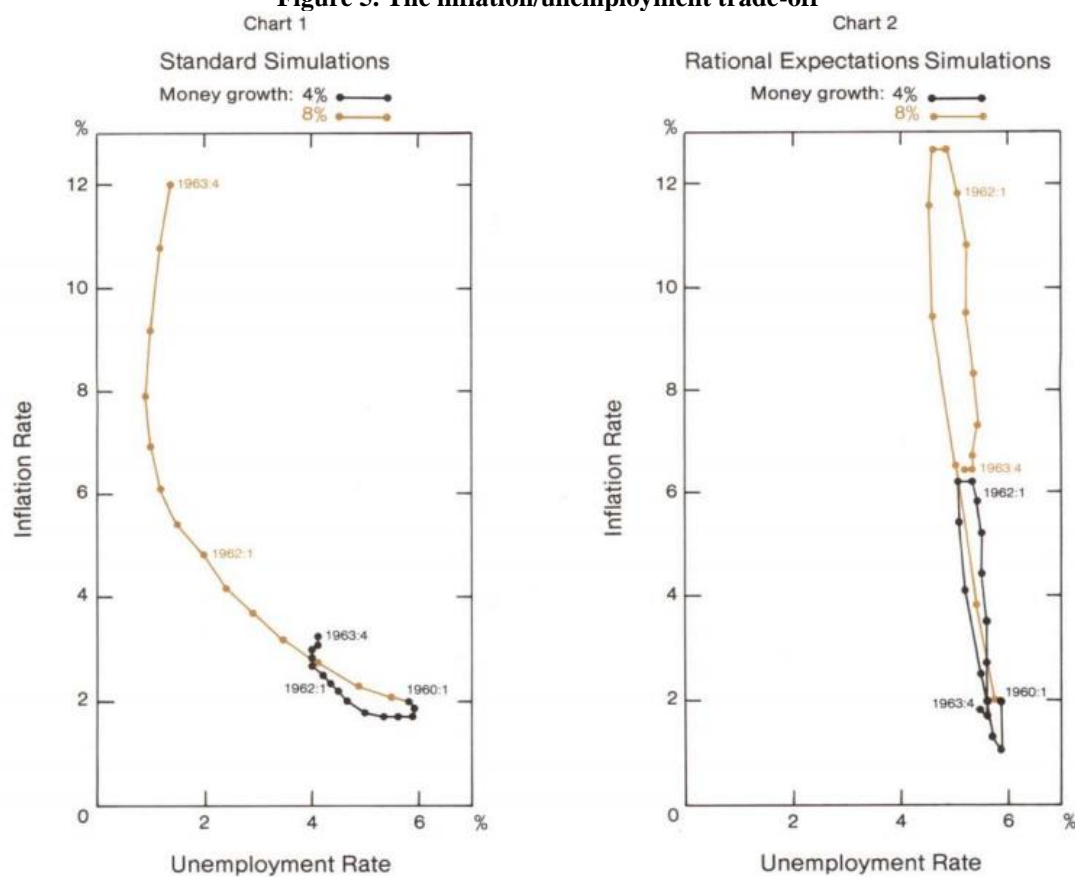
Since the rational expectations simulations come from a model adjusted to assume people know the probable effects of government policies, the large difference between the standard and rational expectations simulations is the result of the unadjusted St. Louis model assuming people will be fooled about the course of inflation. And because this model

calculates an anticipated inflation rate, we can measure just how badly it thinks they will be fooled. The forecast errors made by agents in the model's 8 percent money growth simulation are shown in Chart 3. These errors are the differences between the expectations of inflation computed from the expectation equation in the model and the actual rates of inflation predicted by the model. The most striking feature of these errors is the persistence of under prediction. Obviously the St. Louis model assumes people learn very slowly. For the last three and a half years of the period shown people would expect less inflation than actually occurred. Even though their forecasts were never even approximately vindicated by experience, they would continue to forecast in the same way for further development.

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Figure 5. The inflation/unemployment trade-off



Source: Federal Reserve Bank of Minneapolis (Quarterly Review Fall 1978)

### Conclusion

In order to ensure final conclusion adequate response of economic agents to changes in economic policy, it is necessary that they be notified in advance of these changes and trust forecasts and assessments of state structures. The problem of accounting for free trade versus protectionism or “rational expectations”

is a problem of the effectiveness of economic policy, its ability to influence the course of economic events. As for Uzbekistan I found out that due to economic policy while still in transition period macroeconomic stability of the country should be the first indicator for sustainable economic growth for prospective life of population.

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