3.5 Impacts Of Returns To Scale And Specialization

The tabulation on the following pages provides a summary of these effects. There are two major contributions from changed production possibilities. First, they provide a positive contribution to final demand through our assumption of exogenously increased investment; second, reduced long-term inflation (and a positive effect on net exports) follows from increased labour productivity and reduced unit labour costs.

The exogenous increase in investment, with increased consumption that follows from improved real disposable personal income, raises final domestic demand. Although this generates positive impacts on imports, these effects are more than offset by reduced domestic prices and costs, and real net exports are generally increased, notably in the longer term.

Increased demand is reflected in generalized increases of industry output. In turn, this generates positive impacts for employment in most industries. The induced employment gains in manufacturing, however, only partly offset the direct employment loss that reflects our assumption of disembodied technical change and aggregate employment is reduced by approximately the gains that are generated by the tariff change. This partially offsets the tightening labour market effect that is generated by the removal of non-tariff barriers.

The productivity gains provide major benefits in the form of reduced inflation, especially in the longer term. Consequently, they contribute to more than one-half of the exchange appreciation that is