

# Arguments for and Against Trade Protection



# Assessment Objectives

## Specific Expectations

AO2	Explain and provide examples of arguments in favour of trade protection
AO2	Explain and provide examples of arguments against trade protection
AO3	Evaluate free trade versus trade protection, referring to the following: the arguments in favour of and against trade protection, the advantages and disadvantages of the various trade protection measures.

# Arguments for trade protection

- ▶ Trade barriers create some winners and some losers, but in all cases result in inefficiency in production and global resource misallocation.
- ▶ The validity of trade protectionist policies may depend on non-economic considerations, or on the expectation that longer-term economic benefits of trade protection are greater than short-term costs.

## 1. Infant industry argument

- A new domestic industry (sunrise industry) that has not had time to establish itself and achieve efficiencies in production, and may therefore be unable to compete with more “mature” competitors firms from abroad.
- Considered to be one of the strongest arguments in favour of trade protection in developing countries.

# Arguments for trade protection

## 2. National security

- Certain industries are essential for national defence, and should be protected so that a country can produce them itself.
- A problem is that it can be used by industries that have an indirect use in defence to try to acquire protection against foreign competition.

## 3. Health, safety and environmental standards

- Many countries maintain health, safety and environmental standards that all imported products must meet before they are allowed to enter.
- Each country sets its own standards, and governments are justifiably concerned that imported goods may fall short of these.
- There is a concern that these standards may be used as a form of “hidden” protection to keep certain goods out if they are competing with domestically produced goods.

## 4. Efforts of a developing country to diversify

- Refers to change involving greater variety, and is used to refer to increasing the variety of goods and services produced and/or exported by a country; it is the opposite of specialization.
- A number of developing countries, especially **economically least developed countries (ELDCs)** are very highly specialized in producing and only exporting a few primary commodities.
- Such excessive specialization carries its dangers, and countries may be better off diversifying their production and exports.
- To be able to diversify, countries may have to use trade protection policies to keep out imports of good they would like to produce themselves.

## 5. Anti-dumping

- **Dumping** refers to the practice of selling a good in international markets at a price that is below the cost of producing it (usually by providing export subsidies).

# Arguments for trade protection

- Dumping is considered an unfair trade practice, and is illegal according to international agreements.
- **Anti-dumping** an argument that justifies trade protectionist policies; if a country's trading partner is dumping, then the country should have the right to impose trade protection measures (tariffs or quotas) to limit imports of the dumped good.
- It is often difficult to prove dumping is being practised.

## 6. Unfair competition

- Practices that countries may use in order to gain a competitive advantage over other countries in order to unfairly increase their exports at the expense of other countries.
- **Example(s):** Maintaining an undervalued currency whereby countries seek a lower value of their currency in order to make their exports more competitive in foreign markets.

## 7. Correcting a balance of payments deficit

- A balance of payment deficit occurs when the outflow of money from a country is greater than the inflow, and usually happens when there are more imports than exports.
- Trade protection can be used as a short-term emergency measure if there is a serious balance of payments deficits.
- Limits imports and therefore the need to make payments abroad, but decreased imports would come at the expense of falling exports in exporting countries, and there is a risk of retaliation.

## 8. Tariffs as a source of government revenue

- Tariffs may be used as a source of government revenues, but should be a temporary measure and gradually phased out as countries develop.
- Tariffs are a regressive type of tax, and so have negative impacts on income distribution; in addition, they have negative effects of allocative efficiency.

## 9. Protection of domestic jobs

- According to this argument, restrictions on imports are needed to protect domestic employment.
- Import restrictions increase domestic production, thus increasing employment.
- If restrictions apply to goods that are used as inputs in the production of other goods, it is likely that there will be higher costs of production due to higher prices of the imported inputs, lower production in these industries, and therefore increased unemployment.
- If unemployment in the domestic economy falls due to import restrictions, this means that unemployment increases in countries that are forced to export less.



# Arguments against trade protection

## 1. Producers and workers gain from all types of trade protectionism

- Protectionist policies are usually undertaken with a view to protecting domestic production and domestic employment.

## 2. Higher production costs and reduced efficiency

- Long-term reliance on protection against foreign competition eliminates incentives for firms to lower costs and operate efficiently.

## 3. Consumers lose in most cases

- Higher prices of protected goods and lower quantities of goods available in the market.
- The exception is production subsidies, where the quantity consumed and price paid by consumers remain unaffected.
- Consumers also face reduced consumer choice through lower imports.

# Arguments against trade protection

## 4. Income distribution in most cases worsens

- The only exception is production subsidies, where the price paid by consumers does not change.

## 5. Foreign producers are worse off in all cases

- This is apparent from the reduction in imports of the country imposing protectionist measures.

## 6. Domestic and global resource allocation lose

- Domestically, the appearance of welfare loss means resource misallocation.
- There is resource misallocation on a global scale as protection means that production moves away from lower cost producers in other countries to higher cost producers who are enjoying protective measures.

# Arguments against trade protection

## 7. Negative effects on the price level, real GDP and employment

- Some domestically produced goods that are protected may also be used as inputs in the production of other goods.
- The short-run aggregate supply curve (SRAS) decreases, causing cost-push inflation.
- Real GDP falls and unemployment increases, while the price level also increases.

## 8. Negative effects on a country's export competitiveness

- Some domestically produced goods that are protected may be used as inputs in the production of other goods that are exported.
- This results in lower competitiveness in export markets due to higher prices.

# Arguments against trade protection

## 9. Trade protection may give rise to trade wars through retaliation

- As one country imposes barriers on imports, other countries may retaliate by imposing their own barriers.
- This can produce chain reactions with countries becoming more and more protectionist, with serious negative effects on global output and resource allocation.

## 10. Trade protection creates a potential for corruption

- **Example(s):** Restrictions on imports may pave the way for bribes and smuggling goods illegally into a country, or may result in tariff and other revenues going into the pockets of bureaucrats rather than the government budget.

# Arguments against trade protection: Summary

Stakeholder	Tariffs	Quotas	Production Subsidies	Export Subsidies	Administrative Barriers
Producers	Gain	Gain	Gain	Gain	Gain
Workers	Gain	Gain	Gain	Gain	Gain
Government	Gain	Neutral	Lose	Lose	Natural
Taxpayers	Neutral	Neutral	Lose	Lose	Natural
Consumers	Lose	Lose	Neutral	Lose	Lose
Producer Efficiency	Lose	Lose	Lose	Lose	Lose
Income Distribution	Lose	Lose	Neutral	Lose	Lose
Resource Allocation	Lose	Lose	Lose	Lose	Lose
Foreign Producers	Lose	Lose	Lose	Lose	Lose