3.2. Protectionism

Protectionism is the practice of following protectionist trade policies. A protectionist trade policy allows the government of a country to promote domestic producers, and thereby boost the domestic production of goods and services by imposing tariffs or otherwise limiting foreign goods and services in the marketplace. Protectionist policies also allow the government to protect developing domestic industries from established foreign competitors.

Types of Protectionism

Protectionist policies come in different forms, including:

1. Tariffs: The taxes or duties imposed on imports are known as tariffs. Tariffs increase the price of imported goods in the domestic market, which, consequently, reduces the demand for them.

2. Quotas: Quotas are restrictions on the volume of imports for a particular good or service over a period of time. Quotas are known as a "non-tariff trade barrier." A constraint on the supply causes an increase in the prices of imported goods, reducing the demand in the domestic market.

3. Subsidies: Subsidies are negative taxes or tax credits that are given to domestic producers by the government. They create a discrepancy between the price faced by consumers and the price faced by producers.

4. Standardization: the government of a country may require all foreign products to adhere to certain guidelines. For instance, the UK Government may demand that all imported shoes include a certain proportion of leather. Standardization measures tend to reduce foreign products in the market.

Reasons for Protectionism

An economy usually adopts protectionist policies to encourage domestic investment in a specific industry. For instance, tariffs on the foreign import of shoes would encourage domestic producers to invest more resources in shoe production. In addition, nascent domestic shoe producers would not be at risk from established foreign shoe producers. Although domestic producers are better off, domestic consumers are worse off as a result of protectionist policies, as they may have to pay higher prices for somewhat inferior goods or services. Protectionist policies, therefore, tend to be very popular with businesses and very unpopular with consumers.

Arguments for Protection:

The economists at different times put forward different arguments to justify the policy of protection. Some of the arguments are, however, proved to be fallacious and so cannot be accepted. There are some other arguments which prove to be good and so these are widely accepted.

1. **Infant Industries:** The infant industry argument suggests that new industries should be given temporary protection in

order to enable them to build up this experience. This argument applies where the industry is small and young, and where costs are high but fall as the industry grows. According to this argument, there are some industries in which a country would really have comparative advantages if and only if it could get them started. If faced with foreign competition, such infant (young and growing) industries would not be able to pass the initial period of experiment and financial stresses. But given protection for a short period, they can be expected to develop economies of mass production and they would ultimately be able to face foreign competition without protection. So, at the infant stage such industries should be protected for a period till they can face competition independently.

2. Diversification of Industries Argument: A policy of production is also advocated to diversify a developing country's industrial structure. A country cannot rely on one or a few industries only; it is necessary that a large number of industries of diverse varieties develop in the long run. This strategy will reduce the risk of losing foreign markets; for, in case of failure to export one commodity, other goods may be exported.

3. Employment Protection: The dynamics of the world economy mean that at any time some industries will be in decline. If those industries were responsible for a significant amount of employment in a country in the past, their decline would cause problems of regional unemployment. There s justification for a country to protect a contracting industry to slow down its rate of decline so that time is given for people to find jobs elsewhere in the economy.

4. Employment Creation: Protection to home industries may create employment opportunities in the country, and thus reduce the magnitude of unemployment. But this argument is also fallacious; for protection may create employment in some home industries, but by reducing imports it reduces employment opportunities in the foreign countries. So, such a beggar-my-neighbour high-tariff policy might create employment in the short run only before other nations retaliate. Protection can of course increase employment in another way. By improving the balance of trade it can increase employment and income provided the other countries do no retaliate. But even this argument is not convincing as protection cannot maintain high employment indefinitely through export surplus.

5. Balance of Trade: Some countries experience imbalance in their trade with the rest of the world. If they are importing too many goods they may correct a temporary problem by imposing tariffs on imports. A suitable tariff policy can create and maintain a favourable balance of trade.

The restrictions on imports for the purpose of protection will create a surplus in the balance of trade of the country. But this argument is wrong. If all countries simulta- neously follow this policy, none would find foreign buyers for the sale of goods and so none would gain.

6. Dumping to Reflect Low Marginal Cost of Production: Dumping is a problem which confronts many countries. It is an example of price discrimi- nation at the international level. By following the practice of dumping foreign sellers try to capture the home market by selling their goods at low prices. Protection of home industries is necessary to resist such a policy. It refers to the selling of products on overseas markets at prices below those prevailing on domestic markets. The danger here is that the dumping of products could cause prices to drop drastically. This could benefit the consumers in the short run. But, in the long run, domestic producers could be forced out of business making room for the foreign suppliers in the future. Producers may be off-loading products on foreign markets to keep prices up in their home markets. The price of a Japanese camera, for example, is higher in Tokyo than in New York. Therefore, the effects of dumping are undesirable and, if it can be detected, some protection against its adverse effects is justified.

7. Improving the Terms of Trade: Countries can improve their position when they are the sole (or dominant) buyer of a commodity. This is rare, but if American importers of tea agreed with one another to restrict imports' then the world price would fall. Of course, this would lower the incomes received by the producers of tea and so might be thought undesirable as they are mostly poor countries.

8. Retaliation: Protecting an industry as a retaliation for protection introduced by other countries is questionable. It was used by the USA when it felt that the European Union was using hidden subsidies to lower the price of steel exported to the USA.

9. Unfair Foreign Competition: Often countries follow a policy of protec- tionism against unfair foreign competition. 'Unfair' competition can take a variety of forms. Sometimes, foreign governments can subsidise their export industries. This means that domestic industries cannot compete fairly. Similarly, foreign firms may 'dump' their products overseas, either because they cannot be sold on their domestic market, or in order to destroy competitor. They could then increase their prices and make large profit Countries also require protection against low-cost imports. It is often argued that declining industries need a period of protection in order to allow the decline to take place gradually, so that workers can retrain as new industries develop. A variation of this approach says that industries in high wage countries should have protection against goods made by low-paid labour.

This, of course, denies the advantages of comparative advantage which derive from lower- costs. Instead, the argument is that if foreign firms pay low wages, this is a form of unfair competition and domestic firms should be protected. This would safeguard the position of domestic workers Critics, however, argue that this would, in fact, reduce the wages of workers in poor countries and make consumers of rich countries pay higher prices. Protecting an industry against 'unfair' competition is also questionable countries often will claim that competition is unfair when, in fact, a country may just be using its comparative advantage to lower costs. This argument is used against some of the low-wage economies and the difficult issue is to decide whether wages are low due to the abundance of labour as a factor of production or whether exploitation is present. If the latter is the case, protection may not be the answer to the problem.

Arguments Against Protection

The policy of protection is also criticised on various grounds:

(a) It creates obstacles or barriers to free multinational trade. Due to high tariffs imposed by other countries, a country is not allowed to produce goods in which it has cost advantages. So, protection reduces world production and con- sumption of internationally traded goods,

(b) Owing to higher tariff on imports, the consumers are compelled to buy home goods, often of inferior quality and often at higher prices,

(c) Protection gives shelter to weak home industries. If it is permanent, home industries would not get any incentive to compete freely with their foreign counterparts. There would be need for continuation of protection for an indefinite period,

(d) Protection may lead to trade wars and international conflicts among trading nations,

(e) Protection give rise to such abuse as 'wire-pulling' in political quarters, vested interest in the protected sector, etc.