



DP IB Economics: SL



Your notes

4.3 Arguments For & Against Trade Protection

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4.3.1 Arguments For & Against Trade Protection

Arguments for Trade Protection

- Despite the benefits that free trade offers, there are many good arguments which would support the use of protectionism in certain instances

Arguments for Protectionism

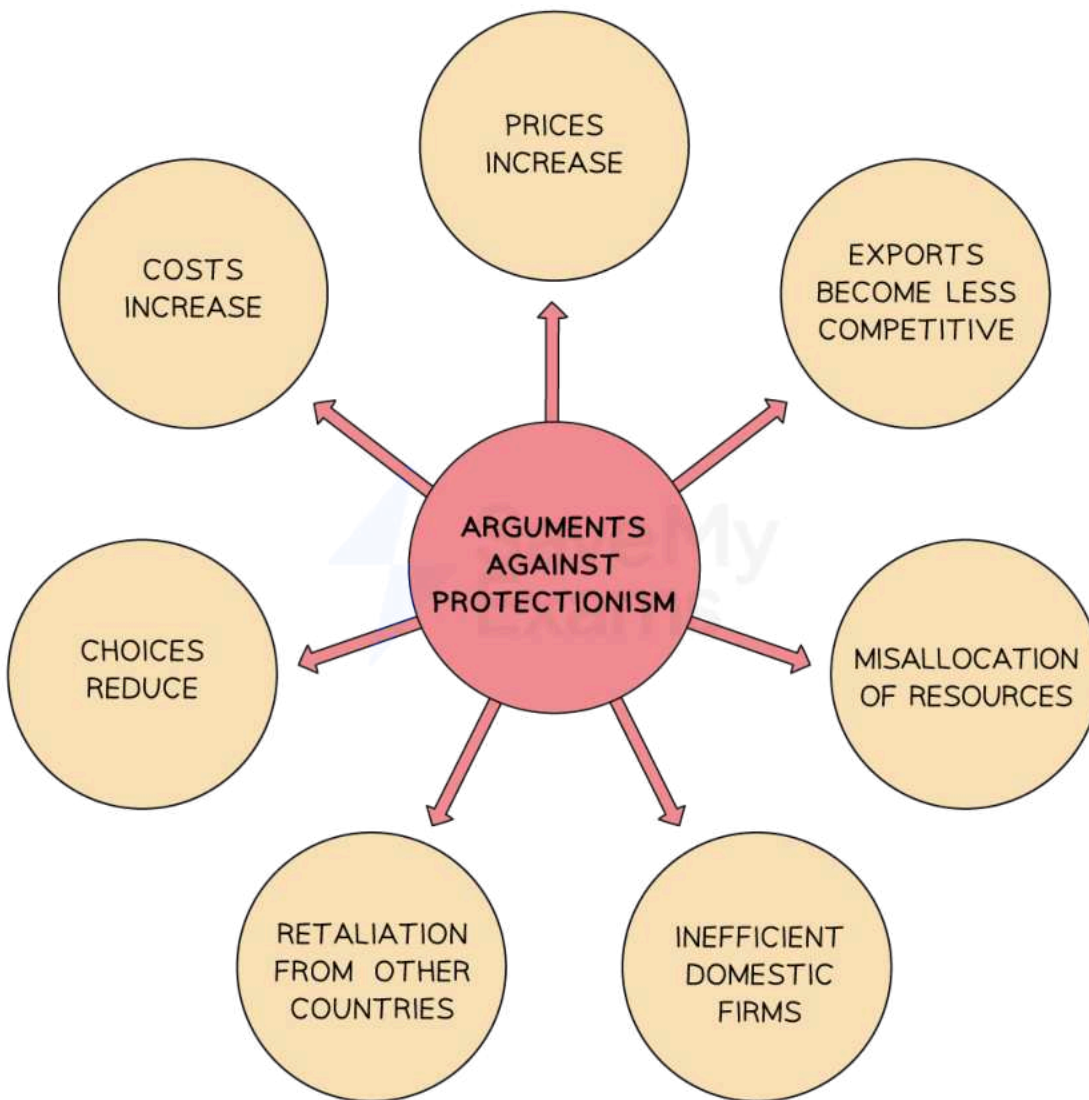
| Reason | Explanation |
|----------------------------------|---|
| Infant industries | <ul style="list-style-type: none"> To protect new firms that would be unlikely to succeed at start-ups due to the level of global competition. Once established support is removed |
| Sunset industries | <ul style="list-style-type: none"> Similar to above, but at the other end of the life cycle, these firms are on their way out and the government chooses to support them to help limit the economic damage that would occur if they closed abruptly |
| Strategic industries | <ul style="list-style-type: none"> Industries such as energy, defence and agriculture are essential to self-sufficiency and security. Being reliant on other countries for these creates vulnerabilities for a nation |
| Dumping | <ul style="list-style-type: none"> Dumping is anti-competitive and can harm a country's industries |
| Employment | <ul style="list-style-type: none"> When firms outsource production to other countries or certain industries are experiencing structural unemployment governments will step in to protect jobs |
| Current Account deficit | <ul style="list-style-type: none"> When imports > exports the amount of money leaving the country to support foreign firms is greater than that entering to support domestic firms. Protectionism aims to correct this imbalance |
| Labour/environmental regulations | <ul style="list-style-type: none"> Many countries offer cheap labour and low-cost production due to poor environmental regulations. Protectionism can help apply pressure to bring about change in these countries |



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Arguments Against Trade Protection

- The arguments against trade protection are evident from the impact that each form of protection has on the stakeholders. These can be summarised in the diagram below



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Seven common arguments against protectionism



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1. **Reduced choice**

Protectionism reduces both the quantity and variety of goods/services available to customers

2. **Increased prices**

Protectionism either reduces the supply of goods/services which leads to higher prices - or in the case of tariffs, directly leads to higher prices

3. **Increased costs**

Manufacturers who rely on imported raw materials face higher costs of production. If protectionism is widespread it may generate inflation in the economy and/or lead to a loss of employment

4. **Retaliation**

Foreign producers are hurt by protectionism and it is common for their governments to retaliate with their own measures which further harm free trade

5. **Reduction in export competitiveness**

Protectionism reduces the need to be efficient or to innovate. Over time this leads to higher prices and worse quality products which will reduce export sales

6. **Resource misallocation**

Global welfare is reduced as protectionism shifts production away from more efficient foreign producers to less efficient domestic producers

7. **Domestic inefficiency increases**

With a reduced level of competition, domestic firms will be less **productively efficient** and will spend less on research, development and innovation

An Evaluation of Free Trade Versus Protectionism

- **Trade liberalisation** has helped to generate significant economic growth and **economic development**
- As an economy moves towards free trade, **structural unemployment** often develops as certain industries move abroad
 - Without an **intentional government program** to retrain these workers, they often fall through the cracks and their quality of life reduces significantly
 - It has been argued that structural unemployment is at the **heart of nationalism** as angry workers seek to expel foreigners and get their jobs back
 - Voters are able to influence the **political agenda** and protectionism goes through periods of immense popularity
- **More economically developed countries (MEDCs)** have the funds available to provide significant export subsidies to their firms
 - The aim is usually not to protect these firms but to help them gain a global monopoly

- As monopolies develop they gain more revenue and **generate more tax revenue** which may go back to their government (often it goes to off-shore bank accounts)
- **Less economically developed countries (LEDCs)** are often pushed into free trade agreements by MEDCs with a focus on resource extraction
 - MEDCs frequently place tariffs on the **import of manufactured goods** with **added value** from LEDCs
 - This prevents LEDCs from **generating higher profits** e.g. cocoa beans are exported from Ghana to the USA at low prices and without any import tariffs, however, there is a high tariff on the import of Ghanaian chocolate to the USA
- This argument is not as simple as free trade is better. **The context** of the trade and the nature of the trading partners ultimately decides whether a path of free trade or protectionism would serve a nation better
 - There is no doubt free trade generates **higher output and income**, but the distribution of this income may be vastly unfair



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