Methods and mechanism used to protect business interests commerce essay

According to investopedia, government actions and policies that restrict or restrain international trade, often done with the intent of protecting local businesses and jobs from foreign competition. Typical methods of protectionism are import tariffs, quotas, subsidies or tax cuts to local businesses and direct state intervention. Protectionism is the economic policy of restraining trade between states through methods such as tariffs on imported goods, restrictive quotas, and a variety of other government regulations designed to discourage imports and prevent foreign take-over of domestic markets and companies (source: Wikipedia).

Protectionism, policy of protecting domestic industries against foreign competition by means of tariffs, subsidies, import quotas, or other restrictions or handicaps placed on imports of foreign competitors. (source: Britannica Encyclopedia)

PROTECTION OF LOCAL INDUSTRIES

Why do nations impede free trade when the inhibition is irrational? One reason why governments interfere with free marketing is to protect local industries, often at the expense of local consumers as well as consumers worldwide. Regulations are created to keep out or hamper the entry of foreign-made products. Arguments for the protection of local industries usually take one of the following forms:

Keeping money at home

Reducing unemployment

Equalizing cost and price

Enhancing national security

Protecting infant industry

Keeping Money at Home

Trade unions and protectionists often argue that international trade will lead to an outflow of money, making foreigners richer and local people poorer. This argument is based on fallacy of regarding money as the sole indicators of wealth. Other assets, even products, can also be indicators of wealth. Also, this protectionist argument assumes that foreigners receive money without having to give something of value in return. Whether local consumers buy locally made products or foreign products, they will have to spend money to pay for such products.

Reducing Unemployment

It is a standard practice for trade unions and politicians to attack imports and international trade in name of job protection. The argument is based on the assumption that import reduction will create more demand for local products and subsequently create more jobs.

Equalizing Cost and Price

Some protectionists attempt to justify their actions by invoking economic theory. They argue that foreign goods have lower prices because of lower production costs. Therefore, trade barriers are needed to make prices of imported products less competitive and local items more competitive.

Enhancing National Security

Protectionists often present themselves as patriots. They usually claim that a nation should be self-sufficient and even willing to pay for inefficiency in order to enhance national security. Opponents of protectionism however dismiss appeals to national security. A nation can never be completely self-sufficient because raw materials are not found in the same proportion in all areas of the world.

Protecting infant industry

The necessity to protect an infant industry is perhaps the most credible argument for protectionist measures. Some industries need to be protected until they become viable. Here South Korea serves as a good example. It has performed well by selectively protecting infant industries for export purpose.

(Source: adopted from Sak Onkvisit, John J. Shaw, International Marketing: Analysis and Strategy)

Reasons for protectionism:

(source: adopted from econessays. com)

1. Infant industry argument: – small firms need to be protected so as to have time to expand and

gain economies of scale so as to be able to compete on an international basis later on.

However so far this has happened only in big industries such as the steel industry and it gives a motive for firms to remain lazy because they know they don’t have to compete on an

international level e. g. steel industry in the USA.

2. Dumping to prevent firms from selling goods at a loss to destroy the domestic industry. By

allowing free trade there is guarantee for low prices indefinitely because the moment one

firm becomes inefficient more efficient ones will enter the market and take it away.

3. Raise revenue for the government through tariffs.

4. Prevent overspecialization and diseconomies of scale in other words over production in a

country due to the need to export goods because this will also lead to misallocation of

resources which is what we are trying to prevent by free trade.

5. To remove a balance of payments deficit without however tackling the problem at its root

this is inefficiency.

Non-economic reason for protectionism:

1. Strategic interests: some industries such as the defense industry are better to be kept

domestic. For example a country can't depend on others for it weapons industry because in

the case of war it would be left unarmed.

2. Political reasons: lack of willingness to trade due to political differences. For example China

and Japan don't trade due to political disputes.

3. Prevention of the import of demerit goods such as tobacco and alcohol.

4. Way of life and maintenance of traditional way of living.

5. Protection against low wage economies: some countries gain comparative advantage by

offering lower wages. For example people are imposing trade restrictions on China because it

underpays its workers and thus no other economy has the ability to compete with her.

Alternative for protectionism:

1. Offering subsidies to producers, which is an unpopular alternative because the money will

have to be raised through taxes.

2. Free trade area: free trade between member countries; members charge whatever tariffs they

wish towards non-member countries. Examples of these are CAFTA, LAFTA, and NAFTA

etc.

3. Customs union: free trade between member countries; members must charge a common

external tariff against non-member countries. The EU is the only existing such example.

Policies of Protectionism

A variety of policies have been claimed to achieve protectionist goals. These include:

Tariffs: Typically, tariffs (or taxes) are imposed on imported goods. Tariff rates usually vary according to the type of goods imported. Import tariffs will increase the cost to importers, and increase the price of imported goods in the local markets, thus lowering the quantity of goods imported. Tariffs may also be imposed on exports, and in an economy with floating exchange rates, export tariffs have similar effects as import tariffs. However, since export tariffs are often perceived as ‘ hurting’ local industries, while import tariffs are perceived as ‘ helping’ local industries, export tariffs are seldom implemented.

Import quotas: To reduce the quantity and therefore increase the market price of imported goods. The economic effects of an import quota are similar to that of a tariff, except that the tax revenue gain from a tariff will instead be distributed to those who receive import licenses. Economists often suggest that import licenses be auctioned to the highest bidder, or that import quotas be replaced by an equivalent tariff.

Administrative barriers: Countries are sometimes accused of using their various administrative rules (e. g. regarding food safety, environmental standards, electrical safety, etc.) as a way to introduce barriers to imports.

Anti-dumping legislation: Supporters of anti-dumping laws argue that they prevent " dumping" of cheaper foreign goods that would cause local firms to close down. However, in practice, anti-dumping laws are usually used to impose trade tariffs on foreign exporters.

Direct subsidies: Government subsidies (in the form of lump-sum payments or cheap loans) are sometimes given to local firms that cannot compete well against foreign imports. These subsidies are purported to " protect" local jobs, and to help local firms adjust to the world markets.

Export subsidies: Export subsidies are often used by governments to increase exports. Export subsidies are the opposite of export tariffs, exporters are paid a percentage of the value of their exports. Export subsidies increase the amount of trade, and in a country with floating exchange rates, have effects similar to import subsidies.

Exchange rate manipulation: A government may intervene in the foreign exchange market to lower the value of its currency by selling its currency in the foreign exchange market. Doing so will raise the cost of imports and lower the cost of exports, leading to an improvement in its trade balance. However, such a policy is only effective in the short run, as it will most likely lead to inflation in the country, which will in turn raise the cost of exports, and reduce the relative price of imports.

International patent systems: There is an argument for viewing national patent systems as a cloak for protectionist trade policies at a national level. Two strands of this argument exist: one when patents held by one country form part of a system of exploitable relative advantage in trade negotiations against another and a second where adhering to a worldwide system of patents confers “ good citizenship” status despite ‘ de facto protectionism’.

(Source: Protectionist Policies, Wikipedia)

SOURCE: International marketing strategy: analysis, development and implementationBy Isobel Doole, Robin Lowe

Non-tariff barriers to trade (NTBs) are trade barriers that restrict imports but are not in the usual form of a tariff. Some common examples of NTB’s are anti-dumping measures and countervailing duties, which, although they are called “ non-tariff” barriers, have the effect of tariffs once they are enacted.

Their use has risen sharply after the WTO rules led to a very significant reduction in tariff use. Some non-tariff trade barriers are expressly permitted in very limited circumstances, when they are deemed necessary to protect health, safety, or sanitation, or to protect depletable natural resources. In other forms, they are criticized as a means to evade free trade rules such as those of the World Trade Organization(WTO), the European Union (EU), or North American Free Trade Agreement (NAFTA) that restrict the use of tariffs.

Some of non-tariff barriers are not directly related to foreign economic regulations, but nevertheless they have a significant impact on foreign-economic activity and foreign trade between countries.

Trade between countries is referred to trade in goods, services and factors of production. Non-tariff barriers to trade include import quotas, special licenses, unreasonable standards for the quality of goods, bureaucratic delays at customs, export restrictions, limiting the activities of state trading, export subsidies, countervailing duties, technical barriers to trade, sanitary and phyto-sanitary measures, rules of origin, etc. Sometimes in this list they include macroeconomic measures affecting trade.

Six Types of Non-Tariff Barriers to Trade

Specific Limitations on Trade:

Quotas

Import Licensing requirements

Proportion restrictions of foreign to domestic goods (local content requirements)

Minimum import price limits

Embargoes

Customs and Administrative Entry Procedures:

Valuation systems

Antidumping practices

Tariff classifications

Documentation requirements

Fees

Standards:

Standard disparities

Intergovernmental acceptances of testing methods and standards

Packaging, labeling, and marking

Government Participation in Trade:

Government procurement policies

Export subsidies

Countervailing duties

Domestic assistance programs

Charges on imports:

Prior import deposit subsidies

Administrative fees

Special supplementary duties

Import credit discriminations

Variable levies

Border taxes

Others:

Voluntary export restraints

Orderly marketing agreements

Examples of Non-Tariff Barriers to Trade

Non-tariff barriers to trade can be:

Import bans

General or product-specific quotas

Rules of Origin

Quality conditions imposed by the importing country on the exporting countries

Sanitary and phyto-sanitary conditions

Packaging conditions

Labeling conditions

Product standards

Complex regulatory environment

Determination of eligibility of an exporting country by the importing country

Determination of eligibility of an exporting establishment(firm, company) by the importing country.

Additional trade documents like Certificate of Origin, Certificate of Authenticity

Occupational safety and health regulation

Employment law

Import licenses

State subsidies, procurement, trading, state ownership

Export subsidies

Fixation of a minimum import price

Product classification

Quota shares

Foreign exchange market controls and multiplicity

Inadequate infrastructure

“ Buy national” policy

Over-valued currency

Intellectual property laws (patents, copyrights)

Restrictive licenses

Seasonal import regimes

Corrupt and/or lengthy customs procedures

Types of Non-Tariff Barriers

There are several different variants of division of non-tariff barriers. Some scholars divide between internal taxes, administrative barriers, health and sanitary regulations and government procurement policies. Others divide non-tariff barriers into more categories such as specific limitations on trade, customs and administrative entry procedures, standards, government participation in trade, charges on import, and other categories. We choose traditional classification of non-tariff barriers, according to which they are divided into 3 principal categories.

The first category includes methods to directly import restrictions for protection of certain sectors of national industries: licensing and allocation of import quotas, antidumping and countervailing duties, import deposits, so-called voluntary export restraints, countervailing duties, the system of minimum import prices, etc. Under second category follow methods that are not directly aimed at restricting foreign trade and more related to the administrative bureaucracy, whose actions, however, restrict trade, for example: customs procedures, technical standards and norms, sanitary and veterinary standards, requirements for labeling and packaging, bottling, etc. The third category consists of methods that are not directly aimed at restricting the import or promoting the export, but the effects of which often lead to this result.

The non-tariff barriers can include wide variety of restrictions to trade. Here are some example of the " popular" NTBs.

Licenses

The most common instruments of direct regulation of imports (and sometimes export) are licenses and quotas. Almost all industrialized countries apply these non-tariff methods. The license system requires that a state (through specially authorized office) issues permits for foreign trade transactions of import and export commodities included in the lists of licensed merchandises. Product licensing can take many forms and procedures. The main types of licenses are general license that permits unrestricted importation or exportation of goods included in the lists for a certain period of time; and one-time license for a certain product importer (exporter) to import (or export). One-time license indicates a quantity of goods, its cost, its country of origin (or destination), and in some cases also customs point through which import (or export) of goods should be carried out. The use of licensing systems as an instrument for foreign trade regulation is based on a number of international level standards agreements. In particular, these agreements include some provisions of the General Agreement on Tariffs and Trade and the Agreement on Import Licensing Procedures, concluded under the GATT (GATT).

Quotas

Licensing of foreign trade is closely related to quantitative restrictions – quotas – on imports and exports of certain goods. A quota is a limitation in value or in physical terms, imposed on import and export of certain goods for a certain period of time. This category includes global quotas in respect to specific countries, seasonal quotas, and so-called " voluntary" export restraints. Quantitative controls on foreign trade transactions carried out through one-time license.

Quantitative restriction on imports and exports is a direct administrative form of government regulation of foreign trade. Licenses and quotas limit the independence of enterprises with a regard to entering foreign markets, narrowing the range of countries, which may be entered into transaction for certain commodities, regulate the number and range of goods permitted for import and export. However, the system of licensing and quota imports and exports, establishing firm control over foreign trade in certain goods, in many cases turns out to be more flexible and effective than economic instruments of foreign trade regulation. This can be explained by the fact, that licensing and quota systems are an important instrument of trade regulation of the vast majority of the world.

Agreement on a " voluntary" export restraint

In the past decade, a widespread practice of concluding agreements on the " voluntary" export restrictions and the establishment of import minimum prices imposed by leading Western nations upon weaker in economical or political sense exporters. The specifics of these types of restrictions is the establishment of unconventional techniques when the trade barriers of importing country, are introduced at the border of the exporting and not importing country. Thus, the agreement on “ voluntary” export restraints is imposed on the exporter under the threat of sanctions to limit the export of certain goods in the importing country. Similarly, the establishment of minimum import prices should be strictly observed by the exporting firms in contracts with the importers of the country that has set such prices. In the case of reduction of export prices below the minimum level, the importing country imposes anti-dumping duty which could lead to withdrawal from the market. “ Voluntary” export agreements affect trade in textiles, footwear, dairy products, consumer electronics, cars, machine tools, etc.

Problems arise when the quotas are distributed between countries, because it is necessary to ensure that products from one country are not diverted in violation of quotas set out in second country. Import quotas are not necessarily designed to protect domestic producers. For example, Japan, maintains quotas on many agricultural products it does not produce. Quotas on imports is a leverage when negotiating the sales of Japanese exports, as well as avoiding excessive dependence on any other country in respect of necessary food, supplies of which may decrease in case of bad weather or political conditions.

Export quotas can be set in order to provide domestic consumers with sufficient stocks of goods at low prices, to prevent the depletion of natural resources, as well as to increase export prices by restricting supply to foreign markets. Such restrictions (through agreements on various types of goods) allow producing countries to use quotas for such commodities as coffee and oil; as the result, prices for these products increased in importing countries.

Embargo

Embargo is a specific type of quotas prohibiting the trade. As well as quotas, embargoes may be imposed on imports or exports of particular goods, regardless of destination, in respect of certain goods supplied to specific countries, or in respect of all goods shipped to certain countries. Although the embargo is usually introduced for political purposes, the consequences, in essence, could be economic.

Standards

Standards take a special place among non-tariff barriers. Countries usually impose standards on classification, labeling and testing of products in order to be able to sell domestic products, but also to block sales of products of foreign manufacture. These standards are sometimes entered under the pretext of protecting the safety and health of local populations.

Administrative and bureaucratic delays at the entrance

Among the methods of non-tariff regulation should be mentioned administrative and bureaucratic delays at the entrance which increase uncertainty and the cost of maintaining inventory.

Import deposits

Another example of foreign trade regulations is import deposits. Import deposits is a form of deposit, which the importer must pay the bank for a definite period of time (non-interest bearing deposit) in an amount equal to all or part of the cost of imported goods.

At the national level, administrative regulation of capital movements is carried out mainly within a framework of bilateral agreements, which include a clear definition of the legal regime, the procedure for the admission of investments and investors. It is determined by mode (fair and equitable, national, most-favored-nation), order of nationalization and compensation, transfer profits and capital repatriation and dispute resolution.

Foreign exchange restrictions and foreign exchange controls

Foreign exchange restrictions and foreign exchange controls occupy a special place among the non-tariff regulatory instruments of foreign economic activity. Foreign exchange restrictions constitute the regulation of transactions of residents and nonresidents with currency and other currency values. Also an important part of the mechanism of control of foreign economic activity is the establishment of the national currency against foreign currencies.

The transition from tariffs to non-tariff barriers

One of the reasons why industrialized countries have moved from tariffs to NTBs is the fact that developed countries have sources of income other than tariffs. Historically, in the formation of nation-states, governments had to get funding. They received it through the introduction of tariffs. This explains the fact that most developing countries still rely on tariffs as a way to finance their spending. Developed countries can afford not to depend on tariffs, at the same time developing NTBs as a possible way of international trade regulation. The second reason for the transition to NTBs is that these tariffs can be used to support weak industries or compensation of industries, which have been affected negatively by the reduction of tariffs. The third reason for the popularity of NTBs is the ability of interest groups to influence the process in the absence of opportunities to obtain government support for the tariffs.

Non-tariff barriers today

With the exception of export subsidies and quotas, NTBs are most similar to the tariffs. Tariffs for goods production were reduced during the eight rounds of negotiations in the WTO and the General Agreement on Tariffs and Trade (GATT). After lowering of tariffs, the principle of protectionism demanded the introduction of new NTBs such as technical barriers to trade (TBT). According to statements made at United Nations Conference on Trade and Development (UNCTAD, 2005), the use of NTBs, based on the amount and control of price levels has decreased significantly from 45% in 1994 to 15% in 2004, while use of other NTBs increased from 55% in 1994 to 85% in 2004.

Increasing consumer demand for safe and environment friendly products also have had their impact on increasing popularity of TBT. Many NTBs are governed by WTO agreements, which originated in the Uruguay Round (the TBT Agreement, SPS Measures Agreement, the Agreement on Textiles and Clothing), as well as GATT articles. NTBs in the field of services have become as important as in the field of usual trade.

Most of the NTB can be defined as protectionist measures, unless they are related to difficulties in the market, such as externalities and information asymmetries information asymmetries between consumers and producers of goods. An example of this is safety standards and labeling requirements.

The need to protect sensitive to import industries, as well as a wide range of trade restrictions, available to the governments of industrialized countries, forcing them to resort to use the NTB, and putting serious obstacles to international trade and world economic growth. Thus, NTBs can be referred as a “ new” of protection which has replaced tariffs as an “ old” form of protection.

CASE 1:

A case for good protectionism

Bharat Jhunjhunwala (source: The Hindu Business Line)

THE defeat of the NDA Government and the victory of the Congress (I) supported by the Left is one more symptom of the growing worldwide backlash against globalization. White- collar workers in industrial countries are losing their jobs to the cheap labor of India and China. Services, such as research, are now being outsourced because scientists in the developing countries are cheaper.

On the other hand, workers in the developing countries are finding that their wages are stagnant while inequality is rising. The belief was that free trade leads to efficient production and also forces domestic government to reduce corruption. This provides relief to the people. Else businessmen would have to pay money to local thugs and politicians to avoid trouble.

Government officers would have to be bribed to run normal business. For instance, a boiler inspector can shut down a plant for 15 days on frivolous grounds. The money paid to politicians and officers by the businessman adds to the cost of production and raises the cost of his produce say, cloth to Rs

25 a metre instead of Rs 20. The cost of production of similar cloth in other countries having good governance, however, remains low because they do not have to bribe politicians and officers.

The cost of other inputs, such as cotton, machines and chemicals, remains the same in all countries because of free trade. Cloth produced in another country can conquer Indian markets if the cost of production in that “ clean” country is Rs 20 and is Rs 25 in “ corrupt” India. Textile mills in India will have to down shutters.

Ultimately, politicians will have to reduce the money they extract from the businessmen failing which they will be killing the goose that lays golden eggs. The same applies to inefficient businessmen.

Globalization will force the Indian businessman to install latest looms in order to survive. This will provide good and cheap cloth to the Indian people. Globalization, indeed, begets clean governance and efficient production.

The difficulty, however, is that free trade also works in the Labor market. Say, India and another country both have clean governments and the cost of production of cloth in both countries is Rs 20 a metre. The wage rate in the other country is Rs 80 per day.

The Indian businessman will not be able to pay more than this rate to his workers as otherwise his cost of production will increase and he will be priced out of the market. The country paying lowest wages wins in free trade. Free trade leads to equalization of wages rates to their global lowest levels. This decline in wages nullifies the benefits from good governance and efficient production. No wonder workers in the industrial countries are opposing free trade and outsourcing. Software programmers are finding their wage rate declining as technology makes it possible to transfer huge amounts of data at the click of the mouse.

The wage rates in most developing countries are also stagnant. Workers in East Asian countries are seeing their wage rates decline due to competition from the less paid Chinese workers. Free trade works as a two-edged sword.

On the one hand, it leads to clean governance and efficient production but on the other it leads to lowering of wage rates to their global minimum. What is the solution to this problem? How can the benefits of free trade be secured while creating higher wages for the workers?

Protectionism enables domestic prices to remain higher than the global prices. Such higher prices can be used to support corruption, inefficient production or higher wages. The solution comes from using protection not for corruption or inefficient production but for higher wages. Suppose India were to impose an additional tax of Rs 5 per metre on cloth imports. The price of cloth in the Indian market would become Rs 25 instead of Rs 20 earlier.

This margin can be taken away by corrupt politicians and officers, or used to maintain inefficient production in obsolete mills, or to raise wages of the workers. The ability lies in avoiding the first two uses and promoting the third. If the government establishes, say, a system to trap corrupt politicians and officers, promotes domestic competition to avoid inefficient production, and implements policies that lead to higher wages, then this protectionism becomes pro-people.

Free trade is necessarily anti-people because it leads to low wages even if it provides good governance and efficient production. Protectionism can possibly be pro-people if applied correctly. What about exports, though? It is possible to prevent cheap imports by imposing tariffs. But how will exports be made if the domestic wage rates are high?

The solution is to use the receipts from import taxes to provide export subsidies to Labor-intensive products. The higher cost due to high wages can be neutralised by the subsidies. It is clear that free trade will not lead to the welfare of the people anywhere in the world. Protectionism makes it possible to secure people's welfare but only if applied correctly. But bad protectionism that supports corruption is worse than free trade. The challenge is to embrace good protectionism.

CASE 2

FREE TRADE OR PROTECTIONISM?

The Case Against Trade Restrictions

by Vincent H. Miller & James R. Elwood

(source: isil. org)

The Lure of Protectionism

The argument for so-called " protectionism" (called " fair trade" by some) may at first sound appealing. Supporters of " protectionist" laws claim that keeping out foreign goods will save jobs, giving ailing domestic industries a chance to recover and prosper, and reduce the trade deficits. Are these claims valid?

Protectionism: What It Costs

Classical Liberal philosopher John Stuart Mill astutely observed in the last century that “ Trade barriers are chiefly injurious to the countries imposing them.” It is true today as it was then, for the following reasons:

LOST JOBS: Protectionist laws raise taxes (tariffs) on imported goods and/or impose limits (quotas) on the amount of goods governments permit to enter into a country. They are laws that not only restrict the choice of consumer goods, but also contribute greatly both to the cost of goods and to the cost of doing business. So under “ protectionism” you end up poorer, with less money for buying other things you want