Protectionism - arguments for and against essay

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An infant industry is an industry that is in its early stages of development. It usually only has a small percentage of the local market because of foreign competition. It generally costs the infant industries more to produce a unit than their foreign competitors, so they are disadvantaged when they come to the price of the product.

Many argue that these industries need to be protected until they become more established and efficient so they can be able to compete with their more established foreign competitors. If this was to happen, then the protected industry must have the potential to sell the goods at a lower price then the foreign competitors, which means that the firm must be more efficient, and produce at a lower price. On the other hand, if the infant industry has potential to compete with foreign competition in the long run, then the entrepreneurs will start a business in that industry even if protection is not offered. If this is the case, then some may suggest that the infant industry argument is invalid and that protection is only offered to infant industries that can never establish themselves.

The Strategic Industries Argument: Governments argue that it is necessary to protect certain strategic industries from competition. This is a political argument rather than a economic one, because the decision to define a certain industry as a strategic industry cannot be made purely made on an economic basis. An example of a strategic industry is the military industry.
The Protection Of Domestic Employment: Protection seems to be used during times of depression or recession. If the foreign products are more expensive relative to the domestic products, then the consumers will buy the domestic

product. With this increase in demand for the locally produced product, the producers will need to look for more local employment.

Some also argue that a decrease in protection will cause the local producers to be less competitive so that will increase local unemployment. By using protection to promote local employment, some say that we are exporting our unemployment to our trading partners. They may use protection against our imports in retaliation. Prevention Of Dumping: Dumping is when a foreign country sells its goods on domestic markets at a price lower than its production cost.

Foreign producers use dumping to clear their surplus stock or to create a monopoly in a foreign country by eliminating local competition; this is called predatory dumping. We know when dumping is occurring when the prices for the good are lower on the foreign market than on the producers local market. Dumping can be extremely dangerous to local producers. The General Agreement on Tariffs and Trade (GATT) and the European Community (EC) has banned the practice of dumping. The Cheap Labour Argument: Some suggest that industries need to be protected because they cannot compete with cheap foreign labour. Firstly, workers are paid on the basis of what they produce.

A reason for Australia’s high wages for workers is because the workers are more productive. Another reason for cheap foreign labour is because the country may have a lot of workers, so they are cheaper. In the case of Australia, we have a population of only about 20 million, that is not much compared to other countries such as India and China, who’s populations is of over a billion. Some countries may have cheap labour and others may have cheap capital.

One can gain by exporting goods where they have a comparative advantage over other countries in that area while other countries can import goods where they have a comparative disadvantage in other areas. So this brings the argument to that foreign labour is not unfairly cheap; but the problem is that some domestic labour is used to produce good which should be produced somewhere else. To Promote Diversification in LDCs: When a economy is diverse, it will be more flexible and is more capable of adjusting to the changing demands of the international environment. We can use tariffs and other forms of protection to promote new local industries, which leads to diversification in the economy. By making the economy more diverse, we are spreading the risks and makes the economy less prone to the price and output fluctuations. One problem with diversification is that some scarce resources may be placed into less efficient industries.

To Overcome Balance of Payments Disequilibrium: When the amount of imports and exports is equal to each other, the country reaches equilibrium. When the amounts of imports and greater than the amount of exports, the country is in a deficit. In order to pay off their deficits, the country will need to loan money. In order to aid this situation, the country may use protection to discourage and limit the amounts of imports entering the country.

Arguments Against Protection-Comparative Advantage: Comparative advantage is when one country has an advantage in an area of production over others, eg. Australia has a comparative advantage in producing wheat and wool over other countries because Australia has the climate and the land to do so. If each country produced the product they have a comparative advantage in, then the output of each country will be a lot great due to their efficiency. Increased Competition: By taking away all forms of protection, the domestic firms are subject to competition from foreign firms. By doing so, this takes away the firms ability to generate a large amount of market power and it allows the consumer to access a greater variety of goods at a lower price.

Greater Mobility of Capital: Some argue that when capital is mobile, it can be directed to the most productive uses. By doing so, this will make production of goods more efficient and when this happens, the firm can produce more goods at the same cost, thus the consumers can benefit from the lower prices. Productive investments can also be undertaken even where domestic savings are scarce. The Spread of Technology: Free trade encourages direct investment eg. Establishment of businesses and factories by Multi-National Companies.

Multi-National Companies often introduce new, modern, productive and management techniques. This technology can filter through to the rest of the economy. Protection Misallocates Resources: When protection is used, it transfers the resources from efficient industries to inefficient industries. When this happens, the industries that are efficient and competitive will be disadvantaged to aid the inefficient and less competitive industries. When this happens, the scarce resources are wasted to the total output of the economy will be less than the normal output.

In the long term, this will lower living standards and lower economic growth. Inflationary Effects: Protection in the form of tariffs raises the price of imports and allows the domestic to charge higher prices for their products. Unless the demand for the imported good is inelastic, the consumers will react to the higher price by consuming less. The unprotected export and import-competing industries will be forced to pay higher prices for the inputs purchased from protected industries, this will increase their cost of production.

By doing so, they will lose their international competitiveness. Reduced Incentive to Innovate: When a domestic industry is protected from competition, it will reduce the pressure on domestic industries to respond to the changing demands of the international environment. Also, with pressure and competition, the domestic producer has less incentive to develop and introduce more efficient methods of production and technological advances are then hindered. By failing to innovate, the industries are delayed to the structural changes that should occur as the industries adapt to the changing market conditions.

Because of this, production will add to the waste of resources, lower productivity and will reduce international competitiveness. Protection Leads to Retaliation: It is illogical to think that a country can place barriers on another country's imports without the importing country placing barriers their exports in retaliation. By protection import-competing industries, this may in fact hamper the export-competing industries by lowering demand for their products from trade partners. A reduction in demand for exports will mean that the export industries will need to cut back on production levels and reduce employment levels. Protection Reduces Welfare: From the arguments above, we can see that protection results in a reduction in consumer demand, lowers demand for exports, increases costs, lowers productivity, places scarce resources into inefficient industries, redistributes income and it reduces international competitiveness. In the long term, this will lead to a fall in living standards and it lowers the rate of economic growth.

In conclusion, the effect of protection is a fall in the general level of welfare in the economy.