The any benefit of improved terms of

The suggested implication of all this investigative research and model-building is that the developing countries should not be bogged down by the philosophical idealism of free trade. They should be ready to discard and replace it with a judiciously framed policy of trade regulation. The popular arguments advanced in favour of protection should be viewed in the context of this under-lying theme.

1. Terms of Trade: It is claimed that use of tariffs and other trade restrictions improves the terms of trade of a country. However, a number of factors may prevent this favourable outcome including the following: i.

The demand and supply elasticities of the tradable goods have to be " appropriate" for the terms of trade to improve. A small country lays hardly any ability to affect world prices and its own terms of trade. ii. With an improvement in terms of trade, volume of trade may decrease to such an extent that any benefit of improved terms of trade is lost. iii.

Trade restrictions may invite retaliatory action by other countries. Retaliation by large countries can be all the more damaging. 2. Bargaining Strength: It is often argued that a country can use its protectionist policy as a bargaining point for getting trade concessions from its trading partners. This argument is reasonably valid where the exporting country has some kind of a natural monopoly. Actually, however, such monopolies usually do not last forever because of the development of their substitutes. In addition, like all such arguments, the argument of " bargaining strength" also suffers from some limitations including the following: i.

The countries with which the country in question is trading should have something to offer in exchange which means that they must also be following a protectionist policy. ii. An underdeveloped country suffers from an inherent weakness vis-a-vis the developed ones and cannot use its protectionist measures as an effective bargaining tool. iii. Protectionist measures, particularly by a developing country, are prone to invite retaliation by others.

3. Dumping: It is considered a legitimate right of a country to protect itself from dumping by another country. 4. Diversification: These days, a modern economy is expected to pursue a long term goal of diversification and a multi-sectoral structure. It is believed that such a policy helps an economy in achieving balanced development and inherent strength. Its capacity to restructure itself helps it in improving its terms of trade.

It is better placed to reap the benefits of external economies. What is relevant is that a well-executed policy of protection can accelerate the process of achieving this goal. 5.

Self-sufficiency/Self Reliance: This objective is closely connected with that of diversification of the economy. A protectionist policy is considered to be an effective (and frequently an essential) device for achieving this objective.

Elaboration:

Though closely related, the twin concepts of self-sufficiency and self-reliance are distinct from each other. Self-sufficiency in an item means its adequate production within the domestic economy and thereby eliminating the need for its import. In the extreme situation of complete self-sufficiency, all imports to a country come to an end, converting it into a “ closed economy”. In contrast, a country is self-reliant when it can pay for all its normally required imports out of its export earnings. 6.

Infant Industry Argument: It is one of the oldest and most popular arguments in favour of protection and was first advanced by economists like Alexander Hamilton (1790) and Fredrich List (1882). It recognises the hurdles that a free-trading country faces in promoting and strengthening an industry for which it has a potential; and advocates that a policy of protection may be adopted for exporting this potential. 7. Foreign Direct Investment: Theory of free trade is based on the assumption that factors of production do not move from one country to the other. However, with the phenomenon of direct foreign investment, all this has changed. Producers, in search for reducing costs, are looking for opportunities to shift their production centres to low-cost areas and/or closer to consumer markets.

Therefore, when a country imposes import restrictions and import costs go up, the exporters of other countries start exploring the possibility and advantages of shifting their production centres to the protected markets. This helps the host country in accelerating its growth rate. Moreover, direct foreign investment has the advantage that the risk of failure is borne by the foreign investors and they also bring in the latest technology and work culture with them.