PROTECTIONISM

The theory of International Trade based on comparative costs stresses that the benefits of International Trade can be held by the trading countries only when the trade is free from all restrictions. But it was realised soon that the free trade, no doubt, advantageous for developed countries but it is highly injurious for the developing countries due to the various reasons. Free trade policy has been generally conducted by the developing countries and they have utilised the restricted trade policy for the purpose of providing protection to the local economy against the competition of developed and technically advanced countries.

Arguments for Protection:

The following arguments are extended in favour of protection:

1. Infant Industry Argument:

This argument was given by a German economist Friedrich List, according to whom newly emerging German Industries (infant industries) were in need of protection against Britain's develop and establish industries.

2. Diversification of Industry Argument:

Again, List was of the opinion that the local Industries could be protected and country may not depend on a few industries. Otherwise it will have to depend on other countries which will neither be socially nor economically and nor politically advisable.

3. Employment Argument:

If the existing local industries are exposed to foreign competition they will be ruined and thereby rate of unemployment will increase. Protection establishes and enhances employment opportunities.

4. Conservation of Resources Argument:

Carey, Patten and Jevons argued that in absence of restrictions free trade transfers the resources from a particular country to other countries. Moreover, the exporter of raw material loses the producers profits. Protection consumes the local natural and mineral resources.

5. Defence Argument:

Defence is better than opulence or guns are better than butter. These are the arguments in favour of defence protection provides the opportunity to develop the defence industries and to curtail dependence on other countries. Free trade thrusts overdependence.

6. Revenue Argument:

Protection import duties may be the source of revenues for the government. Custom duties have been fairly productive all over the world.

7. Key Industry Argument:

Efforts for economic development will be useless in the absence of basic or key industries. For example, no economic and structural development is possible without development of iron and steel industry. Since basic industries are crucial and strategic therefore, they must be provided with necessary protection.

8. Balance of Payment Argument:

An adverse balance of payments is a root cause of various economic problems, therefore, check on imports, through different protective tariffs, becomes necessary to rectify adverse balance of payments.

Forms of Restrictions:

Protectionism may take various forms which can be discussed in terms of trade barriers as under:

1. Import Prohibition:

Sometimes, certain commodities are prohibited to import by law and if they are allowed to import, they are allowed under certain conditions. Sometimes, some countries curtail imports by way of refusing to export some raw materials unless they are processed at home.

2. Exchange Control:

It is a system of government through which it regulates the foreign exchange. All the purchasing and selling of foreign currencies are handled by the government. Through exchange control, the government can rectify an adverse balance of payments by restricting and curtailing imports. Under this system, a limited amount of foreign exchange is permitted to consume on imports

3. Import Licences:

Under the system, importers are only permitted foreign currency to pay for imports sanctioned by the monetary authorities. In such cases, licences have to be obtained before goods can be imported. Similarly, where imports of certain goods are subject to quota restrictions such goods can be imported only by importers who have obtained the necessary import licences.

4. Import Monopolies:

The government, sometimes, can make a monopoly to import some goods. It is termed as “State Monopoly” for imports.

5. Quota System:

With reference to international trade, quotas have been used as an alternative to tariffs as a means of restricting imports. A country may allot quotas to its suppliers, by fixing a maximum amount of commodity can be imported during a period.

There are two kinds of quota: Custom quota and Import quotas. Custom quota allows a certain amount of a commodity to import at a favourable duty and beyond this, normal duty is charged on the other. Import quotas are more serious in nature. According to this type of quotas, an arbitrary limit of import is fixed beyond which imports during a time are not allowed at all.

Advantages of Quotas (on Imports):

The quota system is advantageous because:

(a) It is ***visible in nature***.

(b) ***Home manufacturers*** are aware of the amount to be imported and ***can regulate their production*** accordingly.

(c) Quotas are ***less resented***.

(d) This can be ***used as bargaining counters*** in trade negotiations.

Disadvantages of Quotas:

The quota system is also subject to following the demerits:

(a) ***Home market*** becomes isolated and thereby ***is not benefited by price oscillation*** outside the country.

(b) ***Government loses its revenues***.

(c) Quota system ***concentrates undue power*** in the hands ***of administrative officials***.

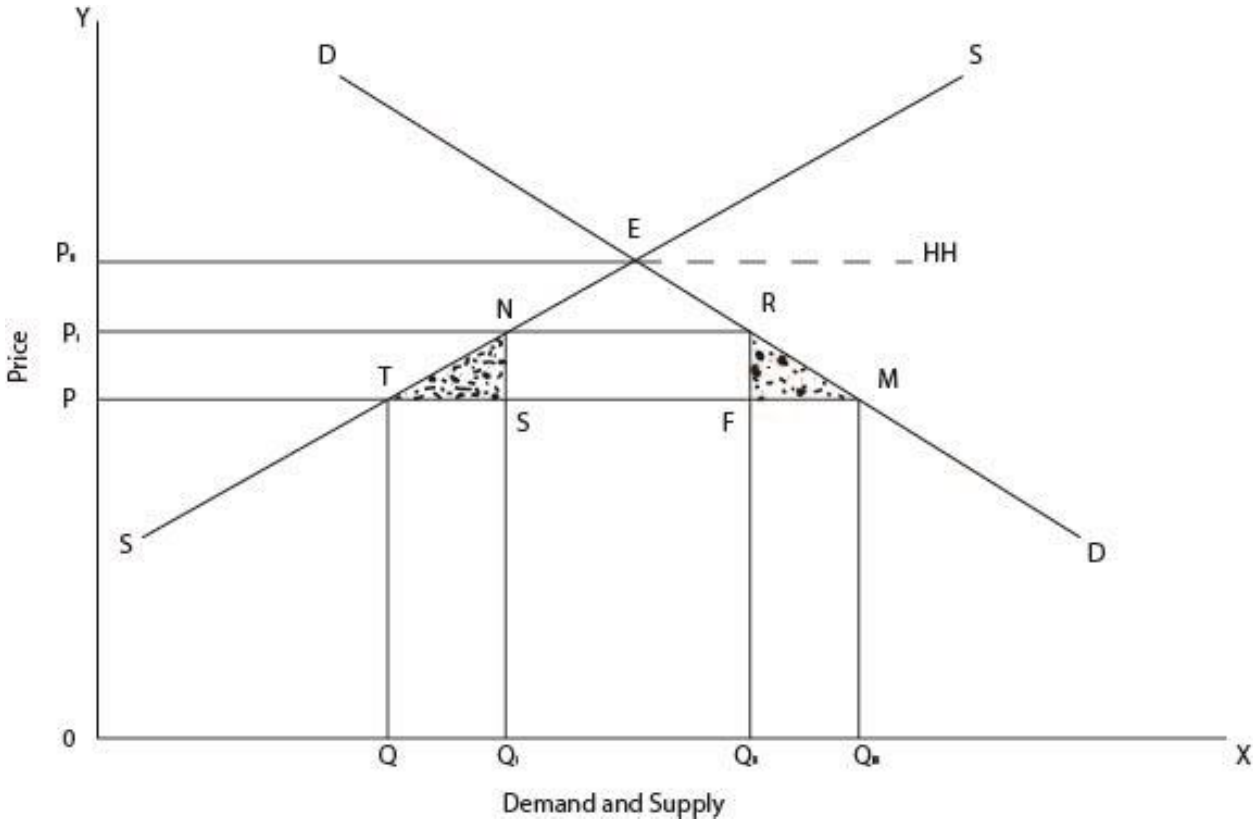
6. Protective Tariffs:

Tariff is a schedule of charges for goods and services. But more correctly, a system of duties imposed on goods imported (or exported) either for revenue purposes of for protection of both. It is also defined as the tax levied on the imports.

The tariff can be classified into two: Prohibitive tariffs and non-prohibitive tariffs. The first type is so light that it completely discourages any import. The second type injures but not kills off the trade.

Effects of Tariffs:

Tariff, no doubt, is an important tool of commercial policy with which a government can regulates its balance of payments in favour through controlling imports. It is a double edged weapon; on the one hand it restricts the consumption based on imports and on the other, it can ship the use of resources from one to the other. The effect of tariffs is to change the relative prices of goods and services and to change the relative prices of factors of productions. Have a glance over the diagram:



The diagram shows demand and supply (domestic) along x-axis while price along y-axis. SS and DD are the supply and demand curves respectively. Before the tariff is imposed, domestic demand is OQ_{III} and domestic supply is OQ is and the price is OP. At this price, demand (OQ_{III}) exceeds the supply (OQ) before the gap is filled by imports equal to QQ_{III}.

You know that the tariff of PP_I is imposed. Since at OP price the imports have infinite elasticity, they will have no effect of tariff. But it will raise the price from OP to OP_{II} in domestic market. At OP_I price, foreign supply line is shifted to PHH and imports are reduced from Q_IQ_{III} to Q_IQ_{II} (=NR). Consequently, the domestic production increased from OQ to OQ_I (or by QQ_I).

Tariffs bring about the following effects:

(a) Consumption Effect:

Tariffs curtail consumption through increase in price. When tariffs are imposed, price increased to the extent of tariffs amount. In the preceding diagram, imposition of tariff by PP_I decreases consumption from OQ_{III} to OQ_{II}.

(b) Redistribution effect:

Imposition of tariffs reduces consumers' surplus because it increases prices. Consequently, some income is transferred from consumers to the producers and to the income is redistributed. In the diagram this effect is illustrated by quadrilateral $PTNP_I$.

(c) Protective effect:

As a result of tariffs imposition, prices of imports become high so the imports are curtailed. Decrease in imports provides protection to the local producers. Protective effect increases domestic output as it is shown from OQ to OQ_I.

(d) Revenue effect:

If the rate of tariff is multiplied by the total quantity imported during a time, government revenue can be calculated. Revenue effect is given in the diagram equal to NSFR.

Source: Saeed Ahmed Siddiqui