**Protectionism Handbook**

**A2 Economics**

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**Protectionism in Argentina**

**Keep out**

**South America’s two biggest economies are imposing heavy-handed trade restrictions. Our first article looks at Argentina, our** [**second**](http://www.economist.com/node/21530144) **at Brazil**



IN RECENT years BlackBerrys have become an essential component in the young professional’s toolkit in Buenos Aires. But if you failed to buy one before the southern-hemisphere winter, you may be out of luck. “We have trouble getting them,” says an assistant at a Claro mobile-phone store in posh Recoleta. “We haven’t had them for months,” is the answer at a Personal shop in leafy Palermo. Movistar advertises the 8520 model on its home page, but the phone is in fact sold out.

At South America’s southern tip, the missing BlackBerrys are almost ready to roll off the line. On October 3rd Brightstar, a multinational manufacturer, will begin importing kits of the phones’ parts to its factory in Tierra del Fuego, the normal base for cruise ships going to Antarctica. Some 300 workers will brave the frigid austral fog to assemble the pieces and put them in locally sourced packaging.

Making BlackBerrys south of the Magellan strait will cost $23m upfront, plus $4,500-5,000 a month per worker, some 15 times more than in Asia. But the government touts the project as a triumph of its trade policy. It will help cut foreigners’ share of Argentina’s mobile-phone market from 96% in 2009 to a forecast 20% by the end of 2011. “We have a domestic market with growing demand. The goal is to supply it with local labour and production,” said Débora Giorgi, the industry minister, when the deal was announced.

Argentine manufacturers have been booming ever since the 2001 crash. Over most of that period, a cheap peso has ensured their competitiveness. But since 2005 inflation has been in double digits. As the trade surplus has dwindled, Cristina Fernández, the president, has beefed up her industrial policy. According to Global Trade Alert, a database of restrictions on international commerce, Argentina now imposes more trade limitations deemed “harmful” than any country save Russia.

Even before Ms Fernández’s late husband, Néstor Kirchner, became president in 2003, Argentina was taxing farm exports. The policy was meant to raise revenue. But the Kirchners later justified it as a way of discouraging commodity exports in favour of manufacturing. In 2008 Ms Fernández sparked protests by trying to raise taxes on soyabeans, Argentina’s chief export, and lost a congressional vote. Since then the country has restricted maize and wheat exports, leaving farmers with an estimated 4m tonnes of maize they can neither sell at home nor ship abroad. Beef exports have also been limited, which caused ranchers to stop raising cattle and led to lower leather output and beef consumption. Many foreign leather firms, such as Italy’s Italcuer, have left.

On the import side, Argentina cannot raise tariffs on its own because it belongs to the Mercosur customs union. So it is resorting to informal tools. Its main method is “non-automatic licensing”, a tactic recognised by the World Trade Organisation that lets countries delay imports for 60 days.

Argentina has made no pretence of honouring that time period. In January it expanded the list of products requiring licences from 400 to 600. It was a limit on phone imports that led Research in Motion to hire Brightstar to make BlackBerrys in Argentina (tax incentives then led the firm to Tierra del Fuego). Other affected goods include toys, pharmaceutical ingredients, tyres, fabrics, leather and farm machinery. On September 15th Argentina blocked imports of books, and over 1m piled up at the borders. Imports of Harley-Davidson motorcycles are frozen until 2012.

For firms that refuse to (or cannot) move production to Argentina, the government offers another option: deals to export goods worth at least as much as a company’s imports. In January customs officials stopped letting Nordenwagen import Porsches. Its cars languished in port for three months before the firm succumbed to a deal. Since its owners also possess Pulenta Estate, a vineyard, they agreed to launch a new line of mass-market wines for export, erasing the family’s trade deficit. They are also considering canning fruits. “It’s not the same margins as fine wines, but it takes time and investment. We’re trying to make it profitable,” says Eduardo Pulenta, the company’s export manager. “We’ll keep working to import cars. That’s what we know how to do.”

The net effect of these policies is hard to measure. Since 2005 imports have grown faster than exports. But that gap might have been bigger without the trade limits. The industry ministry says Argentina has substituted $5 billion of imports a year since 2009 (1.4% of GDP). Local consumers bear most of the cost, although some will fall on taxpayers now that the government is offering loans to exporters at negative real interest rates. Marcelo Elizondo, head of the UCES business school in Buenos Aires, says the interventions have affected the trade balance only slightly. “But it’s a deterrent,” he says. “It’s a general message for everyone who wants to import that it will be expensive and complicated, and you’re better off producing here.”

**What is protectionism?**

**Protectionism** represents any attempt by a government to impose restrictions on trade in goods and services between countries:

* **Tariffs** - import taxes.
* **Quotas** - quantitative limits on the level of imports allowed.
* **Voluntary Export Restraint Arrangements** – where two countries make an agreement to limit the volume of their exports to one another over an agreed period of time.
* **Embargoes** - a total ban on imported goods.
* Intellectual property laws (patents and copyrights).
* **Export subsidies** - a payment to encourage domestic production by lowering their costs.
* **Import licensing** - governments grants importers the license to import goods.
* **Exchange controls** - limiting the amount of foreign exchange that can move between countries.

Quotas, embargoes, export subsidies and exchange controls are all examples of non-tariff barriers to international trade.

**Tariffs**

A tariff is a tax that raises the price of imported products and causes a contraction in domestic demand and an expansion in domestic supply. The net effect is that the volume of imports is reduced and the government received some tax revenue from the tariff.

Average import tariffs between OECD countries are around 3 per cent; but tariff peaks reach 506 per cent in the EU, and 350 per cent in the US. The highest tariffs are typically levied on goods from the developing world. Among non-agricultural products, the EU has 135 tariff lines over 15 per cent and about 600 tariff lines between 10 and 15 percent, many in labour-intensive products in which developing countries have a comparative advantage. The USA has 230 tariff lines above 15 per cent, and Australia has nearly 800.

**Import Protection in the European Union – selected products**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Average tariff rate (%) | Non tariff barrier % | Anti-dumping duty % | Overall % |
| Cereals | 14.0 | 5.0 |  | 19.0 |
| Meat | 11.2 | 64.8 |  | 76.0 |
| Dairy Products | 9.7 | 100.3 |  | 110.0 |
| Tobacco | 47.3 |  |  | 47.3 |
| Clothing | 11.6 | 19.0 |  | 30.6 |
| Footwear | 7.4 |  | 17.5 | 24.9 |

**Import Quotas**

The Government might seek to limit the level of imports through a quota. Examples of quotas were found in the textile industry under the terms of the **Multi-Fibre Agreement** which expired in January 2005 and which led, in 2005, to a [trade dispute between the EU and China over the issue of textile imports.](http://news.bbc.co.uk/1/hi/business/4194474.stm)

Quotas introduce a physical limit of the volume (number of units imported) or value (value of imports) permitted

**Administrative Barriers**

Countries can make it difficult for firms to import by imposing restrictions and being 'deliberately' bureaucratic. These trade barriers range from stringent safety and specification checks to extensive hold-ups in the customs arrangements. A good example is the quality standards imposed by the EU on imports of dairy products.

**Preferential Government Procurement Policies and State Aid**

Free trade can be limited by preferential behaviour by the government when allocating major spending projects that favour domestic rather than overseas suppliers. These procurement policies run against the principle of free trade within the EU Single Market – but they remain a feature of the trade policies of many developed countries within Western Europe. Good examples include the award of contracts to suppliers of defence equipment or construction companies involved in building transport infrastructure projects.

The use of **financial aid from the state** can also distort the free trade of goods and services between nations, for example the use of subsidies to a domestic coal or steel industry, or the widely criticized use of export refunds (subsidies) to European farmers under the Common Agricultural Policy (CAP) which is criticized for damaging the profits and incomes of farmers in developing countries.

**The Economic Argument For Protectionism**

**Infant Industry Argument**

The essence of the argument is that certain industries possess a potential (latent) comparative advantage but have not yet exploited the potential economies of scale. Short-term protection from established foreign competition allows the ‘infant industry’ to develop its comparative advantage. At this point the trade protection could be relaxed, leaving the industry to trade freely on the international market. The danger of this form of protection is that the industry will never achieve full efficiency. The short-term protectionist measures often start to appear permanent.

**Protection – a reaction against “import dumping”**

**The nature of dumping**

Dumping is a type of **predatory pricing behaviour** and is also a form of **price discrimination**. The concept is used most frequently in the context of trade disputes between nations, where businesses in one or more countries may seek to produce evidence that manufacturers in another country are exporting products at a price below the true cost of production. True dumping according to the definitions employed by the World Trade Organisation is illegal under WTO rules. But it can be difficult, time-consuming and costly to prove allegations of dumping, not least the problems in calculating the production costs of a supplier in their own domestic market.

**Export subsidies and dumping in developing countries**

Many developing countries have complained about the effects of dumping caused by the system of **export refunds** (subsidies) offered to producers by the European Union. These subsidies have the effect of reducing the costs of suppliers and allow them to offload their surplus production into overseas markets. This can have a very damaging effect on prices, demand and profits for the domestic producers of developing countries trying to compete in their home markets.

The charity Oxfam has been especially vocal in its criticism of the effects of the trade policies of the developed world in sustaining high levels of poverty in many of the world’s poorest nations. You can read more about their current campaign on trade by accessing this site: <http://www.oxfam.org.uk/what_we_do/issues/trade/>

**Protection against dumping**
[Anti-dumping](http://www.wto.org/english/tratop_e/adp_e/adp_e.htm) is designed to allow countries to take action against dumped imports that cause or threaten to cause material injury to the domestic industry. Goods are said to be dumped when they are sold for export at less than their normal value. The normal value is usually defined as the price for the like goods in the exporter’s home market.
*Source: DTI web site* [*www.dti.gov.uk*](http://www.dti.gov.uk/)

**Anti-dumping tariffs - recent examples**

**Tyres:**
India has initiated anti-dumping investigations against imports of bus and truck tyres from China and Thailand

**Norwegian salmon:**
The European Union (EU) has imposed anti-dumping measures on Norwegian farmed salmon in the form of a minimum import price of 2.80 Euro per kilogram. The EU acted in response to complaints from EU salmon farmers, mainly in Scotland and Ireland, that a sudden surge in imports from Norway was driving them out of business.

**Television picture tubes**
The European Commission has opened an investigation into claims that Chinese, Korean, Malaysian and Thai companies are selling cathode-ray colour television picture tubes in Europe at prices below their cost. The EU industry group provided evidence that cathode ray imports had increased volume and market share. In the recent past, the EU has antidumping duties against a range of Chinese products from aluminium foil to zinc oxides. China is the EU's second largest trading partner after the United States, accounting for 12 percent of all EU imports in 2004 - mostly machinery, vehicles and other manufactured goods.

**Shoes:**
European shoemakers have alleged that China and Vietnam shoe producers are illegally dumping leather, sports and safety shoes on the European market. The EU Trade Commissioner Peter Mandelson has said that “China has a responsibility to ensure that illegal dumping does not take place” and an investigation is now underway.

If a company exports a product at a price lower than the price it normally charges on its own home market, it is said to be “**dumping**” the product. In the short term, consumers benefit from the low prices of the foreign goods, but in the longer term, persistent undercutting of domestic prices will force the domestic industry out of business and allow the foreign firm to establish itself as a monopoly. Once this is achieved the foreign owned monopoly is free to increase its prices and exploit the consumer. Therefore protection, via tariffs on 'dumped' goods can be justified to prevent the long-term exploitation of the consumer.

The World Trade Organisation allows a government to act against dumping where there is genuine **‘material’ injury** to the competing domestic industry. In order to do that the government has to be able to show that dumping is taking place, calculate the extent of dumping (how much lower the export price is compared to the exporter’s home market price), and show that the dumping is causing injury. Usually an ‘anti-dumping action’ means charging extra import duty on the particular product from the particular exporting country in order to bring its price closer to the “normal value”.

**Externalities, Market Failure and Import Controls**

Protectionism can also be used to take account of **externalities** and dealing with **de-merit goods**. Goods such as alcohol, tobacco and narcotic drugs have adverse social effects and are termed de-merit goods. Protectionism can safeguard society from the importation of these goods, by imposing high tariff barriers or by banning the importation of the good altogether.

**Non-Economic Reasons**

Countries may wish not to over-specialise in the goods in which they possess a comparative advantage. One **danger of over-specialisation** is that unemployment may rise quickly if an industry moves into **structural decline** as new international competition emerges at lower costs

The government may also wish to protect employment in **strategic industries**, although clearly value judgements are involved in determining what constitutes a strategic sector. The recent trade dispute arising from the decision by the United States to introduce a tariff on steel imports is linked to this objective. The US steel tariff was declared unlawful by the WTO in July 2003 and eventually the United States was pressurized into withdrawing these tariffs in the late autumn of 2003.

Tariffs are not usually a major source of tax revenue for the Government that imposes them. In the UK for example, tariffs are estimated to be worth only £2 billion to the Treasury, equivalent to only around 0.5% of the total tax take. Developing countries tend to be more reliant on tariffs for revenue.

**The Economic Argument Against Protectionism**

**Protectionism – Hurting Consumers**
Tariffs, non-tariff barriers and other forms of protection serve as a tax on domestic consumers. Moreover, they are very often a regressive form of taxation, hurting the poorest consumers far more than the better off. In the EU for instance, the nature of existing protection means that the heaviest taxes tend to fall on the necessities of life such as food, clothing and footwear.
*Source: DTI Economics Report on Trade Liberalisation and Investment, April 2004* [*www.dti.gov.uk*](http://www.dti.gov.uk/)

According to Professor [**Jagdish Bhagwati**](http://en.wikipedia.org/wiki/Jagdish_Bhagwati)**,** “the fact that trade protection hurts the economy of the country that imposes it is one of the oldest but still most startling insights economics has to offer.”

The stupidity of protection has been confirmed by a range of studies from around the world. These indicate that that it has brought few benefits but imposed substantial costs. Among the main criticisms of protectionist policies are the following:

* **Market distortion**: Protection has proved an ineffective and costly means of sustaining employment.
	1. **Higher prices for consumers**: Trade barriers in the form of tariffs push up the prices faced by consumers and insulate inefficient sectors from competition. They penalise foreign producers and encourage the inefficient allocation of resources both domestically and globally. In general terms, import controls impose costs on society that would not exist if there was completely free trade in goods and services. It has been estimated for example that the recent tariff and other barriers placed on imports of steel into the US increased the price of every car produced there by an average of $100
	2. **Reduction in market access for producers:** Export subsidies, depressing world prices and making them more volatile while depriving efficient farmers of access to the world market. This is a major criticism of the EU common agricultural policy. In 2002 the EU sugar regime lowered the value of Brazil, Thailand and South Africa’s sugar exports by over $700 million – countries where nearly 70 million people survive on less than $2 a day.
* **Loss of economic welfare:** Tariffs create a deadweight loss of consumer and producer surplus arising from a loss of allocative efficiency. Welfare is reduced through higher prices and restricted consumer choice.
* **Regressive effect on the distribution of income:** It is often the case that the higher prices that result from tariffs hit those on lower incomes hardest, because the tariffs (e.g. on foodstuffs, tobacco, and clothing) fall on those products that lower income families spend a higher share of their income. Thus import protection may worsen the inequalities in the distribution of income making the allocation of scarce resources less equitable
* **Production inefficiencies:** Firms that are protected from competition have little incentive to reduce production costs. Governments must consider these disadvantages carefully
* **Little protection for employment:** One of the justifications for protectionist tariffs and other barriers to trade is that they help to protect the loss of relatively low skilled and low paid jobs in industries that are coming under sever international competition. The evidence suggests that, in the long term, tariffs are a costly and ineffective way of protecting such jobs. According to the DTI study on trade published in 2004, since 1997 UK employment in textiles manufacturing has fallen by 45%, in clothing manufacture by nearly 60%, and in footwear manufacturing by around 50% - and this despite the protection afforded to European Union textile manufacturers. The cost of protecting each job runs into hundreds of thousands of Euros for the EU as a whole. Might that money have been spent more productively in other ways? Often there is a huge opportunity cost involved in imposing import tariffs.
* **Trade wars**: There is the danger that one country imposing import controls will lead to “retaliatory action” by another leading to a decrease in the volume of world trade. Retaliatory actions increase the costs of importing new technologies
* **Negative multiplier effects**: If one country imposes trade restrictions on another, the resultant decrease in total trade will have a negative multiplier effect affecting many more countries because exports are an injection of demand into the global circular flow of income. The negative multiplier effects are more pronounced when trade disputes boil over and lead to retaliation.

**Higher taxes and higher prices**
Protectionism imposes a **double burden on tax payers and consumers**. In the case of European agriculture, the cost to tax payers is about €50 billion a year, plus around €50 billion a year to consumers via artificially high food prices – together the equivalent of over £800 a year on the annual food budget of an average family of four.
Furthermore huge distortions in international agriculture markets prevent the world’s poorest countries from trading in the products they are best able to produce. Continuing barriers to trade are costing the global economy around $500 billion a year in lost income.
*Source:* [*www.dti.gov.uk*](http://www.dti.gov.uk/) *(Economics Paper 10)*

Protectionist policies rarely achieve their aims. They can be costly to administer and they nearly always provide domestic suppliers with a protectionist shield that encourages inefficiencies leading to higher costs.

Protectionism is a ‘second best’ approach to correcting for a country’s balance of payments problem or the fear of rising structural unemployment. And import controls go against the principles of free trade enshrined in the theories of comparative advantage. In this sense, import controls can be seen as examples of government failure arising from intervention in markets.