天津外国语大学(天外)
Tianjin Foreign Studies University (TFSU)

Global Economics

Online class starts at 08:00

(Beijing Time, GMT+8)

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March 14, 2023

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Arguments for and against Protection

Why do most countries have policies that limit imports? The previous two lectures found only bad barriers, ones that brought net harm to the world economy. Because free trade led to a fully efficient outcome for the world in our analysis, any trade barriers could only be bad. We did find one barrier, the nationally optimal tariff, that could be good for the country that imposed it. But it, too, was bad for the world as a whole, and it could end up being bad for the country that tried to impose it if other countries retaliate by raising their own tariffs on products that the first country exports.

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Arguments for and against Protection

We know that a tariff or nontariff barrier (NTB) to imports of a product can

- Increase domestic production of the product.
- Increase employment of labor and other resources in this domestic production.
- Decrease domestic consumption of the product.
- Increase government revenue.
- Alter the distribution of income or well-being in the country.

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- Increase government revenue.
- Alter the distribution of income or well-being in the country.

Corresponding to each of these effects, here are five generic arguments in favor of tariffs (or NTBs) that we will examine:

- If there is something extra good about local production of a product, then a tariff can be good for the country because the tariff leads to more domestic production of the product.
- If there is something extra good about employing people or other resources in producing a product, then a tariff can be good for the country because the tariff leads to more employment in the sector as local production of the product increases.
- If there is something extra bad about local consumption of a product, then a tariff can be good for the country because the tariff leads to less domestic consumption of the product.
- If there is something extra good about the government collecting more revenue, then a tariff can be good for the country.
- If it is desirable to enhance the incomes of factors used intensively in the importcompeting industry, then a tariff can be good for the country.

Arguments for and against Protection

In each of these cases, the tariff could also be good for the world as well.

Our analysis here will establish two main conclusions:

- There are valid “second-best” arguments for protection—situations in which protection could be better than free trade.
- Some other government policies are usually better than import barriers in these situations.

Arguments for and against Protection

Key points

If there are few situations in which import protection is the best policy for a country, why do we see so many import barriers? The second part of the lecture focuses on the politics of protection.

We examine how political actions by different selfinterested groups in the country can influence political decisions about import barriers. Our political excursion indicates that institutions are important. Import protection is more likely in a representative democracy for products in which import-competing domestic producers organize into effective lobbies but domestic consumers do not.

THE IDEAL WORLD OF FIRST BEST

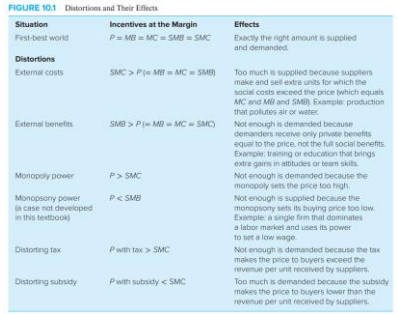

FIGURE 10.1 Distortions and Their Effects

Situation	Incentives at the Margin	Effects
First-best world	$P = MB = MC = SMB = SMC$	Exactly the right amount is supplied and demanded.
Distortions		
External costs	$SMC > P (= MB = MC = SMB)$	Too much is supplied because suppliers make and sell extra units for which the social costs exceed the price (which equals MC and MB and SMB). Example: production that pollutes air or water.
External benefits	$SMB > P (= MB = MC = SMC)$	Not enough is demanded because demanders receive only private benefits equal to the price, not the full social benefits. Example: training or education that brings extra gains in attitudes or team skills.
Monopoly power	$P > SMC$	Not enough is demanded because the monopoly sets the price too high.
Monopsony power (a case not developed in this textbook)	$P < SMB$	Not enough is supplied because the monopsony sets its buying price too low. Example: a single firm that dominates a labor market and uses its power to set a low wage.
Distorting tax	P with tax $> SMC$	Not enough is demanded because the tax makes the price to buyers exceed the revenue per unit received by suppliers.
Distorting subsidy	P with subsidy $< SMC$	Too much is demanded because the subsidy makes the price to buyers lower than the revenue per unit received by suppliers.

An ideal, or “first-best,” world in which all private incentives aligned perfectly with benefits and costs to society as a whole. In a first-best world, any demand or supply curve can do double duty, representing both private and social benefits or costs. The domestic demand curve represented not only marginal benefits of an extra bicycle to its private buyer but also the extra benefits of another bicycle to society as a whole. The domestic supply curve represented not only the marginal cost to private producers of producing another bicycle at home but also the marginal cost to society as a whole.

The first row of summarizes what an economist means by a first-best world. The market price (P) acts as a signal to consumers and producers.

- Consumers buy the product up to the point where the price they are willing to pay, which equals the extra private benefits (MB) they receive from another unit, just equals the price (P) that they must pay.
- The extra benefit to society (SMB) is just the extra benefit (MB) that the consumer gets.
- Producers supply the product up to the point where the price (P) they receive just covers the extra costs (MC) that they incur in producing another unit of the product.
- The extra costs to society (SMC) of producing another unit of this product are just the extra costs (MC) that the individual firm incurs.

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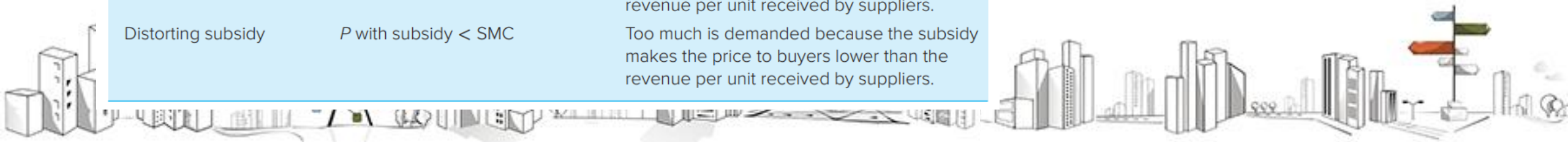
Distorting subsidy	*P* with subsidy < SMC	Too much is demanded because the subsidy makes the price to buyers lower than the revenue per unit received by suppliers.

That is, all five values are equal:

Price (P) = Buyers' private marginal benefit (MB) = Social marginal benefit (SMB)
= Sellers' private marginal cost (MC) = Social marginal cost (SMC)

P = Market price
MB = Private marginal benefit of an activity (to those who demand it)
MC = Private marginal cost of an activity (to those who supply it)
SMB = Social marginal benefit of an activity (to everybody affected)
SMC = Social marginal cost of an activity (to everybody affected)



THE REALISTIC WORLD OF SECOND BEST

Our world is not ideal. Distortions exist, and they do not automatically cancel each other out. The distortions result from ongoing gaps between the private and social benefits or costs of an activity. We live in a second-best world, one that includes distortions. As long as these gaps exist between what private individuals use to make their decisions and the full effects of these decisions on society, private actions will not lead to the best possible outcomes for society

Source: YouTube cover for 2019 Huawei Annual Report Press Conference – Braving the Storm

THE REALISTIC WORLD OF SECOND BEST

There are two major sources of distortions in an economy. First, market failures are ways in which private markets fail to achieve full economic efficiency. Second, government policies can distort an otherwise economically efficient private market. Figure 1 provides information on six specific types of distortions, with the first four being types of private market failures and the last two being government policies that can create distortions.

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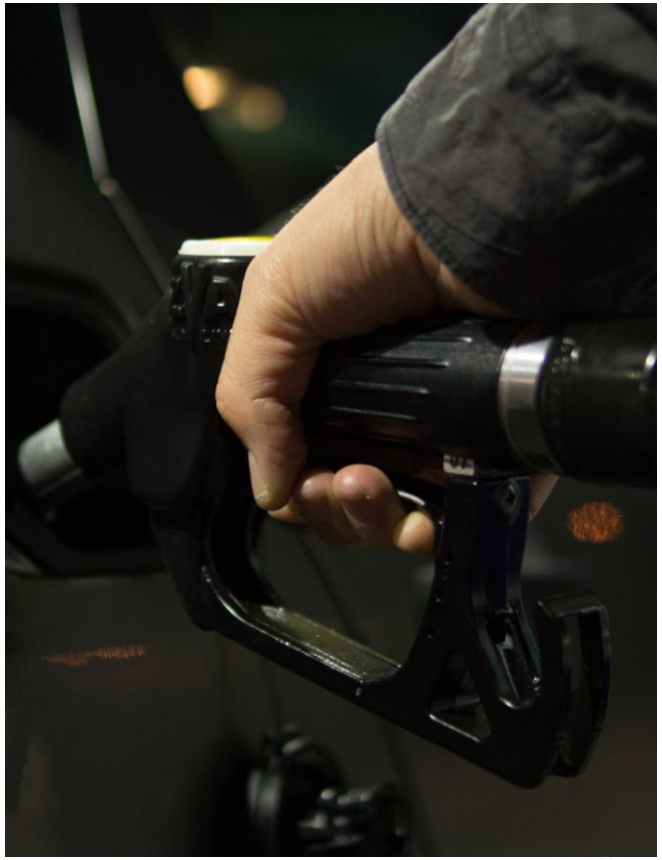
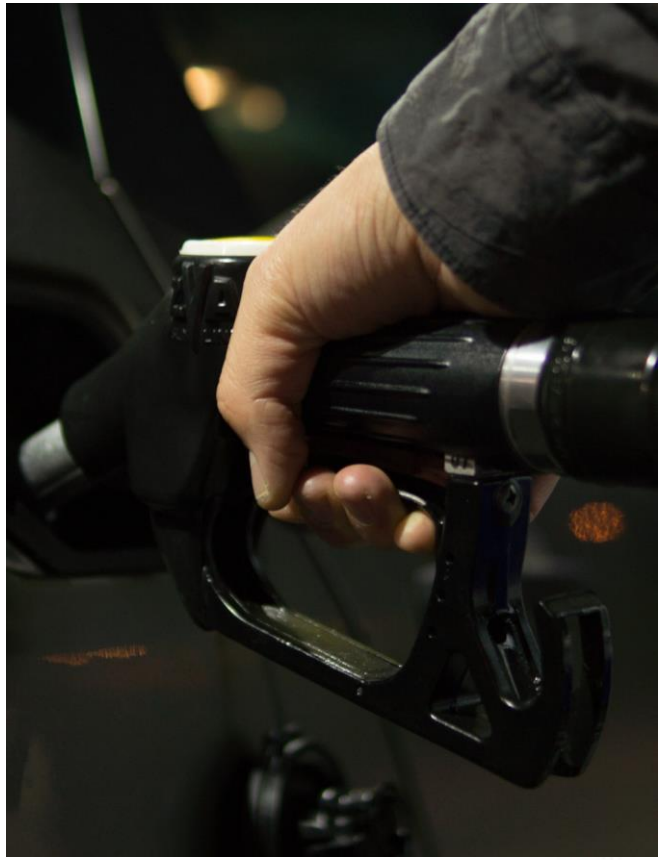
The first two types of distortions in the figure are externalities or spillover effects (net effects on parties other than those agreeing to buy or sell in a marketplace). The first example of an externality is the classic case of pollution. Consider the case of river pollution. If the sellers of paper products are not forced to do so, they do not reckon the damage done by the paper mills' river pollution as part of the cost of their production. So the pollution costs are not incorporated into the price of paper. Similarly, buyers of petroleum fuels do not reckon that the social cost of air pollution from using those fuels is part of the fuel price that they have to pay. If some costs of producing or consuming a product are ignored by the private decision-makers, then too much of the product is produced or consumed.



THE REALISTIC WORLD OF SECOND BEST

Our second example of an externality supposes that jobs in a certain importcompeting sector generate greater returns for society than are perceived by the people who decide whether or not to take the jobs. These external benefits can happen, for instance, if working in the sector brings gains in knowledge, skills, and attitudes that benefit firms or people other than the workers and employers in the sector. In this example the social marginal benefits (SMB) of working in the sector are higher than the wage rate (or the price, P) that workers receive. If some benefits of the activity are ignored by private decision-makers, then too little of the activity occurs (in the example, too few people are hired into jobs in the sector).



Monopoly power

- Monopoly power can create a distortion because a powerful seller restricts output to raise price and increase profits. For a domestic monopoly firm, free trade can eliminate this distortion by forcing the domestic firm to compete with foreign firms. Monopsony power can create a distortion because a powerful buyer sets a price that is too low
- In the absence of any other distortion, a tax creates a distortion by artificially raising the price to buyers.
- In the absence of any other distortion, a government subsidy creates a distortion by artificially lowering the price to buyers. Essentially, a subsidy is like a negative tax. We will examine subsidies later in this lecture and in the next lecture.

Government Policies toward Externalities

External costs and external benefits pose some of the most intriguing policy problems in economics. How should a society try to fix distortions caused by externalities? There are two basic alternative approaches for government policy. One approach is the taxor-subsidy approach developed by British economist A. C. Pigou. The other approach is the property-rights approach, which builds on the ideas of Nobel Prize winner Ronald Coase.

[1]For example, the property-rights approach says that, if there is a problem of a paper mill polluting a river, we can make private incentives include all social effects by making the river someone's private property. Either let the downstream river users own it and charge the paper mill for any pollution, or let the paper mill own the river and demand compensation for cleaning it up. Choose between these two property-right assignments by choosing the one that costs less to implement and enforce. The property-rights approach will resurface in Chapter 13's treatment of international environmental issues.

[2]We can see this more broadly and also clear up a possible confusion. In Figure 10.1 a tax and a subsidy are listed as possible sources of distortions. That is, if the market otherwise gets to the first-best solution (because there is no other distortion), then introducing a tax or subsidy causes a distortion. If, instead, a distortion already exists, then the market will not get to the first-best outcome by itself. If a distortion already exists, then an appropriate tax or subsidy can improve the market outcome. But the wrong tax or subsidy could make things even worse.

The tax-or-subsidy approach

The tax-or-subsidy approach says that we should spot distortions in people's and firms' private incentives and have a wise government policy correct the incentives with taxes or subsidies. What if social marginal cost exceeds private cost and market price (SMC > MC = P = MB = SMB), as in the pollution case? The government should levy a tax of (SMC − MC) to bring everything into equality by raising the market price to match the full social marginal cost (including the external costs created by the pollution). If the social marginal benefit exceeds the private benefit and the market price (SMB > MB = P = MC = SMC), as in the training case, let the government pay a subsidy of (SMB − MB) so that decision-makers in the marketplace recognize the full social returns.

The Specificity Rule

Externalities and other incentive distortions complicate the task of judging whether a trade barrier is good or bad for the nation as a whole. Realizing this, some scholars have stressed that there is no cure-all prescription for trade policy in a second-best world. Once you realize that distortions exist, things become complicated. It seems that each situation must be judged on its own merits.

The specificity rule states that it is usually more efficient to use the government policy tool that acts as directly as possible on the source of the distortion separating private and social benefits or costs. In short, identify the specific source of the problem and intervene directly at this source.

The specificity rule

The specificity rule applies to all sorts of policy issues. Let's illustrate it first by using an example removed from international trade. Suppose that the problem is crime, which creates fear among third parties and direct harm to victims. Since crime is caused by people, we might consider combating crime by reducing the whole population through compulsory sterilization laws or taxes on children. But such actions are obviously inefficient ways of attacking crime because less social friction would be generated (per crime averted) if we fought crime more directly through greater law enforcement and programs to reduce unemployment, a major contributor to crime.

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PROMOTING DOMESTIC PRODUCTION OR EMPLOYMENT

Protectionists often come up with reasons that it is good to maintain high levels of domestic production of a product that is imported or high levels of employment of workers (and perhaps other resources) in this domestic production. They offer reasons that this is good for the nation as a whole (and not just for the firms and workers that receive the protection). In fact, most popular second-best arguments for protection can be viewed as variations on the theme of favoring a particular import-competing industry because there are extra social benefits to domestic production or employment in this particular import-competing industry.

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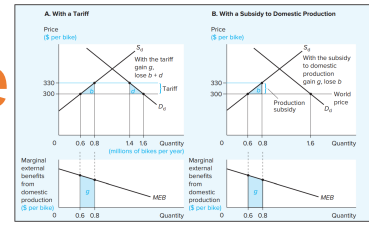
small country case

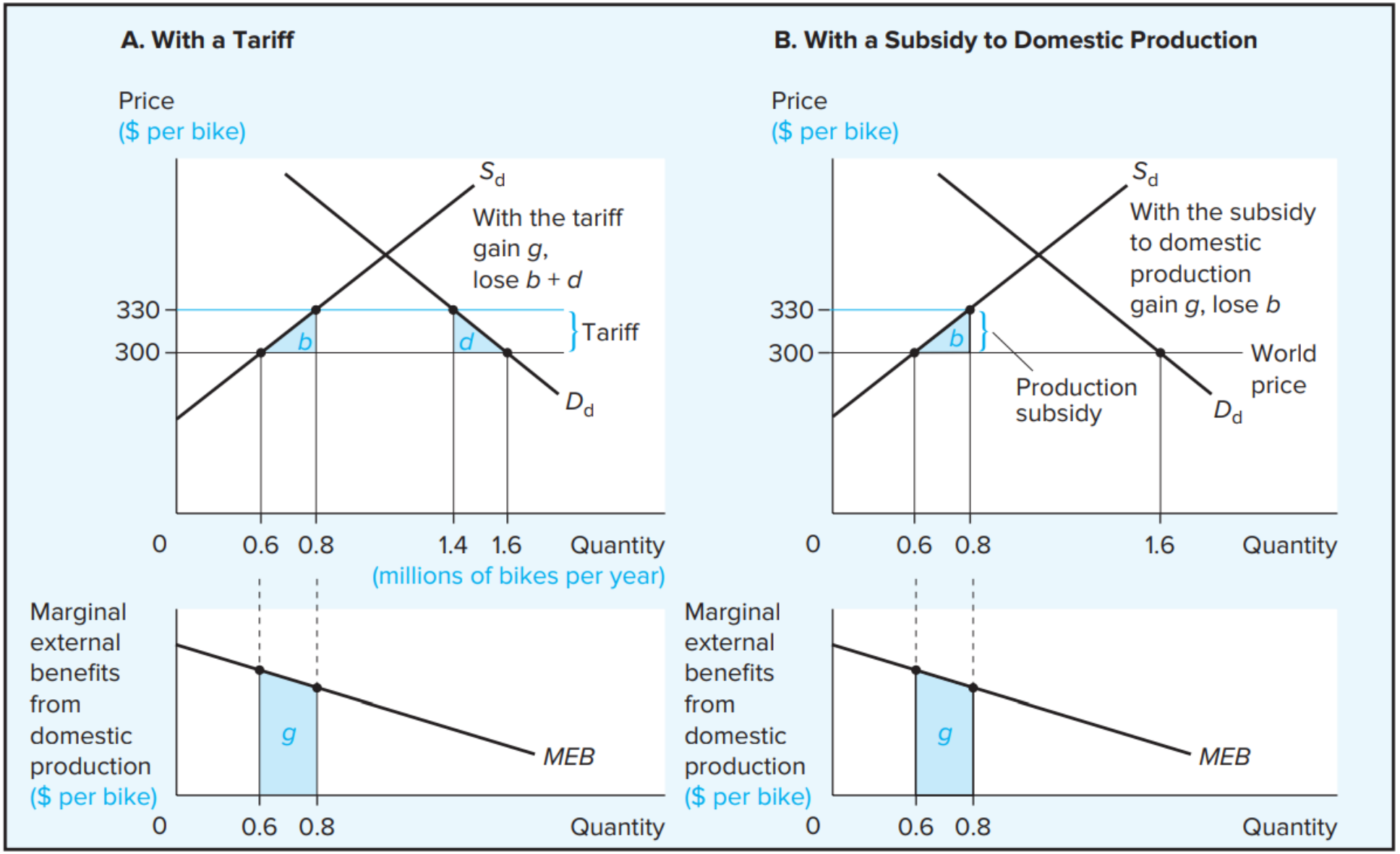
Here are several versions that we will examine in this lecture



- Local production of this product produces spillover benefits because other firms and industries benefit from production know-how or management techniques introduced by the firms in this industry.
- Employment in this industry imparts new worker skills and attitudes, and some workers carry these when they switch jobs to work for other firms and industries.
- By producing now at high cost, firms in the industry can find ways to lower their costs over time.
- There are extra costs to workers if they are forced to switch to jobs in other industries.
- The country and its citizens take pride from producing this product locally.
- The product is essential to national defense.
- Employment in the industry is a way to redistribute income to poor or disadvantaged members of society.

Compare the effects of two ways of getting the same increase in domestic output (0.2 million = 0.8 – 0.6 million) and in domestic jobs. Both the $30 tariff and the $30 subsidy to domestic production encourage the same change in domestic production. But the tariff also needlessly discourages some consumption of imports (the amount 0.2 million = 1.6 – 1.4 million) that was worth more to the buyers than the $300 each unit of imports would have cost the nation. The production subsidy is better than the tariff because it strikes more directly at the task of raising domestic production of this good.

FIGURE 2 Two Ways to Promote Import-Competing Production



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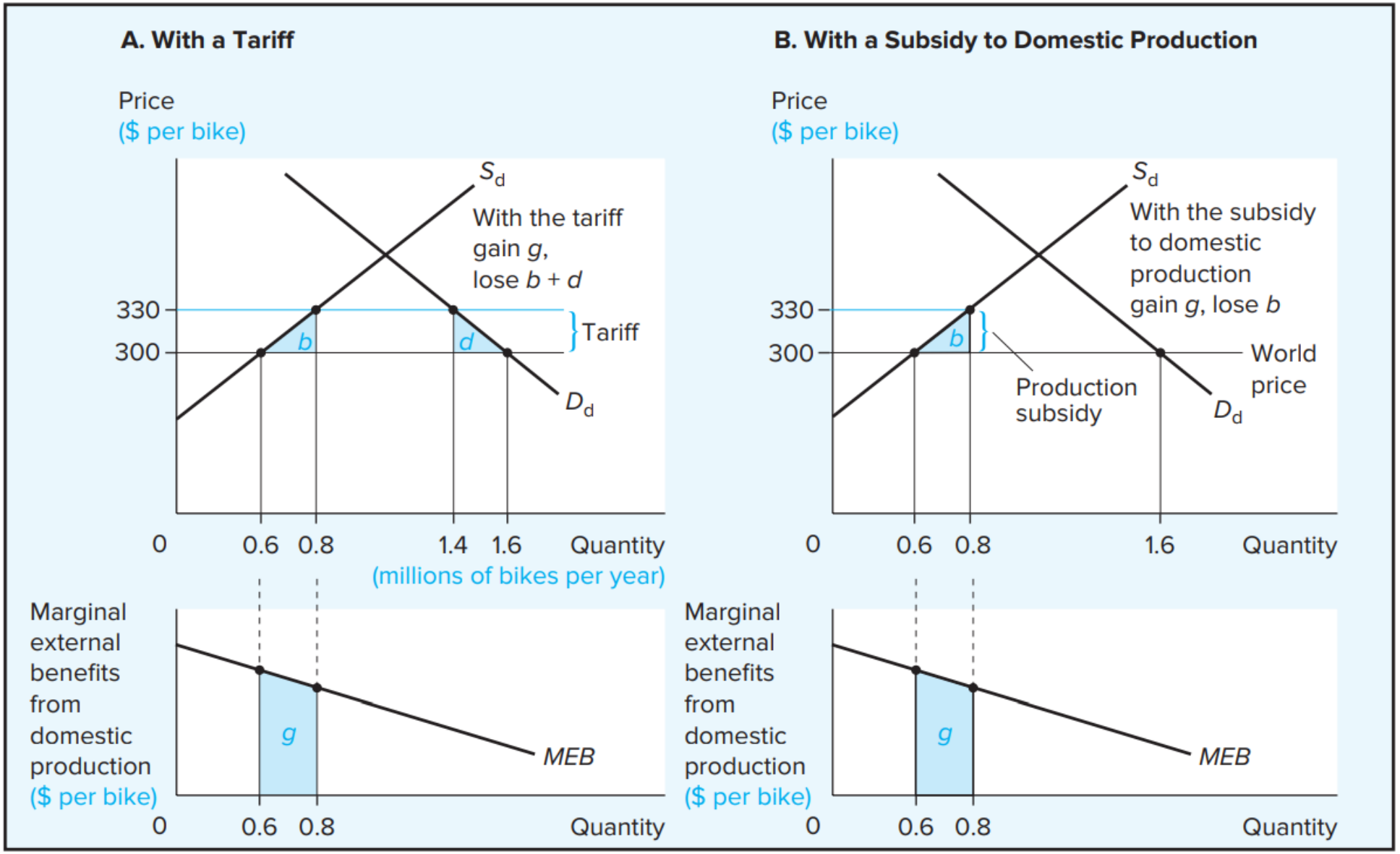


THE INFANT INDUSTRY ARGUMENT

The analysis of using a tariff to promote domestic production helps us judge the merits of a number of popular arguments for protection. Of all the protectionist arguments, the one that has long enjoyed the most prestige among both economists and policymakers is the infant industry argument, which asserts that a temporary tariff is justified because it cuts down on imports while the infant domestic industry learns how to produce at low enough costs.

Examples of THE INFANT INDUSTRY ARGUMENT

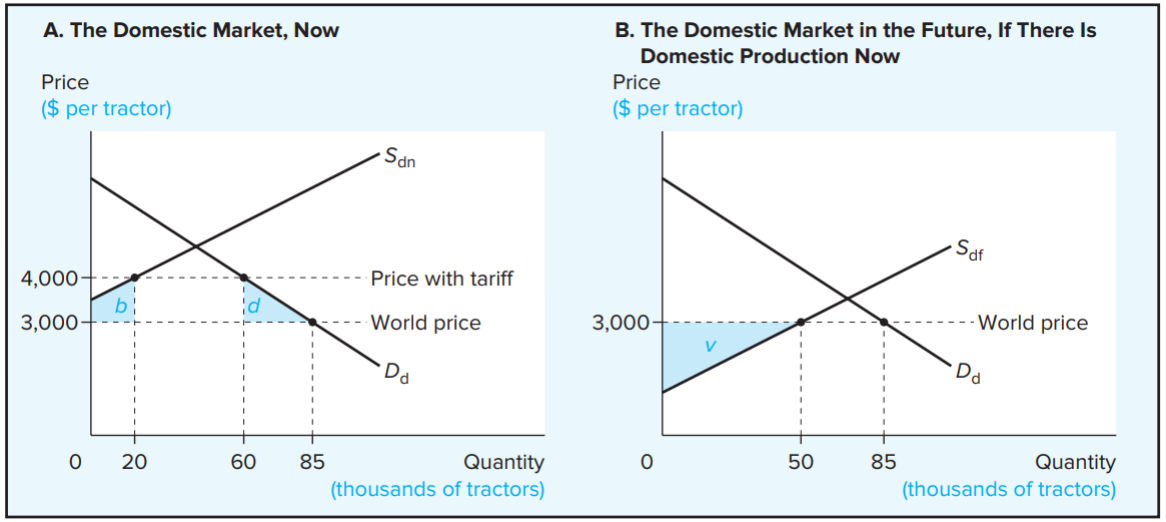
The infant industry argument has been popular with aspiring countries at least since Alexander Hamilton used it in his Report on Manufacturers in 1791. The United States followed Hamilton's protectionist formula, especially after the Civil War, setting up high tariff walls to encourage production of textiles, ferrous metals, and other goods still struggling to become competitive against Britain. Similarly, Friedrich List reapplied Hamilton's infant industry ideas to the cause of shielding nascent German manufacturing industries against British competition in the early 19th century. The government of Japan has believed strongly in infant industry protection—sometimes, but not always, in the form of import protection. In the 1950s and 1960s in particular, Japan protected its steel, automobile, shipbuilding, and electronics industries before they became tough competitors and the import barriers were removed.

https://pixabay.com/illustrations/globe-network-community-friends-7817766/

10-minute break

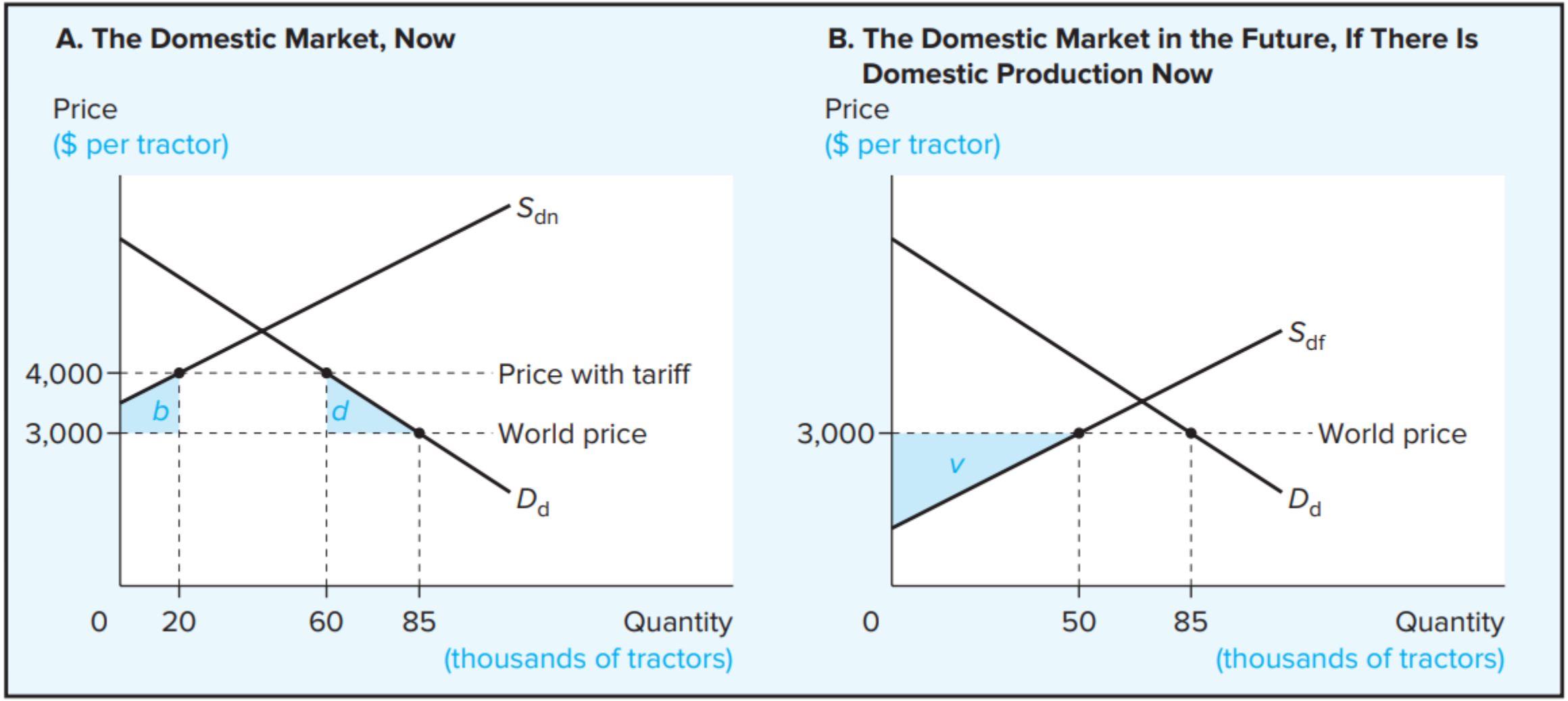
How It Is Supposed to Work

Figure 3 provides a schematic for understanding the infant industry argument, using the example of small farm tractors. Now, as shown in the left side of the figure, no amount of production in this country is cost-competitive by world standards (the current domestic supply curve Sdn is everywhere above the world price of $3,000 per tractor). Apparently, no domestic production would occur now with free trade. If the country's government imposes a tariff of 33 percent, the domestic price rises to $4,000 per tractor and domestic firms produce 20,000 tractors. Now (and for as many years as this situation persists) we know that the country incurs inefficiencies of area b and area d because of the tariff.

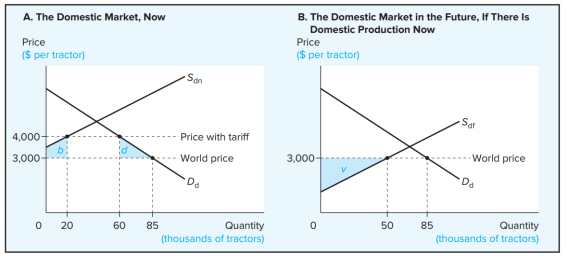


With free trade now, there would be no domestic production. A tariff can induce domestic production now of 20,000 tractors per year. After a number of years of domestic production, the domestic firms will find ways to lower their costs, so the domestic supply curve in the future is lower. The government can remove the tariff in the future, and the future production of 50,000 tractors per year is cost-competitive by world standards.

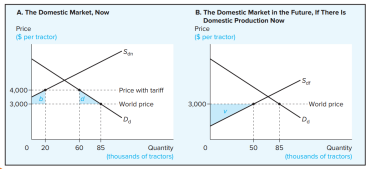
FIGURE 3 The Infant Industry Argument. How Valid Is It?



Three questions to ask



- First, is any government policy really needed?
- Second, if the government is going to provide assistance, what government policy is best?
- Third, will the infant industry really grow up?



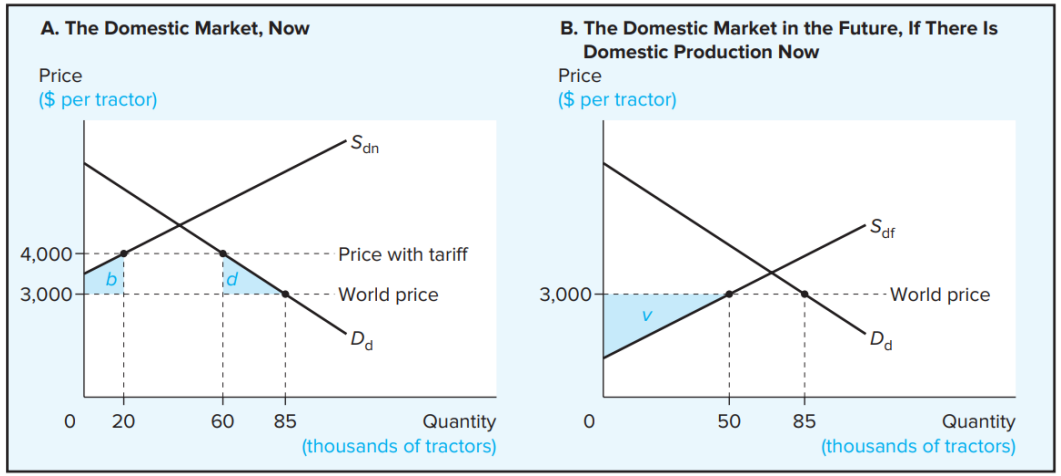
First, is any government policy really needed?

The infant industry argument seems to be a story about firms that would make losses when they begin operations but eventually will become profitable. This is not an unusual business problem; in fact, it describes almost any new business. The standard solution is for the firm to obtain private financing, using personal wealth, borrowing from relatives and friends, obtaining bank loans, using venture capital, and so forth. If private financing is available, there is nothing left for the government to do.

1. There are imperfections in the financial markets.
2. The benefits from the early business investments do not accrue to the firms making these early investments.

Second, if the government is going to provide assistance, what government policy is best?

If the goal is to induce early production even when the early firms are not cost-competitive by world standards, we know that a production subsidy is better than a tariff or other import barrier. In Figure 3A, the national cost of a production subsidy in the early phase is only area b, not areas b and d.



Third, will the infant industry really grow up?

It is cheap to claim to be a firm in an infant industry; it is much harder to become internationally competitive. If the tariff is truly temporary, then firms have a powerful incentive to grow up. But the pressure is much less if the firms expect that they can ask for more time with the tariff because childhood is longer than they planned for.

Examples of successful and failed infant industry protection

- There are cases of apparently successful infant industry protection, such as computers and semiconductors in Japan. The qualifier apparently is used because it is difficult to be sure that the eventual national benefits were more than the initial national costs, and because it is also difficult to show how much of a difference the government assistance actually made in the future success of the national industry.
- Another apparent success is Airbus in Europe, a case in which the governments provided subsidies and loans, not import protection. There are also many cases of failed infant industry protection. For instance, Brazil first offered “temporary” protection to its nascent automobile industry in 1952. More than 60 years later the tariff on imports is still 35 percent, and Brazil recently added an additional import tax that can be reduced if the car firm has sufficient local content or local research and development. It has been a long toddlerhood for auto production in Brazil.

https://www.istockphoto.com/photo/flags-of-brazil-and-japan-gm641734172-116298793

Conclusion

1. There can be a case for some sort of government encouragement.
2. A tariff may or may not be good.
3. Some form of government help other than a tariff is a better infant industry policy than a tariff.
4. It is hard for a government to know which industries to support because it is difficult to predict which industries can reduce their costs enough in the future to create net national benefits.

THE DYING INDUSTRY ARGUMENT AND ADJUSTMENT ASSISTANCE

The issues and results that arise in the infant industry debate also arise in the debate about saving declining or dying industries from import competition. Once again, protection against imports might or might not be better than doing nothing. And, once again, doing something else is better than blocking imports.

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Should the Government Intervene?

With regularity, rising imports of a product threaten the well-being and even the survival of import-competing domestic firms and industries. Time and again society faces a choice: Should the firms be allowed to shrink, perhaps to go out of business, or should they be protected?

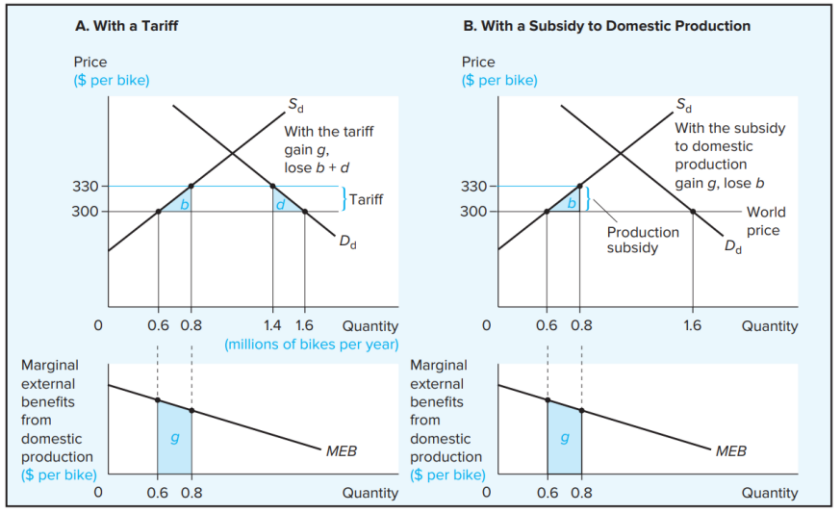
If we are in a first-best world, the answer is clear. Since the social value of anything is already included in private incentives, ordinary demand and supply curves are already leading us to the right choice without any government intervention. If rising import competition is driving domestic producers out of business, so be it. Adjustment out of the industry is necessary so that the country can enjoy the net gains from increasing trade. It is true that there will be some losses to workers, managers, investors, and landowners. They must shift their resources into other uses that may not pay quite as well as the original uses did. These losses are already measured in the loss of producer surplus. Consumers gain more, and net national well-being increases.

In a series of studies, David Autor, David Dorn, and Gordon Hanson documented exactly these types of effects. They examined what they called the “China shock,” the large shift in U.S. trade patterns as China expanded its exports of labor-intensive manufactured products to the United States during 1991–2007. U.S. imports of manufactured goods from China, as a percentage of U.S. manufacturing production value, rose from less than 1 percent in the early 1990s to about 7 percent in 2007. They calculated that there were about 1.5 million fewer jobs in U.S. manufacturing by 2007 because of the increased imports from China. (Still, imports from China explain only about one-fifth of the total manufacturing job decline during this time—technological change was more important.)

https://pixabay.com/illustrations/manufacturing-industry-report-book-1674579/

Figure 2

While displaced workers and other resources are unemployed, they lose all income, not just the loss of producer surplus that would occur if they could easily shift into the next-best employment. In this case, the amount of their income that imports take away is a loss to society as well as to them. Wouldn't it be better for society to intervene? Wouldn't blocking the rising imports be better than standing by while the domestic industry withers?



5-minute break till 10:55

Trade Adjustment Assistance

Governments in a number of developed countries offer trade adjustment assistance to workers and firms in import-threatened industries. For instance, in the United States workers can petition the U.S. Department of Labor for this assistance. If the department accepts that this group of workers is being harmed by increased imports, workers who lose their jobs receive up to 30 months of unemployment compensation (much more than the 6 months that is usual in most states), and they are eligible for retraining programs and subsidies for job search, health insurance, and moving expenses

THE DEVELOPING GOVERNMENT (PUBLIC REVENUE) ARGUMENT

Import tariffs can be justified by another second-best argument relating to conditions in developing countries. In a poor nation, the tariff as a source of revenue may be beneficial and even better than any feasible alternative policy, both for the nation and for the world as a whole

The developing government argument

The developing government argument states that in poor developing nations the import tariff becomes a crucial source, not of industrial protection but of government revenue. Revenue can be raised more cheaply by simply guarding key ports and border crossings with a few customs officials who tax imports than by levying more elaborate kinds of taxes. Production, consumption, income, and property cannot be effectively taxed when they cannot be measured and monitored.

OTHER ARGUMENTS FOR PROTECTION: NONECONOMIC OBJECTIVES

The other leading arguments for tariff protection relate to the national pursuit of noneconomic objectives, that is, goals other than achieving economic efficiency. The potential range of such arguments is limitless, but the view that people do not live by imported bread alone usually focuses on three other goals: national pride, national defense, and income distribution. Fortunately, a modified version of the specificity rule applies to a country pursuing a noneconomic objective: To achieve the noneconomic objective with the least economic cost to the nation, use a policy that acts as directly as possible on the specific objective

National Pride

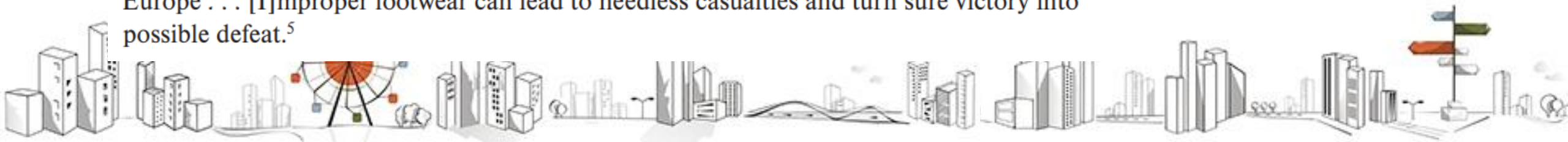
Nations desire symbols as much as individuals do, and knowing that some good is produced within our own country can be as legitimate an object of national pride as having cleaned up a previous urban blight or winning Olympic medals. As long as the pride can be generated only by something collective and nationwide, something not purchased by individuals in the marketplace, there is a case for policy intervention. If the pride is generated by domestic production itself, then the appropriate policy tool is a domestic production subsidy, not an import barrier. Only if the pride comes from increased self-sufficiency is restricting imports the best policy approach.

https://pixabay.com/illustrations/medal-trophy-achievement-award-1622523/

National Defense

The national defense argument says that import barriers would help the nation to have or to be ready to produce products that would be important in a future military emergency. It has a rich history and several interesting twists to its analysis. English mercantilists in the 17th century used the national defense argument to justify restrictions on the use of foreign ships and shipping services: If we force ourselves to buy English ships and shipping, we will foster the growth of a shipbuilding industry and a merchant marine that will be vital in time of war.

In the event of war or other national emergency, it is highly unlikely that the domestic footwear industry could provide sufficient footwear for the military and civilian population . . . We won't be able to wait for ships to deliver shoes from Taiwan, or Korea or Brazil or Eastern Europe . . . [I]mproper footwear can lead to needless casualties and turn sure victory into possible defeat.[5]



Income Redistribution

A third, less economic objective to which trade policy might be addressed is the distribution of income within the nation. Often one of the most sensitive questions in national politics is either “What does it do to the poor?” or “What effect does it have on different regions or ethnic groups?” A tariff could sometimes be defended on the grounds that it restores equity by favoring some wrongly disadvantaged group, even though it may reduce the overall size of the pie to be distributed among groups. It is certainly important to know the effects of trade policy on the distribution of income within a country.

THE POLITICS OF PROTECTION

If the economic case for import protection is so weak, why do most countries have many import barriers in place? Why are import barriers high for some products and low for others? In each country import barriers are adopted and maintained through a political process of decision-making. Understanding the answers to questions about why import barriers exist requires a mixture of political and economic insights. There is a growing literature on the “political economy of trade barriers.” It focuses on activities by pressure groups and the self-interested behavior of political representatives who seek to maximize their chances of staying in office.

The Basic Elements of the Political–Economic Analysis

Let's take a look at the political process that leads to a decision about whether or not to impose a tariff on imports of a good, say, socks. As we have seen in previous lectures, imposing the tariff will have different effects on the well-being of different groups in the country, with both winners and losers. In addition, we presume that the tariff would cause some economic inefficiency—a decrease in national well-being because the losers lose more than the winners gain. When will such a tariff be enacted? Why? There are a number of key elements in our political–economic analysis:

1. The size of the gains for the winners from protection, and how many individuals are in the group of winners.
2. The size of the losses for the losers from protection, and how many individuals are in the group of losers
3. Individuals' reasons for taking positions for or against protection
4. Types of political activities and their costs
5. Political institutions and the political process.

When Are Tariffs Unlikely?

Under some circumstances, inefficient trade barriers would be rejected, and we would have a world closer to free trade than we observe. Let's consider two sets of circumstances.

Our first case is direct democracy. Consider what will happen if we have (1) a direct vote by individuals on each tariff (or import barrier), with (2) voting (almost) costless so that (almost) everyone votes, and (3) each person voting based on her direct interest as a winner or a loser from protection. Nearly always the number of losers, Nc (the number of consumers of the product), is larger than the number of winners, Np (the number of people involved in production of the import-competing product).

The trade barriers that we see in most countries depart from what simple majorityrule democracy would give us. Indeed, countries usually do not use direct votes to set protection. Rather, a group of elected representatives or some other government officials decide. Winning the political fight is gaining the support of a majority of these representatives or officials.

When Are Tariffs Likely?

Lobbying and contributions can lead to political decisions enacting protection if protectionist groups are more effective than other groups in organizing their political activities. In this case we reach a surprising conclusion: The group with the smaller number of individuals can be more effective. We can see two different reasons for this surprising conclusion. Both are based on the fact that each individual in the smaller group tends to have a larger individual gain.

Free Rider Problem: Definition and Examples - MasterClass

31 Jul 2022 — The free rider problem describes what happens when **many people enjoy a seemingly free resource without paying for it**.

Consider what happens when some members of the group can decide to “free-ride” on the contributions of others in the group. The free-rider problem arises whenever the benefits of a group effort fall on everyone in the group regardless of how much each individual does (or does not) contribute (in time, effort, voting, or money). Each selfishly rational individual tries to get a free ride, letting others advance the common cause. The free-rider problem usually affects a large, dispersed group more seriously than it affects a small, well-defined group. Conquering the free-rider problem is what political action groups—special interests—are all about

The tariffs imposed by the U.S. government on steel imports in 2002 provide a stark example of the political economy of protection. The small number of American steel firms were well organized as a political lobbying force. The industry employed only about 200,000 workers, about 0.1 percent of the U.S. workforce, but the United Steelworkers union was also politically active. Users of steel were much more dispersed. They did achieve some organization and mount a campaign to oppose the tariffs, but their effort was not as effective. In addition, steel firms and steelworkers were concentrated in a few states, including West Virginia, Pennsylvania, and Ohio, that were considered crucial for the 2002 and 2004 elections. In March 2002 the protectionists won—President George W. Bush announced new tariffs of up to 30 percent on imports of many types of steel. The box, “How Sweet It Is (or Isn’t),” presents another example by examining the political–economic forces in play for sugar protection.

Applications to Other Trade-Policy Patterns

The tariff escalation pattern is a general symptom of the importance of group size and concentration to effective lobbying. Economists have found that nominal and effective tariff rates rise with the stage of production. That is, tariff rates are typically higher on final consumer goods than on intermediate goods and raw materials sold to producing firms. The explanation would seem to be that household consumers are a particularly weak lobby, being many people who are not well organized into duescollecting lobbying associations.

Final conclusion

Our discussion began in this section with the general question of why the overall level of trade barriers is higher than the analysis of economic efficiency would justify. But now that we have examined the political economy of trade barriers, we might easily ask the opposite question. Given the power of well-organized import-competing producers favoring protection, as well as the appeal of sympathy for local producers struggling against imports produced by foreign firms, why are our import barriers not so very high?

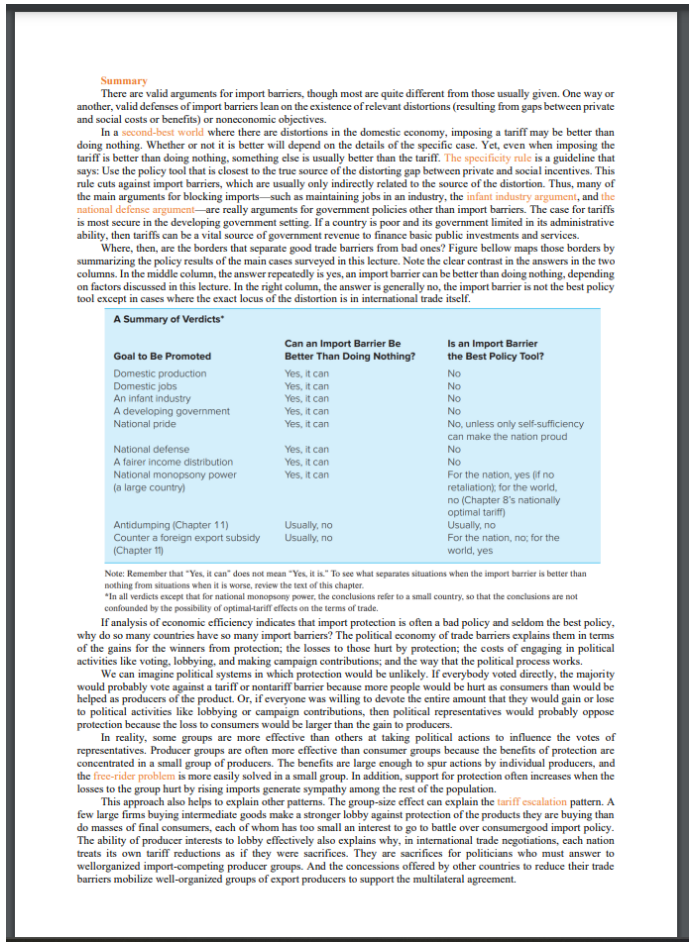
One reason is that there are organized producer groups that are opposed to protection. These include firms that use imported products in their own production, the wholesalers and retailers who distribute imports, and export producers who generally favor free trade. A second reason is that we have used mutual “concessions” during multilateral trade negotiations to lower trade barriers. There is probably also a third reason. Economic ideology probably does have some impact. Politicians who espouse the merits of free enterprise, markets, and competition probably do see that protection is inconsistent with these concepts. This does make them somewhat less likely to support protection.

Summary

Task 1. Please, read the review of the summary. Free-rider problem.

There are valid arguments for import barriers, though most are quite different from those usually given. One way or another, valid defenses of import barriers lean on the existence of relevant distortions (resulting from gaps between private and social costs or benefits) or noneconomic objectives.

Key Terms			
	Second-best world	Infant industry argument	National defense argument
	Externalities	Trade adjustment assistance	Free-rider problem
	Spillover effects	Developing government argument	Tariff escalation
	Specificity rule		Sudden-damage effect



Summary

There are valid arguments for import barriers, though most are quite different from those usually given. One way or another, valid defenses of import barriers lean on the existence of relevant distortions (resulting from gaps between private and social costs or benefits) or noneconomic objectives.

In a second-best world where there are distortions in the domestic economy, imposing a tariff may be better than doing nothing. Whether or not it is better will depend on the details of the specific case. Yet, even when imposing the tariff is better than doing nothing, something else is usually better than the tariff. The specificity rule is a guideline that says: Use the policy tool that is closest to the true source of the distorting gap between private and social incentives. This rule cuts against import barriers, which are usually only indirectly related to the source of the distortion. Thus, many of the main arguments for blocking imports—such as maintaining jobs in an industry, the infant industry argument, and the national defense argument—are really arguments for government policies other than import barriers. The case for tariffs is most secure in the developing government setting. If a country is poor and its government limited in its administrative ability, then tariffs can be a vital source of government revenue to finance basic public investments and services.

Where, then, are the borders that separate good trade barriers from bad ones? Figure bellow maps those borders by summarizing the policy results of the main cases surveyed in this lecture. Note the clear contrast in the answers in the two columns. In the middle column, the answer repeatedly is yes, an import barrier can be better than doing nothing, depending on factors discussed in this lecture. In the right column, the answer is generally no, the import barrier is not the best policy tool except in cases where the exact locus of the distortion is in international trade itself.

A Summary of Verdicts*

Goal to Be Promoted	Can an Import Barrier Be Better Than Doing Nothing?	Is an Import Barrier the Best Policy Tool?
Domestic production	Yes, it can	No
Domestic jobs	Yes, it can	No
An infant industry	Yes, it can	No
A developing government	Yes, it can	No
National pride	Yes, it can	No, unless only self-sufficiency can make the nation proud
National defense	Yes, it can	No
A fairer income distribution	Yes, it can	No
National monopsony power (a large country)	Yes, it can	For the nation, yes (if no retaliation); for the world, no (Chapter 8's nationally optimal tariff)
Antidumping (Chapter 11)	Usually, no	Usually, no
Counter a foreign export subsidy (Chapter 11)	Usually, no	For the nation, no; for the world, yes

Note: Remember that "Yes, it can" does not mean "Yes, it is." To see what separates situations when the import barrier is better than nothing from situations when it is worse, review the text of this chapter.
*In all verdicts except that for national monopsony power, the conclusions refer to a small country, so that the conclusions are not confounded by the possibility of optimal-tariff effects on the terms of trade.

If analysis of economic efficiency indicates that import protection is often a bad policy and seldom the best policy, why do so many countries have so many import barriers? The political economy of trade barriers explains them in terms of the gains for the winners from protection; the losses to those hurt by protection; the costs of engaging in political activities like voting, lobbying, and making campaign contributions; and the way that the political process works.

We can imagine political systems in which protection would be unlikely. If everybody voted directly, the majority would probably vote against a tariff or nontariff barrier because more people would be hurt as consumers than would be helped as producers of the product. Or, if everyone was willing to devote the entire amount that they would gain or lose to political activities like lobbying or campaign contributions, then political representatives would probably oppose protection because the loss to consumers would be larger than the gain to producers.

In reality, some groups are more effective than others at taking political actions to influence the votes of representatives. Producer groups are often more effective than consumer groups because the benefits of protection are concentrated in a small group of producers. The benefits are large enough to spur actions by individual producers, and the free-rider problem is more easily solved in a small group. In addition, support for protection often increases when the losses to the group hurt by rising imports generate sympathy among the rest of the population.

This approach also helps to explain other patterns. The group-size effect can explain the tariff escalation pattern. A few large firms buying intermediate goods make a stronger lobby against protection of the products they are buying than do masses of final consumers, each of whom has too small an interest to go to battle over consumergood import policy. The ability of producer interests to lobby effectively also explains why, in international trade negotiations, each nation treats its own tariff reductions as if they were sacrifices. They are sacrifices for politicians who must answer to wellorganized import-competing producer groups. And the concessions offered by other countries to reduce their trade barriers mobilize well-organized groups of export producers to support the multilateral agreement.

Case-Study 01

Task 2

Please, read the case study and answer to the questions. The file has been sent to you in our Chat.

Zuo Zhiye
It can lobby other companies in the same industry to increase the price of the final product at the same time
12:34

Zou Yujie 2007574016
The company could not change America's sugar policy, and it might raise the price of sugar to protect it.
maoyuqing
no. but the company can use the corn sweetener to reduce the cost of production
2007574042李弈乐LiYile
No, the company may actively seek policies that restrain sugar imports.
2007574023GongXirui
Companies that produce jelly beans have a greater demand for sugar, and there are many more companies in the supply chain that demand sugar, all of which drive the market for manufacturing sugar as an initial ingredient to be larger and lead to a policy discourse that still falls to the sugar producers.
2007574041Sun Zhuxuan
I suppose that the company can not change the policy, but it can use other things like corn sweeteners to supersede sugar and reduce the costs.
Zuo Zhiye
Maybe they can improve the recipe? Like choosing a sugar substitute? Have reached to reduce production costs
200718班成轩超ChengXuanchao
Substitutes can be found to reduce raw materials for production

Case Study How Sweet It Is (or Isn't)

Do you like to eat things that are sweet? If you do, and if you live in the United States or Japan, then you are a victim of your country's protectionist policies toward sugar. The domestic price of your sugar is about double the world price. For the United States, on average during 2015–2017, the domestic price of raw sugar was $0.27 per pound, while the world price was $0.16 per pound. For the United States, sugar protection costs consumers about $3.5 billion per year.

If you live in either of these countries, have you ever sent a letter to your legislative representative asking him or her to oppose sugar protection, a policy that is clearly against your interests? Have you contributed money or time to a group that lobbies the government to end sugar protection? Do you know anyone who has ever done so? Presumably not. Why not? While $3.5 billion per year sounds like a lot of money, it is only about $11 per person per year. As discussed in the text, the average gain for any one person to oppose this protection is small. It's not worth your effort.

The situation is different for sugar producers. For the United States, the increase in domestic producer surplus is about $1.5 billion per year. These gains are concentrated in a small number of firms. It is worth it for them to actively seek policies that restrain sugar imports. Two companies, American Crystal in North Dakota and Minnesota, and Flo-Sun in Florida, have been particularly active, contributing millions of dollars in recent years to Democratic and Republican congressional candidates and political parties. For Flo-Sun, owned by two brothers, Alfonso and Jose Fanjul, one estimate is that protectionist sugar policies add $65 million per year to their profits. A few million bucks to defend this profit stream is definitely a good investment.

Another group active in lobbying is the American Sugar Alliance, representing major U.S. sugar growers. In addition, the high domestic price for sugar expands demand for corn sweeteners, a close substitute for sugar. Corn farmers in the American Midwest like the sugar protection, and they have a major influence on the positions taken by their states' representatives and senators.

The Coalition for Sugar Reform, which includes food manufacturers that use sugar, consumer groups, taxpayer advocates, and environmental groups, is active in opposing sugar protection. It has some good arguments on its side. As Jeff Nedelman, a spokesperson for the coalition, said, "This is a corporate welfare program for the very rich."* The coalition points out that jobs are being lost as sugar-using firms shift production to other countries where sugar prices are cheaper. Furthermore, by polluting and disrupting water flows, the protected sugar production in Florida is also a cause of serious environmental decline in the Everglades. These are good points, but they are no match for the money and organization of the proponents of protection.

Foreign sugar producers, many of them poor farmers in developing countries, are also hurt by protectionist policies in importing countries. Researchers estimate that the world sugar price would rise by 17 percent if the United States removed its sugar policies. But it is not easy for foreign interests to have an effect on the U.S. political process. Foreigners don't vote, and political opponents can charge that legislators who openly side with foreigners against U.S. workers and companies are "anti-American."

So the sugar protection policies continue. For the United States, the net cost to the country is close to $2 billion per year. It is not that sugar is so large or important a part of the economy that we have to protect it. In the United States, about 15,000 people work growing sugar, and about 14,000 people work in sugar refining. If we shifted to free trade, employment would probably decline by less than 3,000. The small number of people who lose their jobs could be reemployed with little trouble in other sectors of the economy. Instead, we see the pure political economy of protection, with the producer interests in this case much better organized and effective than the consumers are.

DISCUSSION QUESTION

A U.S. company (like Jelly Belly) makes its gourmet jelly beans in the United States, and sugar is about half the cost of production. Can the company change U.S. sugar policy? If not, what are its other options?

*As quoted in "Sugar Rules Defy Free-Trade Logic," *New York Times*, May 6, 2001.

Questions and Problems

1. A single firm's innovations in production technology often benefit the production of other firms because these other firms learn about the new technology and can use some of the ideas in their own production.

a. Is there an externality here?

b. How would an economist rank the following two policies in this situation? Why? i. A tariff on imports, to make sure that domestic production using the new technology occurs.

ii. A subsidy to domestic production, to make sure that domestic production using the new technology occurs.

c. What third policy (a tax or a subsidy to something) would the economist recommend as even better than these two?

2. What is the specificity rule?

Questions and Problems

- Defenders of protection against imports claim that it is needed to protect domestic jobs. Although it sometimes sounds like any people who lose their jobs to increased imports are unemployed forever, we know that that is not true. Workers lose their jobs for many reasons, and nearly all of them then look for and find other jobs. It may take awhile and the new jobs may not pay as much (at first) as the previous jobs did, but they will be reemployed.

Focus on Labor How Much Does It Cost to Protect a Job?

Defenders of protection against imports claim that it is needed to protect domestic jobs. Although it sometimes sounds like any people who lose their jobs to increased imports are unemployed forever, we know that that is not true. Workers lose their jobs for many reasons, and nearly all of them then look for and find other jobs. It may take awhile and the new jobs may not pay as much (at first) as the previous jobs did, but they will be reemployed.

So the proponents of protection are really saying that restrictions on imports are needed to *maintain jobs in the import-competing industry that is receiving the protection*. We know that import barriers can maintain jobs in an import-competing industry by permitting domestic production at a level higher than it would be with free trade. But we also know from the discussion in the text that the specificity rule shows that an import barrier is not the best government policy to accomplish this objective.

Still, governments do use tariffs and nontariff barriers to prop up domestic production and maintain jobs in import-competing industries. How large are the costs of doing so? We can examine the costs in two ways. First, how much does it cost domestic consumers of the product per job maintained? That is, what is the consumer surplus loss per job maintained? Second, what is the net cost to the country per job maintained?

We can turn to researchers at the Institute of International Economics to provide some estimates. Hufbauer and Elliott (1994) examined 21 highly protected industries in the United States, and Messerlin (2001) examined 22 highly protected industries in the European Union, both for 1990. Their estimates assume that the tariffs and import quotas do not affect world prices, the small-country assumption that is standard for this chapter.* Here is what they found:

	Production Worker Jobs Maintained	Cost per Job Maintained ($ thousands)	
		To Domestic Consumers	To the Nation
United States (21 industries)	191,764	169	54
European Union (22 industries)	243,650	191	99

For the 21 industries in the United States, the jobs maintained by import protection represented about 10 percent of workers in these industries and less than 0.2 percent of the U.S. labor force. For the European Union, the maintained jobs were about 3 percent of workers in the 22 industries and less than 0.2 percent of the labor force.

These estimates show the high cost of maintaining industry jobs through high levels of import protection. For the United States, consumers paid an average of about $169,000 per job maintained, and in Europe about $191,000 per job. Per year, this was over six times the average annual compensation for a manufacturing worker in each country. It would have been much cheaper for domestic consumers to simply pay these workers not to work than it was to maintain their jobs using import protection. For some specific industries the consumer cost per job maintained in the industry is breathtaking:

- For the United States, $600,000 for a sugar job and $498,000 for a dairy products job.
- For the European Union, $512,000 for an autoworker job and $474,000 for a chemical fiber job.

The net national cost per job was also high in both countries: $54,000 in the United States and $99,000 in the European Union. The net national cost per job was higher than the compensation earned by the typical manufacturing worker. It is worth noting that the average net national costs per job were this high because some of the protection was through VERs and similar policies that permit foreign exporters to raise their prices. Even if we remove these price markups lost to foreign exporters, the net national cost per job was still rather large—an average $18,000 in the United States and $42,000 in the European Union.

If our goal is to maintain jobs in these industries, the specificity rule says we can do better. Just paying the workers to have jobs in which they do nothing would be less costly. Indeed, the cost per person of a high-quality worker adjustment program that offers training and assistance to these workers to find well-paying jobs in other industries would be much less than the net national cost of maintaining these jobs through high import barriers.

*If, instead, the importing country is a large country, then including the effects of a change in the world prices would have almost no effect on the estimates of the cost to consumers per job maintained. For each industry both the numerator and the denominator of the calculation used to obtain the estimate would change by about the same proportion. Ignoring the world price change could result in estimates of the net cost to the country per job maintained that are larger than the costs actually are. If the importing country is large enough to drive down a product's world price when it imposes a tariff or quota, then the gains from the improved terms of trade would be set against the standard efficiency losses.

Questions and Problems

- Can you describe plausible conditions under which a nation would benefit from subsidizing imports of a good?
- Australia has only one firm that makes aircraft. Without assistance from the government, that firm has lost most of its business to imports from the United States and Europe. Which of the following policies would be most costly for the Australian nation as a whole, and which would be least costly?

Policy A: Paying the lone Australian firm a production subsidy per plane, without protecting it against imports.

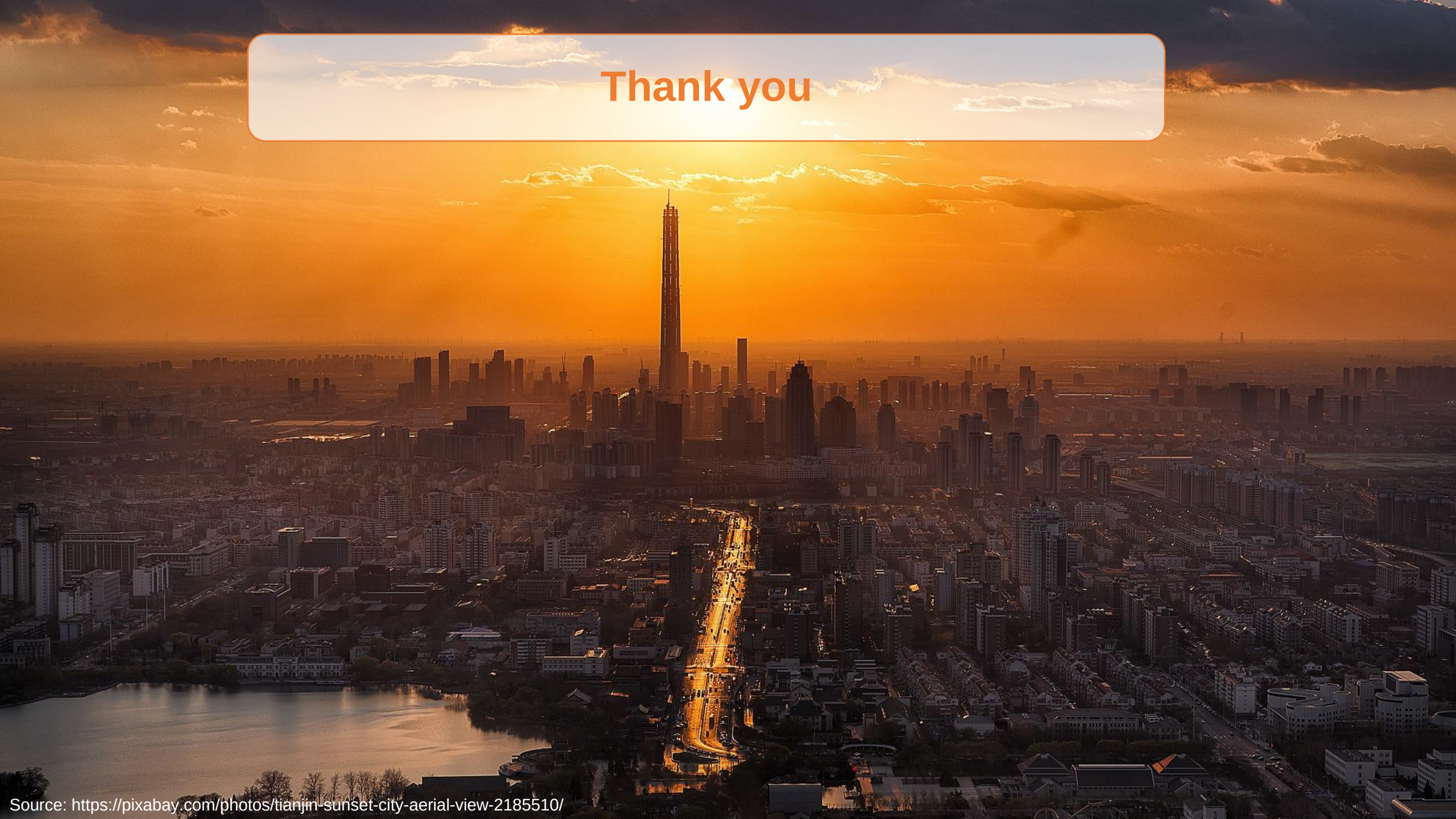
Policy B: Imposing a tariff equal to the production subsidy in policy A.

Policy C: Imposing an import quota that cuts imports just as much as policy B would.

Questions and Problems

- Do you favor or oppose the government policy of offering extra adjustment assistance to workers displaced by increasing imports? Why?
- What is the free-rider problem, and how does it affect trade policy?

Thank you



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