

## Chapter 9

### Non-tariff Trade Barriers and the New Protectionism

#### Session 2




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### Lecture overview

- Fallacious and Questionable Arguments for Protection
  - The infant – industry and other qualified arguments for protection
  - Strategic Trade and Industrial policies
  - The World Trade Organization
- (Hoàng Thị Chinh. 2005. Giáo trình Kinh tế quốc tế. NXB Thống kê. pp 162-191)




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### Introduction

The case for free trade:

*“If a country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage” (Adam Smith)*




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### Introduction (cont.)

- Many people are unconvinced about the benefits of trade.
  - They say it is unfair and therefore the government should introduce regulations to correct the unfairness
- => Protectionism

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### FALLACIOUS AND QUESTIONABLE ARGUMENTS FOR PROTECTION

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### Fallacious Arguments for Protection

- Protect domestic labor against cheap foreign labor
  - E.g: China exports garments to the US
  - Reasons for fallaciousness
    - Productivity: Higher domestic wages does not mean higher cost, but higher productivity.
    - Comparative advantage: Mutual beneficial trade could still be based on comparative advantage

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### Fallacious Arguments for Protection (cont.)



- Scientific tariff
  - This is the tariff rate that would make the price of imports equal to domestic prices.
  - However, this would
    - eliminate international price differences
    - Eliminate competition
    - Do not promote the domestic efficient producers

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### Questionable Arguments for Protection



- Reduce domestic unemployment
- Cure a deficit in a nation's BOP
- Reasons
  - Protection is a beggar-thy-neighbor policy.
  - As a result, other nations are likely to retaliate => trade war => political tension => all nations lose in the end.
  - Domestic unemployment and BOP deficit must be corrected/solved with appropriate monetary, fiscal and trade policies rather with trade restriction which causes loss to others.

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### The infant – industry and other qualified arguments for protection




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## The Infant-Industry arguments

- The Infant-Industry Arguments:
  - Nation may have a potential comparative advantage in a commodity but may lack of know-how and initial small level of output
  - That industry should be protected during infancy until it can develop, can meet foreign competition, and be viable and competitive internationally
  - The permanent gains to the industry will pay for the temporary losses caused by the protection.

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## Other Qualified Arguments

- Qualifications for Infant-Industry Arguments:
  - More justified for developing nations
  - Difficult to identify the infant industry
  - Production subsidy can do better
  - It is useless unless it makes the industry more efficient

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## Who gets protected?

- Government often act for special interest groups.
  - E.g: Impose a tariff (Who will benefit? Loss?) or Lower a tariff (Who will benefit? Loss?)
  - Often act for interests of producers. WHY?
- Producers:
  - Few => gain a great deal from protection
  - => Strong incentive to lobby the government to protect
- Consumers:
  - Many => loses diffused among many
  - => Little motivation to lobby government to remove trade barriers

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## The Strategic Policy and Industrial Policies




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### Concept

- Recent developments in trade theory that establish possible gains from protectionism of significant external economies
- A nation can create a comparative advantage in such fields by protecting temporarily.
  - crucial to future growth in the nations.
  - subjects to high risks
  - require large-scale production to achieve economics of scales
  - give rise to extensive external economies when successful.
- E.g: the steel industry in the 1950s, the semiconductors in the 1970s and 1980s in Japan; Airbus from the 1970s in Europe and semiconductors in the US in 1970s
- To some extent similar to infant industry arguments
  - Difference?
  - This is **advanced for industrial nations** to acquire a comparative advantage **in crucial high technology industries**.




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### Difficulties in carrying out the strategic and industrial policies

- Firstly, extremely difficult to choose/identify the appropriate industries to protect and nurture.
  - Secondly, since most leading nations undertake strategic trade policy at the same time => potential benefits to each may be small.
  - Thirdly, this comes at the expense of other countries => retaliate and trade war
- => Special interest groups can milk strategic trade policies for their benefit at the expense of national welfare.
- => *Free trade is still the best policy, after all. That is, free trade may be suboptimal in theory, but it is optimal in practice.*




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## Strategic trade policy and game theory



Game theory

		Airbus	
		Produce	Don't produce
Boeing	Produce	-5, -5	0, 100
	Don't produce	0, 100	0, 0

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## Strategic trade policy and game theory



- Two firms (Boeing and Airbus) compete in the international market but are located in two different countries (United States and Europe).
- Both firms are interested in manufacturing airplanes, but each firm's profits depends on the actions of the other.
- Each firm decides to produce or not depending on profit levels.

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## Strategic trade policy and game theory



- Cells indicate the payoffs to Boeing and Airbus, respectively.
  - Cell I : losses if both firms decide to produce.
  - Cell II: Boeing enters the market first, gaining a strategic advantage and enabling it to deter entry for the rival Airbus, and make monopoly profits.
  - Cell III: Airbus enters the market first, and deters the entry of Boeing, and makes monopoly profits.
- => the firm that enters the market first could be reversed by activist policy e.g. a subsidy.

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### Strategic trade policy and game theory

- The predicted outcome depends on which firms invests/produces first.
  - If Boeing produces first, then Airbus will not find it profitable to produce.
  - If Airbus produces first, then Boeing will not find it profitable to produce.
- But a subsidy of 25 by the European Union can alter the outcome by making it profitable for Airbus to produce *regardless of Boeing's action*.

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### Strategic trade policy and game theory (cont.)

Game theory with subsidy of 25 of the EU

		Airbus	
		Produce	Don't produce
Boeing	Produce	-5, 20	0, 100
	Don't produce	0, 125	0, 0

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### Strategic trade policy and game theory (cont.)

- If Boeing expects that the European Union will subsidize Airbus, Boeing will be deterred from entering the industry.
  - Thus, the subsidy of 25 will generate profits of 125 for Airbus.
  - The subsidy raises profits more than the amount of the subsidy itself because of its deterrent effect on foreign competition.
- A government policy to give a domestic firm a strategic advantage in production is called a **strategic trade policy**.

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## THE WTO




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## GATT

- GATT was established in 1947
- GATT's membership: over 120 nations
- GATT objectives: eliminate barriers to trade
- 8 rounds of negotiations




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## GATT (cont.)

Round	Dates	Tariff-cut %
1. Geneva	1947	21
2. Annecy	1949	2
3. Torquay	1951	3
4. Geneva	1956	4
5. Dillon	1960-61	2
6. Kennedy	1964-67	35
7. Tokyo	1973-79	33
8. Uruguay	1986-1993	34

MTN Rounds 1 to 6 addressed mainly tariff issues.  
MTN Rounds 7 to 8 addressed reduction of both tariff & NTBs




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## WTO

- The WTO: 1 January 1995



WTO Building

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## WTO (cont.)

- Members?
  - 153 countries
- Budget: 188 million Swiss Franc  
[http://www.wto.org/english/thewto\\_e/about\\_e/about\\_e.htm](http://www.wto.org/english/thewto_e/about_e/about_e.htm)
- Director - General?




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## WTO (cont.)

- What is the WTO
  - Not superman
  - It is an organization for liberalizing trade
  - It is a negotiation forum
  - It is a set of rules
  - It helps to settle disputes
  - Born in 1995, but not so young

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## WTO (cont.)



- The WTO negotiations addresses trade restrictions in at least 3 ways:
  - **Reduction of tariff rates** through multilateral negotiations.
  - **Prevention of non-tariff barriers:** quotas and export subsidies are changed to tariffs because the costs of tariff protection are more apparent.
    - Subsidies for agricultural exports are an exception.
    - Exceptions are also allowed for "market disruptions" caused by a surge in imports.

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## World Trade Organization (cont.)



Doha Round - deadlocked

Trade issues	Winners	Losers
Health	Aids patients in Africa	US drug companies
Agricultural subsidies	Australia	French farmers
US refuses to import more textiles (VERs)	US textile companies	Textile producers in China & S. Asia.
Anti- dumping laws	Foreign steelmakers	US steelmakers
Labor and Environmental standards	The world	Polluters(ACs& DCs)
Trading blocs		

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## Key words



- Fallacious arguments for protection
- Scientific tariff
- Infant-industry
- Infant – industry arguments
- Strategic trade policy
- Industrial policy
- Game theory
- GATT's negotiation Round
- Doha Round's deadlock

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END OF THE SESSION.  
THANK YOU



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