

Econ 340

Lecture 7 Reasons for Protection

Outline: Reasons for Protection

- Reasons that DO NOT Make Economic Sense
 - Pauper Labor
 - Fairness
 - Patriotism
 - Retaliation
- Reasons the DO Make Economic Sense, with Counter-Arguments
 - Revenue
 - Optimal Tariff
 - Infant Industry
 - National Security
 - Culture
 - Unfair Trade
 - Protect Favored Industry
 - Retaliation...
- Production Subsidy versus Tariff
- Why Aren't Tariffs Higher?

Lecture 7: Reasons

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Why Do Countries Use Protection?

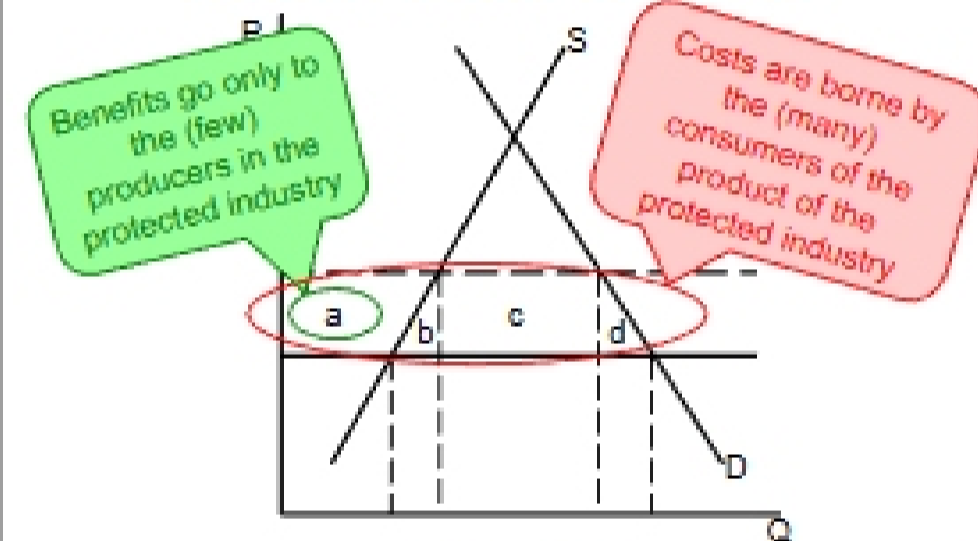
- Models say that tariffs, quotas, etc. mostly hurt the countries that use them
- But almost all countries do use them, and always have, even more than today. Why?
- Many reasons have been given (I list 24 in my Glossary); we'll go through some of them.
- Of these, what usually explains actual protection today is

Protect a Favored Industry
- Why?
 - Benefits of protection go to a few
 - Costs of protection, though larger, are spread over many

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Recall Effects of Tariffs



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Un-sensible Reasons for Protection

- "Un-sensible"?
 - Reasons that are based on misunderstanding of what protection will actually do

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Un-sensible Reasons for Protection

- Pauper Labor Argument
 - “We hold that the most efficient way of protecting American labor is to prevent the importation of foreign pauper labor to compete with it in the home market...” (Democratic Party Platform, July 9, 1896)
 - Based on belief that trade with poor countries will drive US wages down to the very low (“pauper”) levels of poor countries

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Un-sensible Reasons for Protection

- Pauper Labor Argument – Answer
 - See Ricardian Model: Labor in poor countries earns low wages because it is less productive than labor in rich countries. Trade will in fact raise wages in both
 - Caveat: Heckscher-Ohlin Model implies Factor Price Equalization (FPE)
 - At level above poor-country autarky wage But below the rich-country autarky wage Thus an element of truth to the pauper labor argument
 - But empirical evidence indicates technology differences account for much of the wage difference, preventing FPE
 - Thus rich-country wages may fall due to trade, but not nearly to poor-country levels

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Un-sensible Reasons for Protection

- Fairness Argument
 - It is “unfair” to make workers compete with those who are either more productive or lower paid.
 - Analogy is to players in a game, who want a “level playing field”
- Answer
 - Trade is not a “zero-sum game”: There are benefits for both countries
 - If “field is tilted” favoring another country’s exports (e.g., by a subsidy, low wages, or cheap currency), we actually benefit from that.
 - Also, even those who lose can be compensated by others in their countries, who gain

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Un-sensible Reasons for Protection

- A few years ago, I got an e-mail from something called Third Way, promoting harsher treatment of China in trade.
 - Their report: “China’s Trade Barrier Playbook: Why America Needs a New Game Plan”
 - And their graphic...

Lecture 6: US

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Un-sensible Reasons for Protection

- Patriotism Argument
 - “We should buy from producers inside our country, so that the benefit goes to them instead of to foreigners.”



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Un-sensible Reasons for Protection

- Patriotism Argument - Answer
 - This confuses costs and benefits: in fact, buyers benefit from consumption, while sellers incur the cost of production
 - If we import and don't export, then we enjoy the fruits of someone else's labor
 - If we both import and export, then comparative advantage says that we (and they) both benefit more

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Un-sensible Reasons for Protection

- Retaliation Argument
 - "If others use tariffs against our exports, then we should use tariffs against their exports."
 - This assumes that their tariffs hurt us (which they do), and that we gain by fighting back
- Answer
 - From the theory, foreign tariffs are irrelevant to the effects of our own tariffs
 - If using a tariff would hurt us when others do not protect, then it will also hurt us when they do
 - So retaliation does not help us

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Sensible Reasons for Protection

- "Sensible"?
 - Reasons based on effects that protection may actually have
 - These too have counter-arguments
 - Why they may not work
 - Why another policy would work better (that is, protection is "second best")

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Sensible Reasons for Protection

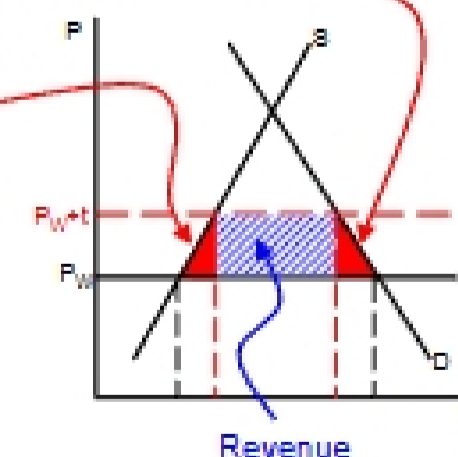
- Revenue Argument
 - Tariffs collect revenue for government
 - Tariffs may be the only tax that a weak government can manage
 - Tariffs are easier to collect than other taxes, because you only have to monitor the border (not the whole inside of the country)
- Counter-argument: Tariff is 2nd best
 - If other taxes are feasible, then almost any other tax causes less distortion than a tariff
 - Reason: A tariff distorts both supply and demand
 - Example: Tax consumption...

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Recall Effects of Tariffs: Small Country

- Because demanders and suppliers both are led by the tariff to behave as if the good's value were $P_w + t$,
- when in fact the country can buy or sell it for P_w



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