Imports of goods and services stir up worries everywhere. Some firms and workers in high-income countries like the United States, Japan, or the nations of the European Union fear that they will suffer if they must compete against firms in low-income countries of Latin America, Asia, or Africa that can pay lower wages. Conversely, some firms and workers in lower-wage countries like Mexico, India or Nigeria fear that they will suffer if they must compete against the very productive workers and advanced technology in high-income countries. Some environmentalists worry that multinational firms may evade environmental protection laws by moving their production to countries with loose or nonexistent pollution standards. Some politicians worry that their nation may become too dependent on certain key imported products, like oil. All of these fears tend to reach the same basic policy recommendation: Imports of foreign products should be reduced or even cut off. Government policies to reduce or block international trade are called protectionism, because they have the effect of protecting domestic producers from foreign competition.

There are three main tools of protectionism. Tariffs are taxes imposed on imported products, and by making imported products more expensive to consumers, they discourage imports. Import quotas are numerical limitations on the quantity of products that can be imported. Finally, nontariff barriers are all the other ways that a nation can draw up rules, regulations, inspections, and paperwork to make it more costly or difficult to import products. A rule that every imported product must be opened by hand and inspected with a magnifying glass, by one of just three government inspectors available at any given time, can limit imports just as effectively as high tariffs or low import quotas.

One barrier to trade that operated from the mid-1970s up to 2004 was a global system of quotas on textile imports called the Multi-Fibre Arrangement, which

**protectionism**: Government policies to reduce or block imports.

**tariffs**: Taxes imposed on imported products.

**import quotas**: Numerical limitations on the quantity of products that can be imported.

**nontariff barriers**: All the other ways a nation can draw up rules, regulations, inspections, and paperwork to make it more costly or difficult to import products.
dictated exactly the quantity of textile imports that each high-income country would accept from each low-income country. A federal agency, the U.S. International Trade Commission (ITC), estimated in the late 1990s that if the United States removed these import quotas and allow unrestricted imports of textiles, the U.S. textile industry would end up reducing production so that 130,000 jobs in that industry would disappear. However, the U.S. textile industry jobs that are saved by import quotas come at a cost. Because the textile import quotas prevent consumers from purchasing less expensive imports, consumers end up paying more for clothing—about $10.4 billion more per year, according to the ITC. The ITC also estimated that if the United States eliminated its textile import quotas, then consumers would save money on clothing and spend it elsewhere in the economy, leading to the creation of about 130,000 jobs elsewhere in the U.S. economy. Moreover, many parts of the U.S. textile industry would probably remain strong even if textile imports expanded. For example, it often makes economic sense to use high-powered mechanical looms to weave cloth near where the cotton is grown. New technologies, some using lasers, that make personal body measurements and then connect to machines that will produce custom-fitted clothing are not too many years away.

Those workers in the poorest countries of the world who would otherwise have jobs producing textiles, but find their opportunities blocked by import quotas, might gain considerably if the United States and other high-income nations reduced their barrier to trade. As part of international trade negotiations in the 1990s, the United States and other industrialized countries agreed to phase out the Multi-Fibre Arrangement at the end of 2004. But when the multinational limits on textile trade ended, the United States and the European Union soon imposed their own limits on textile imports from China and other sources. Workers and firms in many low-income nations around the world are watching, skeptically but hopefully, to see if whether the promises to eliminate trade barriers against their textile products will eventually be kept.

This chapter begins with an economic analysis of who benefits from protectionism and who pays the costs of protectionism, using demand and supply analysis. The chapter then considers a list of concerns raised about global trade and in particular about imports. For example, how do imports affect the number of jobs, the level of wages, and work conditions? How might imports affect promising but immature domestic industries? What about the trade and environmental issues? The primary international agreement through which nations negotiate over their trade rules—including rules about tariffs, quotas, and nontariff barriers—is the World Trade Organization. The membership of the WTO includes about 150 nations, which includes most of the major (and minor) economies of the world. The chapter closes with a discussion of the history and direction of the WTO, as well as various regional trade treaties.

**Protectionism: An Indirect Subsidy from Consumers to Producers**

To the noneconomist, restricting imports may appear to be nothing more than taking sales from foreign producers and allowing domestic producers to achieve greater sales. But this analysis is incomplete, because firms do not operate in a vacuum. Instead, firms sell their products either to consumers or to other firms (if they are business suppliers). A demand and supply analysis of protectionism shows that protectionism is just not a matter of domestic gains and foreign losses, but a policy that imposes substantial domestic costs as well.
Demand and Supply Analysis of Protectionism

Consider international trade in sugar between two countries called Tartar and Plaque, illustrated in Exhibit 6-1. In the original supply and demand equilibrium without trade, the equilibrium price of sugar in Tartar is 12 cents per pound, with an equilibrium output of 30 tons. In Plaque, the equilibrium price of sugar in a world without trade is 24 cents per pound, with an equilibrium quantity of 80 tons. These equilibrium points are labeled with the point E.

If international trade between Tartar and Plaque now becomes possible, profit-seeking firms will spot an opportunity: buy sugar cheaply in Tartar, and sell it at a higher price in Plaque. As sugar is shipped from Tartar to Plaque, the quantity of sugar produced in Tartar will be greater than the quantity consumed in that country (with the extra production being exported) and the amount produced in Plaque is less than the amount consumed in that country (with the extra consumption being imported). The quantity of trade will be determined when price of sugar is the same in two countries—and thus there is no incentive to trade further. As shown in Exhibit 6-1, the equilibrium with trade occurs at a price of 16 cents per pound. At that price, the sugar farmers of Tartar supply a quantity of 40 tons, while the consumers of Tartar buy only

Exhibit 6-1  The Sugar Trade between Tartar and Plaque

Before trade, sugar sells in Tartar for 12 cents a pound and in Plaque for 24 cents per pound. When trade is allowed, businesses will buy sugar cheaply in Tartar and sell it in Plaque. The result with free trade will be that Tartar exports 15 pounds of sugar, Plaque imports 15 pounds of sugar, and the price is the same in the two countries at 20 cents per pound. If trade is only partly open between the countries, it will lead to an outcome between the free-trade and no-trade possibilities.
Chapter 6  Globalization and Protectionism

Low-Income Countries and Agricultural Trade

Here is a stark comparison about priorities, which has been widely publicized by the international aid organization Oxfam.

High-income countries of the world—meaning primarily the United States, Canada, countries of the European Union, and Japan—subsidize their domestic farmers by about $1 billion per day, including the value both of direct subsidies to farmers and indirect subsidies that come in the form of limiting imports of farm products. However, the total amount of foreign aid from these same high-income countries to the poor countries of the world is about $70 billion per year.

The support of farmers in high income countries is devastating to the chances of farmers in low-income countries. Even when their climate and land are well-suited to products like cotton, rice, sugar or milk, the high income countries block their exports. In some cases, the situation gets even worse when the governments of high-income countries, having bought and paid for an excess supply of farm products, gives away those products to poor countries and drives local farmers out of business altogether. Shipments of excess milk from the European Union to Jamaica have caused great hardship for Jamaican dairy farmers. Shipments of excess rice from the United States to Haiti drove thousands of low-income rice farmers in Haiti out of business. The opportunity costs of protectionism aren’t paid just by domestic consumers, but also by foreign producers—and for many agricultural products, those foreign producers are the world’s poor.

25 tons. The extra 15 tons of sugar production, shown by the horizontal gap between the demand curve and the supply curve in Tartar, is exported to Plaque. In Plaque, at a price of 16 cents, the farmers produce a quantity of 72 tons and consumers demand a quantity of 87 tons. The excess demand of 15 tons by the consumers of Plaque, shown by the horizontal gap between demand and domestic supply at the price of 16 cents, is supplied by imported sugar.

The sugar farmers of Plaque are likely to argue that, if only they could be protected from sugar imported from Tartar, the country of Plaque would have higher domestic sugar production, more jobs in the sugar production industry, and Plaque’s sugar farmers would receive a higher price. If the country of Plaque sets a high tariff on imported sugar, or sets an import quota at zero, then the result will be that the quantity of sugar traded between countries level could be reduced to zero, and the prices in each country will return to their levels before trade was allowed.

Blocking only some trade is also possible. For example, say that Plaque passed a sugar import quota of 7 tons; that is, Plaque will import no more than 7 tons of sugar, which means that Tartar can export no more than 7 tons of sugar. As a result, the price of sugar in Plaque will be 20 cents, which is the price where the quantity demanded is 7 tons greater than the domestic quantity supplied. Conversely, if Tartar can only export 7 tons of sugar, then the price of sugar in Tartar will be 14 cents per pound, which is the price where the domestic quantity supplied in Tartar is 7 tons greater than domestic demand. In general, when a country sets a low or medium tariff or import quota, then the equilibrium price and quantity will end up in between the cases of no trade at all and completely free trade.

Who Benefits and Who Pays?

Using the demand and supply model, consider the impact of protectionism on producers and consumers in each of the two countries. For producers of the protected good, the sugar farmers of Plaque, restricting imports is clearly positive. Without a need to face imported products, these producers are able to sell more, at a higher price. For consumers in the country with the protected good, the sugar consumers of Plaque, restricting imports is clearly negative. They end up buying a lower quantity of the good and paying a higher price for what they do buy, compared to the equilibrium quantity and price without trade.
The fact that protectionism pushes up prices for consumers in the country enacting such protectionism is not always acknowledged openly, but it’s not controversial. After all, if protectionism didn’t benefit domestic producers, there wouldn’t be much point in enacting such policies in the first place. Protectionism is simply a method of requiring consumers to subsidize producers. The subsidy is indirect, since it is paid by consumers through higher prices, rather than a direct subsidy paid by the government with money collected from taxpayers. But protectionism works like a subsidy, nonetheless. The American humorist Ambrose Bierce defined “tariff” this way in his satirical 1911 book, The Devil’s Dictionary: “Tariff, n. A scale of taxes on imports, designed to protect the domestic producer against the greed of his consumer.”

It’s also worth remembering that the “consumers” of a good are not always households—sometimes firms sell to other firms. A situation like this arose in March 2002, when President George Bush announced a set of tariffs on imported steel, which would range from 8%–30% of the cost of the steel (depending on the precise kind of steel). Few households purchase a chunk of steel directly. However, U.S. companies that buy steel and turn it into components for lawn mowers, school furniture, cars, boats, certain kinds of cans, and many other products, were deeply concerned that if they had to pay a higher price for the steel they need, they will lose sales to imported products from other countries that contain steel. Since for every worker who actually produces steel there are about 40 workers in industries that use steel, protecting jobs in steel from foreign imports may put even more jobs at risk in other industries. In December 2003, Bush ended the quotas on imported steel.

The impact of protectionism on producers and consumers in the foreign country is complex. When import quota is used to impose partial protectionism, the sugar producers of Tartar receive a lower price for the sugar they sell in Tartar—but a higher price for the sugar they are allowed to export to Plaque. Indeed, notice that some of the price of protectionism, paid by domestic consumers, ends up in the hands of foreign producers in this case. Foreign consumers of sugar in Tartar would seem to benefit from protectionism in Plaque, because it reduced the price of sugar that they pay. On the other hand, at least some of these consumers of sugar in Tartar also work as sugar farmers, so their incomes and jobs are reduced by protectionism. Moreover, if trade between the countries is shut down, consumers of Tartar would miss out on better prices for the goods that Tartar is importing—which do not appear in our single-market example of sugar protectionism.
But the central focus here is not on how protectionism affects other countries, but how it affects one’s own country. Protectionism is a policy where the domestic consumers of a product (consumers may include either households or other firms) are required to pay higher prices to benefit domestic producers of that product. In addition, when a country enacts protectionism, it loses the economic gains it would have been able to achieve through a combination of comparative advantage, learning, and economies of scale that were discussed Chapter 3. With these overall costs and benefits in mind, let us now consider, one by one, a number of arguments that have been made for restricting imports.

International Trade and Its Effects on Jobs, Wages, and Working Conditions

In theory, at least, imports might injure workers in several different ways: fewer jobs, lower wages, or poor working conditions. Let’s consider these in turn.

Fewer Jobs?

In the early 1990s, the United States was negotiating the North American Free Trade Agreement with Mexico, an agreement that would reduce tariffs, import quotas, and nontariff barriers to trade between the United States, Mexico, and Canada. H. Ross Perot ran for U.S. President in 1992 as a third-party candidate, and one of his prominent campaign arguments was to claim that if the United States expanded trade with Mexico, there would be a “giant sucking sound” as U.S. employers relocated to Mexico so that they could pay lower wages. After all, average wages in Mexico were at that time about one-eighth the U.S. level. Well, NAFTA passed Congress, President Bill Clinton signed it into law, and it took effect in 1995. For the next six years, the U.S. economy had some of the most rapid job growth and low unemployment in the history of the country. Those who feared that open trade with Mexico would lead to a dramatic decrease in jobs were proven 100% wrong.

This result was no surprise to economists. After all, the trend toward globalization has been going on for decades, not just since NAFTA took effect in 1995. U.S. imports were equal to 5.4% of the U.S. economy in 1970, but to 16.2% in 2005. If trade did reduce the number of available jobs, then the United States should have been seeing a steady loss of jobs from the 1970s through the 1990s. Instead, the number of U.S. jobs rose from 78 million in 1970 to 142 million in 2005 and the share of U.S. adults with jobs rose from 57% in 1970 to 66% in 2005.

Protectionism certainly saves jobs in the specific industry being protected, but for two reasons, it costs jobs in other unprotected industries. First, if consumers are paying higher prices to the protected industry, they inevitably have less money to spend on goods from other industries, and so jobs are lost in those other industries. Second, if the protected product is sold to other firms, like sugar or steel, so that other firms must now pay a higher price for a key input, then those firms will have a hard time competing against foreign producers who don’t need to pay the higher price. The hidden opportunity cost of using protectionism to save jobs in one industry sacrifices the jobs that are not created in other industries. This is why the U.S. International Trade Commission, in its study of textile import quotas mentioned at the start of this chapter, predicted that reducing trade barriers to textile imports would reduce textile jobs by 130,000, but would
also create 130,000 other jobs in the U.S. economy. Protectionism reschedules jobs, but it doesn’t create more jobs.

Moreover, the costs of saving jobs through protectionism can be very high. Exhibit 6-2 shows some estimates of the consumer costs in higher prices of “saving jobs” through protectionism. Saving a job through protectionism typically costs much more than the actual worker’s salary. For example, a study done in 2001 found that using protectionism to save an average job in the steel-producing industry, jobs that paid on average $72,000 per year (including both salary and benefits like health insurance), would cost $360,000 per job saved.

Why does it cost so much to save jobs through protectionism? The basic reason is that not all of the extra money paid by consumers because of protectionism goes to save the jobs of workers. For example, if tariffs are imposed on steel imports so that buyers of steel pay a higher price, U.S. steel companies earn greater profits, buy more equipment, pay bigger bonuses to managers, give pay raises to existing employees—and also avoid firing some additional workers. Only part of the higher price of protected steel goes toward saving jobs. Also, when an industry is protected, the economy as a whole loses the benefits of playing to its comparative advantage. Thus, part of the higher price that consumers pay for protected goods is wasted by this lost economic efficiency.

There’s a bumper sticker that speaks to the threat some U.S. workers feel over imported products: “Buy American—Save U.S. Jobs.” A more accurate, if less catchy, bumper sticker might say: “Block Imports—Save Jobs for Some Americans, Lose a Roughly Equal Number of Jobs for Other Americans, and Also Pay High Prices.”

### Trade and Wages

Even if trade does not reduce the number of jobs, it could affect the wages of workers. Here, it is important to separate issues about the average level of wages from issues about whether the wages of certain workers may be helped or hurt by trade.

Because trade raises the amount that an economy can produce by letting firms and workers play to their comparative advantage, trade will also cause the average level of wages in an economy to increase. Workers who can produce more will be more desirable to employers, which will shift the demand for their labor out to the right, and increase wages in the labor market.

However, even if trade increases the overall wage level, it will still benefit some workers and hurt others. Workers in industries that are confronted by competition from imported products may find that demand for their labor decreases and shifts back to the

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**Exhibit 6-2  Cost to U.S. Consumers of Saving a Job through Protectionism**

A number of different studies have attempted to estimate the cost to consumers in higher prices per job saved through protectionism. Here is a sample of results from various studies in the 1980s and 1990s.

<table>
<thead>
<tr>
<th>Industry</th>
<th>Annual Cost to Consumers per Job Saved</th>
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</thead>
<tbody>
<tr>
<td>Quotas on textiles imports</td>
<td>$551,000 per job saved</td>
</tr>
<tr>
<td>Quotas on imported cars</td>
<td>$772,000 per job saved</td>
</tr>
<tr>
<td>Tariffs on frozen concentrated orange juice</td>
<td>$461,000 per job saved</td>
</tr>
<tr>
<td>Tariffs on imported sugar</td>
<td>$600,000 per job saved</td>
</tr>
<tr>
<td>Limits on imported machine tools</td>
<td>$348,000 per job saved</td>
</tr>
<tr>
<td>Tariffs on softwood lumber</td>
<td>$758,000 per job saved</td>
</tr>
<tr>
<td>Tariffs on luggage</td>
<td>$933,000 per job saved</td>
</tr>
<tr>
<td>Tariffs on steel</td>
<td>$360,000 per job saved</td>
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</tbody>
</table>
left, so that their wages decline with a rise in international trade. Conversely, workers in industries that benefit from selling in global markets may find that demand for their labor shifts out to the right, so that trade raises their wages.

One concern is that while globalization may be benefitting high-skilled, high-wage workers, but imposing costs on low-skilled, low-wage workers. After all, high-skilled U.S. workers presumably benefit from increased sales of sophisticated high products like computers, machinery, and pharmaceuticals on world markets. Meanwhile, low-skilled U.S. workers must now compete against extremely low-wage workers worldwide for making simpler products like toys and clothing. Chapter 16 will discuss the inequality of wages in the U.S. economy in detail. But there are a number of reasons to believe that while globalization has helped some U.S. industries and hurt others, it has not focused its negative impacts on the wages of low-skilled Americans.

First, it seems unlikely that intra-industry trade, where the U.S. trades similar goods like machinery, computers and cars with other high-wage economies like Canada, Japan, Germany, and the United Kingdom, has a heavier impact on the wages of low-skill, low-wage Americans. After all, most U.S. workers in these industries have above-average skills and wages—and many of them are doing quite well in the world of globalization. Remember, intra-industry trade makes up more than half of U.S. trade.

Second, many low-skilled U.S. workers hold service jobs that cannot be replaced by imports from low-wage countries. For example, lawn care services or moving and hauling services or hotel maids cannot be imported from countries of long distances like China or Bangladesh. Competition from imported products is not the primary determinant of their wages.

Finally, while the focus of the discussion here is on wages, it’s worth pointing out that low-wage U.S. workers suffer from protectionism in all the industries that they don’t work in, because protectionism forces them to pay higher prices for basic necessities like clothing and food.

The benefits and costs of increased trade in terms of its effect on wages are not distributed evenly across the economy. However, the growth of international trade has helped to raise the productivity of U.S. workers as a whole—and thus helped to raise the average level of wages.

**Labor Standards**

Workers in many low-income countries around the world labor under conditions that would be illegal for a worker in the United States. Workers in countries like China, Thailand, Brazil, South Africa and Poland are often paid less than the U.S. minimum wage. For example, in the United States the minimum wage is $5.15 per hour; a typical wage in many low-income countries might be more like $5 per day, or even less. Moreover, working conditions in low-income countries may be highly unpleasant, or even unsafe. In the worst cases, production may involve the labor of small children or even workers who are treated as slaves. These concerns over standards of foreign labor don’t affect the majority of U.S. trade, which is intra-industry and carried out with other high-income countries that have labor standards similar to the United States, but it is nonetheless morally and economically important.

In thinking about labor standards in other countries, it’s important to draw some distinctions between what is truly unacceptable and what is merely painful to think about. Most people, economists included, have little difficulty with the idea that production by six-year-olds confined in factories or by slave labor is morally unacceptable, and
they would support aggressive efforts to eliminate such practices—including shutting out imported products made with such labor. But many cases are less clear-cut. An article in the New York Times described the case of Ahmed Zia, a 14-year-old boy from Pakistan. He earns $2 per day working in a carpet factory. He dropped out of school in second grade. Should the United States and other countries refuse to purchase rugs made by Ahmed and his co-workers? If the carpet factories were to close, the likely alternative job for Ahmed is farm work, and as Ahmed says of his carpet-weaving job: “This makes much more money and is more comfortable.” Other workers may have even less attractive alternative jobs, perhaps scavenging garbage or prostitution. The real problem for Ahmed and many others in low-income isn’t that globalization has made their lives worse, but rather that they have so few good life alternatives.

Similar issues apply to adult workers in low-income counties that produce goods for export to the United States and other high-income economies like the European Union and Japan. Many of these workers receive wages that would be illegally low in the United States and other high-income countries. They are unprotected by U.S. rules...

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<tr>
<th>Country</th>
<th>Number of ILO Conventions Ratified, 2006</th>
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<tr>
<td><strong>High-Income Economies</strong></td>
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<tr>
<td>United States</td>
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<tr>
<td>Canada</td>
<td>30</td>
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<tr>
<td>France</td>
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<td>Japan</td>
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<td>Germany</td>
<td>82</td>
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<td>United Kingdom</td>
<td>86</td>
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<tr>
<td><strong>Middle-Income Economies</strong></td>
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<tr>
<td>Brazil</td>
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<td>Mexico</td>
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<td>Iraq</td>
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<td>South Korea</td>
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<td>Indonesia</td>
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<td>Poland</td>
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<td>Russian Federation</td>
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</tr>
<tr>
<td><strong>Low-Income Economies</strong></td>
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<td>China</td>
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<tr>
<td>India</td>
<td>40</td>
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<tr>
<td>Ghana</td>
<td>47</td>
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<tr>
<td>Nigeria</td>
<td>38</td>
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</table>
that seek to assure holidays, safe workplaces, and prohibitions against discrimination and sexual harassment. Nonetheless, the jobs they have making carpets or toys or shoes pay much better than their alternative jobs. Low wages and poor working conditions are not a clever ploy by people in low-income countries to sell more in world markets. For them, jobs with wages and working conditions that Americans wouldn’t touch with a 10-foot pole can still look like a great step forward.

There is some irony when the U.S. government or U.S. citizens take issue with labor standards in low-income countries, because the United States is not a world leader in government laws to protect employees. In western European countries and Canada, all citizens are guaranteed health insurance by the government; the United States offers no such guarantee. Many European workers receive six weeks or more of vacation per year; in the United States, vacations are often two or three weeks per year. If European countries accused the United States of using unfair labor standards to make U.S. products cheaply, and announced that they would shut out all U.S. imports until the United States adopted national health insurance, added more national holidays, and doubled vacation time, Americans would be outraged. Yet when U.S. protectionists start talking about restricting imports from poor countries because of low wage levels and poor working conditions, they are making a very similar argument.

The Infant Industry Argument

Imagine a country that wants to start its own computer industry, but at present, the country has no computer firms that can produce at a low enough price and high enough quality to compete in world markets. However, the politicians, business leaders, and workers of this country hope that if the local industry only had a chance to get established, before it needed to face international competition, then a domestic company or group of companies could develop the skills, management, technology, and economies of scale that it needs to become a successful profit-earning domestic industry. Thus, the *infant industry* argument for protectionism is to block imports for a short time, to allow the infant industry time to mature, before eventually it starts competing on equal terms in the global economy.

The infant industry argument is theoretically possible, even sensible: give an industry a short-term indirect subsidy through protection, and then reap the long-term economic benefits of having a vibrant healthy industry. But the practical implementation is tricky. In many countries, infant industries have gone from babyhood to senility and obsolescence without ever maturing. Meanwhile, the infant industry protectionism that was supposed to be short-term often took a very long time to be repealed. As one example, Brazil treated its computer industry as an infant industry from the late 1970s until about 1990. Thus, in an attempt to establish its computer industry global economy, Brazil largely barred imports of computer products for the several decades. This policy guaranteed increased sales for the Brazilian computer industry. But by the mid-1980s, Brazil had a backward and out-of-date computer industry, typically lagging the world standards for price and performance by 3–5 years—a long time in this fast-moving industry. After more than a decade, during which Brazilian consumers and industries that would have benefited from up-to-date computers paid the costs and Brazil’s computer industry never competed effectively on world markets, Brazil phased out its infant industry policy for computers.
Protectionism for infant industries always imposes costs on domestic users of the product, and typically has provided little benefit in the form of stronger competitive industries.

However, several countries in East Asia offer an exception where infant industry protection has been used with some success. Japan, Korea, Thailand and other countries in this region have sometimes provided a package of indirect and direct subsidies targeted at certain industries, including protection from foreign competition and government loans at interest rates below the market equilibrium. In Japan and Korea, for example, subsidies helped get their domestic steel and auto industries up and running.

Why did the infant industry policy of protectionism and other subsidies work fairly well in East Asia? A study by the World Bank in the early 1990s offered some guidelines to countries thinking about infant industry protection: (1) Don’t hand out protectionism and other subsidies to all industries, but focus on a few industries where your country has a realistic chance to be a world-class producer. (2) Be very hesitant about using protectionism in areas like computers, where many other industries rely on having the best products available, because it’s not useful to help one industry by imposing high costs on many other industries. (3) Have clear guidelines for when the infant industry policy will end. In Korea in the 1970s and 1980s, a common practice was to link protectionism and subsidies to export sales in global markets. If export sales rose, then the infant industry had succeeded and the protectionism could be phased out. If export sales didn’t rise, then the infant industry policy had failed and the protectionism could be phased out. Either way, the infant industry protectionism would be temporary.

Following these rules is easier said than done. Politics often intrudes, both in choosing which industries will receive the benefits of being treated as “infants” and in choosing when to phase out import restrictions and other subsidies.

Also, if the government of a country wishes to impose costs on its citizens so that it can provide subsidies to a few key industries, it has many tools for doing so: direct government payments, loans, targeted tax reductions, government support of research and development to develop new technologies, and so on. The point here is not necessarily to advocate such subsidies, but merely to point out that when industrial subsidies are desired, it is not necessary to provide them through protectionism.

The Dumping Argument

**Dumping** means selling goods below their cost of production. **Anti-dumping laws** seek to block imports that are sold below the cost of production and to impose tariffs that would increase the price of these imports to reflect their cost of production.

**The Growth of Anti-Dumping Cases**

Since dumping is not allowed under the rules of the World Trade Organization, nations that believe they are on the receiving end of dumped goods can file a complaint with the WTO. Anti-dumping complaints have risen in recent years, from about 100 cases per year in the late 1980s to 250 new cases each year in the early 2000s. Individual countries also frequently started their own anti-dumping investigations. In the early 2000s, the U.S. government was initiating about 60 anti-dumping cases per year. The U.S. government has dozens of anti-dumping orders in place from past investigations. In 2002, for example, some imports that were under anti-dumping orders included aspirin...
and pasta from Turkey, canned pineapple from Thailand, roofing nails from Taiwan, rubber thread from Malaysia, preserved mushrooms from Indonesia and India, and folded gift boxes from China.

**Why Might Dumping Occur?**

Why would foreign firms export a product at less than its cost of production—which presumably means making a loss? This question has two possible answers, one innocent and one more sinister.

The innocent explanation is that market prices are set by demand and supply, not by the cost of production. Perhaps demand for a product shifts back to the left or supply shifts out to the right, which drives the market price to low levels—even below the cost of production. When a local store has a going-out-of-business sale, for example, it may sell goods at below the cost of production. If international companies find that there is excess supply of steel or computer chips or machine tools that is driving the market price down below their cost of production—well, this may be the market in action.

The sinister explanation is that dumping is part of a long-term strategy in which foreign firms would sell at below the cost of production in the short-term for a time, and when they have driven out the domestic U.S. competition, they would then raise prices. This scenario is sometimes called “predatory pricing.”

**Should Anti-Dumping Cases Be Limited?**

Anti-dumping cases pose two questions. How much sense do they make in economic theory? How much sense do they make as practical policy?

In terms of economic theory, the case for anti-dumping laws is weak. In a market governed by demand and supply, the government doesn’t guarantee that firms will be able to make a profit. After all, low prices are difficult for producers, but benefit consumers. Moreover, although there are plenty of cases in which foreign producers have driven out domestic firms, there are zero documented cases in which the foreign producers then jacked up prices. Instead, the foreign producers typically continue competing hard against each other and providing low prices to consumers.

But even if one could make a case that the government should sometimes enact antidumping rules in the short term, and then allow free trade to resume shortly thereafter, there is a growing concern that anti-dumping investigations often involve more politics than careful analysis. Calculating the appropriate “cost of production” under law can be as much an art as a science; for example, if a company built a new factory two years ago, should part of the cost of factory be counted in this year’s cost of production? When a domestic industry complains loudly enough, government regulators seem very likely to find that unfair dumping has occurred. Indeed, a common pattern has arisen where a domestic industry files an anti-dumping complaint, the governments meet and negotiate a reduction in imports, and then the domestic producers drop the anti-dumping suit. In such cases, anti-dumping cases often appear to be little more than a cover story for imposing tariffs or import quotas.

In the 1980s, almost all of the anti-dumping cases were initiated by the United States, Canada, the European Union, Australia and New Zealand. But by the early 2000s, countries like Argentina, Brazil, South Korea, South Africa Mexico, and especially India have been filing the majority of the anti-dumping cases before the WTO. As the number of anti-dumping cases has increased, and as countries like the United States and the European Union feel targeted by anti-dumping actions of others, the WTO may well propose some additional guidelines to limit the reach of anti-dumping laws.
The Environmental Protection Argument

The potential impact of global trade on the environment has become controversial. A president of the Sierra Club, an environmental lobbying organization, once wrote: “The consequences of globalization for the environment are not good. . . . Globalization, if we are lucky, will raise average incomes enough to pay for cleaning up some of the mess that we have made. But before we get there, globalization could also destroy enough of the planet’s basic biological and physical systems that prospects for life itself will be radically compromised.” If free trade means the destruction of life itself, then even economists would convert to protectionism! But while globalization—and economic activity of all kinds—can pose environmental dangers, it seems quite possible that with the appropriate safeguards in place, the environmental impacts of trade can be minimal. In some cases, trade may even bring environmental benefits.

In general, high-income countries like the United States, Canada, Japan, and the nations of the European Union have relatively strict environmental standards. In contrast, middle- and low-income countries of the world like Brazil, Nigeria, India, and China have lower environmental standards. The general view of the governments of such countries is that as soon as their people have enough to eat, decent health care, and longer life expectancies, then they will spend more money on sewage treatment plants, scrubbers to reduce air pollution from factory smokestacks, national parks to protect wildlife, and so on. This gap in environmental standards between high-income and low-income countries raises two worrisome possibilities in a world of increasing global trade: the race to the bottom scenario and the question of how quickly environmental standards will improve in low-income countries. Let us consider these two issues in turn.

The Race to the Bottom Scenario

The race to the bottom scenario of global environmental degradation runs like this. Profit-seeking multinational companies shift their production from countries with strong environmental standards to countries with weak standards, thus reducing their costs and increasing their profits. Faced with such behavior, countries reduce their environmental standards to attract multinational firms, which after all provide jobs and economic clout. As a result, global production becomes concentrated in countries where it can pollute the most and environmental laws everywhere race to the bottom.

Although the race-to-the-bottom scenario sounds plausible, it does not appear to describe reality. In fact, the financial incentive for firms to shift production to poor countries to take advantage of their weaker environmental rules does not seem especially powerful. When firms decide where to locate a new factory, they look at many different factors: the costs of labor and financial capital; whether they are close to a reliable suppliers of the inputs that they need; whether they are close to customers; the quality of transportation, communications and electrical power networks; the level of taxes; and the competence and honesty of the local government. The cost of environmental regulations is a factor, too, but typically environmental costs are no more than 1–2% of the costs faced by a large industrial plant. The other factors that determine choice of location are much more important than trying to skimp on environmental protection costs.

When an international company does ultimately choose to build a plant in a low-income country with lax environmental laws, it typically builds a plant similar to those they operate in high-income countries with stricter environmental standards. Part of the reason for this decision is that designing an industrial plant is a complex and costly task, and so if a plant works well in a high-income country, companies prefer to use the
same design everywhere. Also, companies realize that if they create an environmental
disaster in a low-income country, it is likely to cost them a substantial amount of money
in paying for damages, lost trust, and reduced sales—and by building up-to-date plants
everywhere they minimize such risks. As a result of these factors, foreign-owned plants
in low-income countries often have a better record of compliance with environmental
laws than do locally-owned plants.

Perhaps the hardest task for those who predict a race to the bottom scenario is
explaining why it hasn’t already happened. After all, globalization has been expanding
for decades—and at the same time, environmental standards have been growing stronger
both in high-income and in low-income countries of the world. For low-income countries,
globalization has often meant importing some of the environmental values of high-
income countries—and also having higher income levels to afford greater environmental
protection. Apparently, the competitive pressures from mobile multinational firms that
might encourage governments to reduce their environmental standards are not nearly as
strong as the counterbalancing pressures to increase environmental standards.

**Pressuring Low-Income Countries for Higher Environmental Standards**

In some cases, the issue is not so much whether globalization will pressure low-income
countries to reduce their environmental standards, but instead whether the threat of
blocking international trade can be used to pressure these countries into adopting
stronger environmental standards. For example, restrictions on ivory imports in high-
income countries, along with stronger government efforts to catch elephant poachers,
have been credited with helping to reduce the illegal poaching of elephants in certain
African countries.

However, it would be highly undemocratic for the well-fed citizens of high-
income countries to attempt to dictate to the ill-fed citizens of low-income countries
what domestic policies and priorities they must adopt, and how they should balance
environmental goals against other priorities for their citizens. Also, if high-income
countries want stronger environmental standards in low-income countries, they have
many other options than the threat of protectionism. For example, high-income countries
could pay for anti-pollution equipment in low-income ones, or could help to pay for
national parks. They could help carry out the scientific and economic studies that would
help environmentalists in poor countries to make a more persuasive case for the economic
benefits of protecting the environment, especially since environmental protection is
very important to two industries of key importance in many low-income countries:
agriculture and tourism. Environmental advocates can set up standards for labeling
products, like “this tuna caught in a net that kept dolphins safe” or “this product made
only with wood not taken from rain forests,” so that consumer pressure can reinforce
environmentalist values. The United Nations sponsors treaties to address issues such
as climate change and global warming, the preservation of biodiversity, the spread of
deserts, and the environmental health of the seabed, as well as other issues. Countries
that share a national border or are within a region often sign environmental agreements
about air and water rights, too. The World Trade Organization is also becoming more
aware of environmental issues and more careful about assuring that increases in trade
don’t inflict environmental damage. Along with these other policy tools, high-income
countries could refuse to import a limited number of specific products where the product
is very closely linked to the environmental danger—like not importing the ivory from
elephant tusks.
These concerns about the race to the bottom or pressuring low-income countries for more strict environmental standards do not apply very well to the roughly half of all U.S. trade that occurs with other high-income countries of the world. Indeed, many European countries have stricter environmental standards in certain industries than the United States.

The Unsafe Consumer Products Argument

One argument for shutting out certain imported products is that they are unsafe for consumers; indeed, consumer rights groups have sometimes warned that the World Trade Organization would require nations to reduce their health and safety standards for imported products. This fear seems exaggerated. The WTO explains its current agreement on this subject in this way: “It allows countries to set their own standards. But it also says regulations must be based on science. . . . And they should not arbitrarily or unjustifiably discriminate between countries where identical or similar conditions prevail.” Thus, under WTO rules, it is perfectly legitimate for the United States to pass laws requiring that all, say, food products or cars sold in the United States meet certain safety standards approved by the U.S. government, whether or not other countries choose to pass similar standards. However, such standards must have some scientific basis, and it would be unfair to impose, say, one set of health and safety standards for domestically produced goods but a different set of standards for imports, or one set of standards for imports from Europe and a different set of standards for imports from Latin America.

The National Interest Argument

It is sometimes argued that nation should not depend too heavily on other countries for supplies of certain key products. This argument has been made for commodities that are important to the U.S. economy as a whole, like oil, and for special materials or technologies that might have weapons applications. But upon closer consideration, this argument for protectionism proves rather weak.

The issue is not whether certain products, like oil, are highly important to the U.S. economy both for personal use in transportation and heating and for a wide array of industrial uses. Oil provides about 40% of all the energy in the United States and more than half of the oil used in the U.S. economy is imported. Several times in the last few decades, when disruptions in the Middle East have shifted the supply curve of oil back to the left and sharply raised the price of oil, the effects have been felt across the U.S. economy.

But none of this makes a very convincing argument for restricting imports of oil. If the United States needs to be protected from a possible cutoff of foreign oil, then a more reasonable strategy would be to import all of the United States’ petroleum supply now, and save the U.S. domestic oil resources for when or if the foreign supply is cut off. It might also be useful to import extra oil and put it into a stockpile for use in an emergency, as the U.S. government did by starting a Strategic Petroleum Reserve in 1977. Moreover, it may be necessary to discourage people from using oil, and to start a high-powered program to seek out alternatives to oil. A straightforward way to do this would be to raise taxes on oil. (Such a tax increase on oil could be offset with cuts in
other taxes, so that the total tax burden need not rise.) But it makes no sense to argue that because oil is highly important to the U.S. economy, then the United States should shut out oil imports and use up its domestic supplies of oil more quickly.

Whether or not to limit certain kinds of imports of key technologies or materials that imports might be important to weapons systems is a slightly different issue. If weapons builders are not confident that they can continue to obtain a key product in wartime, they might decide to avoid designing weapons that use this key product, or they can go ahead and design the weapons and stockpile enough of the key high-tech components or materials to last through an armed conflict. Indeed, there is a U.S. Defense National Stockpile Center that has built up reserves of many materials from aluminum oxides, antimony, and bauxite to tungsten, vegetable tannin extracts and zinc (although many of these stockpiles have been reduced and sold in recent years). But why shut out a high technology product, like a specialized type of computer chip or screen, for all the potential civilian-sector users—including businesses that may need the technology so that their products can be competitive in world markets—perhaps with some direct government subsidies for research

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**Public Attitudes about Global Trade**

Do people prefer the freedom to buy imports, or do they prefer restricting imports to help domestic firms? People in many countries, unconcerned about the logical contradiction, want both. Professor Richard Rose of the University of Strathclyde in Scotland reported the results of a survey done in 2002 of people in 20 countries. They were asked two questions:

**Question 1:** Which of the following approaches do you think would be the best way to improve the economic and employment system in this country?

a. Protect our local industries by restricting imports from other countries OR

b. Remove import restrictions to increase international trade with other countries.

**Question 2:** Nowadays multinational companies sell things such as soft drinks, televisions, computers and cars in this country and worldwide. Do you think that for people like yourself to be able to buy such multinational products in this country is:

a. A good thing

b. Not such a good thing

c. Doesn’t make any difference.

Those who favored both removing import restrictions to increase trade and saw benefits to consumers were categorized as in favor of open trade. Those who favored both restricting imports and saw no benefits to consumers were categorized as protectionist. Those who favored open trade for consumers but import restrictions, or vice versa, were categorized as “confused.”

The results suggest that in most countries, other than China, a strong and reliable majority for open trade will require persuading some of the “confused” to join those who already favor open trade. In turn, this means emphasizing how consumers benefit from open trade and how even a country’s firms will perform better, in the long run, if they must face the test of global competition. Professor Rose argues: “If governments wish to promote free trade, their best strategy is to campaign in favor of the freedom of consumers to buy what they want wherever it is made, for every citizen is a consumer.”

<table>
<thead>
<tr>
<th>Country</th>
<th>Open</th>
<th>Confused</th>
<th>Protectionist</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>62%</td>
<td>26%</td>
<td>12%</td>
</tr>
<tr>
<td>Japan</td>
<td>54%</td>
<td>25%</td>
<td>21%</td>
</tr>
<tr>
<td>Germany</td>
<td>51%</td>
<td>25%</td>
<td>24%</td>
</tr>
<tr>
<td>Canada</td>
<td>49%</td>
<td>22%</td>
<td>29%</td>
</tr>
<tr>
<td>South Korea</td>
<td>45%</td>
<td>33%</td>
<td>22%</td>
</tr>
<tr>
<td>South Africa</td>
<td>45%</td>
<td>32%</td>
<td>23%</td>
</tr>
<tr>
<td>United States</td>
<td>43%</td>
<td>26%</td>
<td>31%</td>
</tr>
<tr>
<td>Brazil</td>
<td>43%</td>
<td>25%</td>
<td>33%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>42%</td>
<td>32%</td>
<td>26%</td>
</tr>
<tr>
<td>Mexico</td>
<td>35%</td>
<td>35%</td>
<td>30%</td>
</tr>
</tbody>
</table>

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Chapter 6 Globalization and Protectionism

and development in key areas—rather than sheltering domestic producers from foreign competition.

One final reason why economists often treat the national security argument skeptically is that almost any product can be touted by lobbyists and politicians as vital to national security. In 1954 the United States became worried that it was importing half of the wool required for military uniforms, so it declared wool and mohair to be “strategic materials” and began to give subsidies to wool and mohair farmers. Although wool was removed from the official list of “strategic” materials in 1960, the subsidies for mohair continued for almost 40 years were repealed in 1993, and then reinstated in 2002. All too often, the national interest argument has become an excuse for handing out the indirect subsidy of protectionism to certain industries or companies. After all, decisions about what constitutes a key strategic material are made by politicians, not nonpartisan analysts.

**National Security and Scissors and Shears**

What follows is actual testimony before Congress in the early 1960s from a lobbyist arguing that the national interest demands a higher tariff on imported scissors and shears.

[My name is B.C. Dueschle. I am vice president of the Acme Shear Co., located in Bridgeport, Conn. I appear before this committee as president of the Shears, Scissors & Manicure Implement Manufacturers Association, the only national trade association of domestic manufacturers of scissors and shears. The scissors and shears industry is a distinct industry and should not be confused with the larger industry and the flatware industries. . . .

We have never requested or suggested that a complete embargo be placed on the import of scissors and shears. All that we have asked for and desire is a fair competitive opportunity, not an advantage. . . .

We realize that the domestic scissor and shear industry with its 1,000-plus employees accounts for only a fraction of 1% of the gross national product, but we see this as no justification for letting the industry be completely destroyed by imports produced with low-cost labor.

The workers in the domestic scissor and shear industry do not want to become wards of the State; they want to use their skills, which have taken many years to develop. These workers are not interested in retraining; over many years they have developed a skill they are proud of and want to continue the work they are happy doing. . . .

Under the provisions of this bill, scissors and shears would be buried in a category with many other items and the duty cut 50%. This would mean a reduction of at least 20 cents per pair at the retail level for scissors and shears now being retailed at $1 to 1.29 per pair. . . .

These few remaining manufacturers would be forced to close their doors and discharge their employees. The United States would then become wholly dependent on imported scissors and shears.

We cannot understand how it would be in the national interest to permit such a loss. We would lose the skills of the employees and management of the industry as well as the capital investment in production equipment. In the event of a national emergency and imports cutoff, the United States would be without a source of scissors and shears, basic tools for many industries and trades essential to our defense.

The scissors and shear industry is one of the oldest in the world. The skill was brought to the United States from Germany at a time when the United States needed new industry and a scissors and shear industry in particular.

Scissors and shears of all sizes and types are used in every school, retail establishment, office, factory, hospital, and home in the United States. Scissors cannot be classified as a luxury, gimmick, or novelty.

Scissors are used to separate us from our mothers at birth; to cut our toenails; to trim the leather in our shoes; to cut and trim the materials used in every piece of clothing that we wear.

They are used to cut our fingernails, to trim our mustaches, the hair in our ears and nose, and to cut the hair on our heads—even down to the end of the road when our best suit or dress is cut down the back so that the undertaker can dress us for the last ride. Scissors are truly used from birth to death. They are essential to our health, education, and general welfare.

I ask you gentlemen, is this industry one that should be permitted to become extinct in this country?
## How Trade Policy Is Enacted: Global, Regional, and National

These public policy arguments about how nations should react to globalization and trade are fought out at several levels: at the global level through the World Trade Organization and through regional trade agreements between pairs or groups of countries.

### The World Trade Organization

The World Trade Organization was officially born in 1995, but its history is somewhat longer. In the years after the Great Depression and World War II, there was a worldwide push to build institutions that would tie the nations of the world together. For example, the United Nations officially came into existence in 1945. The World Bank, with a focus on assisting the poorest people in the world, and the International Monetary Fund, with a focus on addressing issues raised by international financial transactions, were both created in 1946. The General Agreement on Tariffs and Trade (GATT), which provided a forum in which nations could come together to negotiate over reductions in tariffs and other barriers to trade started in 1947. In 1995, the GATT transformed itself into the World Trade Organization.

The GATT process was to negotiate an agreement to reduce barriers to trade, sign that agreement, pause for breath, and then start negotiating the next agreement. The rounds of talks in the GATT, and now the WTO, are shown in Exhibit 6-3. Notice that the early rounds of GATT talks took a relatively short time, included a relatively small number of countries, and focused almost entirely on reducing tariffs. Since the 1970s, however, rounds of trade talks have taken year, included a large number of countries, and included an ever-broadening range of issues.

The sluggish pace of GATT negotiations led to an old joke that GATT really stood for Gentleman’s Agreement to Talk and Talk. But the slow pace of international trade talks is understandable, even sensible. Having dozens of nations agree to any treaty is a lengthy process. GATT often set up separate trading rules for certain industries, like agriculture, and separate trading rules for certain countries, like the low-income countries.

### Exhibit 6-3 The Negotiating Rounds of GATT and the World Trade Organization

<table>
<thead>
<tr>
<th>Year</th>
<th>Place or Name of Round</th>
<th>Main Subjects</th>
<th>Number of Countries Involved</th>
</tr>
</thead>
<tbody>
<tr>
<td>1947</td>
<td>Geneva</td>
<td>Tariff reduction</td>
<td>23</td>
</tr>
<tr>
<td>1949</td>
<td>Annecy</td>
<td>Tariff reduction</td>
<td>13</td>
</tr>
<tr>
<td>1951</td>
<td>Torquay</td>
<td>Tariff reduction</td>
<td>38</td>
</tr>
<tr>
<td>1956</td>
<td>Geneva</td>
<td>Tariff reduction</td>
<td>26</td>
</tr>
<tr>
<td>1960–61</td>
<td>Dillon round</td>
<td>Tariff reduction</td>
<td>26</td>
</tr>
<tr>
<td>1964–67</td>
<td>Kennedy round</td>
<td>Tariffs and anti-dumping measures</td>
<td>62</td>
</tr>
<tr>
<td>1973–79</td>
<td>Tokyo round</td>
<td>Tariffs, nontariff barriers</td>
<td>102</td>
</tr>
<tr>
<td>1986–94</td>
<td>Uruguay round</td>
<td>Tariffs, nontariff barriers, services, intellectual property, dispute settlement, textiles, agriculture, creation of WTO</td>
<td>123</td>
</tr>
<tr>
<td>2001–</td>
<td>Doha round</td>
<td>Agriculture, services, intellectual property, competition, investment, environment, dispute settlement</td>
<td>144</td>
</tr>
</tbody>
</table>
in the world. There were rules, exceptions to rules, opportunities to opt out of rules, and precise wording to be fought over in every case. Like the GATT before it, WTO is not a world government, with power to impose its decisions on others. The total staff of the WTO in 2006 is about 625 people and its annual budget is $150 million, which makes it smaller in size than many large universities.

### Regional Trading Agreements

Many nations belong both to the World Trade Organization and to regional trading agreements. The best-known and most successful of these regional trading agreements is the European Union. In the years after World War II, leaders of the nations of Europe reasoned that if they could tie their economies together more closely, they might be more likely to avoid another devastating war. Their efforts evolved into what is now known as the European Union. The EU, as it is often called, has a number of goals. For example, in the early 2000s it introduced a common currency for Europe, the euro, and phased out the old national forms of money like the German mark and the French franc. Another key element of the union is to eliminate barriers to the mobility of goods, labor and capital across Europe.

For the United States, the best-known regional trading agreement is the North American Free Trade Agreement (NAFTA), which reduced barriers to trade between the United States, Mexico, and Canada. NAFTA was signed into law by President Clinton in November 1993 and took effect in 1995. However, the U.S. also participates in some less-known regional trading agreements, like the Caribbean Basin Initiative that offers reduced tariffs for imports from these countries, and a free trade agreement with Israel.

The world has seen a flood of regional trading agreements in recent years. About 100 such agreements are now in place; a few of the more prominent ones are listed in Exhibit 6-4. Some are just agreements to talk and talk; others set specific goals for reducing tariffs, import quotas, and nontariff barriers. One economist described the current trade treaties as a “spaghetti bowl,” which is what a map with lines connecting all the countries with trade treaties looks like. There is some concern among economists who favor free trade that some of these regional agreements may promise free trade, but actually act as a way for the countries within the regional agreement to try to limit trade from anywhere else. In some cases, the regional trade agreements may even conflict with the broader agreements of the World Trade Organization.

### Trade Policy at the National Level

Yet another dimension of trade policy, along with international and regional trade agreements, happens at the national level. The United States, for example, imposes import quotas on sugar, because of a fear that such imports would drive down the price of sugar and thus injure domestic sugar producers. One of the jobs of the U.S. Department of Commerce is to determine if imports from other countries are being dumped at less than a governmentally-determined “fair” price. If so, the U.S. International Trade Commission—a government agency—determines whether domestic industries have been substantially injured by the dumping, and if so, the president can impose tariffs that are intended to offset the unfairly low price.

In the arena of trade policy, the battle often seems to be between national laws that increase protectionism and international agreements that try to reduce protectionism, like the WTO. Why would a country pass laws or negotiate agreements to shut out
Chapter 6  Globalization and Protectionism

One plausible answer is that international trade agreements offer a method for countries to restrain their own special interests. A member of Congress can say to an industry lobbying for tariffs or quotas on imports: “Sure would like to help you, but that pesky WTO agreement just won’t let me.” In this way, international trade agreements are like getting a personal trainer; they pressure you to follow through on the healthy behavior that you should be doing, anyway.

Long-Term Trends in Barriers to Trade

In the newspaper headlines, trade policy appears rife with disputes and acrimony. Countries are almost constantly threatening to challenge “unfair” trading practices of other nations. Cases are brought before the dispute settlement procedures of the WTO, the European Union, NAFTA, and other regional trading agreements. Politicians in national legislatures, goaded on by lobbyists, often threaten to pass bills that will “establish a fair playing field” or “prevent unfair trade”—although most such bills seek to accomplish these high-sounding goals by placing more restrictions on trade. Protesters in the streets may object to specific trade rules or to the entire practice of international trade.

But through all the controversy, the general trend in the last 60 years is clearly toward lower barriers to trade. The average level of tariffs on imported products charged by industrialized countries was 40% in 1946. By 1990, after decades of GATT negotiations, it was down to less than 5%. Indeed, one of the reasons that GATT negotiations shifted from focusing on tariff reduction in the early rounds to a broader agenda was that tariffs had been reduced so dramatically that there wasn’t much more to do in that area. U.S. tariffs have followed this general pattern; after rising sharply during the Great Depression,
they have dropped off to less than 2% by the end of the century. Although measures of import quotas and nontariff barriers are less exact than those for tariffs, they generally appear to be at lower levels, too.

Thus, the last half-century has seen both a dramatic reduction in government-created barriers to trade, like tariffs, import quotas, and nontariff barriers, and also a number of technological developments that have made international trade easier, like advance transportation, communication, and information management. The result has been the powerful surge of international trade called globalization.

**The Trade-offs of Trade Policy**

Economists readily acknowledge that international trade is not all sunshine and roses and happy endings. On average and over time, the average person gains from international trade, both as a worker who has greater productivity and higher wages because of the benefits of specialization and comparative advantage, and as a consumer who can benefit from a shopping all over the world for a greater variety of quality products at attractive prices. But the average person is hypothetical, not real, representing a mix of those who have done very well, those who have done all right, and those who have done poorly. It is a legitimate concern of public policy not just to focus on the average or on the success stories, but also on those have not been so blessed. Workers in other countries, the environment, and prospects for new industries and materials that might be of key importance to the national economy are also all legitimate issues. The common belief among economists is that it is better to embrace the gains from trade, and then to deal with the costs and trade-offs with other policy tools, rather than cutting off trade to avoid the costs and trade-offs—but also losing the benefits of international trade.

To gain a better intuitive understanding for this argument, consider the hypothetical example of an American company called Technotron. Technotron invents a new scientific technology that allows the firm to increase the output and quality of its goods with a smaller number of workers at a lower cost. As a result of this technology, other U.S. firms in this industry will lose money and will also have to lay off workers—and some of the competing firms will even go bankrupt. Should the U.S. government protect the existing firms and their employees by making it illegal for Technotron to use its new technology?
Most people who live in market-oriented economies would oppose trying to block new technology. Certainly, there is a case that society should provide temporary support and assistance for those who find themselves without work. Many would argue for government support of programs that encourage retraining and acquiring additional skills. Government might also support research and development efforts, so that other firms may find ways of outdoing Technotron. But blocking the new technology altogether seems like a mistake. After all, few people would advocate giving up electricity because it caused so much disruption to the kerosene and candle business. Few would suggest holding back on improvements in medical technology because they might cause companies selling older and less effective medical care to lose money. In short, most people view disruptions due to technological change as a necessary cost that is worth bearing.

Now, imagine that Technotron’s new “technology” is as simple as this: the company imports what it sells from another country. In other words, think of foreign trade as a type of innovative technology. The objective situation is now exactly the same as before. Because of Technotron’s new technology—which in this case is importing goods from another country—other firms in this industry will lose money and lay off workers. But just as it would have been inappropriate and ultimately foolish to respond to the disruptions of new scientific technology by trying to shut it down, it would be inappropriate and ultimately foolish to respond to the disruptions of international trade by trying to restrict trade.

Some workers and firms will suffer because of international trade. But in a living, breathing market-oriented economy, some workers and firms will always be experiencing disruptions, for a wide variety of reasons. Corporate management can be better or worse. Workers for a certain firm can be more productive or less. Tough domestic competitors can create just as much disruption as tough foreign competitors. Sometimes a new product is a hit with consumers; sometimes it’s a flop. Sometimes a company is blessed by a run of good luck or stricken with a run of bad luck. For some firms, international trade will offer great opportunities for expanding productivity and jobs; for other firms, trade will impose stress and pain. The disruption caused by international trade is not fundamentally different from all the other disruptions caused by the other workings of a market economy. Trying to prevent all the disruptions of a market-oriented economy from happening has an opportunity cost: it means blocking the economic gains from trade.

In other words, the economic analysis of free trade doesn’t rely on a belief that foreign trade is not disruptive or does not pose trade-offs; indeed, the story of Technotron begins with a particular disruptive market change—a new technology—that causes real trade-offs. But in thinking about the disruptiveness of foreign trade, or any of the other possible costs and trade-offs of foreign trade discussed in this chapter, the best public policy solutions typically don’t involve protectionism, but instead involve finding ways for public policy to address the particular issues while still allowing the benefits of international trade to occur.

Key Concepts and Summary

1. There are three tools for restricting the flow of trade: tariffs, import quotas, and nontariff barriers. When a country places limitations on imports from abroad, regardless of whether it uses tariffs, quotas, or nontariff barriers, it is said to be practicing protectionism.
2. Protectionism will raise the price of the protected good in the domestic market, which causes domestic consumers to pay more but benefits producers.

3. As international trade increases, it contributes to a shift in jobs away from industries where that economy does not have a comparative advantage and toward industries where it does have a comparative advantage. Overall, however, the increase in trade does not have much affect on the number of jobs.

4. Global trade should raise the average level of wages by increasing productivity. However, this increase in average wages may include both gains to workers in certain jobs and industries and losses to others.

5. In thinking about labor practices in low-income countries, it’s useful to draw a line between what is unpleasant to think about and what is morally objectionable. For example, low wages and long working hours in poor countries are unpleasant to think about, but for people in low-income parts of the world, it may well be the best option open to them. Practices like child labor and forced labor are morally objectionable and the rules of the WTO allow any country to refuse to import products made using these practices.

6. The infant industry argument for protectionism is that small domestic industries need to be temporarily nurtured and protected from foreign competition for a time so that they can grow into strong competitors. In some cases, notably in East Asia, this approach has worked. But often, the infant industries never grow up.

7. Dumping occurs when prices are set at below the cost of production. Strategy is to set prices at a level below production costs, absorb losses until competitors are driven out of the market, and then when competition has been eliminated or greatly reduced to raise prices substantially and earn high profits. While there are some historical examples where this strategy has worked, it does not appear to arise very often, if at all, in global trade. More often, anti-dumping complaints seem to be a convenient excuse for imposing protectionism.

8. Low-income countries typically have lower environmental standards than high-income countries because they are more worried about immediate basics such as food, education and health care. There are a variety of ways for high-income countries to encourage stronger environmental standards in low-income countries, including some movement to make sure that new opportunities opened up by free trade don’t injure the environment. Except for a small number of extreme cases, shutting off trade seems unlikely to be an effective method of pursuing a cleaner environment.

9. Under the rules of the World Trade Organization, countries are allowed to set whatever standards for product safety they wish, but the standards must be the same for domestic products as for imported products. If there is a dispute over whether a health and safety standard is being imposed without a scientific basis, it can be appealed to the WTO.

10. The national interest argument for protectionism holds that it is unwise to import certain key products because if the nation becomes dependent on key imported supplies, it could be vulnerable to a cutoff. However, it is often wiser to stockpile
resources and to use foreign supplies when available, rather than preemptively restricting foreign supplies so as not to become dependent on them.

11. Trade policy is determined at many different levels: administrative agencies within government; laws passed by the legislature; regional negotiations between a small group of nations (sometimes just two); and global negotiations through the World Trade Organization.

12. During the second half of the twentieth century, trade barriers have in general declined quite substantially both in the U.S. economy and in the global economy.

13. One reason why countries sign international trade agreements to commit themselves to free trade is to give themselves protection against their own special interests. When an industry lobbies for protection from foreign producers, politicians can point out that because of the trade treaty, their hands are tied.

14. International trade certainly disrupts what would otherwise have been the pattern of an economy. This is hardly surprising, since all sorts of competitive market forces are disruptive, whether domestic or international, often causing companies and industries to rise and fall. Government has a role to play in cushioning workers against the disruptions of the market. But just as it would be unwise in the long term to clamp down on new technology and other causes of disruption in domestic markets, it would be unwise to clamp down on foreign trade. In both cases, the disruption brings with it economic benefits.

Review Questions

1. Who does protectionism protect? What does it protect them from?

2. Name and define three policy tools for enacting protectionism.

3. How does protectionism affect the price of the protected good in the domestic market?

4. Does international trade, taken as a whole, increase the total number of jobs, decrease the total number of jobs, or leave the total number of jobs about the same?

5. Is international trade likely to have roughly the same effect on the number of jobs in each individual industry?

6. How is international trade, taken as a whole, likely to affect the average level of wages?

7. Is international trade likely to have about the same effect on everyone’s wages?

8. Do the jobs for workers in low-income countries that involve making products for export to high income countries typically pay these workers more or less than their next-best alternative?

9. What’s an infant industry? Why does protecting it often work better in theory than in practice?

10. What is dumping? Why does prohibiting it often work better in theory than in practice?

11. What is the race to the bottom scenario?

12. Which group of countries typical has more strict environmental standards: countries with higher incomes or lower incomes?

13. Do the rules of international trade require that all nations impose the same consumer safety standards?

14. What is the national interest argument for protectionism with regard to certain products?

15. Name several of the international treaties where countries negotiate with each other over trade policy.

16. What is the general trend of trade barriers over recent decades: higher, lower, or about the same?

17. If opening up to free trade would benefit a nation, then why don’t nations just eliminate their trade barriers, and not bother with international trade negotiations?