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Reasons for Protection: Tariffs and NTBs have mostly undesirable effects; nonetheless, virtually every country uses these methods of protection. Why?

I. Reasons that do NOT make economic sense

A. Pauper Labor

Concept: it is believed to be difficult to trade with countries that have relatively low wages (how to compete?) and a fear that trade will lower domestic wages (perhaps to the level of those abroad).

Problems: This argument ignores productivity (why foreign wages are low—productivity low). Productivity differences allow for competition between low and high wage countries. Also ignored: Ricardian model and comparative advantage.

B. Fairness

Concept: Unfair for domestic producers to compete with foreign producers who have advantages (national resources, etc.). Often said that the "playing field is not level." We need to erect barriers to offset the advantages of foreign producers.

Problems: the argument imagines that the country is like a firm, but the nation should care about all its citizens, not one single firm. It imagines trade as a zero-sum game (but it is not). There are gains from trade even if one nation has an advantage over another. This ignores comparative advantage.

C. Patriotism

Concept: purchasing goods from home country is more patriotic.

Problems: if people purchased only domestic goods this would imply no trade and no trade makes a country worse off. In fact, it may be inefficient to buy from home; and again, countries benefit by trading according to comparative advantage.

D. Retaliation

Concept: If the rest of the world uses tariffs or other forms of protection, we should retaliate by using tariffs ourselves.

Problems: If countries are too small to affect world prices a tariff will unambiguously harm them (small country tariff result), regardless of whether other countries are using tariffs. It is true that a large country may benefit by using a tariff, but if so, this too is true whether or not other countries are using tariffs. A nation cannot undo an effect from a foreign tariff by having one of its own.

II. Reasons that DO make economic sense, with counterarguments.

A. Revenue

Concept: It is true that tariffs generate revenue and they are often the easiest taxes to administer. Historically countries have used tariffs as their first revenue raising method.

Against: However, there are plenty of other taxes that cause fewer dead weight losses (DWL) than tariffs and raise the same revenue.

B. Optimal Tariff

Concept: Applies to large countries (those that are able to influence the world price). A tariff causes a fall in the world price of the imported good. This fall in price benefits the importing nation, and the benefit may be larger than the DWL. This is often called the Terms of Trade argument.

Terms of Trade = relative price of a country's exports compared to its imports.

An improvement in the terms of trade is a rise in this relative price. A worsening in the terms of trade is a fall in this relative price. The "optimal tariff" is used to improve the terms of trade by lowering the world price of imports and thus increasing the relative price of exports compared to imports.

Also called the "monopoly argument" for tariffs because a nation restricts buying a good in order to change prices in its favor (which is roughly analogous to what a monopoly firm does by restricting its supply).

Against: This policy makes the home country better off by making the rest of the world worse off. Since this policy hurts others it will probably result in retaliation, and even if it does not, it is not "nice."

C. Infant Industry Argument

Concept: New industries have high costs because they haven't "learned" yet to produce. Industries often reduce their costs through "learning-by-doing." Given time, new industries in a nation will bring their costs down. However, because initially they have high costs, they can't compete under free trade with foreign firms that are relatively well established. A tariff in this case permits production and fosters learning.

Against: a production subsidy will create the same benefit without distorting the market (without raising the price to consumers) like a tariff does. A production subsidy therefore generates a smaller DWL.

D. National Security

Concept: often articulated as a national defense argument, it means use of a tariff to protect military capability. Or, it may be to avoid vulnerability to shocks on world markets that may effect the production of goods used in the military. We want tariffs to reduce the "dependence" on international resources.

Against: There are better economic policies, like subsidies to keep firms in business, or stockpiles to maintain reserve supplies.

E. Protect Culture

Concept: Protect important elements of culture from being lost due to international influence or competition. For example, France has protected their domestic film industry from international competition.

Against: Is trade policy the best way to protect culture?

F. Protect a Favored Industry

Concept: This is probably the main reason countries have tariffs. Why are certain industries favored? Industries can be favored for many reasons

including political, historical and economic. It is often very painful when industries collapse and tremendous hardship can result from international competition. We can restrict trade to protect an industry and help those who are hurt by trade. But also, protection can be obtained thru political lobbying whether or not it is needed.

Against: Again there are better ways to help people who are hurt thru trade, ways that create less DWL.

G. Retaliation

Retaliation for your own sake does not make sense. But, retaliation can be used as a way to enforce international agreements. The threat of retaliation, as a last resort, provides the ultimate enforcement tool of WTO rules, etc.

In summary, the two main arguments against protection are:

1. Retaliation: protectionist policies often result in the protectionist country also facing high tariffs from other nations.
2. There exist better policies to forward the particular policy goals. Direct subsidies to production instead of tariffs.