

Institut für Ökonomische Bildung
Sommer-Semester 2010
Ökonomie des Protektionismus
Dozent: Prof. Dr. Apolte *
Seminar „Spezielle Probleme der Wirtschafts- und Finanzpolitik“
Ökonomische Theorie der Politik und EU Integration
University of Münster , Germany

New Protectionism and the European Union: A Theoretical Background with a Critical Overview of Current Developments

I. Introduction

"Protectionism is a misnomer. The only people protected by tariffs, quotas and trade restrictions are those engaged in uneconomic and wasteful activity. Free trade is the only philosophy compatible with international peace and prosperity." 1

Walter Block – Senior Economist, Fraser Institute (Canada)

This provocative opinion seems on the surface to be quite credible. It would be in line with the powerful, unmistakable trend towards trade liberalization witnessed in recent decades. In fact, nearly all countries in the world have discovered and exploited the benefits of free trade. Facilitated and driven by the globalization of the world economy and the increased interdependence between nations, the reduction of trade barriers has yielded significant gains in the welfare and prosperity of many nations. Consumers experience lower prices as foreign producers expand their exports to new markets. Indeed, one could argue that increasing economic integration has even correlated with a decline in armed conflict, at least in the West. Protectionism, the counterpart of free trade, seems outdated and is publicly admonished by politicians as if it were a remnant of a bygone era. Yet **despite current trends and public comments by politicians, protectionism is still widespread, both in obvious and less obvious forms.** Even the strongest proponents of free trade, such as the European Union and the United States, impose protectionist measures that they have a hard time eliminating. What are some of the newer barriers to free trade, and how can the existence of protectionism be explained? This paper attempts to shed light on the matter by looking at economic theory and by examining present-day protectionist threats.

In the first part of the paper I lay the theoretical groundwork for my analysis by highlighting the economic benefits of free trade that have caused it to become so popular in the past century at the expense of protectionism, the other major policy option. I then examine the most popular instruments of protectionism. Drawing upon arguments in the political economy literature, I explain why protectionism remains so prevalent despite its welfare reducing effects.

In the second part of the paper, these theoretical insights are translated to the current situation of the European Union. The EU was created largely to promote trade and eliminate protectionism from within. Though the EU has greatly increased trade in the region and is seen as an emblem of trade liberalization, it is in reality far from perfection with regards to eliminating protectionism. I look at three contentious issues involving accusations of protectionism and how this important trading bloc has responded to them. This includes a look at its Common Agricultural Policy, protectionist impulses from within the EU itself, and the at times heated relationship with its most important trade partner, the United States. These problems show the challenges and dangers of protectionism, even in the current day.

I find that, despite all the progress made towards free trade, present day protectionist policies prevent much greater economic benefits from being realized.

Yet, at the same time, these present-day obstacles are not enough to cast a shadow on the many positive developments made towards a barrier-free world in recent decades.

...B. Bucking the Trend: New and Traditional Protectionism

More common and relevant recently have been technical and administrative protectionist barriers - customs, safety, and health regulations, or indirect taxes (such as VAT or sales taxes), together often termed the ‘new protectionism’...For example, a country could argue that labeling requirements for food or technical requirements for cars are simply meant to protect the consumer and have nothing to do with protectionist motives. Although in some cases legitimate, administrative barriers are in other cases thinly veiled disguises for restricting imports, especially in sectors where the country or region may have a competitive disadvantage.

...The key to unraveling the mystery of protectionism is to understand that social welfare is only one component that influences public policies. Just as important is lobbying.

Helpful insights into the influence exerted by lobbyists can be found in the political economy literature. Trade restrictions are usually “advocated by those special groups in the nation that stand to benefit from such restrictions. (Salvatore: 235)” These self-interested groups, many of whom fear that competition from abroad will take away their business, include a wide array of actors ranging from industry-based coalitions of capital owners to industry associations and labour unions. Protectionist measures, just like all policy decisions, are the “endogenous outcome” of a complicated political process that involves not only welfare considerations, but the interests of voters and special interests (GWR 1991: 13).

According to the theories of Mancur Olson,⁵ small and well-defined interest groups (that are better informed than consumers and politicians) have a large stake in policy outcomes. These groups “stand to gain a great deal (monetarily) from protection,” (Salvatore: 239) and each member exerts a direct influence in the decision-making process. In this way, they have a better chance to succeed in their lobbying efforts than larger groups that are negatively affected by policy changes, such as domestic consumers or foreign producers. They have an incentive to lobby the government to adopt protectionist measures as long as the marginal benefit of doing so exceeds the marginal cost of the lobbying effort (GWR:13).

...Politicians and policy makers are just as self-interested as the special interests because they seek to win elections and maintain political power. Lobbyists can help politicians achieve their goals through campaign finance donations or by mobilizing their constituents if the politician vows to support their position. Interest groups can also influence politicians in office by providing (usually biased) reports and research that show to what extent their industry or livelihood could suffer if certain protectionist legislation does not get passed.

For the politician, it can be a worthwhile investment to enact policies lobbied for by a small interest group even if he or she knows that it comes at the expense of the general population. Consumers that could punish this behaviour in elections barely notice their welfare losses because they are spread out over the entire population. They may not even know its root cause due to the non-transparency of the political system, and can only with great effort be mobilized to organize and resist harmful policies. Political economy theorists argue that politicians are ultimately hostage to these interest groups.

To look at it in another way, trade policy is therefore determined by a “political contest” between the lobbying expenditures of the domestic industries that seek protectionism on the one hand and the consumers on the other (GWR: 13).

...The European Union is in an interesting position in that, while protectionist barriers have in theory been eliminated between member states within the union (qualifications in section IV: C), significant protectionism is allowed against nonmembers.

...Though the EU prides itself with its free trade policies, the EU in reality does still protect key industry sectors. The most notorious example of EU protectionism involves its contentious Common Agricultural Policy (CAP).

...In a recent study (2009), economists Natalie Chen and Dennis Novy found significant trade barriers in the EU, and that the “most substantial costs are technical barriers.” The study found that, while costs associated with geography and transportation explains 25% of the variation in trade integration, policy factors, including technical barriers, explain 7% of the variation, a finding that the authors believe is far from negligible.

...In fact, **there has been discussion for years about creating a free trade pact, or at least coming closer to a barrier free marketplace between the EU and the U.S. This is a goal that has been set forth by the Transatlantic Economic Council (TEC), a bilateral forum created in 2007 to increase cooperation on trade policy and improve relations. Yet this goal is far from being realized because regulatory differences are still significant** and harmonizing many of them remains illusive, due in no small part to the many special interests involved. **The EU Commission’s Vice President for Enterprise and Industry recently stated that even with a FTA, this root problem would not be cured (Palmer/Reuters – 27.10.2009). Indeed, divisive regulatory issues have continuously strained the trading relationship in recent years.** While tariffs are fairly low, nontariff, administrative barriers, especially those involving product safety, environment and labour policies, and agriculture, still loom large.

A current dispute between the US and the EU involves the **US export of poultry to Europe**. Europe has banned all imports from American producers of poultry since 1997 because the meat is processed with pathogen reduction treatments. American poultry exporters believe that the ban, supposedly in place due to health concerns, is completely unfounded and prevents them from entering the lucrative European market. **Despite years of negotiations and continued evidence that the chemicals cause no negative health effects, EU agencies have continuously prevented efforts to lift the restrictions. Heavy lobbying by European agricultural interests has almost certainly played an important part. As a result, the US lodged a complaint with the WTO last year, and the WTO is currently reviewing the matter (USTR Press Release – 08.10.2009). This and other contentious issues, such as US export of genetically modified food to Europe, have repeatedly provoked sharp debate. I believe that it is quite possible that many of these unduly strict health regulations are simply disguised forms of protectionism.**

...**Regulatory differences have significant opportunity costs.** According to a recent study by the European Commission that analyzed the economic losses induced by non-tariff trade barriers between the EU and U.S., simply reducing all “actionable” regulatory differences would increase GDP in the EU by €122 billion per year and increase total exports by 2.1%.¹⁵ The US, in turn, would experience gains of €41 billion per year in GDP and 6% in higher exports...

* Prof. Dr. Thomas Apolte is a professor of economics and public policy at the Faculty of Economics and Business Science, University of Münster, Germany. <http://www.uni-muenster-mca.de/mca-concept/lecturers/prof-dr-thomas-apolte/> ; <http://www.wiwi.uni-muenster.de/ioeb/organisation/apolte.html>

Bibliography:

...Jagdish Bhagwati, "Protectionism." *The Concise Encyclopedia of Economics*. 2008. Library of Economics and Liberty. 4 May 2010. Available Online: <<http://www.econlib.org/library/Enc/Protectionism.html>> Accessed on: 04.05.2010.

Kogan, Lawrence, “Precautionary Preference: How Europe Employs Disguised Regulatory Protectionism to Weaken American Free Enterprise.” 2005. *International Journal of Economic Development*, Vol. 7, Nos 2-3. Available Online: <<http://www.spaef.com/article.php?id=966>> Accessed on: 10.05.2010.

Krugman, Paul, “Is Free Trade Passe? 1987. *The Journal of Economic Perspectives*, Vol. 1, No. 2.