The Effects of Free Trade on Domestic and Infant Industries

Sultan Gashgari

Abstract – Arguments have been made whether the advantages of free trade outweigh the disadvantages and the vice versa. This study explores both the positive and negative effects of free trade using relevant and pertinent examples by various industries in different countries. Free trade is a practice where international markets eliminate barriers to trade such as taxes and tariffs. It has been widely urged that free trade adversely affects domestic and infant industries. It introduces unfair competition as the already established foreign industry has an advantage when it comes to resources, market power, and experience. Free trade also leads to lose of jobs when infant and local industries are stifled and finally close down due to losses or stagnant economic position. On the other hand, free trade creates competition that leads to improvement of the quality of products and services at better prices. North American Free Trade Agreement and the European Economic Area are the major free trade agreements widely known. The US decision to set up an auto-assembly plant in Mexico was a bold move as it created job opportunities for the local. The American auto makers competes with the Japanese automakers industry enabling Japanese improve the quality of their automobiles, and the impact of Chinese bicycle industry on the US bicycle manufacturing industry are some of the examples deeply discussed in the study. They show the real life impact of free trade on local and infant industries. The study also discusses measures taken by a country to combat a particular situation as a result of free trade to protect the local and young industries. Different arguments by various economists on the effects of free trade on domestic and infant industry are also explored to bring out the real situation clearly.

Free trade is the practice by certain international markets whereby they eliminate trade barriers such as tariffs and taxes. The exercise ensures that there is no restriction of imports into and export out of the countries in agreement. The two examples that clearly exemplify the free trade phenomenon are the North American Free Trade Agreement and the European Economic Area that have established and operational open markets (Anderson, 2006, p. 47). Despite the several benefits that arise from free trade the two main arguments against the practice is the protection of domestic industries and the need to shield infant industries.

The United States being one of the most outspoken advocates of free trade argues that open markets are able to achieve prosperity for all citizens. They further argue that not all local industries are able to compete with foreign ones. Therefore, a country should sacrifice the loss of a few thousand jobs for the access to better foreign products. Trade restrains are often used to

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protect domestic industries from foreign competition (Tempini, 1999, p. 345). Where a foreign company is a better producer or has more competitive prices, locals are most likely to rely on imports than goods produced domestically. The consequence is non-profitable domestic firms leading to their collapse and ultimately the loss of thousands of jobs. Although economists agree that free trade is advantageous to economies especially in developed countries, it also recognises that open markets injure domestic industries and transfer employment opportunities to foreign competition.

An example is the US decision to set up their auto assembly plans in Mexico since it was the least expensive place to assemble automobiles. The decision affected other automobile assembly operations in the US, thus transferring most of the jobs to Mexico. Other foreign companies improve the quality of their production to be able to meet the quality standards of the US. In the 1970s, the Japanese auto industry improved the quality of their production, thus competing with American automakers such as General motors and Ford (Arnold, 2001, p. 867). To stay competitive, other domestic industries such as the Californian wine industries have improved the quality of their products to compete with wine imports from France.

Infant industries argument against free trade was advanced by economists Fredrick List and Alexander Hamilton. The assertion of the argument was that newly established industry with potential comparative advantage might not succeed if it does not have temporary protection from more competitive foreign industries. An already established foreign industry has the advantage of longstanding experience, market power, resource position, and internal and external economies, thus making competition with domestic infant companies unequal (Dodd & Hasek, 1948, p. 230). Such a competition would result in the quick ruin of infant industries. I agree with this argument because free trade would discourage national development by restricting imports.

In the 1990s, the US bicycle manufacturing companies were faced with great competition from the Chinese bicycle industry. The growing bicycle industry in the US was hindered by what the bicycle manufactures termed as Chinese dumping the products in the US market. Chinese companies such as Phoenix and Forever have increased their exports to the US, thus interfering with the development and competitive advantage of US companies in the industry (Cherunilum, 2006, p. 266). Therefore, the US government would protect its bicycle industry by putting up trade restriction on Chinese imports.

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