By Johan Fourie

INDUSTRY PROTECTION

Open or closed borders, that is the question

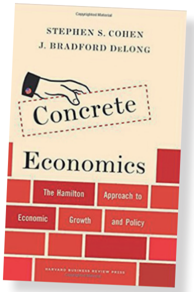
We look at the effects of industry protection on a country's economy. Is it damaging or not? If implemented correctly, as with the Asian tigers, such policies can be liberating.

Most economists would agree that open world trade increases economic growth and raises living standards. Trade barriers reduce countries' ability to specialise in goods and services which they are good at, and force them to produce things they're not good at.

But economists also know that free trade isn't always good for everyone. Uncompetitive industries that employ many thousands can suffer when trade barriers protecting those industries fall.

Many countries protect certain key industries, arguing that they are industries of national security (classic examples are military spending or food security). Other industries are protected because they're young and, it is argued, will become more efficient once they obtain certain economies of scale. This is known as infant industry protection. But many infants never grow up. SA's clothing and textile industry has received government support since the 1930s, and we still pay exorbitant import tariffs on clothes.

But sometimes it works. As *Concrete Economics,* a new book by Stephen Cohen and Brad de Long, explains, the US became the manufacturing hub of the late 19th and early 20th centuries because it was protecting its local industries from cheap British imports. Their comparative advantage switched from agricultural goods to manufacturing goods, leading to higher paying jobs and more dynamic technological innovation.



Concrete Economics details how the US became a manufacturing powerhouse as a result of protectionist policies.

The East Asian tigers followed the same model. By copying the basic and later advanced technological products of the West, they built a domestic industry behind high tariffs. Once they'd built up the necessary technological know-how, they exported their way to prosperity. Now they are at the technological frontier designing and building new phones (Samsung, Korean), computers (Lenovo, Chinese) and robots (Honda, Sony, Fujitsu, Hitachi and Toyota – all Japanese firms).

But it didn't work everywhere. Attempts at import-substitute industrialising failed to propel Argentina, Brazil and many other smaller South American countries to prosperity in the same way it did East Asian countries. Postcolonial Africa only managed to impose a heavy burden on poor consumers without stimulating any large-scale industrial activity. Many African countries remain incredibly protected – just ask any importer to Nigeria, for example – contributing little to the rise of African industry.

Postcolonial Africa only managed to impose a heavy burden on poor consumers without stimulating any large-scale industrial activity.

So are open borders good or bad? A new paper by Pable Fajgelbaum and Amit Khandelwal gives the standard economist response: it depends. Some consumers buy more tradable goods and are therefore more affected by relative price changes caused by international trade. They find that those consumers who gain most are often the poor, who buy more tradable goods and services. Open borders, they claim, are a very good thing if you are poor.

So policymakers are stuck between a rock and a hard place: close borders in the hope that some industries grow beyond infants, at the cost of cheaper goods and services for poor people. Or open the borders and allow the poorest access to cheap goods and services, knowing that some uncompetitive industries will suffer.

Take SA's dispute over chicken imports. Chicken is the most important protein for poor South Africans. By denying them access to cheap food we hurt them – and their children's ability to consume nutritious protein so critical for early childhood development – and perpetuate the cycle of poverty. And by protecting chicken imports, do we really stimulate local economic development in dynamic industries with agglomeration and spill-over externalities? Probably not.

In contrast, we protect the local automotive industry because it creates direct jobs and because vehicles support an entire value chain, from raw material to assembly. Unlike rearing chickens, building a car requires vast numbers of engineers and other skilled artisans that may have large (and unexpected and unplanned) spill-overs in related industries.

What made Japan, the first Asian tiger, so successful was a capable bureaucratic administration that could, with little political influence, judge which industries required support and which didn't. Some that received support failed to deliver, and support was quickly removed. Today we recognise the successful ones: Canon, Kawasaki and Panasonic.

Wherever protection has failed, it is because supported firms gain political influence to protect their support. Bureaucrats are people too – often poorly paid – and find it difficult to challenge entrenched interests of the firms they initially supported. The government bureaucrats that steered Japan's miracle were well remunerated (therefore less corruptible) and were top graduates from Japan's best universities. They had the foresight to invest in industries of the future.

In general, then, open borders are likely to be more beneficial than closed ones, especially to the poor. But this doesn't say there is no role for industrial policy. If political influence can be thwarted – and that's a big if, especially given recent revelations of state capture in SA – support for strategic industries that have large spill-overs can play an important role in building a thriving economy.

The hard questions remain, though: Who picks the winners? And what happens when they fail? ■

editorial@finweek.co.za

Johan Fourie is associate professor in Economics at Stellenbosch University.