

Global Business

Why do governments protect their domestic firms? Describe the main reasons for trade protection and assess whether any of these enhance economic welfare.

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Introduction

Local firms have a significant role in any economy as they do not only produce large revenues for the economy but also help in increasing the human capital and make the local economy more competitive in the global market. Sometimes, these local firms and industries need protection from the foreign market due to several economic, business, political, and strategic reasons (Dunning, 1988). In that case, the government steps out and provides shelter to these local markets in the form of trade protection. Protectionism supporters believe that this protection is good for economic welfare (Tansey, et al., 2005). The essay is divided into five major sections. The first section explains the domestic firms, and their importance while the second section describes the role of the government protecting these firms. The third section puts light on the trade protectionism, and its reasons. The fourth section describes how the protectionism can lead to economic welfare, and the last section concludes the essay.

Domestic Firms and Their Importance

Domestic and local firms are the firms that operate in the domestic economic territory of a country. These firms are mainly initiated, designed, and operated by local people or sometimes the government of the country. These firms are registered as a local company as a small, medium or large company, and depending upon their size, they provide employment to a wide range of people. These local firms abide by the rules of the government and follow the regulations of the market as well (Cetrad, 2015).

Every government tries its best to promote the local firms because no economy can survive without them. They do not only help protect the country from over-reliance on the foreign market, but also increase the productivity of the economy by increasing the flow of money, higher output, and providing employment to millions of people (Snoxall, 2014). Higher productivity and competitiveness of the local firms can eventually make them capable of

entering into the international market, and help the country economically, politically and strategically as well. They also provide better opportunities of research and development. Due to their vital role in the economy, every government focuses to protect and promote these local firms (Malchow-Moller, et al., 2011).

Role of the Government

After globalization, transformation in international strategic relations, and WTO treaties entered into the equation of world politics, economics and business, most of the economic and business models supported free markets including free mobility of goods, services, and labour, lower or no trade barriers, and lower tariffs, a huge number of economic and business analyst still support protectionism, and argue that it is one of the most influential ways to protect and help an economy grow. Many governments also adopt mixed market strategies supporting free market frameworks, and some protectionism at the same time (Elwell, 2006).

As reported by Shah (2010), the role of the state is always primary when it comes to controlling the local economy, and other business practices. It is the job of the government to make sure that the market operates in a less structured framework, but the competition is not so fierce that the local economies start losing their grip on the business, and might even consider leaving the business (Lenway & Murtha, 1994). Instead of the never ending popularity of capitalism, and stirred up arguments on free trade and markets, the role of government is still not negligible in the formation of economic, business and trade mechanism of any country. The government does not only regulate the businesses operating in the economy but also makes sure that they are provided with the support and protection they need to be safe from the intruders (Hill, 2013). Therefore, it is always the decision of the government whether there should be a trade barrier or not, and the government decides this on the basis of prevailing economic and business scenarios. After scrutinizing the economy, the government can interrupt the system by designing reforms, decentralizing a sector, provide incentives to some specific sector, remove barriers form a specific sector, invite investment or protect a sector from the foreign markets by implementing trade protectionism (Crown, 2012).

Trade Protection - An Overview

The main characteristic of trade protectionism is to limit the imports and exports in a country. It is done mainly by putting barriers on imports and exports, and the major objective behind this act of protectionism is to provide a shelter to domestic markets, and protect them from fierce international competition and enhance their comparative advantage (Elwell, 2006). Initially, the protectionism buys the local firms some time to prepare for international competition, and when they feel that they have enough training, skills, human and physical capital to face the competition, the need for protectionism reduces (Economics Online, 2015). Trade protectionism is not as straight forward as it seems; it needs proper policy framework, documentation, inspection, and research. The government needs to make sure that the benefits from protectionism would be enough to offset the losses incurred. One of the major reasons for the protectionism is increasing the welfare for the domestic producers (Lawley, 2013).

The extent and effects of protectionism change by the market structure; if the market is smaller in structure, it is more likely to get affected by trade especially when the trade is done with a country bigger than the home country. In that case, analysts believe that it is always rational to form some trade protections to make sure that the limited resources and labour force of the economy do not dry off or get over shadowed by the foreign market (Batabyal & Beladi, 2009).

Reasons of Trade Protectionism and Linkage to Economic Welfare

Trade protectionism does not only help protect the companies who are already operating in the market; it is also helpful in protecting the companies who have just entered or are planning to enter the local market. It also helps provide a shelter to the companies that have decreasing returns to scale, and gives them a chance to regain their reputation and increase their output. It also protects non-renewable resources and increases employment in the local economy. Analysts believe that it reduces the chances of unnecessary, and unfair competitions, and limits the over-reliance on international trade providing better options to boost the economy, and the living standards of the people as well (Economics Online, 2015).

Moreover, it is also reported that due to increasing and a necessary trend of globalization, some extent of protectionism has become very important for the protection of local economies. Some analysts believe that protectionism might be against the free market fundamentals and free mobility of labour across the nations. But the supporters of protectionism argue that it does not only help motivate the local producers but is also very effective in increasing the local mobility of the labour force within the country increasing their welfare (Barro, 2004).

It is reported that the trade protectionism can also help support the small and medium enterprises (SME) in the country because small and medium businesses need shelter to grow in a compact environment, which protectionism can provide (Cetrad, 2015). These protectionism policies might also help deal with some market imperfections and help the economy grow in a dynamic and perseverant way. But the protectionism in the form of trade barriers is not the only solution; trade unions and associations are also important to keep the effects of protectionism positive. Moreover, it is the job of the government to observe and decide when SME's are competitive enough to compete internationally, and then the protectionism can be abolished to enhance the internationalization of firms (Fliess & Busquets, 2006).

One of the disadvantages of protectionism is reduced revenue because no tariffs are collected on imports and exports. But supporters of protectionism argue that instead of protectionism, the target of economic welfare is still met by increased economic growth in the local economy (Viju & Kerr, 2012). The supporters believe that complete reliance on internationalization is not healthy for the economy, and instead of protectionism, with higher employment opportunities, productivity, human capital, and specialization, the economy can still grow substantially, and achieve higher welfare (Nagoya University, 2009).

Conclusion

Local firms are the firms that are registered with the local government and abide by the rules of the government to operate in the market. These firms play a vital role in the local economy as they are not only a source of income, money circulation, and output in the economy but also provide employment to millions of people, and help the economy politically, and strategically.

Due to the non-negligible importance of local firms, every government tries its best to support them, and trade protectionism is one of the ways of protection. The purpose of trade protection is to protect these local firms from fierce, and unfair international competition. Supporters of protectionism believe that instead of some drawbacks of trade protectionism practiced by the governments, it is a good way to enhance economic welfare as it increases human capital, and employment opportunities in the country, provides higher revenue, and protects the economy from over dependence on foreign economies.

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