

M.A. & B.A., Economics

International Economics

Infant Industry Argument for Protection

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- The oldest existing argument for protection is the Infant-industry argument. It was forwarded in the 1940s by the German economist and politician Friedrich List.
- The core of the Infant-industry argument is the existence of some kind of internal economies. A firm cannot compete if it is small. It has to be large before it can harvest all the economies of scale in production and become competitive.
- Therefore, it has to be protected for sometime, and be permitted to grow, without meeting immediate competition from abroad. When the firm has become fully developed, the tariff can be dismantled and free trade can be allowed. This is the essence of the argument.



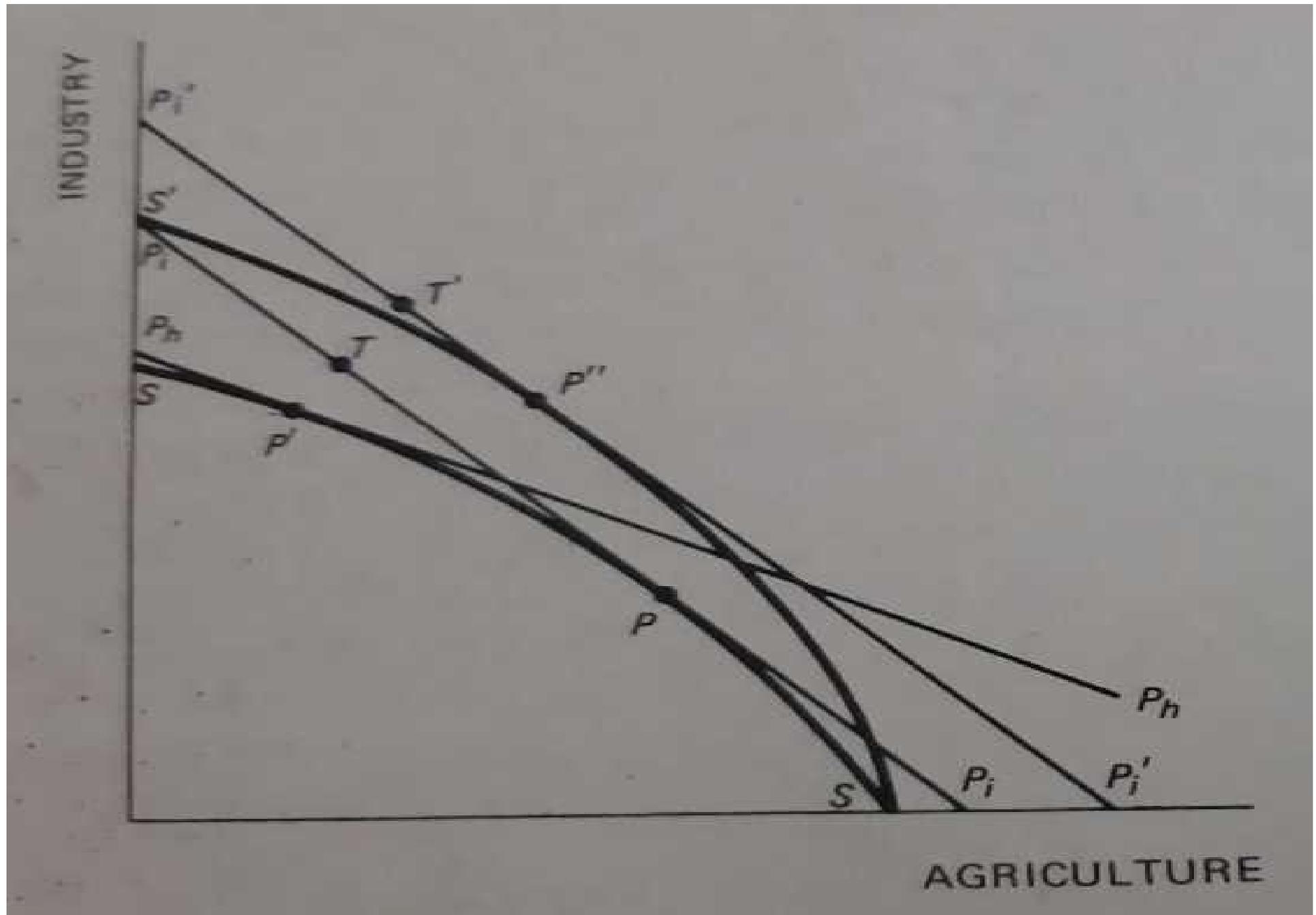
- The country List had in mind when he developed the Infant-industry argument was Germany of the mid 19th century. Great Britain was then the leading Industrial State and German industry had difficulty competing with the older, more established British industry.
- List was modern in his views in so far as he saw industry as a prerequisite of progress. On this score he had no doubts: 'Manufactories and manufacturers are the mother and children of municipal liberty, of Intelligence, of the art and science, of internal and external commerce, of navigation and improvements in the transport, of Civilization and political power.
- Free trade was good for Britain, whose position was already established. For young, emerging German industry, however, tariffs were necessary. The Infant-industry argument soon won acceptance, and even the dean of classical economics in the 1950s, John Stuart Mill gave it a niche in his exposition of classical economic theory.
- List was, in other words the first successful German economist .



Figure 1 is a geometric illustration of the Infant-industry argument for protection. To start with, the country has the production-possibility curve SS . The international terms of trade are given by the line P_iP_i , which is tangential to the production-possibility curve at P . The country produces at P and moves by trade to T . This depicts the country's situation under free trade.



Fig1 Infant Industry Argument for Protection



The country now wants to protect its industry. It introduces a tariff so that the price for domestic consumers and producers now becomes $P_h P_h$. This price line is tangential to the production possibility curve at P' , and under protection the country will produce and consume at this point. Protection lowers the country's welfare as seen from the fact that P' is to the south-west of T . This is, however, only what happens in the short run. Protection gives rise to a substantial increase in production of industrial goods.



Thereby internal economies can be reaped, industrial skills can be learned, etc and this will lead to an increase in productive capacity, there will be an outward shift in the country's production-possibility curve. After sometime of protection, the new production-possibility curve will be $S'S$. The country can then start free trade again. If the same international terms of trade prevail as before protection, the country will produce at P'' ($P''iP''i$ is parallel to P_iP_i). Through trading, the country can then move to T' . As T' is to the north-east of T , it represents higher social welfare. By nurturing an infant-industry for some time, the country has thus been able to reach a higher level of welfare than would have been possible if it had been engaged in free trade all the time.



- A protectionist policy initially implies a lowering of welfare. In the usual manner a tariff will cause a production and consumption cost. For protection to produce social benefits, the infant-industries must grow up. They must eventually be able to compete at world market prices. They must pass what is sometimes called 'Mill's test'.

- Not only, however, do they have to grow up; for a protectionist policy to be profitable, they will also have to be able to pay back the losses due to protection during the infant-industry period. They will have to pass what is sometimes called 'Bestable's test'. Only then is there a clear cut case of infant-industry argument.



Study Material Source

Bo Soderston, International Economics.

