

explainity easily explained

Thema: Protectionism

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explainity explained: Protectionism

We have all heard something about protectors – on skateboards, motorbikes or mountain bikes: protectors keep us safe from injuries. This is what the Latin root ‘protegere’ actually means: to protect. These days we frequently read business news headlines like: “The government is taking protectionist measures.” But what precisely does protectionism mean? And what is its connection with business?

Let’s take the imaginary country of Drolland. By introducing protectionist measures, President Ridiculo has a clear objective: to shield the domestic economy from competition from foreign companies.

Measures like this may involve increasing import tariffs. Commodity trader Mike, for instance, looks abroad to buy his steel cheaply, which he then sells in Drolland. But the higher costs of purchase force him to introduce significant price increases as well. And that scares off his customers! Now he only buys his steel on the domestic market. In other words: the demand for products manufactured locally rises, and the supply of foreign products drops. Initially, this can help to make plenty of jobs in the country secure. President Ridiculo uses these measures to isolate Drolland from the foreign markets.

Emerging sectors benefit initially as well: Mike’s sister Sarah, for instance, works at a start-Up in Drolland Valley that manufactures drones. Corporations from abroad are no longer able to compete directly, so Sarah has time to test how the company’s drones perform on the home market and how they can be manufactured as cheaply as possible. So, protectionism can initially lead to greater prosperity, especially in large countries like Drolland – but always at the expense of other countries. And that has consequences:

There is a lack of international competition and there is a slump in innovation. This means the products are no longer state-of-the-art – and often even more expensive than before. Foods that do not grow in Drolland, bananas for instance, simply disappear from the market.

And President Ridiculo? He ends up sitting on a mountain of debt caused by an emerging imbalance. He supported domestic companies with plenty of money – but growth has suffered at the same time, as the companies are usually only able to sell their products on the domestic market.

In response to President Ridiculo’s unilateral actions, former trade partners now also turn their backs on Drolland. What’s more, they too introduce protectionist policies to isolate their markets. There is a risk of a protectionist spiral – which in extreme cases can even lead to a global economic crisis, like in the 1930s.

President Ridiculo had only intended to protect the domestic economy. But now he has achieved precisely the opposite. He gradually realizes that although economic protectionism can provide Drolland with short-term benefits, in the long-term it will inevitably lead to catastrophic consequences. So, he decides without further ado that the elevated import tariffs need to be reduced and that instead the country should strengthen its relationships with important trade partners.

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