



## **Expensive Milky, Cheap Shirts: The Effect of Blocking International Trade**

By: Ori Katz

*This paper reviews Israel's trade policy for two specific industries: textile and food, comparing price differences and the impact on employment in an industry that was opened to import competition versus one that remained closed. The data shows that competition lowered prices in the textile industry without having a negative effect on employment. The paper also discusses Israeli agriculture's positive externalities (i.e. benefits as an indirect effect), and argues for replacing trade protections with direct subsidies.*

The introductory **first chapter** describes the opposition to international trade both globally and in Israel.

The **second chapter** reviews the comparative analysis of the different trade policies for the textile versus the food industries.

The **third** and **fourth chapters** examine these policies' ramifications – the former looking at apparel and foodstuffs' prices and changes in prices, and the latter on employment and unemployment.

The **fifth chapter** details the reform needed in the food industry, discussing the question of state support of the industry; direct vs indirect support; and the difference between quotas and tariffs.

### **Summary:**

From time immemorial, human societies have featured opposition to free trade, subsidies of domestic manufacturers and "mercantilist" viewpoints. While the past two centuries have seen a growing consensus among economists in favor of free trade, many politicians still insist on conducting "trade wars", raising tariffs and subsidizing various industries.

In Israel, both the textile and food industries, seen by leaders as important strategic assets, have been protected from overseas competition since before the State was established. Textile and food manufacturers maintained close relationships with the government, and while other industries gradually opened to international trade, they remained relatively closed. In the early 2000s, however, the textile industry opened to import competition. Such circumstances offer an opportunity for a comparative study regarding the effect of opening a market to competition.

This comparison demonstrates that while clothing prices in Israel are low by international standards, food prices are high, and this pattern emerged after the textile industry was opened to importation. It also shows that despite the earlier concerns, opening the market caused no economic or social upheaval. Analysis at the local authority level shows that import competition did not increase unemployment or reduce labor force participation rates for adults in those localities that were relatively dependent on the textile industry, even after controlling for general trends in the labor market in the past twenty years and the specific features of different municipalities.

However, despite social protests such as the "Milky protest" and committees, reports and policy steps taken to permit importation, powerful counter forces are still preventing the change that was wrought in the textile industry from happening in the food one. The food industry's successful prevention of openness to trade is largely due to claims of this industry's positive externalities, i.e. indirect benefits, among them "food security", land ownership in strategic areas, landscape improvement and more. Most of these claims are, on closer scrutiny, unreasonable, and the ones with merit are more aptly met with direct subsidies than by propping up the entire industry through the prevention of international competition. Such protections raise prices for consumers, and support manufacturers who create no positive externalities. We recommend directly subsidizing the desired positive externalities while opening the market to free import.

In recent years, temporary and limited quotas for importation in the food industry have been employed to lower specific prices, but this policy is misguided, and very different from opening the market to free importation. Comparative statics analysis of the effect of import quotas reveals that they do not lower prices as much as free import does, nor do they promote the domestic production's efficiency, but rather reduce consumer surplus and create significant incentives for corruption. The World Trade Organization therefore recommends replacing import quotas with tariffs as a preliminary step to lowering tariffs and opening the markets.

### **Recommendations:**

High food prices are not inevitable. The food industry can replicate the textile industry's success and provide citizens with products of high quality and low prices while preserving the positive externalities of the agricultural industry by direct subsidy. We recommend **removing trade barriers to the import of foodstuff** – tariffs, standards, licensing and the like – and **abandoning the use of temporary import quotas**. Concurrently, we recommend **moving from indirect to direct subsidy** of some of the agricultural initiatives' **positive externalities** such as landscape enhancement and strategic land holding.

Adopting these recommendations will lower the cost of living and greatly improve the standard of living for the entire population.

[For the full Hebrew paper](#)