Safeguards in the South African poultry sector: an economic perspective

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The recent decision by the Department of Trade and Industry (the dti) to implement a provisional safeguard duty of 13.9% on frozen bone-in chicken imports from the European Union (EU) has placed renewed focus on the South African poultry industry. Poultry producers state that increased imports are threatening to derail the industry in the form of job losses and plant shutdowns. Last year, the South African Poultry Association (SAPA) applied for a safeguard duty on imports of frozen bone-in chicken from the EU. The International Trade and Administration Commission of South Africa (ITAC) is continuing its investigation, but approved a provisional safeguard duty on 15 December 2016. During the initial investigation, Econex was instructed by Shoprite to conduct an economic analysis. We discuss our findings in this note.

We show that the current application for a safeguard duty cannot be seen in isolation and that due consideration should be given to SAPA’s long history of trade protection, which spans almost two decades. This note adds to the debate by discussing safeguard duties in more detail (refer to the technical appendix) and by testing the criteria for the implementation of a safeguard duty. Importantly, it also discusses the negative impact of a safeguard duty on consumer welfare and finds that the commensurate gain by poultry producers will be short-lived and will not contribute to the long-term sustainability of the poultry sector. The harm which SAPA refers to should not be addressed with trade policy, but should rather be dealt with through targeted industrial policy.

About ECONEX
ECONEX is an economics consultancy that offers in-depth economic analysis, covering competition economics, international trade, strategic analysis and regulatory work. The company was co-founded by Prof Nicola Theron and Prof Rachel Jafta during 2005. Both these economists have a wealth of consulting experience in the fields of competition and trade economics. They also teach courses in competition economics and international trade at Stellenbosch University. For more information on our services, as well as the economists and academic associates working at and with Econex, visit our website at www.econex.co.za.
1 Introduction

On 15 December 2016, the Department of Trade and Industry (the dti) levied a 13.9% provisional safeguard duty on frozen bone-in chicken pieces1, as per Article 16 of the Agreement on Trade, Development and Cooperation (TDCA) with the European Union (EU).2 This follows a lengthy process whereby the South African Poultry Association (SAPA) applied to the International Trade Administration Commission of South Africa (ITAC) for a 37% safeguard duty on EU imports of frozen bone-in chicken pieces earlier in 2016.

The provisional safeguard duty will be in place until 3 July 2017, while ITAC continues its investigation. During the initial investigation, industry players were invited to submit reports to be used as input into ITAC’s decision-making process. Econex was instructed by Shoprite to conduct an analysis of the potential economic effects of such safeguard duties.

In this research note, we discuss the basic economic principles of the case at hand. Throughout, we emphasise the economic criteria to be considered by ITAC when evaluating safeguard duties. We start by highlighting SAPA’s long history of relying on trade remedies to protect poultry producers. We then provide a brief discussion of the rationale for the use of trade remedies in international trade. We specifically look at the criteria for the implementation of a safeguard duty and whether SAPA’s application meets the requirements. Finally, we emphasise the effects that a safeguard duty will have on consumer welfare.

2 SAPA’s history of trade protection

SAPA represents a well-organised group of producers in the poultry industry and have used a variety of trade remedies as a way to promote their interests. This has been SAPA’s strategy since the time of the Board of Tariffs and Trade (BTT), the predecessor of ITAC. The timeline below lists some of the main instances where SAPA has applied for trade protection.

It is clear that SAPA’s latest application for safeguard duties cannot be seen in isolation, and should be viewed against the background of its previous (successful) applications to the BTT and ITAC. The South African broiler industry has tried to rely heavily on import tariffs and anti-dumping (AD) duties for its survival, and has seemingly been unable to improve its competitive position despite the various trade remedies already in place. SAPA’s most recent application marks the first time that it has applied for a safeguard duty.

The following section discusses this trade instrument in more detail.

Figure 1: Timeline of SAPA’s trade remedy history
The guiding principle of the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO) is that member countries are bound to their negotiated concessions for imports. However, there are certain exceptions to this rule, as we explain in more detail in the appendix.

An important distinction needs to be made between remedies that level the playing field due to unfair trade practices (such as where firms dump goods in the markets of member states or where governments subsidise exports or import substitution), and protection in the absence of unfair trade.

The first of these categories typically take the form of anti-dumping duties or countervailing measures, while safeguard duties fall within the latter category. This is an important distinction for the purposes of the public debate (especially w.r.t. the effect on consumer welfare), since it means that the motivation and test for the implementation of anti-dumping duties and countervailing measures is different than for a safeguard duty.

### 3.1 Definition and purpose

As briefly mentioned above, safeguard duties are an emergency trade defence measure that temporarily restricts imports of a product (traded in a fair manner) to protect a specific domestic industry from an increase in imports which is causing or threatening to cause serious harm to the domestic industry.

According to ITAC: “Regarding the Anti-Dumping and Countervailing measures, the purpose is to level the playing field to ensure that foreign firms compete fairly with domestic firms. The Safeguard measure is meant to protect a domestic industry against unforeseen and overwhelming foreign competition and not necessarily against unfair trade as is the case with the previously mentioned two instruments...”

Two types of safeguards are available. **Multilateral safeguards** are implemented on a Most Favoured Nation (MFN) basis and therefore apply to all countries. **Regional safeguards** are applied within a Regional Trade Agreement (RTA) and exclude all countries outside of the agreement. Safeguard clauses are often included in RTAs to provide an escape clause in the event that

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4. See the Technical Appendix for a more detailed discussion of the differences between safeguards and anti-dumping and countervailing duties.
6. ibid.
7. ibid.
10. ibid.
11. ibid.
favourable trade conditions impact negatively on one of the parties. It is therefore a politically necessary inclusion in trade agreements to foster trade relationships.12

Since protectionist policies run counter to the WTO’s mandate of fostering international trade, the maximum duration of a safeguard is four years, but may be extended to eight years if justified following a new investigation. Compensation has to be offered if safeguards are implemented for more than four years. The WTO also states that safeguards that apply for longer than one year must be liberalised progressively during the period of implementation and that measures of duration longer than three years should be reviewed at the mid-term point.

Safeguard duties are not used as frequently as anti-dumping duties or countervailing measures. This is indicated in the table below, which shows the prevalence of trade remedies in South Africa between January 1995 and June 2016, in terms of the number of cases initiated and the number of times that the specific remedy has been implemented. It shows that safeguards are not frequently used as a trade remedy, and emphasises the need to fulfil the necessary criteria in order to justify its use.

### 3.2 What are the criteria for a safeguard duty?

From an economic point of view, any trade intervention should be temporary and must address a specific harm. As the current SAPA application calls for trade protection against a fairly traded product, one has to ensure that the requirements for imposing safeguard duties are met.

GATT Article XIX initially offered the basis from which countries would draft their safeguard provisions. However, according to Kruger et al. (2009), Article XIX’s approach was too flexible and vague and included “ambiguous language, demanding standards and uncertain guidelines.”13 This was especially a concern for developing countries. During the Uruguay Round of trade negotiations efforts to re-interpret and revise Article XIX succeeded, leading to the adoption of the **Agreement on Safeguards**. This became the WTO accepted legal framework for using safeguard protection.

This Agreement offers guidelines and procedural steps which WTO members must adhere to when implementing safeguard duties.14 In South Africa’s case, the following is stated regarding agricultural safeguards under Article 16 of the TDCA: “Notwithstanding other provisions of this Agreement and in particular Article 24, if, given the particular sensitivity of the agricultural markets, imports of products originating in one Party cause or threaten to cause a serious disturbance to the markets in the other Party, the Cooperation Council shall immediately consider the matter to find an appropriate solution...”15 (own emphasis)

We note that no single factor can point to the serious disturbance in question and a preponderance of evidence is needed.
to constitute sufficient harm in terms of the safeguard criteria.\textsuperscript{16}

**4 Does SAPA’s current application meet the requirements of a safeguard duty?**

In assessing whether SAPA’s application fulfils the requirements of a safeguard duty under the TDCA, it is important to establish whether there has been (a) a surge in imports, (b) serious injury to the industry (or a threat thereof) and (c) whether there is a causal link between the abovementioned two factors.

### 4.1 Increased imports

Although overall imports (including imports from the EU) increased between 2011 and 2014 (the period of SAPA’s analysis), this does not seem like a ‘surge’ in imports. The increase in EU imports between 2011 and 2012 (seen in Figure 2) followed the removal of all MFN duties on EU imports. In the following year, EU imports only increased marginally, while overall trade decreased. This may, ironically, be ascribed to trade diversion resulting from SAPA’s (successful) import tariff application in 2013, to which the EU was not subjected to. It should also be noted that between 2013 and 2014, total imports increased only slightly and remained at a level below that of 2012.

From the Government Gazette no. 36698 of July 2013, the following factors will be considered by ITAC in making a determination of serious disturbance under the TDCA:

a) The rate and volume of the increase in imports of the product concerned from the EU
   i) In absolute terms; or
   ii) Relative to the production and demand in SA; and
b) Whether the SA industry is experiencing:
   i) Price suppression;
   ii) Price depression
   iii) Price undercutting/price disadvantage with regard to EU as well as other imports;
   iv) Decline in exports;
   v) A change in market share;
   vi) Any other relevant factors placed before the Commission.

None of these factors listed above is necessarily decisive on its own.

The information requested must relate only to the affected SA product that is a like or directly competitive product to the product under investigation.

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\textsuperscript{16} It is important to note that the above criteria apply to the TDCA, which will soon be replaced by the Economic Partnership Agreement between the EU and the South African Development Community (SADC).

\textsuperscript{17} Note that the tariff code for frozen bone-in portions was 0207.1490 until February 2015, after which it was disaggregated into the following codes: 0207.1491 (whole chicken, cut in half); 0207.1493 (leg quarters); 0207.1495 (wings); 0207.1496 (breasts); 0207.1497 (thighs); 0207.1498 (drumsticks); and 0207.1499 (other portions).
The decreased imports from non-EU countries in 2014 and the commensurate increase in EU imports can once again be explained by trade diversion, resulting from SAPA’s 2013 tariff application. This can be seen from the change in the composition of imports over this period (Figure 3).

While there has been an increase in EU and other imports during the last two years (up to November 2016, seen in Figure 2), the composition of trade has changed from where the EU was responsible for 93% of imports in 2014, to 81% in 2015 and 82% in 2016 (Figure 3).

In addition, SAPA claims that imports from the EU have increased relative to South African consumption. We argue that it is more appropriate to look at total imports as a percentage of consumption. This ratio has been relatively stable during recent years. Furthermore, as disposable income increases, the demand for poultry meat is expected to rise. If domestic production does not meet the growth in demand, poultry imports will increase.

Although SAPA’s analysis does not provide evidence of a significant surge in EU imports between 2011 and 2014, the last two years show increased imports from the EU. To justify a safeguard duty, there needs to be clear causation between the increased imports and the serious injury in question, which we turn to below.

4.2 ‘Serious injury’ and causation

‘Serious injury’ guidelines can be found in the WTO rules and dispute settlement procedures and is defined as the “significant overall impairment” of the domestic industry’s trading position. Indicators of injury are broadly similar to those that apply in dumping and subsidy analyses, with an emphasis on the causal link, but importantly “with no requirement that imports be either the sole or the principal cause of injury.”

While this can be used as an argument in support of protection for domestic industry, the WTO states that: “A determination of serious injury cannot be made unless there is objective evidence of the existence of a causal link between increased imports of the product concerned and serious injury.” We note that SAPA’s application refers to many external and internal cost pressures faced by the industry, and one would at least have to eliminate these as sources of the alleged injury before claiming causation.

From SAPA’s application (Table D4.2.1), it is clear that input costs have increased, and its analysis of price suppression and depression submitted as part of its application seems to point to an industry struggling with in-

\[\text{Source: Trade Map (2017)}\]

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18. The similarity with injury indicators used in dumping and subsidy analyses explains the “source” of the list of factors recorded in the Government Gazette no. 36698 as injury factors indicative of serious disturbance under the TDCA (noted on page 5 of the Econex Research Note).

ternal cost pressure. Other contributing factors listed in SAPA’s 2013 tariff application include high raw material (maize) costs, high logistics costs, economies of scale, rapid electricity cost increases and low labour productivity.20 According to Hardin Ratshisusu, the Deputy Commissioner of the Competition Commission, other immediate solutions are available to address these challenges faced by the domestic poultry producers, such as “supplier-development, measures to increase market access, vertical separation and collaborative research and development initiatives”.21

In its safeguard application, SAPA goes so far as to state that “cost increases could not be passed on to consumers because of the imports from the EU”. Competition of this sort favours consumers, and should incentivise domestic producers and policymakers to address the underlying problems in the supply chain.

As we find no surge in total imports, we take this to imply that the injury in question could not have been caused by an increase in imports. Injury that allegedly started between 2011 and 2014 cannot be linked to the increase in imports from the last two years, since the injury had its origin prior to the recent increase in imports. The injury faced by the domestic industry therefore more likely stems from supply-side issues, and not from imports. As such, a safeguard is not the appropriate tool to use to address the injury in question.

Given that SAPA represents a group of well-organised producers, it has more lobbying power than consumers and therefore only emphasises the producer side of the argument. This places the government under significant pressure to act in the interest of producers, while SAPA makes no case for the effect that a safeguard duty will have on consumers. Lee (2003) warns against this kind of political pressure and calls for a minimalist approach to the implementation of safeguards.22 As we explain in the section below, the effect of the injury on the producers needs to be weighed against the higher prices that result from a safeguard duty and hence the welfare cost to consumers.

The implementation of safeguards may therefore have detrimental unintended consequences for the poorest households in South Africa. Since chicken is the most widely consumed protein, it is imperative that it should be affordable. A high safeguard duty will necessarily result in higher prices to

5 Implications for the consumer

Article 3 of the Agreement on Safeguards states that the investigation must give due consideration to “whether or not the application of a safeguard measure would be in the public interest”. Given ITAC’s investigative role and the responsibility it has in advising the South African Government on tariff issues, it is important that the promotion of public interest forms a central part of the investigation.

Under a safeguard duty, poor South African consumers who have a demand for less expensive sources of protein, will have to pay more for their protein, in effect subsidising inefficient poultry producers. In SAPA’s safeguard duty submission, it refers to a flood of “unwanted EU bone-in portions exported into South Africa at extremely low prices”. This clearly only reflects the desires of the producers, since rational consumers would prefer to consume a product at a lower price, especially since the majority of consumers in question find themselves in lower-income groups.

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the detriment of the poor. According to Lee (2003), “A study of welfare economics indicates that welfare sacrifice to customers is inevitably greater than the welfare gain by domestic producers from import restrictions, resulting in net loss to the whole economy. Thus, an excessive measure would unfairly compromise consumer interest.”

The short-run gain for producers will be at the cost of consumer welfare, while not addressing the underlying issues in the local poultry industry which are at the heart of the current domestic industry problems.

ITAC needs to consider the net welfare impact before implementing a safeguard duty. While the domestic sector is losing its competitive position and faces external and internal cost pressures, a safeguard duty is not the correct instrument to address these problems. While it might be true that SAPA will benefit from such duties in the short term, this will be outweighed by the negative effects on the consumer and increased trade diversion in the long run.

6 Conclusion

SAPA’s safeguard application forms part of a larger protectionist strategy that spans almost two decades. Over this period of time, one would expect that domestic producers have had enough time to become more competitive and to address high costs within the industry. However, SAPA’s recent safeguard application suggests otherwise.

Safeguards are a necessary inclusion in trade agreements and aid in facilitating trade liberalisation, often included to act as an escape clause to guard specific industries against injury. Although this feature of safeguards makes trade agreements more attractive, it also opens up the possibility of domestic producers placing pressure on government to act in their interest, often to the detriment of the consumer.

It is easy to abuse safeguard duties, since it is a simple measure to enforce and to justify politically. However, it is important to carefully scrutinise the relevant criteria. We find that SAPA’s analysis of imports between 2011 and 2014 does not give due consideration to total imports and the effect that its own protectionist lobbying had on import trends and trade diversion. Policymakers should be careful to ascribe domestic injury to any recent increase in imports, especially since the domestic injury in question has persisted long before the increase in imports. It is important to eliminate all these other factors as sources of the alleged injury before you can claim causation.

If the criteria of a safeguard duty are not met, it leads to trade distortions and welfare losses in the form of higher prices to consumers. These effects outweigh any gains that producers receive as a result of the duty. It is therefore important that safeguards should not be implemented unnecessarily, especially on a product that is consumed by the poorest households in South Africa.

If government wishes to avoid welfare costs to the poor but rightfully wants to facilitate the development and improve the competitiveness of the poultry industry in the long term, it should shift its focus to supply-side interventions in the form of industrial policy.

7 Appendix: Technical assessment of trade remedies and safeguards

Comments and reporting on the SA poultry industry and the protection it seeks from Government are in general characterised by confused terminology, leading to confusing arguments.
This Appendix seeks to provide some clarity.

The point of departure is the four central principles that underlie GATT 1994 and its predecessor. These are (1) the Most Favoured Nation (MFN) rule, described by the WTO Secretariat (1999: 39) as “the whole edifice of the GATT”; (2) the principle of the reduction and binding of national import tariffs; (3) the rule of national treatment, and (4) the prohibition of protective measures other than import tariffs (the “tariffs only” rule).

The GATT provides for major exceptions to these rules, which can for the purposes of this note be summarised in three categories.

1. Article XXIV of GATT 1947, absorbed in GATT 1994, allows member states to join free trade areas or customs unions, subject to certain conditions. An Uruguay Round negotiated Understanding (Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994) complements the GATT article by clarifying several points that in the past have created difficulties. The essence of the Article and the Understanding is to create a WTO-acceptable framework for member states that belong to an FTA or CU to have genuine regional free trade in “contra-vention” of the MFN principle without serious damage to the goal of multilateral trade.

2. WTO-approved trade remedies provide for remedial action in cases where the actions of governments or firms lead to the nullification or impairment that member states derive from the WTO multilateral trading system. Trade remedies explicitly seek to create a level playing field by providing protection against unfair trade, either through the actions of firms that dump goods in the markets of other member states or governments that subsidise exports or import substitution. These actions must demonstrate convincingly after rigorous investigation to have caused material injury in the markets of like goods, which can subsequently be neutralised by the implementation of AD duties or countervailing measures. In the Anti-Dumping Agreement (Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994) and the Agreement on Subsidies and Countervailing Measures the measures/indicators of injury and the question of causality are virtually the same.

3. While trade remedies allow protection against unfair trade in the markets of like goods, GATT also provides for protection without the required condition of unfair trade. In this regard two sub-categories can be distinguished, both applicable to all WTO member states on the “most-favoured-nation” basis, in the one instance providing protection for the economy in general and in the other protection for a specific industry.
   • The first is to allow countries in balance-of-payments difficulty to use trade restrictions as an exception to the principles of tariff bindings and “tariffs only” as means of protection (Article XII available to developed countries and Article XVIII for developing countries only).
   • The second exception is to provide a general safety valve in the form of safeguards that provide protection not for the economy in general as per balance-of-payments protection but for a specific industry in a member state. This is provided for in Article XIX of GATT 1994, supplemented by the Agreement on Safeguards. The MFN principle is brought into play by the explicit...
condition that “safeguard measures shall be applied to a product being imported irrespective of its source” (WTO, Agreement on Safeguards, Article 2.2).

The Agreement on Safeguards states more clearly than Article XIX the requirements for the application of safeguard measures, the essential elements being a determination by the member state on the basis of increased quantities of imports that cause or threaten to cause serious injury (compared to material injury required in AD action and in countervailing subsidies) to the domestic industry (WTO Secretariat, 1999: 105). Serious injury is defined as “significant overall impairment” of the domestic industry’s trading position. Indicators of such injury are broadly similar to those that apply in dumping and subsidy analyses, with an emphasis on the causal link, but importantly “with no requirement that imports be either the sole or the principal cause of injury” (WTO Secretariat, 1999: 106). The latter can be used as an argument in support of protection for domestic industry.

Safeguards are not intended to provide a permanent safety valve for the protected industry and are only to be applied for as long as necessary to help adjustment. The standard limit is four years with the general principle applying that a safeguard measure, as an exception to the “tariffs only” rule, can be quota allocations, regardless of the source of supply.

The intention with the adoption of the Agreement on Safeguards was to bring greater clarity in the grey area of providing a safety valve for member states by re-establishing, as stated in the preamble to the Agreement, “multilateral control over safeguards and eliminate measures that escape such control”. Voluntary exports restraints (VERS) and orderly marketing arrangements (OMAs) are examples of the measures designed to escape GATT rules.

Trade liberalisation agreements like free trade agreements follow the multi-lateral line of the GATT to provide some form of a safety valve for states participating in a free trade area. In the case of free trade agreements, provision is likely to be made for a temporary protection measure, called a safeguard. While we have not undertaken a comparative study of safeguard clauses in regional trade arrangements and their rules and use, it can be accepted that they will not deviate significantly from the GATT approach. Evidence of this is found in the practices adopted by ITAC within the context of the TDCA, referred to in footnote 2. A crucial difference is that in a regional trade arrangement the GATT MFN rule does not apply, with safeguard protection aimed at imports from fellow members of the free trade area. What remains firmly in place is the fact that safeguards are supposed to provide protection for a limited period of time to create an opportunity for industrial adjustment.

Why, in the context of the problems that the South African poultry industry face, is it important to emphasise the true nature of the exceptions to the principles that govern free trade - multilateral and regional - and specifically to distinguish safeguards from trade remedies? In the first place, it helps to create greater clarity in the public discourse on the poultry industry’s request for protection through trade measures. Reading news reports and listening to the arguments of the pro-protection lobby it becomes clear that dumping, subsidies and safeguards are used interchangeably, if only by implication. Clarity in the use of terminology and definitions should be a first principle in having a rational public debate on policy responses.

Second, distinguishing safeguards from anti-dumping action allows the authorities to avoid the vexing problem of defining normal value in seeking protection against imports...
of brown chicken meat. A number of lobbyists keep on raising the argument that brown meat is imported below cost from the EU, which is either a dumping or subsidy argument. It would appear that the cost of the brown meat is calculated by the “across-the-carcass” method without considering demand for the different chicken pieces. In the developed world the demand for white chicken meat far exceed the demand for legs, quarters and wings; since it is impossible to breed leg- and wingless chickens, the domestic price in the countries of origin in the USA and the EU of brown meat is very low, which allow them to export these pieces at low but profitable prices to countries like South Africa, which has a different demand pattern. However, if the total cost of producing a broiler is calculated and allocated across the carcass the import price would appear to be below normal value. When ITAC’s predecessor, the Board on Tariffs and Trade, investigated the petition against brown meat imports from the USA in 1999 and the subsequent imposition of anti-dumping duties, this approach was followed; needless to say, it was severely criticised by the American exporters and authorities.

Third, focusing attention on the need for safeguards turns the spotlight sharply to the lack of competitiveness. Two considerations come into play here. The first is that the protection is a temporary provision that is supposed to create room for an industry to adapt to competitive market conditions. The second consideration is that it serves to bring into focus the fact that the South African industry faces serious supply constraints which are unlikely to disappear within the restricted time period of safeguard protection. In some reports imports from Brazil are raised as a problem, but this is not developed market nor one that has a bias in favour of white meat. In this case the argument of demand patterns in the country of origin is forsaken for the view that the government subsidises agriculture. The fact that maize is produced very cheaply, thus lowering the cost of producing poultry, because of the two annual crops that Brazil manages to grow in the tropics, is ignored.

Finally, once the argument has been made that safeguard action protects an industry because of its lack of competitiveness caused by supply side constraints, two factors deserve attention. The first is that protection comes at a cost to poor and in many cases unemployed consumers who benefit from the cheap chicken meat and cuts as a main source of protein. Capital and labour are protected at the cost of the absolutely poor. In its extreme it can be argued that the absolutely poor and unemployed are subsidising investment and employment in the poultry industry. The second consideration is that if government is really concerned about public welfare and wishes to avoid this cost to the poor, but wishes to facilitate the development of the poultry industry to levels of competitiveness, the policy focus should shift from demand-side intervention to measures that will address supply-side constraints. This implies a shift from trade to industrial policy, with measures that will have to be found in a range of interventions that will not prove to be prohibited or actionable in terms of WTO subsidy rules.

In conclusion: the protection of the domestic industry against imports is a multi-faceted problem that cannot be dealt with in the simple terms that feature in many of the arguments of the well-organised bodies that represent capital and labour in the current dispute.

In an economy that has severe unemployment problems, job protection and creation must be taken seriously, but this does not mean that the protection that can secure investment and employment in any specific industry is a viable long term solution to the challenge of inclusive growth through job creation and poverty alleviation.
Sources
