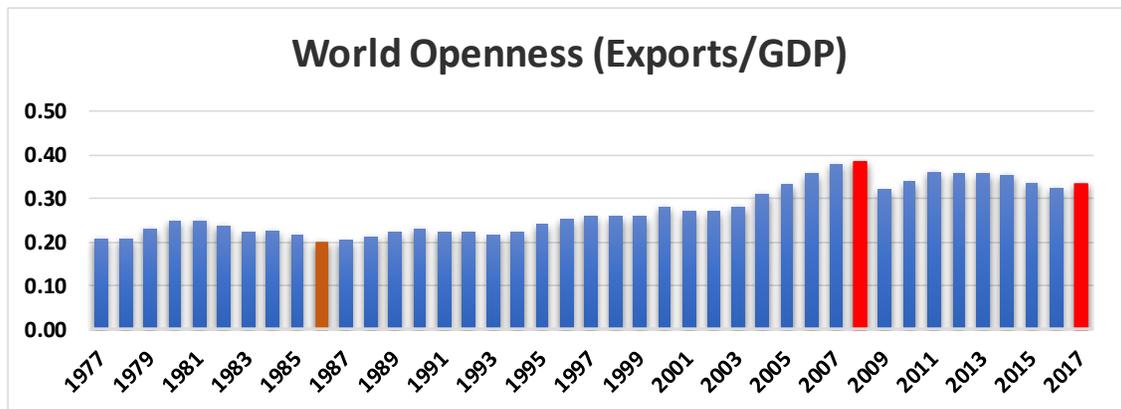


Day 2 Hour 1 Arguments for and against Free Trade

I. Why is free trade advantageous?

In 1986 the level of world openness (defined here as world exports/world GDP with both measured in current USD) was roughly 0.20. Beginning in 1995, openness started to rise, reaching a high of 0.38 in 2008. This is roughly a doubling of international trade activity in 13 short years. The dramatic rise in trade is shown in the figure below. Much of this rise in trade can be attributed to the opening of China and emerging markets, along with the myriad trade relations these countries established and nurtured. There are other reasons as well. Today, there is definitely an increasing trend towards greater economic interdependence among all countries of the world.. But why is free trade so important?



Source: World Bank database

The first thing to note about free trade is that it is between two groups who willingly undertake the exchange. If the trade did not benefit both of these groups, it would not take place. Both buyer and seller must be satisfied whenever there is free trade. This is always true of voluntary exchange, and it is very different from when the government purchases things. Government

may buy something that the majority of people in the country do not want. We should always keep it in mind that free exchange must make both *parties in the exchange* better off.¹

Second, free trade promotes competition and efficiency. When a domestic firm faces only domestic competition, it may not utilize its resources in the least costly manner. It may decide to use its profits to pay dividends to stockholders, rather than using the profits to modernize its factories and upgrade its research. Greater competition places greater pressure on firms to find the least costly way to produce their products. This will free resources which can then be used to manufacture other products in the economy.

Third, free trade can promote development of the economy. Many countries must borrow vast sums of foreign exchange or foreign money to purchase needed goods such as food, medicine, and capital equipment. To get this foreign exchange, such countries must have access to open markets which will allow them to export and earn the foreign exchange. South Korea is a good example of a country which has used foreign loans and a free US consumer market to build their economy into a competitive force.

Fourth, free trade can promote the diffusion of new technologies and ideas. Both Japan and China suffered greatly when they closed their economies to foreign trade. For many years, China was largely behind the world technologically because it refused to engage the rest of the world in trade. Today, China is one of the most advanced countries in the world technologically, but its consumers still remain largely cutoff from the

¹ There is of course the possibility that criminal elements engage in extortion. That is, they require people to buy protection from harm that they themselves create and use to threaten people. This is an example of a private transaction that does not benefit both parties. However, this is not free trade since the criminal element is coercing the buyer to buy protection they are selling. It is not free trade. The existence of criminal elements in society that try to coerce money out of people is one reason why that we need a government.

enormous supply of advanced consumer products in other parts of the world. However, this is not likely to continue in the future. The future rise of Chinese consumers is a force that will no doubt dominate the global economy for decades to come.

Finally, free trade promotes international harmony and peace. History is replete with examples of countries going to war principally because they refused to trade freely with each other. Trading freely between countries creates dependencies that force people and their governments to find ways to overcome their differences. War between EU countries today is unthinkable, even though the region suffered two world wars on their soil during the 20th century with millions losing their lives. A European identity is arising slowly, but it is not as strong as the entrenched national identities. Trade and investment freely moving between countries in the EU is strengthening the bonds between countries there. Free trade is ensuring a peaceful future for the EU.

II. Why is free trade disadvantageous?

While we have listed some of the good points in favor of free trade, we must acknowledge that no country in the world practices pure free trade. Every country in the world engages in some sort of protectionism, although there is less pressure today than before for these policies. But, why do countries seek to protect themselves from foreign trade? Are protectionist actions sometimes justified and the right policy?

First, some industries are important for the national defense and public safety. Generally, most economists agree that agriculture is a necessary industry for every country, since importing food during war might not be feasible. The same argument might be made for certain basic industries such

as steel and chemicals. But, unfortunately, it is difficult to classify industries in this way. Each industry believes that it is necessary to the national defense.

Second, free trade can cause social dislocations and adverse structural changes in the economy. Free trade in agriculture has displaced thousands of domestic farmers in some countries. There are some that say the [tremendous loss of manufacturing jobs in the US](#) beginning in 2000 was caused by cheap imports and off-shoring of work. Manufacturing employment fell about 4.5 million jobs between 2000 and 2018. That's about 3% of the US labor force, but the jobs represented an important part of the well-paying blue collar positions in the US.

Third, some people feel that free trade can only help resource and technology rich countries. They feel that the US is championing free trade because it has the greatest economic strength and will therefore benefit the most. Countries which are underdeveloped and do not possess the resources and technology of the US will not be able to compete. Their economies will not be able to grow if US, European, and Japanese products are allowed to be imported freely. Protection is necessary in order to level the playing field.

Fourth, some people feel that traditional culture suffers when there is free trade. If US pop culture can be imported freely into a country, it might disrupt the value system of the young in that country. A generation gap might even appear between the young and old. This is of great concern in Mainland China where the term "spiritual pollution" was once used to describe this effect. In other countries it has been called "cultural imperialism".

Finally, some people feel that free trade is a wonderful idea theoretically, but it is impossible to enforce. There are simply too many subtle ways that a country can restrict trade. Even if trade is free for a while, if a country feels that its national interests are at stake, it will simply impose protection. In this sense, free trade can never be a law, but can only be a principle -- and as we all know, principles can be subjectively interpreted.