

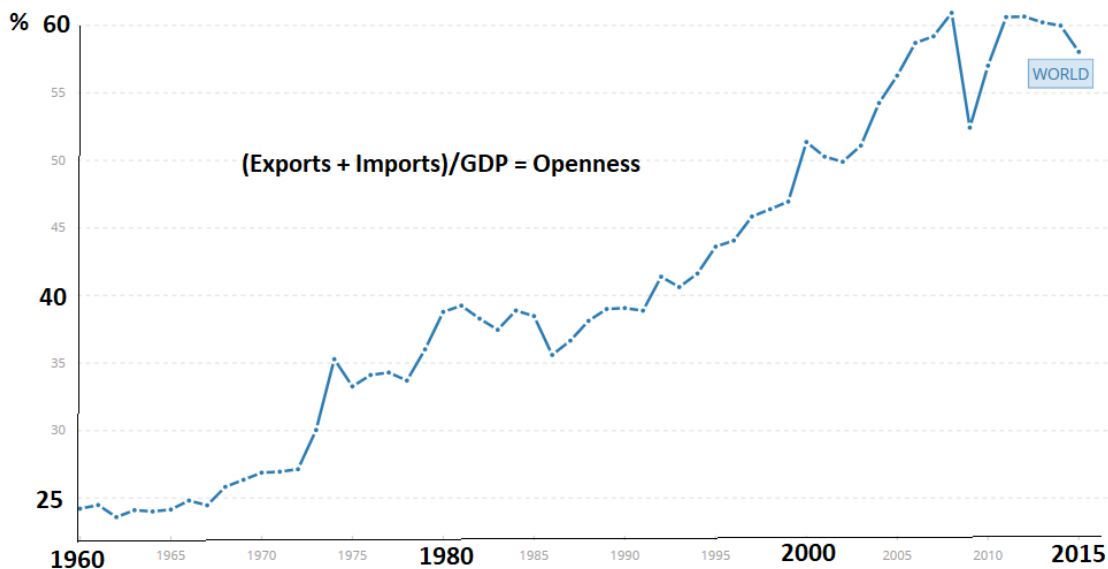
# Chapter 1

## Arguments for and against Free Trade

### I. Why is Free Trade Advantageous?

There has long been an increasing trend towards greater economic interdependence among countries of the world. A great integration of the economies of the world has been accomplished through Mercosur, the African Free Trade Zone (AFTZ), ASEAN, NAFTA, the EU, the inclusion of China and India into the world's trading system, and the growth of Emerging Markets and Developing Economies. The institutionalization of GATT (1948) into the WTO (1995) provided an enormous boost to trade and more recently the proliferation of free trade agreements (FTAs) has further promoted globalization. The lowering of trade barriers for goods and services across borders has lifted hundreds of millions of people out of grinding poverty and has provided hope for a higher standard of living and greater dignity. The maintenance of freedom of trade is a problem of both economics and politics. In this reading, we want to look at why free trade is advantageous and why some people reject it. The last section briefly looks at some ways free trade is suppressed in some countries.

**Figure 1 – Trade as % of GDP**



Source: World Bank

There are five clear reasons why that people support an expansion of free trade.<sup>1</sup> Here they are.

<sup>1</sup> Watch [Milton Friedman](#) discuss free trade and protection. Note his reference to economics and politics. Please take some notes. Its only 12-13 minutes long.

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 groups, it would not take place. Both the buyers and the sellers must be satisfied. This is always true of voluntary exchange, and it is very different from when the government purchases things.<sup>2</sup> We should always keep it in mind that private free exchange must make both parties in the exchange better off.

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 (i.e. labor and capital) 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 grow and provide an exceptional standard of living.

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 decades, China remained largely behind the world technologically because it refused to engage the rest of the world in trade. [Mao believed that China needed to prove it was self-sufficient](#). North Korea has the same odd ideology called [juche](#). However, China has since made impressive progress through the opening of its markets and the aggressive adoption of new technologies. By contrast, North Korea continues to be the hermit kingdom.

Finally, free trade [promotes international harmony and peace](#). History is replete with examples of countries that refused to trade freely with each other and were eventually drawn into war because they didn't have strong business ties that would help to mediate the split. Countries that trade together do not fight each other. The chances today of the US and China becoming embroiled in a hot war is very low. Neither side is willing to pay the high cost of a long and devastating war. Long before any hostilities erupted, trade would have to dwindle to a fraction of its value today. These trade flows make negotiating a solution much more attractive for all concerned.

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<sup>2</sup> Quite often government uses public money to buy things that reward friends and cronies. That is, the public who foot the bill do not necessarily gain from the trade undertaken by government in this case. It is this problem of who is pays for the goods that often keeps the trade from being undeniably, mutually beneficial. It is easy to construct examples where one group pays, but is not necessarily the group that benefits.

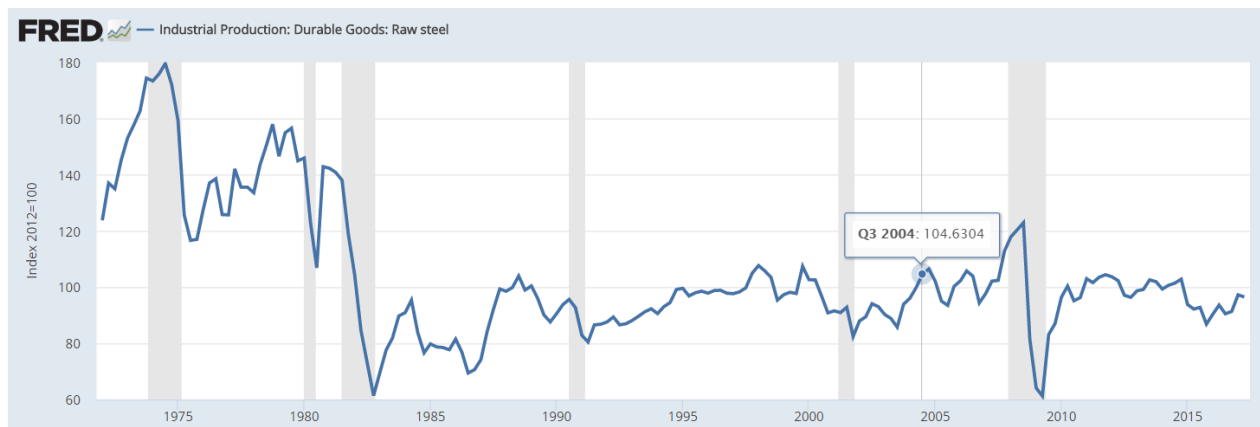
## II. Why is Free Trade Disadvantageous?

While we have listed some of the good points in favor of free trade, we must acknowledge that no country in 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?

First, some industries are important for the national defense. 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. For example, free trade in steel in the US nearly resulted in a destruction of the steel industry as Asian and European producers gained substantial market share. Trade protection was extended in the 1970s and 1980s. However, as Figure 2 shows steel production in the US fell 80% from the 1970s to the 1990s. It has somewhat precariously stabilized for now, but President Trump has claimed that protection of US steel is a legitimate goal for his administration. The share taken by Canada and Mexico through NAFTA has been large at well over 25% of US steel imports. China enjoys only 4% of US steel imports. Today's market requires a scaling down and intensive use of technology. More on this [here](#).

Figure 2 US Raw Steel Production



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 can be imported freely. Protection is necessary to level the playing field.

Fourth, some people feel that traditional culture suffers when there is free trade. Just as technology can spread through greater trade, cultural trends can also spread through trade and economic interaction with foreigners. [Here](#) is a recent and brief 2015 op-ed piece from China that carefully tries to admonish people to show greater respect for their own culture and not fawn over western culture. In 2012, [Hu Jintao](#) specifically warned (the CCP) of the dangers of western values and culture encroaching on the Party's Marxist rigor. It was a pep talk for communists, but alas it seems to have had little effect on trends. Perhaps Marxism in China has become more aggressive with the rise of Xi Jinping, but the country is unlikely to turn away so easily from its trend towards liberalization.

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.

### III. The Tools of Protectionism

When a country restricts its trade with another country, it uses various methods to accomplish its goals. These methods are the tools of protectionism. When we think of protectionism we must consider both protection from trade in goods and services and protection from international financial exchanges. As we have said, all countries practice protectionism to one degree or another.

The most common form of protection is tariffs and quotas. It is also the most visible. Tariffs are an important source of revenue for some countries, and lowering these tariffs would force the government to seek other forms of taxation to offset the loss. Quotas have the undesirable feature of choosing an allocation scheme. For example, a textile quota requires that all textile producers be given some part of the total quota, but such an allocation scheme is almost always unfair.

A more menacing and less visible form of protection is the non-tariff measures (NTM). This is a broad category which includes any restriction on imports which is not a tariff. A good example of this is health and safety regulations. Japan has become the focus of attention for NTM's recently. A ridiculous case, which was discussed often in the news, was Japan's refusal to import foreign beef because Japanese had different digestive systems than foreigners. A similar case occurred when foreign skis were not allowed to be imported because Japanese snow was unlike foreign snow. These examples serve to illustrate that NTM can be an effective, surreptitious way to restrict imports.

Another commonly used tool of protectionism is control of the foreign exchange rate. By making the domestic country's money less expensive, vis-a-vis a foreign country's money, exports can be

increased and imports restricted. In the past, when the world was on fixed exchange rates, a country could improve its trade by devaluing its currency. Its exports would rise, imports would fall, and domestic employment would increase. In contrast to this, the foreign country would find its imports rising, exports falling, and employment shrinking. This policy was aptly called the "beggar thy neighbor" policy.

An oft used method to protect domestic industries is capital controls. In this case, the government limits the amount of foreign exchange which can be bought and sold by any person. This makes it difficult for money to be invested abroad and for foreign firms to invest in the domestic country. Furthermore, some countries allow their citizens to freely invest in foreign countries, but do not allow foreigners to invest as easily in their own country.

Two important tools of protectionism which have become popular in recent years are the voluntary export restraints (VER) and the anti-dumping duties. During the 1970s and 1980s, the US often sought VERs to limit the number of products exported to the US. The best example of this were the VERs on automobiles and steel. Anti-dumping duties are also used to penalize foreign firms who sell their products in the foreign market below the domestic cost of producing them.

#### Discussion Questions:

1. Give some arguments for free trade.
2. Give some arguments for protectionism.
3. Do you feel trade should be free? Why or why not?
4. Does Taiwan have enough foreign products here being sold?
5. What are some of the tools of protectionism?
6. Is Trump right in saying that Chinese trade with the US has been unfair?
7. Is it better for a country to export than to import?
8. Can free trade destroy traditional culture?