VOLUME - 10, ISSUE - 10, OCTOBER - 2021 • PRINT ISSN No. 2277 - 8160 • DOI : 10.36106/gjra

Original Research Paper

Commerce

Economic Impact of Unilateral Free Trade

Aarnav Narain Jalan Modern School- Barakhamba Road, India

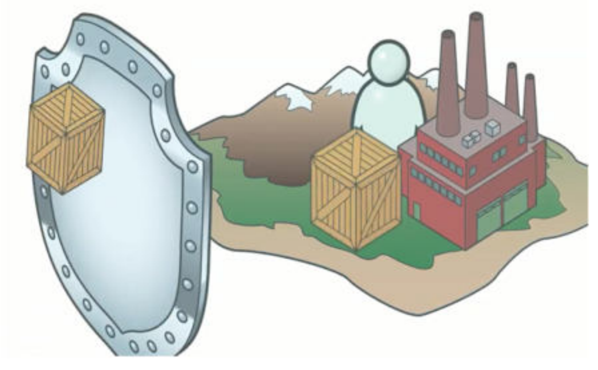
Ms. Anshika Bajaj* *Corresponding Author

KEYWORDS :

INTRODUCTION

President Donald Trump condemned the interdependence of the United States with other countries in a speech on March 24th, 2020 saying, "This crisis has underscored just how critical it is to have strong borders and a robust manufacturing sector. - "… Our goal for the future must be to have American medicine for American patients, American supplies for American hospitals, and American equipment for our great American heroes." [1] The United States has also been part of the ongoing US-China trade war, with both sides imposing numerous tariffs on each other's imports. These actions speak to the protectionist economic policies of the Trump administration.

Protectionism



Protectionism refers to an economic policy in which a country seeks to safeguard its domestic industries from the external competition through tariff and trade barriers that cause foreign goods to become more expensive and therefore undesirable compared to domestic products. On the face of it, this seems like an effective way to safeguard domestic industries however there is a lot more to it.

David Ricardo's Theory of Comparative Advantage

David Ricardo's Theory of Comparative Advantage explains why countries should take part in international trade and directly opposes protectionism. The theory argues that countries can benefit from international trade by specializing in the production of goods for which they have a relatively lower opportunity cost in production i.e. a comparative advantage. For example, if English workers can produce cloth at a low cost and Portuguese workers can produce wine at a low cost, then Ricardo recommends they would exchange these goods they made at a lower cost for ones that they could only make at a higher cost. It follows that the wealth of both countries would increase as labor and capital would be optimally employed and directed to the sectors in which native skill and opportunity were at their greatest. [2]

However free trade continues to remain a politically controversial topic even though it is supported by economists. Dan Ciuriak and Jingliang Xiao (The Canadian Council of Chief Executive) undertook a 2014 study in which theorize that even though the Canadian government would lose roughly about $4 billion in revenue by removing all tariffs, it would save over $75 million budgeted for collection of border taxes and management of free trade agreements. This paper also projects output gains of over $20 billion annually due to additional economic activities because of lower costs for firms engaged in trading. These benefits would surpass those from mutual tariff elimination under any of the major preferential trade agreements that Canada has been pursuing. [3]

When comparing estimated gains from unilateral liberalization to preferential liberalization through trade agreements, not only do the gains from the unilateral route come without the distortions associated with FTAs, they are more certain to be realized as the question of utilization of preference wouldn't enter into the equation. [3] Thus, unilateral free trade policies deserve serious consideration.

Case Studies

An analysis of three countries that have adopted policies of unilateral free trade –Mexico, Australia, and China the clearly demonstrates the practical benefits that these policies have had on their national economies.

1) Mexico

Let us begin with Mexico which offers a great example of unilateral trade liberalization. Between 2008 and 2010, Mexico unilaterally reduced its average industrial tariffs from 10.4% to 5.3% as a key feature of its "National Agenda for Competitiveness" was to decrease and simplify tariffs and imports more competitively. These changes led to Mexico moving from 74 to number 22 in the World Economic Forum rankings for market access. On the export side, the government removed many requirements and established an electronic window to promote easy access to required filings. In addition, the government adopted procedures to accelerate business registrations based on an electronic application. 12,000 internal regulations and over 1300 bureaucratic steps for businesses were eliminated. These regulatory improvements are projected to save Mexican businesses and citizens $ 3.9 billion over a six-year period. [4]

2) Australia

After the Second World War, Australia followed a policy of import replacement to boost its domestic industries. Rising commodity prices and the loss of traditional British markets revealed the negative impact of protectionism on Australian productivity and economy. Trade liberalization began with removing import licensing in 1960, unilaterally cutting tariffs by 25% in 1973, and further tariff reductions thereafter. Between 1970 and 2000, total effective rates of assistance fell from 35% to 5% according to theWorld Trade Organisation. [5] Trade liberalization was a major factor in strengthening the Australian economy which has grown for nearly 3 decades and didn't experience a recession for 27 years according to a 2019 report. [6]

3) China

China's experience presents an interesting model of liberalization. Before the late 1970s, China's commodity trade was almost entirely determined by the State Planning Commission's import plan which covered more than 90% of all imports. At this time, a significant share of China's exports consisted of goods for which it did not enjoy a comparative advantage in production, and producers had no incentive to expand their international sales. This limited China's ability to finance imports embodying advanced technology that could have contributed to productivity growth and economic expansion. In 1977, China was the 30th largest trading country, and its share of world trade was 0.6%. [7]

This system was gradually dismantled in the 1980s and largely abandoned by the end of the 1990s. China unilaterally dismantled its strict control over foreign trade with average tariffs declining from 56% in 1982 to 7.5% by 2015. The coverage of licensing requirements fell from around half of imports and two-thirds of exports to less than 4% and 8% respectively. As a result, imports expanded from just 2.5% of the Chinese economy to over a quarter, [7] while growth accelerated as China took advantage of cheap labor to ultimately become the world's largest exporter. It has remained so since 2009. [8]

Mexico, Australia, and China display a similar pattern of development. Protectionist economic policies cause commodity prices to rise while unilateral liberalization leads to consumers enjoying lower prices and an increase in quality and choice of goods. As economies liberalize unilaterally they also modernize. There is an influx of trade and capital investment and free trade boost economic welfare by fostering specialization, choice, competition, productivity, and spreading best practices.

Arguments for Protectionism

Despite high commodity prices, complacent economies, weakening of industries over the long term, stagnation in quality, innovation, efficiency, and its other ill-effects, protectionism remains popular among politicians and among people.

Common arguments in favor of protectionism are is that lowering trade barriers may cause domestic producers to face greater competition for outside producers. However, economic theory and hard evidence demonstrate that protectionism is an extremely ineffective way to sustain and empower domestic industries and jobs in the long run.

In fact, introducing new tariffs to protect domestic producers tends to harm the citizens of a country. This can be illustrated by the effect one of the tariffs on Chinese goods by the U.S.A had on American citizens.

In 2018 President Trump imposed a tariff on imported washing machines. Not only did this lead to washing machines in the USA becoming more expensive, but it also increased the cost of complementary goods like dryers by nearly 12%. The price increase attributable to the tariffs was $86 and $92 respectively. Nearly all major domestic and foreign brands increased prices following the safeguard tariffs. This measure motivated companies to shift more manufacturing of the U.S.A, foreign producers advertised new jobs on the order of 1,600 following new production plans in the United States. The tariffs resulted in an increase of consumer costs by $ 1.542 billion and bought in approximately $ 82 million. These figures reveal a consumer cost of roughly $820,000 per job. [9]

In practical use, lowering import barriers has led to increased economic activity, saved households a considerable amount of money, and allowed producers from all over the world to tap into international markets and grow their businesses and economy. It also leads to capital investment in local businesses and has turned many small regional businesses into huge companies that provide massive economic value to the state.

Unilaterally free trade and liberalization have, on the whole, turned developing countries into developed countries with modern economies.

Another common argument against unilateral economic liberalization is that it compromises a country's negotiating power. It is considered that trade agreements work best when they are reciprocal.

However, the benefits of unilateral free trade experienced by local consumers and businesses would likely garner support. As consumers of other countries become aware of the benefits of unilateral free trade, their governments may come under pressure to lower import barriers themselves. Moreover, economists have argued that the reciprocation of other countries in lowering trade barriers isn't a condition for the success of unilateral free trade policies in growing a nation's economy. In his book Capitalism and Freedom, famous economist Milton Friedman argues that it would be beneficial for a country to abolish its import tariffs even if other countries don't reciprocate. He proclaims that unilateral free trade is the fastest path to economic prosperity and that reciprocal negotiation of tariff reductions is slow and displays tariffs in a positive light. [10]

Drawbacks of Unilateral Free Trade

The major drawback of unilateral free trade policies is that they harm unspecialized industries that don't have a comparative advantage in a country. These industries produce goods at much higher prices compared to foreign competitors that can produce goods at a cheaper rate. It is these industries that are the most vulnerable and prone to decline when a nation establishes a policy of unilateral free trade. An interesting example is a repeal of the Corn Laws in 19 th century Britain.

Corn Laws were trade restrictions on imported food and grains which were in effect in Britain from 1815 to 1846. They blocked the import of cheap grains into Britain and increased the power of landowners and raised food prices and cost of living for British citizens. The first two years of the Great Famine of Ireland of 1845 forced a resolution due to the urgent need for food supplies and led to the repeal of the Corn Laws. [11]

Although this move came with the benefits of free trade, it caused a massive setback to British agriculture in the following decades. In 1877, the cost of British-grown wheat was around 56 shillings. By 1886 this price had reduced to 31 shillings. Wheat-growing land declined by a million acres. Britain's dependence on imported grains grew from 2% in the 1830s to 45% in the 1880s. The 1881 census recorded a decline of 92,250 agricultural laborers since 1971. Agriculture's contribution to the national income dropped from 17% in 1871 to 7% in 1911. Farmers with mediocre skills and marginal lands were at a disadvantage. Many moved to the cities, and unprecedented numbers emigrated. Many emigrants were small under-capitalized grain farmers who had been squeezed out by low prices and the inability to increase production. [11]

This can be mitigated by liberalizing the economy in phases. The primary phases should include opening up sectors of an economy in which domestic production is specialized. Only after this, the unspecialized sectors of the economy should be opened up to foreign producers. This gives domestic producers time to either adapt and specialize or minimize their estimated losses. The benefits of an open economy can only bear fruit if steps are taken to mitigate the downside. Governments must enable everyone in the economy to find their natural strengths. This can be done by investing heavily in education and measures that maximize social mobility.

CONCLUSION

Intellectually, unilateral free trade wins the argument. In the long term, an economic policy of protectionism is an inefficient way to safeguard domestic industries. It leaves citizens with less money.

On the other hand, unilateral free trade policies increase competition which leads to goods being cheaper to buy for the average consumer. It doesn't allow an economy to become complacent; instead, it forces producers to be responsive and become more efficient. It leaves citizens with more money and makes an economy specialized and competitive, thus serving the economic interests of the country.

ACKNOWLEDGMENT

I would like to express my special thanks of gratitude to my teacher Ms. Anshika Bajaj, who gave me the opportunity to undertake this economics research project on 'Economic Impact of Unilateral Free Trade' and for guiding me and helping me finish the project.

I would also like to thank the Principal, Dr. Vijay Datta, for providing me with the facilities required.

REFERENCES

1. "Remarks by President Trump, Vice President Pence, and Members of Coronavirus Task Force in Press Briefing", James S. Brady Press Briefing Room, 5:43 P.M. EDT, March 24, 2020, https://www.whitehouse.gov/briefings-statements/remarks-president-trump-vice-president-pence-members-coronavirus- task-force-press-briefing-10/
2. Comparative Advantage https:// en. wikipedia. org/ wiki/ Comparative advantage# cite_note-1
3. "Should Canada Unilaterally Adopt Free Trade?" By Dan Ciuriak and Jingliang Xiao, May 12th, 2014 https:// papers. ssrn. com/ sol3/ papers. cfm? abstract id=2435302
4. AID FOR TRADE 2011: STORIES EMERGING FROM THE CASE STORIES https://www.oecd.org/aidfortrade/48294363.pdf
5. Trade and Domestic Reforms: The Australian Experience, Peter Varghese AO, February 3rd 2014, https://www.dfat.gov.au/news/speeches/Pages/trade-and-domestic- reforms-the-australian-experience
6. "Australia has gone 27 years without a recession—here's what's behind the country's economic run", by Andrea Miller, February 8TH, 2019, 12:20 PM EST https:// www.cnbc.com/2019/02/08/australia-has-gone-27-years-without-a-recession.html
7. "Trade Liberalization and Its Role in Chinese Economic Growth", by Nicholas R. Lardy, November 14th, 2003 https:// www. imf. org/ exte rnal/ np /apd/ seminars/ 2003/newdelhi/lardy.pdf
8. Which country is the largest exporter of goods? https:// www. investopedia. com/ ask/answers/011915/what-country-worlds-largest-exporter-goods.asp
9. "The Production Relocation and Price Effects of U.S. Trade Policy: The Case of Washing Machines" by Aaron Flaaen, Ali Horta and Felix Tintelnot, April 18th, 2019 https://bfi.uchicago.edu/wp-content/uploads/BFI_WP_201961-1.pdf
10. Corn Laws https:// en. wikipedia. org/ wiki/ Corn Laws# CITEREF Wood ward 1962
11. "In 1962, Milton Frieman Made the Case for Unilateral Free Trade as the Best and Fastest Path to Economic Prosperity " by Marc J. Perry, October 1st, 2018 https://www.aei.org/carpe-diem/in-1962-milton-friedman-made-the-case-for-unilateral-free-trade-as-the-best-and-fastest-path-to-economic-prosperity/