Free Trade vs. Protectionism: Exploring the Rationale Behind Trade Barriers

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Abstract. International trade plays a crucial role in the global economy. Today, more than 25% of global output is exported goods. Among them, specialization is the core of international trade because countries could apply their comparative advantage to increase productivity and reach economies of scale. However, governments imposed many trade barriers like tariffs and quotas despite the potential inefficiency and waste. This article analyzes trade barriers and finds that international trade promotes competition, economics of scale, scientific and technological innovation, etc. However, in some cases, the government may choose to use some trade barriers temporarily to protect domestic products, increase government revenue, and enhance national defense. How, if used for a long time, it will cause inefficiency and waste resources for industries and consumers. Therefore, the balance between free trade and trade barriers should be found and the trade off should be carefully evaluated in the global context, an open and fair competitive environment should be considered first to promote economic development and improve the quality of human life.

Keywords: Free Trade; Protectionism; Trade barriers.

1. Introduction

Steven E. Landsburg once wrote in his book The Armchair Economist “International trade is nothing but a form of technology”. He learned it from his friend David Friedman about the Iowa Car Crop thought experiment. In the study, the wheat grown in Iowa is shipped to Japan and exchanged for Toyota automobiles, which allows countries to apply their comparative advantages to lift efficiency.

However, governments imposed many trade barriers like tariffs and quotas despite the potential inefficiency and waste. They create these restrictions for reasons, such as increasing government revenues, protecting native producers, etc. In this essay, we will look at the benefits of international trade, the implications of trade barriers, and the trade-off between possible profits from trade and the imposition of limitations. By doing so, we hope to shed insight into the motivations for trade barriers as well as the intricacies of economic efficiency in the global economy.

2. The benefits and challenges of global trade

International trade plays a crucial role in the global economy. Today, more than 25% of global output is exported goods. Among them, specialization is the core of international trade because countries could apply their comparative advantage to increase productivity and reach economies of scale. For example, economist David Ricardo's comparative advantage theory demonstrates that when countries specialize in producing items for which they have a lower opportunity cost, overall output levels grow, generating a win-win situation for trading partners. In recent years, many countries enjoy international trade because trading works as a "dynamic force" to boost economic growth. The empirical study researched by G.V.Vijayasri points out that import substitution and export trading lead to the growth of economies. In addition, international trade fosters the development of technologies, and many technologies are also exchanged between countries. The research on the Chinese economy conducted by Peng Sun and Almas Heshmati indicates that the Chinese government made an all-out effort to develop the country’s science and technology level by imposing many policies to increase the hi-tech trade and the application of new technologies in domestic industries. The government also established the national strategy “Trade Vitalization through Science and
Technology” and a high-tech favorable environment to boost the development of technology in China.

However, the empirical evidence suggests that while international trade has overall positive effects, it can also lead to certain challenges. By Economic Policy Institute, the United States runs a trade deficit each year, which means the country’s imports exceed its exports and reach a negative net balance in its balance of payments. In 2007, the U.S. borrowing was $2 billion every day. Running a trade deficit for an extended period causes the domestic currency to depreciate, making imports more expensive for consumers.

Furthermore, the concentration of production in specific locations or countries might expose the global supply chain to risks. The COVID-19 pandemic illustrated the dangers of over-reliance on specific countries for key products and services. For many exporting countries, the costs of shipping air cargo increase because of the rise in demand for necessities caused by the cancellation of flights. For instance, the air freight costs between China and North America increased by 30%.

To deal with the uncertainty and potential loss in international trade, the government will set up some trade barriers to restrict imports and export to achieve balance. Among them, the most common means of government restrictions include tariffs and quotas.

A tariff is a tax placed by a government on products and services imported from other countries to raise the price and make imports less appealing, or at least less competitive, in comparison to domestic goods and services, and the quota is also imposed by the government to restrict the value of products that a country could trade. These are the most common methods for governments to restrict exports from other countries to limit the development of other economies. There are many reasons for governments to impose these trade restrictions, such as infant industries, reducing trade deficits, and national security concerns.

The infant industry argument is the government creates a set of rules and agreements known as trade policies to ensure balanced trade with other nations, and the government usually gives import quotas and higher tariffs on imports to shield industries. In the study of Jing Ma and Yuduo Lu, they indicate that governments must give temporary protection to the infant industry against foreign competition. A mature industry should reach economies of scale to have a certain competitiveness. The protection will provide some time for infant industries to develop their technologies and skills to achieve economies of scale and compete with foreign industries which already reach it.

The case of the U.S. tinplate industry in the late nineteenth century provides an example of protection for the infant industry by higher tariffs. Right after the civil war, because of the mistake tariff code taken by the Secretary of the Treasury, the tinplate industry did not receive any effective protection. As a result, roughly three-quarters of tinplate was imported from North Wales and was dumping the U.S. market in the late 1860s. However, in 1890, the chairman of the House Ways and Means Committee William McKinley represented the tinplate producers and proposed a higher tariff, pushed from 30 percent to 70 percent for over six years (1 July 1891 to October 1, 1897). Many firms entered the industry after the higher tariff was imposed, the quantity of native production reached the import amount in 1896, and in 1899 the percent of domestic production was nearly 90% of the market.

The higher tariffs may lead to larger government revenues. The empirical evidence points out that in order to collect sufficient revenues to pay off the debt from the Civil War, the U.S. Congress kept tariffs high. As a result, the federal government was running large fiscal surpluses. By the data posted by the WTO in 2022, the total imports of the United States are $2,232.8 billion. To increase national revenues and make the country stronger, in 2018, former United States President Donald Trump raised a series of tariffs against different countries and products, including aluminum and steel. The data provided by the Federal Reserve Bank of New York illustrates a list of the rise in new import tariffs in the United States including 25% on steel imports, 10% on aluminum, and 25% on $50 billions of goods from China. The customs duty of the United States is nearly $100 billion in 2022.

The increase in import tariffs will rise government revenues and decrease the country’s trade deficit at the same time. By doing this, governments could minimize costs and find a balance. However, the high trade deficit will cause the depreciation of the country’s currency and increase the
costs for import goods. In the case of the United States, because of contract processing and the lack of light industry, the U.S. imports far more than it exports. In 2022, about 19.6% of imports are textiles and clothing, and the government has to deal with the huge trade deficit. In 2017, the deficit was $568.4 billion and about 2.9% of GDP. To reduce the trade deficit, the U.S. government introduced many high tariffs in 2018. On 2018, August 16th, the U.S. doubles the tariffs on steel and aluminum imports from Turkey, which responds by doubling its tariffs on 22 U.S. products.

Another reason to give trade barriers is to maintain a reliable national defense. Even, Adam Smith, who is considered the father of free trade, wrote in 1776 that “defense is much more important than opulence”. National security concerns affect the export side. When a country is subject to sanctions and threats, it can fight back by restricting exports. For example, United States President Donald Trump imposed a series of tariffs on Chinese imports due to Chinese theft of U.S. intellectual property. In addition, he said that these planned tariffs would make the United States “a much stronger, much richer nation”.

Conversely, trade barriers come with significant costs and consequences. Since 2016, former President Trump imposed numerous tariffs on a variety of imported goods. These tariffs bring lots of extra revenues for the government, but the tariffs also cause a huge increase in the price of imported goods. According to 2022 import levels, these tariffs currently impact over $350 billion of imports and exports and increase consumer costs by approximately $51 billion every year. In the empirical work, researchers illustrate that the aggregate US real income reduce by approximately $1.4 billion per month by the end of 2018 after President Trump introduced the tariffs.

High tariffs and quotas could build up protectionism for domestic producers, but overall inefficiency will happen. Those who benefit from the policy, the owners, and workers of protected industries, are organized and willing to spend resources to lobby and influence political decisions. Confused consumers and taxpayers often don't realize the extent to which they lose out on tariffs.

Based on the above reasons and consequences, policymakers should evaluate the trade-off between free trade and trade barriers. International cooperation, multilateral trade agreements, and dispute-resolution mechanisms play a vital role in fostering a conducive environment for trade. Policymakers must consider the benefits and costs that come from temporary trade barriers and long-term economic benefits, the potential for innovation and productivity gains, and the welfare of consumers when formulating trade policies. For example, China was isolated in international trade because of planned economic strategy and inward-oriented policy before 1978. The planned economy encouraged the growth of the domestic industry during the initial period, and several national industries were established to foster economic growth. However, due to a lack of competition, the optimization of resource allocation could not be achieved, and the Chinese trade sectors could not enjoy the dynamic benefits of international trade. In the planning era, China ranked near the lowest in the world in gross national income per capita. Since the eleventh Central Committee of the Communist Party of China (CPC) laid the foundation for reform and opening up, many ports in the southeast were established as special economic zones (SEZs) under the influence of Deng Xiaoping, a leader and pioneer for opening up. Then, China start the paralleled trade liberalization and become the world's second-largest economy. Figure 1 shows the sharp increase in China’s GDP per capita after the reform. To make the best decision, policymakers should consider the country's actual situation, analyze the advantages and disadvantages, make a good risk assessment, and then make a choice.
3. Conclusion

In conclusion, multilateralism and free trade have become dominant in international trade, cooperation, and exchanges among different countries promoting win-win results and harmonious coexistence of global trade, because international trade promotes competition, economies of scale, scientific and technological innovation, etc. However, in some cases, the government may choose to use some trade barriers temporarily to protect domestic producers, increase government revenues, and enhance national defense. However, if used for a long time, it will cause inefficiency and waste resources for industries and consumers. Therefore, the balance between free trade and trade barriers should be found and the trade-offs should be carefully evaluated. In the global context, an open and fair competitive environment should be considered first to promote economic development and improve the quality of human life.

References


