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Trade Policy: Free Trade versus Protection

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Abstract

Trade is an engine for the economic growth of most of the countries over the world. Trade policies have played a vital role in the development of the international division of labour with some becoming dominant and others dominated. Since the end of World War II in 1945, globalization has advanced broadly and international trade has been greatly facilitated by agreement among trading countries on a set of rules for international trade. A country can have its own trade policy whether it is free trading or

employs protectionism policy depending on the country's industrial and economic development. In this paper a literature review has been done on both trade policies to summarize their advantage and disadvantage if a country chooses to follow one of them. Then and their implication of trade policy in the respective textile and apparel industry has also been reviewed.

Key Words: Trade policy, free trade, protectionism, Textile and Apparel

1. Introduction

Since the conclusion of World War II in 1945, globalization has advanced broadly and international trade has been greatly facilitated by agreement among trading countries on a set of rules for international trade, known as the General Agreement on Tariffs and Trade (GATT) (Issues, Federal, Bank, & Chicago, 2007; Milner et al., 2004). Today's international trade, through the series development of these rules and agreement, is increasingly involving global value chain (GVC) with a globalized market and fragmented production system. In the existing global division of labour, services, raw materials, parts and components are exchanged across countries before being incorporated as final products that are shipped to consumers all over the world (Oecd, 2015) depending on the trade policy of participating countries.

Countries (developed and developing) are engaging in the international trade through their agreement to the international trade policy to increase their GVC participation to obtain goods and services that some other countries can produce at relatively lower cost than they can in exchange for goods and services that they can produce at lower cost than the other countries can (Issues et al., 2007). And according to a series of theories of international trade and global economy circumstances currently, free trade is the main tendency for international trade development, even though there is unavoidably trade protectionism (Ma & Lu, 2011).

According to Adam Smith, the term 'free trade' is based on agreements between nations to remove import barriers, allowing foreign goods and services to compete on a level playing field with domestic products. 'In other words, free trade implies complete freedom of international exchange. Protectionism, on the other hand is an economic policy of restricting trade between nations through high tariffs on imported or exported goods, restrictive quotas, a variety of restrictive government regulations designed to discourage imports, and anti-dumping laws designed to protect domestic industries from foreign take-over or competition(Adele & Fouda, 2012). Therefore, the aim of this review is to see the comparative advantage and disadvantages of these two trade policies for the developing world to promote their economic growth.

2. Free Trade

In free trade policy, there are no barriers to the movement of goods between countries and exchange can take its perfectly natural course. Free trade is supposed to help the developing country to improve their economic conditions, to modify productive specialization and foreign trade relations in order to increase the relative share in production and trade of tradable goods particularly those produced with labor-intensive technologies(Gallardo, 2005).

Free trade is meant to improve the economy of all participating nations(OECD, 2015), and the policy can be adopted unilaterally or on a bilateral basis by joining a free-trade area which is a group of countries

without any tariffs or other trade restrictions between them, but remaining free to control their trade with non-members of the area(Łopusiewicz, 2011). The main argument for trade liberalization is an assumption that exposing a country's economy to international competition can lead to greater efficiency (Black et al. 2009).

2.1. Benefits of free trade

The classical pro-free trade argument cites the benefits of the increased competition and specialization that free trade brings: lower prices/costs, more variety of goods, and higher quality of goods. In the longer term, these factors increase productivity growth and living standards. Another common argument swings more toward the political side: trade barriers can cause conflict between countries and lead to fearsome trade wars that destroy the potential for mutual benefits from trade, and also spark the possibility of military conflict.

A more contentious justification for free trade is its effect on job creation. Economists pointed out three principal gains from free trade; direct economic advantages of foreign trade, indirect effects as benefits of a high order and the economic benefits of commerce by those of its effects which are intellectual and moral (Irwin & Tervio, 2002). A country's trade policy is the key link in the transmission of these benefits to their national economy (Schiff & Tarr, n.d.). As most nations and regions continue to become more involved in the world economy, it is critical that the states, in their economic development efforts, explore the foreign trade structure

of their economies to obtain a clearer understanding of where their industrial comparative advantages lie (Ma & Lu, 2011).

It is also believed that free trade increases prosperity for participating countries and their citizens' nations by allowing consumers to buy more, better quality products at lower costs. It drives economic growth, enhanced efficiency, increased innovation, and the greater fairness that accompanies rules-based system (Boudreaux, n.d.). In reality it is hard to believe all these things will be true specially for the developing countries whose home industries are at the infant stage to compete with imported products from developed countries.

Both theory and evidence on the free trade suggest that income rises and is more evenly distributed when countries pursue free trade. Comparative advantage is the foundation of international trade and one of the most universal principles in science (Ma & Lu, 2011).

2.2. Arguments against free trade

As free trade is acknowledged to have benefits, there are also a number of arguments against free trade. Free trade implementation has negative results including: aggressive market entry for domestic firms due to import competition from foreign firms, trade diversion, trade imbalance, increasing complexity of the international trading system, economic instability because of the high dependency on global markets, economic underdevelopment, inflexibility, structural unemployment, difficult establishment of developing and new industries, unfair competition,

cultural identity and so on. It is not easy to make free trade fair when developing countries sell raw materials and developed economies manufactured goods. Inequality becomes inherent and unless it is recognized just and fair trade through free trade is not easy to sustain. In general the summery of the disadvantages of free trade is shown in below table

Level	Benefits	Threats
Country	Open market access	Aggressive market entry policy
	Trade creation	Trade diversion, trade imbalance, trade complexity
	Economic growth	Economic instability Economic underdevelopment
	Comparative advantage	Inflexibility
	Employment	Structural unemployment
	Improved investment climate	Difficult establishment of developing and new industries
	Monopoly prevention	Corporate restructuring
	Exchange of raw materials	Environmental concerns
	Intra-industry trade	Exports of primary products
Organisation	Economies of scale	Higher competition
	Foreign exchange rate gains	Dumping
	Production efficiencies	Export concentration
	Higher collaboration	Unfair competition
Consumer	Rising standard of living	Cultural identity
	Greater variety of products	Misrepresentation
	Lower prices	Lower quality

source ((Łopusiewicz, 2011)

3. Protectionism

Though there is no general agreement on what constitutes protectionism, it often involves restricting trade by limiting foreign competition faced by domestic firms. At one end of the spectrum it might be defined as

restrictions on imports through tariffs and quotas; a broader definition might include also the influence of a wider range of government regulations and policies which restrict or distort trade, including those that seek to support domestic industries. Protectionism can thus take many forms, including measures such as subsidies, standards and procurement(Commission, 2014).

Protectionism is used in economics to describe the economic policy which restrains trade between countries or states through methods such as restrictive quotas, tariffs on imported goods and other governmental regulations. These measures are intended to regulate fair competition between imported goods and services and those produced within the country. This policy contrasts with the ideology of free trade, where governments try to reduce the barriers to trade with foreign nations. Protectionism is said to have a largely negative impact on economic growth as well as on economic welfare in general, although this varies largely between different countries and depends considerably on the policy and macroeconomic environment.

From the passage of the Tariff of 1816 to World War II, protectionism was the policy of the United States, "switching to free trade only in 1945, when most of its industrial competitors had been wiped out" by the war. In the late 19th Century, Germany, too, used protectionist measures to grow its industry. After WWII, Japan followed that model(Chang, 2003). Fredrich List advocated the infant industry protection which the Asian

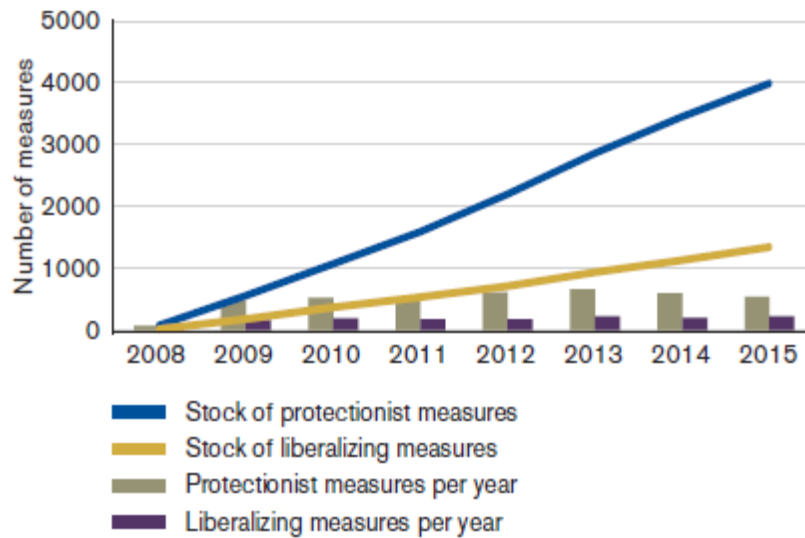
Tigers have used to handle both what they imported and what they exported.

Protection refers to the foreign trade policy of encouraging home industries by paying bounties to domestic producers, or more usually by imposing customs duties on foreign products. The term protection usually carries in a very loose sense the connotation of a tariff on imports; but it may refer to any policy that raises the price of import substitutes and safeguards the interest of domestic producers against foreign competition. Protectionist policies protect the producers, businesses and workers of the import-competing sector in a country from foreign competitors. According to proponents, these policies can counteract unfair trade practices, to allow fair competition between imports and goods and services produced domestically. Protectionists may favor the policy in order to decrease the trade deficit, maintain employment in certain sectors, or favor the growth of certain industries (<https://en.wikipedia>).

Protectionist pressures have been mounting worldwide during the 1980s. These pressures are due to various economic problems inclining the large and persistent balance of trade deficits in the United States; the hard times experienced by several industries; and the slow growth of many foreign countries. Proponents of protectionist trade policies argue that international trade has contributed substantially to these problems and those protectionist trade policies will head to improved results (Coughlin, Chrystal, & Wood, 1988).

Trade protection is the deliberate attempt to limit imports or promote exports by putting up barriers to trade. Despite the arguments in favor of free trade and increasing trade openness, protectionism is still widely practiced through discrimination and trade-restrictiveness (Kommerskollegium, 2016) and the data from General Trade Agreement (GTA) shows that the protectionism policy is prominently practiced more in many countries than the free trade policy.

Protectionism is considered by the economist as the second best approach to correcting for a country's balance of payments problem or the fear of structural unemployment. Import controls go against the principles of free trade. In this sense, import controls can cause government failure. Many countries, though they are advocating free trade policy, but are still using the trade protection policy to improve their economic dominance and to maintain an 'adequate' national defense (Ma & Lu, 2011) but with the systematized trade restriction barriers and it is still safe to say that no state in the world has eliminated all of its trade barriers, and a wide variety of protectionist measures are adopted throughout nation-states and regions of the world.



Protectionist vs. liberalizing measures: Source GAT

Protection of domestic industries allows them to develop a comparative advantage. For example, domestic firms may expand when protected from competition and benefit from economies of scale. As firms grow they may invest in real and human capital and develop new capabilities and skills. Once these skills and capabilities are developed there is less need for trade protection, and barriers may be eventually removed.

3.1. Arguments against Protectionism

No nation has all of the commodities that it needs. Some countries are abundant in certain resources, while others may lack them. Or a country might claim that it has more than enough particular items to meet its needs and enough technology to manufacture or transform its natural products, however, this country might be consuming more than it can

produce internally and thus will need to import from others depicting equilibrium in trade.

The fear of protectionism has deep historical roots(Adele & Fouda, 2012). The first modern political conflict associated with protectionism occurred during the fight over the British Corn Laws in the 19th century (Kommerskollegium, 2016).

Protectionism is frequently criticised as being disadvantageous to the people it is meant to help. A good alternative would be free trade, which allows countries to specialize in the production of products and services in which they have a relative advantage, thus creating more jobs than it destroys. According to economist Stephen Magee, the advantages of free trade outweigh the disadvantages by approximately 100 to 1.

4. In the perspective of Textile and Apparel Industry

Textile and apparel trade policy continues to have a substantial impact on the textile industry in many countries, both in terms of opportunities to export textiles and the pressures brought to bear by imported textiles and apparel.

The Textile and Apparel industries have a long history of protectionism through the Multi-Fiber Arrangement (MFA) that governed world trade in textiles and apparel from 1974 to 2004. Protectionist measures in textile and apparel industry include: tariff barriers, non-tariff barriers, and government subsidies and support packages (Frederick & Gereffi, 2009). After more than forty years of import quotas, the textile and apparel sector

become subject to the general rules of the General Agreement on Tariffs and Trade from 1 January, 2005.

In terms of textile and apparel industries, liberalization has been controversial because both textiles and apparel contribute to employment in developed countries, particularly in regions where alternative jobs may be difficult to find and the sector is among the sectors where developing countries have the most to gain from multilateral trade liberalization. In fact, the prospect of liberalization of the textiles and clothing sectors was one of the reasons why developing countries accepted to include services and intellectual property rights – areas to which they were uncertain at the outset.

Free trade policies have created a level of competition in today's open market that engenders continual innovation and leads to better products, better-paying jobs, new markets, and increased savings and investment in different sector which is true in the textile and apparel industries, though it has its own impact on the dumping issue specially in the developing country where the developed countries' buyer need to dump their excessive and out of season products which has a disadvantage on the environmental issues.

5. Conclusion

In trade policy whether it is a protectionism or free trade they both have their own advantage and disadvantage in the countries' economic and trade development as it is summarized below and countries can evaluate

the advantage and disadvantages of the policies depending on their industrial development. In the perspective of textile and apparel industry, both policies have the same advantage and disadvantage on the development of the industries especially with the issue of dumping the free trade policy has a big impacts.

Trade policy	Advantage	Disadvantage
Free trade	<ul style="list-style-type: none"> ✓ Increased economic growth ✓ More dynamic business climate ✓ Lower government spending ✓ Foreign direct investment ✓ Technology transfer 	<ul style="list-style-type: none"> ✓ Increased jobs outsourcing. ✓ Theft of intellectual property ✓ Crowd out domestic industries. ✓ Poor working conditions ✓ Degradation of natural resources ✓ Destruction of native cultures ✓ Reduced tax revenue
Protectionism	<ul style="list-style-type: none"> ✓ Infant industry protection ✓ Senile industry protection ✓ To diversify the economy ✓ Raise revenue for the government. ✓ Help the Balance of Payments ✓ Cultural Identity ✓ Protection against dumping ✓ Environmental protection 	<ul style="list-style-type: none"> ✓ Market distortion and loss of allocated efficiency ✓ Loss of economic welfare ✓ Extra costs for exporters ✓ Regressive effect on the distribution of income ✓ Production inefficiencies ✓ Trade wars ✓ Negative multiplier effects

Both have positive and negative dimensions. Those that developed like the East Asia Tigers were open to both export orientation and import

substitution. They were inside the global value chain, but they also selected to break aspects of the global value chain. Eventually they managed to use the positive side of each side and try to counter the negative side to undertake the East Asian pattern of development. There are lessons African developing countries can learn. It is either free trade or protectionism, it is how to manage both by valorizing the advantages of each one and countering and breaking away from the disadvantages of both freedom or protectionism of trade. That is the key lesson to recommend for policy learning for developing economies in the Global South.

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