FORUM: Economic and Financial Committee (ECOFIN)
TOPIC: The Issue of Free Trade
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Introduction

In theory, free trade is unassailable. A country may be better at producing every type of goods than another country, but it will continue to make sense to trade. There are very few things that over 90% of economists will agree on. If you ask the question, "Is society overall better off from free trade?" 98%+ of economists would say yes. Imagine putting up tariffs or non-trade barriers between London and Birmingham. It wouldn't make sense. So why put barriers on trade between the UK and China? In practice, if you look in the past, all free trade agreements have resulted in benefits. If so, why are there tariffs and non-tariff barriers? Why isn't there free trade all over the world? Benjamin Franklin once famously said, "No country was ever ruined by trade."

There's a famous cartoon in which Lucy asks Charlie Brown: "Charlie Brown, what would you like. Do you want to be captain of the baseball team or boyfriend of the little red-haired girl?" He replies, "Why can't I be both?" She says, "Well, this is the real world Charlie Brown." Everything one does will come into conflict with the real world. People are irrational and do things that aren't good for them. People are selfish and, unfortunately, we don't live in a world of perfect information where everybody is aware of all the consequences. Theory comes into conflict with real world decision makers. In theory, free trade makes a country better off. In practice, the majority of society are very well off but small segments of society are very much worse off.

Definition of Key Terms

Free Trade

International trade without tariffs, quotas or restrictions. Generally advocated by right-wing, liberal political parties, whilst left-wing parties support "protectionism".

The Four Freedoms

This term refers to the free movement of goods, capital, services and labour in the EU Single Market. They were decided upon in the Treaty of Rome, which was signed on the 25 March 1957 to set up the European Economic Community, the precursor to the modern-day EU. The "four freedoms" are what differentiate the EU Single Market from a Free Trade Area.

Trade Blocs

An intergovernmental agreement in geographic regions where hindrances to trade, eg tariffs or quotas, are reduced or abolished among member countries.

Customs Union

In a customs union, the member states form common trade agreements that decide common tariffs on goods and services from the rest of the globe, with no tariffs on the same goods and services for the participants. It can be considered a free trade zone, with common tariffs and quotas from the rest of the world.

Free Trade Area

A free trade area constitutes a group of countries who agree to put no tariffs or taxes on goods being imported or exported, or services in-between themselves.

Common Market

An agreement between member countries, where they decide to remove fiscal and physical barriers. Uniquely, they allow the free movement of goods, labour, and capital between members. Common markets can improve the individual economies as it increases employment and the GDP of member countries. It also strengthens relationships between the countries.

Comparative Advantage

This advantage occurs when a country can produce a certain good or service at a lower opportunity cost than another. If the country specialises in this good or service, there will be an overall lower opportunity cost, so an increase in economic welfare.

Absolute Advantage

This means that a country requires fewer resources to produce the same amount of products as other countries, and there will be a lower cost to the economy. It's possible to have the absolute advantage in every good and service, and conversely never have the absolute advantage.

Tariffs

Tariffs are added on to imported goods to make them less appealing to consumers. This protects the domestic producers, as their products are tax-free.

Non-Tariff Barriers

Non-Tariff Barriers (NTBs) are restrictions to imports and exports through processes other than tariffs. These include import quotas, custom delays, rules of origin, pre-shipment inspections and import licensing.

Voluntary Export Restraints (VER)

These are government-imposed limits on a quantity of a specific type of goods that can be imported or exported to a specific country during a certain time period. This is generally self-imposed by the exporting country, as the importing country requests a limit to protect the domestic producers of the same product. The exporting country would rather establish a cap rather than incur worse problems with tariffs or quotas.

Infant Industries

These are industries that are recently established and require heavy trade barriers such as tariffs to be imposed from foreign competition, so it can grow.

Protectionism

Protectionism is the policy a government takes to prevent foreign competition taking over domestic products. Tariffs and NTBs are put in place to restrict international trade.

General Overview

Theory
Otherwise referred to as "trade liberalization" or "laissez-faire trade", free trade is the act of trading with the absence of policies, tariffs, or non-tariff barriers. Like Milton Friedman said, "The economics profession has been almost unanimous on the subject of the desirability of free trade." The best way to describe the theory of free trade is with an example.

Imagine you are on a desert island, with two sources of food: Bananas and Crabs. There are only 12 daylight hours in a day, and you need to divide your time sourcing both types of food. It may take you an hour to find a crab, and half an hour to get a banana. In 12 hours, you can collect 12 crabs, or 24 bananas. You split your time to get an even split of each, so you spend 4 hours collecting 8 bananas, and 8 hours collecting 8 crabs. You find another person on the island, named Robinson, who is in the same predicament. He takes 40 minutes to find a crab and 45 minutes to find a banana. In 12 hours he can collect 18 crabs or 16 bananas. He splits his time evenly, to spend 6 hours collecting 9 crabs and 6 hour collecting 8 bananas. In summary: You pick 8 bananas and 8 crabs (total 16) and Robinson picks 9 crabs and 8 bananas (total 17), with a grand total of 17 bananas and 16 crabs per day.

What if you decided to work together? You spend all day collecting bananas, which leave you with 24 bananas every day. He takes the 12 hours to collect crabs, and finds 18 of them. Now, between the two of you, you have 24 bananas and 18 crabs per day, which is more than the total if you had worked separately. As you now have too many of one product, you trade them so that you both end with 12 bananas and 9 crabs.

How did this happen? You were better at collecting bananas, and he was better at collecting crabs, so you both decided to specialize and become more efficient. Therefore, both of you are now better off. Free trade allows companies and countries to specialize on products where they have a comparative advantage, a phenomenon publicized by the economist David Ricardo, to end up in a more advantageous position.

In Practice
Studies have shown that professional economists are seven times more likely to vote for free trade policies than the general public. Politicians generally oppose free trade to garner votes from the working classes, whose jobs would potentially be lost due to foreign competition. Although consumers would be forced to pay higher prices and fewer choices under protectionism, the movement to "buy local" has persisted.

In 1981, the Reagan administration was facing a large problem. US car manufacturers could no longer compete with the Japanese cars entering the market, as they were much cheaper than theirs. The government dictated to the Japanese government that they must restrict their exports to only 20% of the US car industry, or face harsher tariffs applied by Congress. The Japanese self-imposed VER (Voluntary Export Restraints), to prevent suffering further. Although this saved thousands of American jobs, many were unconvinced that this was the best policy. According to the US International Trade Commission, the quota saved 44,000 jobs. The cost in higher car prices were as astronomical as $90,000 per year per job. Further research by the Federal Trade Commission puts the number as high as $240,000 per year per job. The Japanese companies, meanwhile, no longer needed to compete amongst themselves in the American market, so raised their export tariffs and made profits of $2 billion a year.

There are many examples such as this, throughout history. Free trade benefits almost everybody in society greatly, but its pitfalls are concentrated on a small sector of society, which are all the people who have lost their jobs due to foreign competition. You may have to pay £4 instead of £2 for strawberries, which is not a large increase comparatively. Many strawberry farmers may lose their jobs if imports are

much cheaper. If you have many farmers in your constituency, you will ensure that there are tariffs on strawberries to appease your voters, even if in the long run it will benefit everybody in society.

Major Parties Involved and Their Views

The North American Free Trade Agreement (NAFTA)

This agreement created a trilateral trade bloc between Mexico, the US and Canada. It came into effect on January 1, 1994, and will be replaced by the United States-Mexico-Canada Agreement (USMCA) once ratified. Its principal goal was to eliminate barriers in trade and investments between the North American countries, and reduce tariffs on imports and exports. With the USMCA, the US will have more access to Canada's $19 billion dairy sector, incentivize production of vehicles, and increase environmental and labour regulations.

Association of Southeast Asian Nations (ASEAN)

This organisation comprises of 10 nations and promotes intergovernmental cooperation and trade. On 28 January 1992, the ASEAN Free Trade Area (AFTA) was established, which includes a Common Effective Preferential Tariff (CEPT) to promote the free movement of goods between members. Since 2007, member states have lowered import duties to ASEAN countries.

European Union (EU)

The European Single Market, otherwise known as the Common Market, is a single market which guarantees the free movement of goods, capital, services and labour within the EU. This market includes the 28 EU member states as well as Iceland, Lichtenstein and Norway through the Agreement on the European Economic Area. It was designed to integrate countries economically into a single EU-wide economy.

World Trade Organisation (WTO)

The WTO is an international institution that monitors trade agreements, commencing in 1995 after the signing of the Marrakech Agreement. Its two most important functions are that it supplies a forum for negotiating between countries, and ensures that trade policies are carried out. As globalisation progresses, it is necessary to have an unbiased third party arbitrator to ensure the transparency of the trade negotiations. It does this by setting the framework for and reviewing trade policies, and advising developed and less developed countries.

United Nations Conference on Trade and Development (UNCTAD)

Established in 1964, the UNCTAD is an organ of the General Assembly. With 193 member countries, it aids developing countries and formulates policies for development, e.g. fiscal, technological and trade. It aims to eliminate barriers in trade that hinder the progression of countries, negotiate international trade policies, and promote multinational trade.

Timeline

27 December 1945: Bretton Woods System goes into effect. As well as being the moderator of currency exchange, it included restrictions on national trade barriers, as they were considered one of the major reasons for World War II

30 October 1947: First round of the GATT signed in Geneva

18 April 1951: Treaty of Paris signed, which started the European Coal and Steel Community (ECSC), to regulate industrial production under a central jurisdiction

28 January 1992: ASEAN Free Trade Area established

2 May 1992: EEA Agreement signed, which allowed the European Single Market to be extended to countries outside the EU

1 January 1993: European Single Market launched, and the ECSC becomes the European Union (EU)

1 January 1994: NAFTA comes into effect

1 January 1995: World Trade Organisation established

Previous Attempts to Solve the Problem

1) *GATT – General Agreement on Tariffs and Trade*
   The GATT was a legally binding agreement between a multitude of states, which promoted international free trade by diminishing the number of tariffs and NTBs. Its official purpose was the: "substantial reduction of tariffs and other trade barriers and the elimination of preferences, on a reciprocal and mutually advantageous basis." It was the consequence of deterioration of talks to create the International Trade Organisation (ITO), which was discussed in the United Nations Conference on Trade and Employment. It held a total of 8 rounds, and was replaced by the WTO, which was established during the 8th Round in Uruguay, which lasted from 1986 to 1994. The GATT has been successful in reducing tariffs: the average level of tariffs for GATT member states was 22% in 1947, but fell dramatically to 5% by 1999. The Uruguay Round was the most ambitious and the longest. It set out regulations for all trade products and services, and multiple agreements were adopted on Intellectual Property Rights and Investment Measures, to name a few. It concluded in April 1994 in Marrakesh, with the signing of the Final Act of the Marrakesh Agreement.

2) *The United States and the Opening of Trade with Japan (1853)*
   American Commodore Matthew Perry guided his ships into Japanese waters on the 8 July 1853, with the purpose of initiating trade between Japan and the West for the first time in over 200 years. Rumours that Japan had abundant natural stores of coal and its strategic geographic position between California and China enticed the US government to establish diplomatic relations. Perry and the Japanese government signed the Treaty of Kanagawa in 1854, in which Japan promised to protect stranded seamen and open two ports for the refueling of American ships. The first commercial treaty, the Treaty of Amity and Commerce or otherwise known as the Harris Treaty, was signed in 1858, as an extension of the original Treaty of Kanagawa. Once it opened its borders, Japan's military might increased dramatically until it became the most formidable power in the Pacific, and caused the Tokugawa Shogunate to fall from power and the Emperor to take over.

Relevant United Nations Documents and Other Sources

Principles of the WTO

https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm

US-Mexico-Canada Agreement : Text

https://www.fcbf.com/media/US-Mexico-Canada_Trade_Agreement_-_Two-Page_Highlights_Document.pdf

NAFTA Text
https://idatd.cepal.org/Normativas/TLCAN/Ingles/North_American_Free_Trade_Agreement-NAFTA.pdf

GATT Bills
https://www.govinfo.gov/content/pkg/BILLS-103hr5110enr/pdf/BILLS-103hr5110enr.pdf

EU Trade Agreement with Canada
http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf

ASEAN Free Trade Area Legal Text
https://ie.enterprisesg.gov.sg/~/media/IE%20Singapore/Files/FTA/Existing%20FTA/ASEAN%20FTA/Legal%20Text/ASEAN20Free20Trade20Area20Legal20Text.pdf

Free Trade Agreements in South America
http://publicaciones.caf.com/media/38261/caf_tomo_7_.pdf

TPP Full Text
https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text

WTO: The Case for Foreign Trade
https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact3_e.htm

WTO: Agreements
https://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm1_e.htm

American Presidential Proclamation: Adjusting Steel Imports
https://www.whitehouse.gov/presidential-actions/presidential-proclamation-adjusting-imports-steel-united-states/

Questions to Consider

- Should society help displaced workers hurt by free trade? If so, how?
- What are the issues to consider between wealthy and poor countries?
- How do wealthy countries with high wages compete with poor countries with low wages?
- What comparative advantages does your country have?
- Do you have industries you want to protect that would be hurt by free trade?
- Are there national security concerns about free trade?

Possible Solutions

- Tighten up WTO regulations
- Better educate the population to make informed decisions
- Set up an international body, which will "score" a tariff barrier every time one is instated by a head of state (e.g. will save 1,000 jobs at a cost of £ 1,000,000 per job). If the UN had a credible, neutral body that would score every tariff and non-tariff barrier introduced, it could potentially help change lawmaker's minds

- A national system where people who have lost their jobs to foreign competition are retrained in other fields

Conclusion

There is theory, and there is practice. There is economics, and there is politics. What may be economically astute for a statesman to do, may not be politically astute. How they weigh these options based on personal and public policy choice, will influence trade. Hopefully, this committee will band together and make some headway into the issue of free trade, and find a utopian solution that will please all delegates with the perfect amount of bickering.

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