FREE TRADING – THE STRONG DIMENSION OF ECONOMIC LIBERALISM

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Abstract:
Economic theory, taking history on its side, states that free trading brings great benefits to consumers, to society in general and, consequently, it would be the best policy for any country; all together, protectionism has always been present on the international economy stage. For the past two centuries, commercial restrictions (financial and unfinancial) have been one of the intense features of the world's economy. A great paradox of international commerce is that, even if nations want to enjoy the advantages of commercial flows liberalization, they often tend to limit the access to their own markets throughout measures that by their nature vary more and more from the traditional obstructive policies.

Key words: liberalism, free-trading, protectionism, commerce, comparative advantage

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1. INTRODUCTION

Trade has been the bind that "linked up" the two separate worlds, becoming one of the vectors of society progress. The history of trade is ancient, but it always "renews" throughout more and more issues that turn up, and this concept became my motivation for choosing a theme from the vast problematic that is associated to the international trading relations. The aim of this paperwork is to present briefly the main theoretical arguments throughout which the advocates of liberal trading policies argue their option and, to "outline" the place that free trading shares with economic liberalism.

2. FREE TRADE AND ECONOMIC LIBERALISM

For the first centuries A.D. some theologians and philosophers considered the trade between the nations as being a gift from God; Douglas Irwin describes this early vision regarding trade that earned the title of "universal economy doctrine". According to this doctrine, God has unequally spread resources and goods all over Earth in order to generate the trading between various nations and regions. In the IVth century, writer Libanius, was trying to justify the apparition of trade from this perspective. "God has not spread all the goods in every side of the world, but left His gifts in various regions so that, finally, people would be able to develop social relations … And so He created trading in order for all the humans to enjoy the earth's fructifications, no matter the place these were produced"(1).

No exaggeration is being made when stating that commercial exchanges represent the ultimate key to modern civilization. Ludwig von Mises appreciates that trade is "the fundamental social relation" that "… holds together the people in a society"; "the human serves in order to be served" within any commercial relation on a free market.(2)

In a brave wave, Ron Paul, remarks that "politicians love to talk about free trade; but the real free trade doesn't imply either complex treaties nor allocations in order to facilitate the native producers, but the simple elimination of the tax for internal consumers that wish to buy foreign goods". (3)

In reality, there has never existed that kind of trade not to be restricted one way or another. (Hong Kong could though be considered an example of modern much opened economy). History shows, as well, that those countries, which have now a high developing level had not, practiced neither the free trade nor the industrial policies of *laissez-faire*. On the contrary, states as Great Britain and USA, often were passionate advocates of the interference policy, in the first stages of their development.

As part of a state's economic policy, the commercial policy is influenced, among others, by the economic doctrine that predominates in a certain historic period of that respective state; so, the analysis of the foreign economic relations development of a state can be regarded from two perspectives, as a *liberal perspective* and a *nationalist perspective*. Strictly, from the historical point of view, the nationalist perspective has priority, but from the impact point of view, economic liberalism is the dominant doctrine for the last two centuries.

Liberal trading concept, as well as the entire liberal rhetoric, has as main axis the idea of freedom. Free trade respects the individual freedom of the human being; when government interferes to dictate citizens the way to spend their money is like telling the people what they are allowed to do and what they are not allowed to do. In a free society, the individuals that earn their money must be allowed to spend it as they wish. Free trade means that taxes are not so high in order to restrain an individual from choosing freely between the aboriginal and similar foreign products. Free trade means that everyone can sell and buy anything and anytime, without any interference from outside. At the same time, free trade creates favorable conditions for the manifestation of loyal competition that generates extremely benefic effects upon the economical activity; competition encourages producers to realize cheaper products, and this finally favors the consumers.

Free trade bases upon the comparative advantage and international specialization of national economies constitute an optimal estate for the world economy. The world we live in is far away from the ideal one (as *first best*) where "the invisible hand" of the market governs the economic activity, where private stimulants match perfectly with the benefits/costs of society; in the real world (as *second-best*) there are distortions and disequilibrium that contradict sometimes the theoretical arguments.

Th. Pugel demonstrates that in the ideal world as the *first best* the private stimulants match perfectly with the benefits/costs of society - as a whole; in this world, the free trade is efficient, economically speaking. It allows *the invisible hand* of competition to act globally.(4) Individual producers, react the market's price signal, develop their production in every state on levels that are as good as they can be for the whole world. Individual consumers, also reacting to the price signals, increase their consume (purchased products quantities) to levels that ensure the best possible welfare for the entire world.

The world we live in is far away from the ideal one; distortions do exist and they do not automatically reduce one another. We are living in a second-best world, in which exists and manifests disequilibrium between the social costs and benefits and the private ones of an activity. As long as there exists disequilibrium between the way that individuals fundament their decisions and the complete effect of these decisions on society, the private actions will not lead towards the best possible results for society. (For example: in the absence of any distortion, a tax may create a distortion by artificially raising the price. At the opposite pole, in the absence of any distortion, a governmental allocation creates a distortion throughout the artificial raise of price.)(5)

Michel Rainelli presents a simple model throughout which is being demonstrated the impact that introducing custom taxation has on national economy level. The analyzed case is that of a state which contribution to the world consume is low enough in order for the variation not to have any impact on the price of imported goods. The custom tax affects differently the two categories of economic agents inside a national economy: the producers' situation improves while the consumers' aggravates. The overall impact may be evaluated in the terms of national welfare, representing the sum of the economic agents' welfare.

For a given price of a certain good, the consumer's surplus, corresponds with a virtual earn realized by the consumers which were available to buy that product for a higher price. Symmetrically, for each price higher then the initial price, the producers earn an additional profit for those units that they were willing to sell for a smaller price. The introducing of custom tax leads to a raise of the good's price. Consequently, the consumers' surplus diminishes, and the producers' increases, but these two effects do not compensate each other. There is being generated the distortion of production (introducing of custom tax influences the national producers to output more units of the respective good), and on the other hand a distortion of consume (introducing of custom tax influences the national consumers to buy insufficient quantities of the respective g ood). The global impact over the national economy materializes in a net welfare lost.(6)

Many economists believe that besides the elimination of these productions and consume distortions; the free trading has also a series of additional benefic effe cts, especially for the small states in general and for the developing states in particular. Paul Krugman mentions among these, the scale economies and increased opportunities for learning and innovating.

The key argument on which is being built the plea ding of free traders are the following(7):

- Free trade favors *the efficient allocation of production factors*, the states improving their specialization on producing and exporting those goods that bring the greatest advantages;
- Free trading determines *the growth of national prosperity*, being a factor of economical development and growing;
- Free trade facilitates *the improvement for the activity efficiency of firms* throughout obtaining the scale economies; the protected markets determine the production fragmen tation and allow too many firms to enter the protected industrial branch and this way the production scale becomes inefficient for every firm.
- Free trading *accentuates the competition pressures*, instigating entrepreneurs to search new ways for increasing their products' competitiveness; this way, free trading ensures many more reasons for learning and innovating then a „protected" commercial system, where the govern establishes the pattern of imports/exports.

3. THEORETICAL POINTS

For more then two centuries, economists have outlined the benefits of free trading counterpart the costs for applying the commercial restrictions; the traditional case of free trading is built upon the earnings from specialization and trade.

In his famous work, *Wealth of Nations. An Inquiry into the Nature and Causes (1776)* Adam Smith, set the basis for the free trading concept with a persuasion force that maintained its intensity across the ages. In the spirit of the liberal school that he founded, Smith pleads for the natural liberty system where the individual is free to follow up its own interest, while the state has only the role to ensure the legal frame for the development of the economic activity. Promoting his personal interest, the individual promotes at the same time the community interest, being unconsciously lead up by *"an invisible hand"* to accomplish this process of promoting a goal that he does not consciously acknowledge. Free trade is an essential component of the free economic system, since "regularly trading between two countries, without barriers, is always advantageous, even if not equally for the both sides."(8) In Smith's opinion, commerce is not a draw game, as mercantilists used to claim; commerce liberty and regularity brings advantages, it is true thoug h that not always in equal shares for the both partners.

He argues that the state intervention over the commercial flows ensures an unjustified monopoly of the local market. In these conditions, part of the capital and work of a society are artificially oriented towards activities that otherwise they would not seek for, this meaning a deviation from the market's forces free confrontation. In other words, Adam Smith, demonstrates that financial and non-financial barriers restrain free individual action and competition, a freedom that constitutes the engine of economical development.

David Ricardo, aligns himself too in the direction opened up by his predecessor, demonstrating that perfect trade liberty propagates the general advantage (by increasing the o utputs quantities also increases their satisfaction) and reinforces *the universal society of nations*. He proposes a step by step recursion to "the solid principles of an universally free commerce"(9) since this commerce allows each country to obtain the ad vantages throughout the efficient allocation of production factors. "Inside a perfectly free trading system, each country naturally dedicates capital and labor to those kinds of activities that are the most advantageous. This persuasion of the individual advantage is admirably linked to everybody's universal wellbeing."(10)

The comparative advantage principle states that is adequate for a country to specialize on the output and exportation of those goods that ensure the best efficiency; according to Rica rdo, the international trade pattern is not shaped up by the absolute production costs, as considers Smith, but by the opportunity costs. For example, a country is efficient to output the products A and B, and regarding the output for product B is much mor e efficient then other countries; in this case it is more advantageous to export the good B and to import the good A (though it could be produced locally). The comparative advantage principle remains the cornerstone on which has been consolidated the entire international commerce theory.

John Stuart Mill analyzes in more detail the earnings associated to foreign commerce, mentioning the existence of some direct economic advantages, of some indirect advantages and of some moral and intellectual advantag es.

The direct economic advantages derive from the specialization and the countries' opportunity to obtain goods they cannot output; "if each should produce those goods they have the best facilitation" then the world output would be greater.(11) The conse quence would be a more efficient use of world's production forces and even of the world's growth possibilities. As consequence of specialization, a country may produce exportable goods in a bigger quantity then the necessary one for satisfying the local ne ed, so not as a necessity, but as a cheap way to supply with other imported products. This way trading becomes a "method to cheapen the output", in order that finally the consumers to be the beneficiaries.(12)

Besides the direct economic advantages, Mill points out the existence of *indirect advantages*, which result from market's dimensions amplification and products' range diversification. Mill considers that the commodity market extension beyond the national borders leads to a more extended division of la bor, to an intensive use of equipments and, continuing, to inventions and improving of the output process. "A country that outputs for a larger market then the local one may introduce a more extended division of labor, may use a greater part of the product ion capacity and is more interested to innovate and to improve the output processes."(13) In other words, trade has impact on the labor productivity growth and offers the possibility for exploiting the advantages that refer from the scale economies.

Another indirect advantage is given by the fact that openness towards the extraneous throughout commerce sometimes acts like some kind of industrial revolution. Trade facilitates for a country's inhabitants the access to new wares that previously did not knew a bout or could not afford to buy. This way, people are motivated to work more in order to satisfy their new wishes and they even are more tempted to save their money and to gather capital so they can ensure themselves more satisfactions in the future.

J.S. Mill outlines that the *moral and intellectual* ones surpass the economic advantages of the free trading. Centuries ago, besides all the negative sides and effects, the war had though something a little less malignant; it created the contact between people belonging to different worlds. Today, this role attributes to commerce, which is a purpose for the greatest part of the communications that take place between civilized nations.(14) Therefore, commerce is one of the main progress sources; J.S. Mill attribu tes an educational role also, since it teaches the nations how "to look positively" at other nations' welfare and prosperity. And this because a wealthy nation represents a potential commercial partner that is solvent for other nations. Rapid extension and amplification of international trade becomes, as the same author opines, a guarantee not only for the world's peace, but also for continuous progress of ideas, institutions and human rase character.

The hypotheses on which the three liberal classics buil t their pleading are (15):

- the proportions in which products change between them are determined by the quantity of labor necessary for their output;
- the international exchanges are not a goal by themselves, they are subordinated to the economical growth;
- free international trade is an extension on foreign level of the liberal values.

As we can see, Smith, Ricardo, and Mill are convinced of the free commerce virtues. Free trading means an efficient distribution of the output factors, a free competition, and the individuals' freedom of action that is for the benefit of consumers and leads only for a permanent flourishing. The comparative advantage principle and the international specialization ensure to a country an economic efficiency and a greater welfare throughout the participation to international commerce then throughout introducing the commercial protectionism.

Heckscher-Ohlin-Samuelson model continues the ricardian paradigm about the international commerce and tries to find some answers to issues regarding, among others, the immediate results of foreign commerce, the long-term consequences that foreign commerce has upon the economical growth and development, as well as the optimal foreign economic policy. Undertaking and developing the concepts of absolute cost/advantage and relative advantage from the classic theory, the model's authors conclude to the followings (16):

- on short-term, there do not exist losses for the partners in the international exchanges, but only earnings;
- on long-term, the international commerce is more benefic because contributes to each country's economical growth, to equitable repartition both of output factors and final wares between the partners, to generalization of the progressive experience; throughout its stimulation/propagation effect, the less developed countries get closer to the developed ones;
- the necessary condition for efficient realization of commercial exchanges is the absence of financial barriers and of other commercial restrictions; in other words, the optimal foreign commercial policy is that of free-trading, the protectionism being accepted only as an exception, for protecting the industries which are at the begging of their development and for national security reasons.

P. Samuelson appreciates that "the elegant theory of the comparative advantage" represents the unshaken basis of international commerce; free commerce is a compulsory condition in order for the countries to orient their output towards domains that they benefit of the comparative advantage. Each country's specialization in the domain that they have the competitive advantage is benefic for everyone; the exchange terms improve, that means, that finally, workers in each region can produce a bigger quantity of consume wares with the same volume of labor effort. The economy openness generates an increase of the national income, while custom taxation is a source of economic insufficiency; the economic loss endured by the consumers as consequence of introducing the custom taxation for imported wares is bigger then the incomes obtained by the state together with the producers' earnings. But "after the efficient specialization the world moves towards the efficiency's limits". In Samuelson's view, the levy of a custom tax stimulates the local inefficient output, determines the consumers to reduce the acquisition of wares taxed under the efficiency levels and contribute to state's income growth. Out of these effects, the first two ones inevitably imply costs regarding the economic efficiency. (17)

Samuelson also emphasizes the existence of some limits; when the economy confronts with dysfunctions, it is hard to establish if the countries will benefit from the trading process. History has proven that this theory has fewer advocates in those periods when the economic activity is unorganized; for example, while the '30 crisis, nations have built veritable "taxation pill boxes" attempting to recover themselves. The relative advantage theory has regained its attraction force after the Second World War when the industrialized countries met an unprecedented economic growth. But, despite its possible limits, Samuelson attributes the relative advantage theory the status of "one of the biggest truths of political economy" and consider that those nations which do not take it into account "pay a heavy price, quantified in their living standard and economic growth." (18)

Protectionist measures, more or less visible, have become though a reality of the contemporary world; the grotesque situation, as L. Von Mises characterizes, is that all countries wish to limit their importation and, at the same time, to amplify their exportation. These kinds of commercial policies interfere with the world's labor division resulting in a decrease of general labor's productivity. The only one "great achievement' of protectionist taxation is to stop the developing of output where the natural and social conditions are the most favorable. (19)

Milton Friedman is also convinced that "a free commerce not only contributes to world's welfare … but, could also favor peace and harmony between nations…" (20) which differ through historical evolution, language, culture, institutions etc. Not to be submissive to any constraints means being free. From this point of view, protectionism, throughout the rest rictions it imposes, alters individuals' freedom. "…freedom is a whole …anything that limits freedom in one domain of our life may affect freedom in the other domains." (21)

The economic context at the beginning of the XXIst century does not corres pond though to the classic pattern of international commerce, where the readymade wares were produced in one country and transported towards the commodity markets of other countries by air, water, or land. Presently more then one third of the international commerce is the inside-branch type, meaning that a firm outputs the components in a country and mount them together in other country, in order to sell them in a third country or to re-export them in the origin country. Additionally, world economy is influenced by the rapid proliferation of commercial blocks that change the traditional pattern of international commerce.

The globalization phenomenon has extended the exposure degree of firms to the international competition; the markets have been liberalized, and the remarkable progresses in the communications technology domain have generated the integration of financial operations and have facilitated the rapid transmission of market information.

In this kind of context, firms/nations can loose rapidly the comparative advantages they dispose of; in other words, the trade based upon the comparative advantage has become extremely volatile and precarious. When firms from different states have access to the same technologies, they can borrow the capital at the same price, the departure between each ones comparative advantages narrow considerably. An insignificant variation of costs may determine a firm to rapidly migrate from a country to another in order to maintain its competitiveness. This phenomenon is called "kaleidoscopic comparative advantage". (22)

The change of the international context generated two major consequences for the commercial policy (23):

-the firms acknowledged the fact that comparative advantage has gained a volatile character and try to make sure that their rivals do not submit into what they consider to be unfair commerce; they try to pressure the governs and international institutions to harmonize policies in order for all competitors to activate within the same framework;

-international instability accentuation is accompanied by an amplification of the uncertainty feeling of workers; the problem of their jobs incertitude regards at the same time the qualified and unqualified labor; the alternative that firms would reconsider other locatio ns generates pressures coming from the workers in order to introduce a settled framework that should protect their rights.

4. CONCLUSIONS

Economic liberalism has consolidated its concept based on freedom, on individual given primacy, on acknowledged virtues of free competition and free initiative. The key elements of economic freedom are the free initiative, free trade, free competition and, individuals and prosperity protection. The economical freedom also implies the government withdrawal from man y activities, as well as avoiding the blocking actions of free initiative, free trade and the liberty to access and to freely compete on the wares and labor market. In this context the free trade shows like a natural right; it is the expression for individuals' freedom to benefit from their work and the results of their work, to sell and to buy what they want, to whom they want, in the quantities they want and where they want (on the local or foreign market).

Free trade allows nations to benefit of the advantages of international specialization, in a world economy of which predominant characteristic is interdependency. Free trade is the expression of impartial implication of the state, in the purpose of settling and not orienting the commercial flows.

NOTES:

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