Trade Barriers: A Game Between Goverments—Based on David Friedman's Proposition

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Abstract: The aim of this research is to explain why a government imposes trade barriers, even if theoretically free trade will improve the macroeconomic condition of both countries involved. The study is mainly carried out through graph analysis and example analysis. As the research result, the author finds that although the free trade is incredibly complex, it is valuable especially if exploiting comparative advantages and ultimately leads to lower prices and increased quality of life by allowing more consumer surplus to access to more resources. A potential for nations to capitalize on this situation through strategic political tactics can lead to inflated prices compared to their original domestic rates, and the consequent destruction of industries and elimination of competition.

1. Introduction

Free trade has been a hotly contested issue for centuries. The earliest record of a tariff is in Palmyra, an oasis city in the Syrian desert. The tariff was carved on the top of the customs wall, and was levied on slaves, goods and dyed wool to protect domestic industry. In modern times, protests such as those in Germany against CETA (EU Canada trade agreement) have led to thousands of producers feeling disenfranchised about the opposite situation; liberal government policies promoting free trade. The aim of this research is to explain why a government imposes trade barriers, even if theoretically free trade will improve the macroeconomic condition of both countries involved.

2. Analysis on Theories and Examples

2.1 Reasons Why to Support Free Trade

David Friedman was a strong proponent of free trade on an international scale. Both countries can create a useful commodity by exporting what they specialize in. Friedman goes on to state that technological advances like wheat production have helped countries develop as more wheat can be produced per unit of land. This specialized surplus can then be sold. Just as Friedman suggests - a boat full of wheat will "convert" into a car with a country like Japan through trade [1]. He goes further to state that domestic producers of wheat are in competition with domestic producers of cars; both resources have tradable value and therefore a government should not intervene with either unfairly. He stated an intervention in one industry would negatively affect the other as they are in competition for trade. Therefore, Friedman preferred both free trade and minimal government intervention policies.

According to modern economic theory, it is understandable why Friedman was a proponent of free trade. Figure 1, shows the limitations of production for a country producing wine and cotton. This country can produce at any point within the curve, and when maximally efficient can produce along the curve (point A, B or C). The argument for free trade is that if countries have either a comparative advantage in production or even an absolute advantage in production, specialization will result in countries being able to produce more of one good leading to greater returns from trade. For example, if the opportunity cost in this country was ten tonnes of cotton for five bottles of wine, through trade with another country they may be able to acquire six bottles of wine for ten tonnes of cotton. Therefore, it may be worthwhile to specialize in cotton production and trade instead. Theoretically this can result in achieving point Y on the graph, with the country having access to more resources through trade.

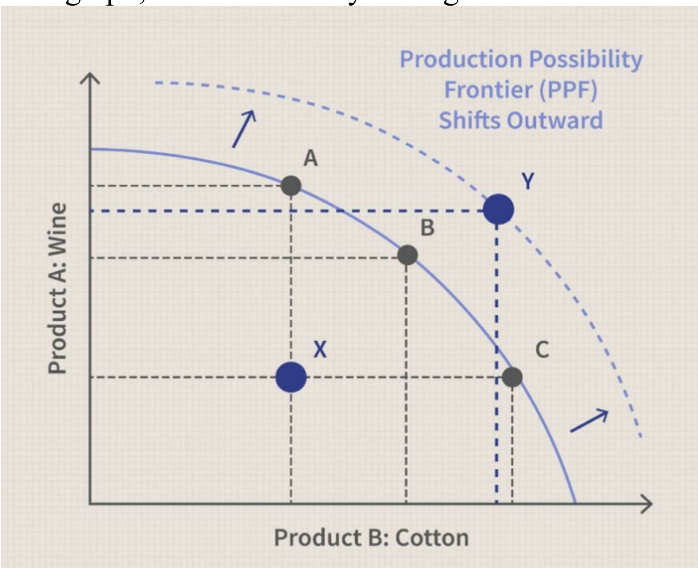

Figure 1 PPF on a national scale.

Adam Smith [2] agreed with this sentiment and believed that when two countries produce different products more efficiently, then both countries can benefit from trade. David Ricardo also agrees with this logic by showing that each country's comparative advantage in production is paramount to benefit from trade. He states that producing goods with lower opportunity costs and trading with other countries in goods with higher opportunity costs can lead to growth, efficiency increases and abundance. The theory of comparative advantage states that even if one country has an absolute advantage, where they can produce all goods more cheaply than another, two countries can still trade on terms that benefit each other; what matters most is relative efficiency. So, whether comparative or absolute advantage exists, there are still benefits to be had from trade.

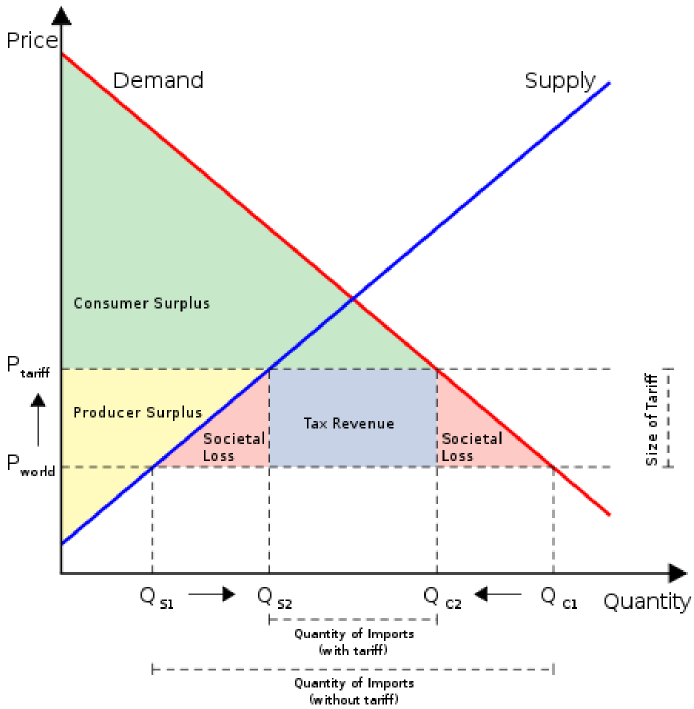

Figure 2 Economic model for trade tariffs effects on the economy.

This strengthens the case for less government involvement in the economy and fewer barriers to trade. Adam Smith [3], a strong proponent of free trade, argued that trade barriers such as tariffs and quotas hurt consumers and hinder specialization and efficiency. Nobel laureate, Milton Friedman, believed that free trade was essential to economic and individual freedom. He argued that government involvement, such as protectionist trade policies would lead to inefficiencies and distortions, while free trade would encourage innovation and competition, thereby raising living standards for all. Similarly, Friedrich Hayek argued that free trade is essential to economic growth and development, and he saw free trade as a key aspect of a free and open society that allows individuals to pursue their own interests and engage in voluntary exchange. It is clear there is a strong body of economic literature that espouse the benefits of global free trade.

In Figure 2, to what extent global trade is beneficial for a country is shown. The P world refers to the price determined by international organizations and is considered to be perfectly elastic. This means that if demand increases in the domestic economy, domestic prices will also increase, however this is not the case for global imports that can theoretically meet all demand requirements. This is considered an excellent advantage; although delivery times may be longer, which is not shown in the graph.

2.2 Explanation for Why a Government May Impose a Tariff

This graph also offers a healthy explanation as to why a government may impose a tariff, regardless of the previously espoused benefits of free trade. The first and most important point being the protection of domestic industry. This is a common practice and the American government has regularly imposed tariffs on a wide range of Chinese goods such as steel, aluminum, and electronics [4]. If a country were to impose a tariff, whereby prices would raise from Pworld to Ptariff, the government would obtain tax revenue represented by the blue-colored area. This tax would lead to more governmental resources to be used on the domestic economy such as healthcare and policing, as well as increasing the amount of domestic business able to remain afloat producing these goods. Consequently, even with the introduction of a tariff, the graph shows that if this remains a reasonable amount, prices would still be lower than if there was full reliance on domestic output, consumption would still increase, and consequently, so would consumer surplus overall; a win-win-win scenario. Therefore, contrary to tariffs being considered negative, there are many positive outcomes that can occur with reasonable policy measures. For instance, Paul Krugman [5] points out that strategic tariffs can provide domestic producers with a competitive advantage, which will increase the producer surplus of the domestic producers.

However, Based on Graph B, it is undeniable that social loss occurs, as a large portion of the total consumer surplus is removed. Some are replaced with taxation and producer surplus, however, there is an undeniable welfare loss shown in the red-colored area in the graph. Before the tariff was imposed, the consumers and producers paid a lower price for these goods and services. However, the tariff resulted in an increase in price from Pworld to Ptariff. As this direct increase in price is borne by the consumer, their purchasing power is reduced. This, in turn, reduces the quantity demanded of these goods, resulting in the overall decline of the welfare of the people; they can no longer access goods at the unregulated price level. This is as Kurer [6] stated, prevents the most effective way of allocating resources.

In this case, producer surplus has replaced some of the consumer surplus resulting in more domestic industries willing and able to produce at a higher price, and therefore domestic output increases. On the surface, this may seem great for domestic residents as jobs increase, output increases as well as consumer confidence. However, Corak [7] aptly states in the long run, this may actually damage domestic businesses further and taking advantage of comparative advantages is key to success in trade. For example, the George W. Bush Administration imposed steel tariffs in 2002 of 30% which were intended to protect the domestic steel industry from foreign competition [8]. While the aim was to boost the struggling steel industry and keep the 187,000 jobs, the tariffs had unintended consequences. The tariff increased the cost of steel for everyone, making it more expensive for industries that rely on steel as an input. Industries such as construction, and vehicle production consequently experienced much higher production costs. The higher steel prices caused by the tariffs made domestically produced cars and other mechanical equipment less competitive compared other global firms. This led to reduced orders, lower profit margins and consequently, staff layoffs. It is estimated that the wider consequences of these tariffs damaged industries so much that the resulting layoffs exceeded 200,000 [8]. This figure exceeds the initial 187,000 jobs that were intended to be saved by the Bush administration. Therefore, not only did these tariffs increase general prices resulting in societal loss, the long-term effects resulted in high-tech industries potentially losing their global competitive edge.

2.3 Power of Quotas

Furthermore, governments regularly utilize the power of quotas for geopolitical purposes, allowing for power games to be played on a large scale. An example of this is China's rare earth minerals export restrictions to Japan in 2010 [9]. It was argued that Chinese fishermen were illegally fishing in Japanese waters, consequently, the Japanese coastguards imprisoned the fisherman and the captain. China, at this time, supplied 93% of the world's rare earth minerals, Japan was a heavy buyer, using these for producing hybrid cars, and guided missiles. Having a powerful monopoly on these goods, the Chinese government blocked exports of rare earth minerals to Japan, demanding their citizens to be released. This directly affected powerful industries heavily reliant on these minerals, and consequently, Japan had to release the prisoners to keep their key industries moving. This led to many countries questioning this monopoly of resources and the power that China has. Nikkei [10] shows that following this incident, Japan invested $134 million in a joint venture with Australia to begin extracting minerals in western Australia. Furthermore, in an effort to reduce dependence on China, America began sourcing and stockpiling rare earth minerals elsewhere SCMP [11]. Therefore, weaponizing rare earths may be very effective in the short run, but ultimately leads to the establishment of new supply chains and eroded trust in the complete global-political sphere.

National security and data protection is also consistently cited factor related to the trade of intangible goods. Recently there have been large-scale discussions of banning Tiktok in the USA. The Guardian [12] highlighted that through American citizens using Tiktok, Congress fears China may obtain user data or promote misinformation and narratives that directly benefit China. Although this can greatly affect employment and trade of services in the USA, it appears that to Congress, the risk of outside cultural influence and data appropriation is more costly to the nation. Congress and several states have banned the use of Tiktok on government-issued devices, and some are considering extending the ban to any app or website owned by ByteDance, Tiktok's parent company. China has countered this argument stating that there is insufficient evidence to prove that TikTok posed a direct and significant threat to national security and this constitutes an abuse of state power. It is clear that with Youtube, Facebook and Twitter banned in China, both countries clearly value data privacy over employment prospects in these fields.

3. Conclusion

Therefore, although the free trade is incredibly complex, it is valuable especially if exploiting comparative advantages and ultimately leads to lower prices and increased quality of life by allowing more consumer surplus to access to more resources. However, in the realm of international trade, a potential for nations to capitalize on this situation through strategic political tactics including practices like dumping or monopolizing goods may exist. This can lead to inflated prices compared to their original domestic rates, and the consequent destruction of industries and elimination of competition. Furthermore, it is not uncommon for companies to wield more influence and power than governments themselves, enabling them to exploit the situation to their advantage. Therefore, free trade is a game in which all nations try to prosper, it requires tact and a skilled hand, and the most skilled players become victorious.

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