Free Trade (Historical Dimensions)

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Description

Discussions of globalization invariably include evaluations of the proposition that the removal of national trade barriers has benefited the participants' economies. Whether these accounts are favourable, sceptical, or critical, and whether they are technical or visceral, they dwell on the eight completed rounds of global trade negotiations held under the auspices of the General Agreement on Tariffs and Trade (GATT) and its successor, the World Trade Organization (WTO). The eight rounds have occurred since World War II. The concept of free trade and associated debates, however, are much older. An intellectual history of free trade with a longer time scale is intrinsic to the history of European empires, classical economics, and a better understanding of current negotiations, assessments, and protests.

Seventeenth Century Origins of Free Trade

During the early modern period (1500-1700), there was intense conflict among European states. Chartered trade companies acted as warrior merchants, especially the Dutch East India Company and the British East India Company. Armed trade was refined into a ruthless art by the Republic of the United Provinces of the Netherlands. At the same time, some kingdoms — for example, France and Spain — attempted to control their economies (Mercantilism) for strategic reasons. Moral philosophers, meanwhile, were critical of trade itself. Unlike Islam which was largely hospitable toward trade and merchants, Christian theology and Church edicts were hostile; they condemned commerce as abetting fraud, promoting avarice, and encouraging worldly gains. Theologians became more liberal as the centuries passed, but the status of merchants who merely traded goods and produced nothing was not high. At best there was theological ambivalence about commerce. Free trade did not have an easy birth in these circumstances.

In the seventeenth and eighteenth centuries, there were early writers about law, preparing treatises on the law among nations and how nations should deal with one another. The most famous of these, the founder of international law, was Hugo Grotius, a Dutch writer and propagandist active in the early 1600s. He was one of the first advocates of free trade. There was an element of national self-interest in his argument, because when he started writing about trade the Portuguese empire had excluded the Dutch from the East India trade, an exclusion that led the Dutch to seize several Portuguese enclaves and to commence building their own empire.

Grotius's *The Law of War and Peace* (1625), made the point that states should not prevent other states from trading with one another; there should be freedom to trade. He also came close to accepting absolute free trade as we understand the term today, and proposed that states should only tax imports enough to pay for state expenses associated with providing security for foreign trade. "For God has not willed that nature shall supply every region with all the necessities of life…. He has granted preeminence in different arts in different nations." In another statement he argued that the very existence of ocean breezes was a sign that God meant that there should be international trade. "Are these things not sufficient indications that nature has granted every nation access to every other nations." Grotius conceived of the world as a single entity, an important step toward globalization today. With him it may be said that globalization as a concept of world unity had its beginnings.

Early Debates: Free Trade or Protection of Home Markets?

Originally, the term free trade or more precisely freedom to trade surfaced in debates in England in the late sixteenth century. These debates concerned the royal charters granted to trading companies, charters that gave them regional monopolies. The term free trade was thus used by anti-monopolists. The shift in the meaning of the term to one that applied to commercial policy came in the mid-1690s when the East India Company began shipping huge quantities of cotton calicoes from India to England. These imports adversely affected domestic production of cotton goods, sparking a clamour for restrictions on the East India Company imports and triggering the first real debate in England. This debate was not over whether the East India Company should be a protected monopoly, but whether there should be free trade in allowing the import of these manufactured goods to continue unimpeded. It was alleged that the imports were causing unemployment and the flight of skilled workers to other countries. These outcomes were contrary to Mercantilist goals.

Eventually the presumption that trade restrictions could accumulate wealth at the expense of enemies and rivals — the doctrine of Mercantilism — was undermined by the theoretical analyses of the Scottish philosopher Adam Smith in his book *The Wealth of Nations*. Smith and a subsequent generation of mainly English writers — the classical economists — established a proposition that is now common among economic thinkers from the early 1800s to the present: free trade is superior to import protection in producing a greater amount of aggregate economic wealth.

The classical economists did have their opponents, notably proponents of mercantilism. Free trade theorists assailed the doctrine of Mercantilism whose advocates produced an enormous and far-ranging body of early economic literature. Most writers and state policies associated with Mercantilism encouraged the state regulation of trade with any of several goals in mind: as accumulation of gold and treasure and the promotion of national wealth; the maximization of employment; the protection of strategically useful home industries; and the increase of state power.

The seventeenth century saw the publication of numerous tracts on trade, simply because the tremendous expansion of overseas trade and exploration during the period promoted many attempts to explain, for the benefit of governments, what observers thought was the essential nature of trade, money and credit, immigration, shipping, and colonies. The pamphlet-based discussion of these topics helped to foster debates over issues that became of lasting interest to the discipline of Economics whose distant origins can be traced to the seventeenth century. Theories about money and prices as well as about trade were conceived of during the era of debates between Mercantilists and free trade advocates.

Mercantilists expressed enthusiasm for policies that would promote merchants and trade; they were not protectionists, but they regarded the aim of trade to be the accruing of benefits to one's own country. An alleged divergence between the private interests of merchants and the broader interests of the nation formed the fundamental basis for the Mercantilist advocacy of the state regulation of trade. State overview, regulation, and subsidy were, they felt, necessary for the alignment of the merchants' interests with the nation's. It is in this period, therefore, that the British and Dutch empires — and even the weakly managed Portuguese empire in Africa — were being extended by government chartered companies. Merchants were being guided and regulated by the state, because companies could have their charters revoked.

Mercantilists were in favour of empires, increasing exports, reducing taxes on exports, and of imposing import taxes on luxury items which they did not think added to the productive stock of the nation. More generally, they were in favour of measures that increased the balance of trade in favour of their own nation against others. In order to export more and import less, these seventeenth century writers recommended the manipulation of exchange rates and modest import duties. Raw materials should enter freely; manufactured goods should be allowed to leave without taxes. The underlying purpose of the Mercantilists' focus on the commodity composition of trade — cheap imported raw materials and manufactured exports — was to promote manufacturing employment.

The sophisticated and complex debates on trade during the seventeenth century were a result of global trade and global imperial struggles for its control. One of the complications of imposing tariffs on imports was recognized and helps explain why in England Mercantilists were unenthusiastic about trade protection. It was realized that trade is essentially a barter activity, and if imports are blocked, then the affected exporting country would have less available to trade for the purchase of goods from the country imposing the trade restrictions. Protective tariffs harmed exports, thus frustrating the Mercantilist goal of a favourable balance of trade.

The Maturation of Free Trade Thought and Debates

Mercantilists had the view that there was a natural disharmony between private interests and public interests, and that this disharmony led to a misallocation that could only be remedied by proper government intervention. Free trade thought confronted this general notion of the state directing a nation's international commerce. It was in the debates over Indian cotton, noted earlier, that an argument about the merits of the division of labour was first worked out with harsh sophistication (Henry Martyn's *Considerations upon the East India Trade* in 1701). If Indian cotton displaced the labour of some domestic tradesmen, argued Martyn, then the country had not lost anything because it gained nothing from having people employed so uselessly. There could be areas where their labour might be more usefully applied.

The most important work in the history of the development of the discipline of Economics and for the idea of free trade came with the publication of Adam Smith's *Wealth of Nations* in 1776. There were earlier statements — by Henry Martin, for example — about the value of free trade, but these were isolated fragments within larger works. The Wealth of Nations was the first book committed to providing an analytically coherent framework for thinking about the economics of trade policy. For the next two hundred years, trade policy debates had to confront Smith's ideas. Smith set up a specific criterion to evaluate the effects of various commercial policies: will a policy increase or decrease the wealth of the nation?

He made several arguments to support the idea that greater national wealth would follow from free trade rather than from protection. First, high tariffs or importation prohibitions create a monopoly for domestic producers, enabling them to charge higher prices, and thus leading to sloth, mismanagement, and a failure to innovate with technological improvements. The people in that industry might benefit, but it is doubtful if the society benefits. Second, Smith believed that self-interested individuals acting on their own behalf would lead to the most efficient allocation of resources from the standpoint of the whole society. Third, Smith established the idea of opportunity costs, that is the trade-offs between alternative activities under resource constraints. He argued that if the amount of resources in a nation were fixed, then increasing the output in any one sector would put strains on the whole stock of resources, and thus the costs of using those resources in some other area of the economy. Thus, to protect a sector against cheaper outside competition would warp resource allocation and cause an increase in the costs of production in sectors that otherwise were more efficient and more competitive.

Smith's ideas would be refined in the early 1800s by a handful of individuals known collectively as classical economists. Whereas Mercantilists had proposed that the aim of trade was to get resources to make domestic products, the classical economists believed that the point of manufacturing at home was to acquire imports. The benefit of trade is not selling exports, but being able to purchase imports. The classical economists were hostile to the Corn Laws which benefited English aristocratic land owners by protecting English grain against imports. In the 1840s, during the potato famine and a period of economic distress, the arguments of the classical economists led to a change in government policy; the Corn Laws were removed. American grain flooded England and brought down food prices, and allowed the English economy to become more concentrated on manufacturing. An indirect consequence was the remarkable increase in population that owed much to improved diet.

However, several of the club of classical economists — Robert Torrens and his associate John Stuart Mill — identified one of the most enduring arguments against a state declaring free trade unilaterally. Classical economic orthodoxy proposed that because of opportunity costs it was always better to opt for free trade. Torrens pointed out that if a state took this step and a trading partner remained protectionist, the free trade state, lacking its former market, would have to buy imports from its protectionist trading partner by using gold reserves. For free trade to be beneficial, it had to be reciprocal according to Torrens. This argument helps explain why we have a multilateral agency today overseeing trade practices. The World Trade Organization and its forerunners were created to supervise global reductions in protectionism, in order to prevent the series of retaliatory measures which Torrens predicted. A free trade state, according to Torrens, would not gain if its trading partners were protectionist. In these circumstances, according to Torrens, the free trade state should abandon free trade. In the 1930s, the last time that states engaged in this kind of behaviour, there was an intensification of an international depression.

Another criticism of free trade was proposed by a friend of free trade, John Stuart Mill. He suggested in 1848 that protective tariffs might be tried for a limited time to promote a new fledgling or "infant" industry. The subsequent debates over infant industries hinged on three key issues as to whether the protective tariff would: create new wealth or merely divert wealth from more productive areas; allow time for producers to develop new techniques, or just stifle the incentives for innovation; generate long term benefits, or simply foster costly industries that would return time and again for government support. In England, the classical economists generally argued against the infant industries claim, but a decidedly different view was taken in the United States, and many European countries, especially Germany. In these places, the argument for state intervention was that new countries or countries behind in technological developments needed time to catch up with dominant states, whether these be Great Britain in the nineteenth century or the United States in the twentieth century. Thus, there should be protection to allow time for technology transfers.

One problem with these arguments was that there is no guarantee that infant industries would use the time bought by protection to up-grade; once a country starts using protective tariffs it can get habituated to them and can, according to the classical theory of free trade, inflict hardship on a country exceeding the costs of harming a segment of the population by exposing that segment to the destructive impact of free trade. Another problem is that if the infant industry was not one that was suitable for the country's resources, why should consumers prop it up by paying higher prices for the domestic product than what they would pay for imports? It might be that the industry is considered strategically important, or that a sector of workers is to be protected, or that an agricultural country chooses industrial protection in an attempt to become more of an industrial producer. In each of those cases, however, the risk is that a country is put on a course of investing in things that will detract from maximizing overall national wealth.

By and large, with exceptions and with political posturing to the contrary, free trade is the prevailing policy of the executive branch of government in major industrialized countries, because their governments recognize the temptations and the costs of protection and aspire to resist them. They also want to avoid a round of retaliatory measures that could lead to a break down of trade like that in the 1930s. Legislative branches of government and local jurisdictions have been less enthusiastic at times, because they have to manage the social costs of allowing unprotected areas to decline.

Non-economic Arguments

There are critics of framing the trade debate entirely in terms of economic theory and wealth maximization. They would contend that the criterion of wealth is too narrowly materialistic and excludes other important societal considerations. There are a multitude of non-economic arguments for protection that are a perennial feature of trade policy debates. The criticisms of the economic approach are fine as far as they go, but proponents of protection often allege that such a policy will benefit the nation without stating exactly the criteria being used to reach such a conclusion, or without exploring the possibility that the desired non-economic ends may be achieved by policies other than protection.

Free trade historically meant the unencumbered movement of goods. More recently, the term has been applied to services, including financial, legal, engineering, cultural, and educational activities which are often restricted or protected by national governments. The long historical perspective suggests that resolutions of negotiations on goods and services will not occur swiftly, that negotiations moving toward free movement will not cease, and that the general arguments pro and con are well-known.

Suggested Reading:

Irwin, Douglas. 1996. *Against the tide: An intellectual history of free trade*. Princeton: Princeton University Press.

Landreth, Harry and David Colander. 2002. *History of economic thought*. Boston: Houghton Mifflin.

McMaster University Archive for the History of Economic Thought

website. www.economics.mcmaster.ca (accessed 17 February 2005).