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# A CHILD'S GUIDE TO THE UNDERSTANDING OF FREE TRADE AND PROTECTIVE TARIFFS

THE first thing to understand about International Trade is that it is not basically any different from national trade, that is, trade between people within a country.

The second thing of importance is that it is not governments that trade, but individuals or companies. It is true that governments do sometimes buy goods from other countries for their own use (for example, armaments) and also that governments do sometimes buy goods for redistribution in their own country for special reasons that will be dealt with later, but all this is only a very small part of the trade that takes place internationally.

The reasons people in different countries trade with each other are simply that they can buy things cheaper than they can from suppliers in their own country, or that certain goods are not manufactured or grown in their own country. For instance, tobacco, cocoa, rice, bananas, etc., are not grown in Great Britain because the cli-

mate is unsuitable, and so these goods are imported from other countries. Individuals who want these goods buy them from the shops; the shops in turn buy them from wholesalers and the wholesalers buy them from the importers. The demand therefore comes first from the individual shoppers in any country who desire these things.

We all know how uneconomic it would be if each of us had to make his own shoes, build his own house, bake his own bread and supply himself with all his needs by his own labour. So it is that individuals concentrate on producing those things which it is easiest for them to produce and then exchange their goods for those produced by other people. In the same way that individuals find themselves best able to produce certain kinds of goods and services within a country, so individuals and companies all over the world find that they are better at producing certain kinds of goods than other people in other countries - and so exchange takes place.

In some primitive communities, people simply exchange their goods directly, without using money, and this is known as "barter". It is a clumsy method because people cannot measure very easily the value of one article with another. It would be difficult, for instance, to measure a cow against a suit of clothes or a number of bags of wheat, and so money has developed. The process of exchange is then made easier. People simply produce their goods and exchange them for money, and then, when they are ready, exchange this money for the goods they require. In international trade it is exactly the same, although, because countries have different kinds of money, it does mean that when prices are calculated it has to be done bearing in mind what other peoples' money will buy in their own country.

Trade is a natural thing and does not require governments to run it.

In the old days people brought their goods to the market place to exchange them, but now, although the goods are shipped from place to place in bulk, the transactions are done through cash, cheques, and banks. Banks have built up over the years a great reputation for trustworthiness and so they act as agents in seeing that people get paid for the goods they deliver even if it is thousands of miles away.

To take one example. Suppose there is in one country a demand by the people for certain kinds of clothing, films and motorcars which are not made in that country, or which, if they were made in that country would be more costly than imported goods from another country. Shopkeepers are aware of this demand and are anxious to supply the goods, as this is good business for them. They ask their wholesalers if they can supply these goods and the wholesalers ask the importers. The importers then find out what people in other countries have to offer, and if the price and quality is right they then order large quantities of these goods and pass them through the wholesaler to the shopkeeper. Eventually they reach the shopper. In this way we can regard the people who run the shops, warehouses and importing businesses as agents, operating on behalf of the shopper. These people, of course, have to work, and their costs are passed on in the price of the goods the shopper eventually buys.

People are anxious to sell as well as to buy, as this is good business, and so those who wish to sell have agents or salesmen in different countries who offer their goods to the importers.

Where trade is free - that is, where governments do not interfere - everything goes smoothly and everyone is eventually satisfied.

In the same way that there is competition among suppliers of goods within a country, so is there competition among suppliers of goods in different countries and through this competition the shoppers in all countries eventually get the best value for money.

Yet international trade does not run very smoothly today. Why is this? Why cannot shoppers, wholesalers and importers who help to move goods between one country and another, be left to trade without hindrance? This is a very good question, and we must examine the reasons why governments impose upon traders, so many different kinds of controls and regulations, and in fact sometimes prevent trade from taking place altogether.

We shall examine each of these regulations in turn so that we can get a clear picture of what is going on and then we must use our own judgement to see whether governments are doing what is best for the people or not.

## Import Duties or Tariffs

WHY do governments levy import duties or taxes on goods coming into their countries?

There are two reasons:-

1) To raise revenue, just like any other kind of tax.

2) To "protect" the producers of certain goods in the home country from competition.

Import duties levied for the first reason are called *tariffs for revenue* and duties levied for the second reason are called *tariffs for protection.*

The word "tariff" really means a list, so that a list of the goods and the different rates of taxes they bear when they come into a country is known as a tariff. Therefore, in international trade, the word "tariff" has come to mean import duties.

The sole effect of tariffs for revenue is to make goods dearer for the consumer to buy, while the government of the country gets the tax for its own purse. Revenue tariffs are always levied on goods that are not manufactured or grown in the home country and which must be supplied from another country. For example, in Britain the government puts import duties on such things as wine and tobacco to raise revenue - these are often called "customs and excise duties." Thus it can be seen that tariffs or import duties which are simply to raise money for the government of a country are not much different from other kinds of taxes on goods.

Import duties levied on goods for the purpose of protecting the home producer from competition must be regarded in quite a different light.

It is true, of course, that these protective tariffs do raise money for governments, so they will always be favoured by governments for this reason alone. But the main idea behind tariffs for protection is that, if the duties are high enough, they will keep out of the country goods made by people in other countries.

It may well be asked, why should governments want

to keep goods out of the country when the people are willing to buy them? It does not make sense. If people did not wish to buy the goods they would not ask for them in the shops, the shop-keepers would not order them from the whole-salers, and the wholesalers would not ask the importers to import them. When goods from abroad come into the country, it must mean that people wish to buy them. But why should buyers prefer them to the similar goods produced by people in their own country? The answer is simply that people like to get the best value for their money, and if producers from other countries can make goods of the same or even better quality, and pay the cost of transporting them over long distances, and still offer them for sale at a price cheaper than that at which the home producer offers the same goods, then naturally people at home will prefer to buy the foreign goods.

Why, then, are the people of a country not left to decide for themselves whether they prefer certain goods produced abroad to similar ones produced at home? The reason is, that the producers of goods at home, finding that producers in other countries can give better value than themselves, are afraid of losing their businesses. They therefore ask their government to keep out the goods from abroad, or to make them dearer by means of tariffs so that they can continue to sell their own goods profitably at home.

For instance, if a shoe manufacturer cannot sell his shoes cheaper than £10 a pair, and shoes of the same quality and style can be imported from another country at £6 a pair, he will try to get his government to put an import duty on those shoes to make them dearer and closer to the price of the home produced shoes. This is called protecting the home producer from competition.

Now of course this is good for the producer of shoes at home. He can go on selling his shoes at £10 a pair and he will not lose his business. But what about the people in his country who have to pay anything up to £4 more than they need to? There is no protection for them!

Sometimes, because goods are not of equal quality or style, people might still prefer to buy the imported shoes in preference to the home produced ones, so that while a protective tariff tends to keep goods out of the country it need not keep them out entirely. However, unless the tariff is entirely ineffective, it must substantially reduce the number of goods coming in from other countries.

Those who benefit from protective tariffs are the manufacturers at home who cannot stand up to competition of the same type of goods from abroad. Because they cannot make their goods as cheaply or as well as the producer in the other country, they often think up arguments to try to prove that protective tariffs are good for *everyone* in the home country, including the customer!

## The Unemployment Fallacy

ONE of the favourite arguments of those who seek to protect their own businesses against competition from abroad is that free trade would cause unemployment. This is the argument:

If goods that are cheaper or better than those manufactured in our own country are allowed to come in from other countries, then it will mean that the workers in other countries will get the jobs making these goods instead of our own workers. Suppose that Britain removed import duties from Swiss watches, then (so the argument goes)

British watch manufacturers would sell fewer watches and so they would manufacture less. This in turn would require less labour and so unemployment would arise in the British watch industry.

Now this seems reasonable enough, but we have not seen *the other side of the picture*.

We have seen that trade is simply the exchange of goods for goods. There cannot be trade if goods go one way and not the other. Therefore if we stop taking goods from other countries, they must stop taking goods from us! So what would happen in the case of the Swiss watches is that as soon as people in Britain stopped buying Swiss watches (because the import duty had made them too costly for people to buy), the exporters in Switzerland would no longer receive British money in payment for their watches. Therefore, people in Switzerland would have less British money to spend on goods produced in Britain. As spending would be *less*, the demand for British goods would be *less* - causing unemployment in Britain.

Now you will see that *tariffs* cause unemployment! This is the other side of the picture.

The contradictory arguments that protective tariffs cause unemployment and that free trade causes unemployment are both "half-truths". The whole truth of the matter is that changing from free trade to protective tariffs, or from protective tariffs to free trade, does not cause unemployment in general - it only *shifts employment* from one trade to another.

Let us see how this happens so as to get the true picture.

Mr A exchanges the hats he makes for shoes that are made by Mr B. Then Mr A says "I can make my own shoes and give myself employment; why should Mr B have the work?"

So Mr A makes his own shoes. But he has now lost the job of making hats for Mr B since Mr B will not be able to take hats from Mr A if Mr A will not have any of his shoes. Has Mr A benefited? No. He has merely changed his job from making hats to making shoes. He has no extra employment, and if it takes him longer to make his own shoes (or if it is more costly for him to do so) then he is the loser - and so of course is Mr B. Remember that trade takes place only when it is cheaper to buy from someone else.

It is true of course that unemployment in a *particular industry* may be caused by importing freely from other countries, but only in the short run. More employment is created elsewhere in the country by the demand for goods to send out in exchange for the goods that come in.

The government of any country could make lots of work for its people if it kept out *all* foreign goods by very high protective tariffs - so much work in fact, that everyone would have to work day and night in order to keep the same standard of living, because home produced substitutes for previously imported goods would take longer to make and be more costly. For example, people in Britain could grow their own grapes in specially heated glasshouses and make their own wine, but it would be very much more expensive than importing it from countries where grapes can grow out of doors without the need for specially heated glasshouses and where, of course, it is much cheaper to make the wine. It is far better for

people in Britain to make machines and exchange them for wine - it gives just as much employment and better rewards. It must be remembered that we do not want work for work's sake - we want the things that work brings us, and we get more reward for our labour if we are allowed to exchange the results of our work freely.

## The Low Wages Fallacy

WHAT concerns most working people today is wages and prices. We have seen that freedom to trade means freedom to buy from producers abroad those goods that cost less. But supposing you were told that free trade would lower your wages, would you not think free trade a bad thing? It would be, if the statement were true, but it is not. Free trade cannot lower your wages. But why should anyone want to make a statement that is not true? The answer is simple - because it is to *their* particular advantage.

If people can be wrongly persuaded that free trade lowers wages, then they will be opposed to free trade, and that is what the protectionists want, for it is to their advantage to keep foreign goods out of the country so that they can sell their own dearer or inferior goods.

The argument that these protectionists use to try to show that free trade lowers wages is false, but plausible to those who do not study the question. This is the false argument.

If the wages of the people who make the foreign goods are lower than the wages of the people in the country that buys them, this will lower the wages of the people in the buying country. This is because manufacturers in the importing country will be forced to pay lower wages to their work-

ers so as to reduce costs to enable them to sell their goods at the same low price as those being imported.

Now let us suppose that a manufacturer tried to lower wages for *this reason,* what would happen?

The first thing is that not all manufacturers at home are in competition with manufacturers abroad. Many manufacturers are not bothered with competition from abroad because they can already make and sell their goods cheaper - or because the goods they make or grow cannot be easily obtained from abroad. As these employers do not compete with firms from abroad they would naturally still go on paying the usual wages. So if the firms that were worried by foreign competition tried to lower their wages, their workers would leave them and get jobs where wages were not lowered. So in the end the protectionist firms would have to pay the same wages as everybody else in order to get workers.

But, you might say, if workers left to join other firms, would not competition for the jobs bring wages down?

If you think this would happen then you have forgotten something. It is this: When goods are imported into a country, other goods must be sent out in exchange. So we see that extra labour is needed to make the goods to send out in exchange. The demand for labour would be the same in the end, and so would the rate of wages.

Wages may vary according to skill, but they do not vary just because the goods have to face competition. If the skills are equal then the wages must be equal, no matter who sells the goods or who buys them.

If firms in a particular industry could lower wages regardless of what could be earned in other industries in the same country, you may be sure that they would do so now without waiting for an excuse! But of course they cannot, for the reasons explained.

So free trade does not lower wages, but it does *lower prices,* and this is good for wage earners.

Another thing that betrays the protectionists' arguments is that they never say that free trade is all right when goods come from *high wage* countries like the United States; they still seek protection from competition.

Do not be misled by the "low wages" argument of people who are afraid of honest competition from abroad.

But when people see through these false arguments, the firms that want protection think up new ways to get their governments to keep out goods from abroad.

## Emotive Words and Infant Industries

WE have seen that the two opposing interests in the question of free trade versus protective tariffs are 1) the producers who do not want competition from abroad and 2) the consumers who must pay more if goods are taxed to protect home industries. Yet many manufacturers succeed in persuading people that protective tariffs are in everyone's interests. They do so often by the use of "coloured" words - that is, words that affect peoples' emotions rather than their minds.

Take the word "protection" itself. This word

makes people think of looking after someone who is weak, or of protecting someone from his enemies, so the use of this word "protection" is intended to gain ones sympathy.

Now let us take a simple statement in plain words and see how the protectionists change the words so as to seek your support.

"An abundance of inexpensive goods from abroad has come into this country."

Protectionists say: "A flood of cheap foreign goods has been dumped on us."

Note the use of the word "cheap" which makes many people think of bad quality; "flood" which makes us think of being swamped or drowned; "foreign" suggests enemies, and "dumped" suggests rubbish. Another use of coloured words is to call all competition "unfair" or "cut-throat", and to describe trade in war-like terms such as "defending our markets" or "attack on our trade." Protectionists never say, help *my* motor business or *my* horticultural business, but talk of *our* motor business and *our* horticultural business. When manufacturers talk of "we", "our", and "us" beware, it is *their* interests they wish to protect, not ours.

It is all very clever but we should not be deceived by emotional language.

Now let us look at two other words used in protectionist arguments. They are "encourage" and "infant".

It is argued that home industries should be encouraged. This means, of course, to the protect-

ionist that they should be enabled to get higher profits than they would get in a free market.

One could likewise encourage robbers by putting up barriers against the police. But is it right? It is a good thing to encourage people but not so that other people stand to lose by it.

Now take the word "infant". Infant industries are new industries that hope to grow into big ones. These industries, it is argued, should specially be protected from competition from abroad, otherwise they might die.

What is ignored in this argument is that if a new industry cannot grow and face honest competition without help, then that industry is not economic. Does a man opening a new shop in the High Street expect the Government to close all the shops of his competitors while he "gets on his feet?" Or should the Government stop people buying goods from the other shops so as to "encourage" the new shop?

And if the new industries are to be supported by protection from competitors abroad their goods *must be dearer* for people to buy than those from abroad. If not, the new industries would not need to be protected!

Manufacturers abroad can produce certain goods cheaper than we can at home only if their costs of production are lower. Protecting an "infant" industry does not lower its production costs. The trouble with protecting infant industries is that once they get this protection from competition, they never grow up!

That new or infant industries can get on well enough without protection if they are basically

competitive has been proved over and over again. People who invest money in new industries are not likely to waste their money if they know the new industries cannot eventually compete with other manufacturers, whether at home or abroad.

Whatever the reasons put forward for protection, remember it is always the customer who has to pay the higher prices asked.

## Trade Interference Helps Nobody

IS IT good to export, and bad to import? Of course not. One cannot do one without doing the other because trade is simply the *exchange* of goods. The more is exported, the more must eventually be imported and vice versa. Yet in spite of this simple logic, many governments are creating the impression that importing is bad for a country and exporting is good. Clearly, if this statement is taken to its final conclusion it would mean that it would be good for a country to send vast quantities of goods abroad and receive nothing in return! This indeed would not be good business. The absurdity is made more obvious when we realise that it would be quite impossible for *all* countries to export and none to import, for one country's exports are another country's imports.

Some people, while agreeing that trade must eventually balance, nevertheless argue that trade must be made to balance *artificially* if a country is importing more than it is exporting. But what is forgotten is that it is only government action that prevents the balance taking place naturally in the first place!

This natural way works quite simply by the market adjustment of the value or purchasing power of one country's currency with another. What

happens is that through changes in the exchange rates of currencies, the goods in the country that is importing more than it is exporting become *cheaper to buy;* this means that more goods are sold or exported - exports go up. At the same time, the adjusted exchange rate makes imports *dearer to buy* and this cuts down imports. This is the natural way that trade balances itself. Whenever trade alters between countries, for whatever reason, it is immediately reflected in the rate of exchange of one currency with another.

Now, it is interference with the exchange rates that starts the trouble. Governments do not allow the natural rate of exchange to operate; they fix it at what they think it ought to be. Thus the problems of international trade are unnatural, that is to say, it is governments themselves that create their own trade problems.

It is bad enough for the people of any country to have to pay more for goods from abroad because of import duties, but governments make goods dearer still, and scarcer still, when, in their attempts to balance trade artificially, they impose quotas, which cut down imports, surcharges, which make imports dearer, and restrictions on spending money abroad; all of which are as unnecessary as they are troublesome.

If we look at any large market place for the buying and selling of goods, do we observe trade not balanced? Do we find more goods are bought than sold? Do the traders need anyone to tell them how much to buy and sell, and what prices to charge? Of course not, because trade is natural.

International trade should be no different. Because different countries use different currencies

the situation is not altered - provided the different currencies may be exchanged freely for what they are worth. And that is decided by what they will buy.

Every person who buys from abroad expects to pay for his goods, and every person who sells expects to be paid. *Trade must balance* if left alone.

It is wrong for governments to fix the price of their national currencies - and foolish too.

What happens when a man insists that his goods are worth more than people are willing to pay him? Why, he cannot sell them! So his "exports" drop.

If buyers and sellers (and remember, it is *people* that trade, not governments) agree on a price, whether they are trading at home or abroad, both are satisfied. When governments change prices by interfering with the currency exchange rates, it upsets trade and acts to benefit one party at the expense of the other - or else it stops people from trading altogether.

So here we have the picture of the world today. Countries are getting into difficulties with their exchanges, international banks are faced with troublesome restrictions, importers and exporters are discouraged, peoples have less choice in what they buy, people pay more than they need to for what they do buy, governments quarrel among themselves over what their money is worth - and all because of the selfish interests of manufacturers who do not like competition, and because of the ignorance of governments that think that planned trade is better than natural trade.

Hong Kong is prosperous, considering its natural

resources are very few, because Hong Kong has free trade; there, goods can be bought cheaply from all over the world. There is no protection and people buy and sell freely. Hong Kong is an example to the rest of the world.

## Trade Arrangements Between Countries - Are they Helpful?

WHEN one hears that one country has made certain trading arrangements with another, we are tempted to fall into the error of thinking that it is governments that trade with one another. Of course this is true of the Soviet Union, China and other communist countries, where private enterprise is not allowed, but for most countries it is individual traders who buy and sell goods. What does it mean, then, when governments make "trade agreements" with other countries? It means that they are interfering with the normal and natural trade. Often this is to help or "protect" home industries, and so it is simply another form of protection.

A government will, for instance, make a regulation limiting the quantity of certain goods that are imported; a "quota" is fixed and when the imports have reached the limit, no more of those goods are allowed into the country.

Often governments bargain with each other to get "concessions". This is sometimes called "horse trading". One government will say to another, "We will reduce tariffs on some of your country's goods if you will reduce your tariffs on some of ours."

Each government speaks as though, by reducing import duties, it is doing a favour to the exporters in other countries. Maybe the exporters

benefit by selling more goods, but the important point is that the people in the home country get *cheaper goods when tariffs are lowered.*

What the bargainers really mean is "If you help *our exporters* by lowering your tariffs, we will help *your exporters* by lowering ours." One would think that only the exporters in each country mattered. In the same way they say "If you put tariffs on our goods, we will put tariffs on yours."

If abolition of tariffs is good for the people of a country, then the tariff should be abolished whatever other countries agree to do.

Some people say that a country cannot have free trade on its own, and that other countries must agree to have free trade as well or it would not be "fair". This is nonsense.

Suppose you were a shoe-maker and you were told by your clothing maker in another country that he was not going to buy your shoes because *his* government had made them too dear by imposing import duties. Would you stop buying his clothing? It would certainly be a silly thing to do if his clothing was good and cheap and the best value you could get. You would not "cut off your nose to spite your face."

Of course this example is very simplified, but what the argument is in effect is that "A" must not be allowed to buy cheaply from "B" because "C" is not allowed to buy cheaply from "D"!

Again Hong Kong is a good example. Although many governments put high import duties on Hong Kong goods coming into their countries, the Hong Kong government does not stop importers in Hong Kong

from buying cheaply from exporters in those same countries.

If a government removes all trade barriers against goods from other countries, it has nothing to fear, even if no other country does the same.

Governments frequently use trade agreements to achieve their political ends. They will, perhaps, say to the government of another country "We will give financial aid to you (or lend you money) provided you spend that money on a certain range of goods in our country." This, of course, is another way of helping particular industries.

Governments also enter into agreements to fix the prices of certain commodities like wheat and sugar - and this often makes those commodities dearer than they otherwise would be.

Another form of protection is for governments to ask exporters in other countries to "voluntarily" restrict their exports of some commodities like butter - so as to keep the price up in that government's own country.

Another bad thing that governments do is to give aid to underdeveloped countries to help them to increase their production, and then put tariff barriers up against their goods!