

Theories and Policies between Liberal and Protection in Terms of Free Trade

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This paper will investigate the key questions of the controversy of free trade. The period of study will start from classical economics to the environment today. A contemporary picture reflected from the free trade and reflexivity will be delivered. The theory is not challenged based on the findings. However, adjustments to policies when an economy implements free trade is necessary. The article will provide a theoretical framework for the government when it faces free trade issues with other countries. The central theme will revolve around policies and factors that affect the mutual benefit of trading parties. The policies from the theoretical perspective on how governments should intervene in the market between protection and trade liberalisation are also included.

Field of Research: Free Trade, Comparative Advantages, The Value of Labour, Environmental Law, Labour Law, Monetary Policies

JEL Classifications: A11, A14, B12, D11, D46, D51, D52, D61, E12, E24, E31, E41, E63, F14, F43, I31, J23, J38, J68, K31, K32, L51, N10, P16, P26, Q11

1. Introduction

Ever since the times when the traditional economic theorists proposed free trade, people who are for free trade, in particularly those who follow the traditional economic perspectives believe that free trade is an integral model where the government cannot easily interfere with the free market. Since the theory was elaborated from classical economists, the notion of free trade has undergone much political and academic debate. The study depicts how humans have worked hard for the freedom of exchange along with the progress of history and how the difficulties remain and how free trade confused the policy makers.

This paper prompts to draw back the originality of economics to investigate the dissents including the evolution of the market, money, labour law, environmental law in relation to comparative advantages. It will also provide insights of the market and the theoretical framework for governments, on how and why they should and should not intervene in the market in terms of free trade.

The article firstly presents the major debate over free trade. Scholar's findings over the benefit of free trade towards the negativity are addressed in the literature review. In order to explain the negativity in context, a methodology of developing an explainable theory by using the multicollinearity studies has come forth. The findings open out from the evolvement of

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trade since the beginning of the history. As the contraction of the evolvement, the article extends to the factors and policies that will affect a country's aggregate value of labour, which is adverse to the wealth of nations and the reciprocity of trading parties.

2. Literature Review

Scholars who advocate free trade state after an estimate, that a state overall can win over those who lose in the free trade market. Nevertheless, Samuelsson (2004) expresses discontent to this idea.ⁱ He believes that free trade will result in a large loss in the power of supply – as a whole a loser will not necessarily lose less than the same amount that the winners win. Aside from Samuelsson, there are many scholars who hold concerns towards free trade. It is to the point that they believe that necessary protection is required towards a country's economy. Hicks (1959),ⁱⁱ believes, that in England the creation of free trade and the discussions about it has caused a loss of confidence towards the concept of free trade. The main reason for this loss of confidence is in the face of mass unemployment, there should be more protectionists' method and to use restrictions to combat the issue of unemployment by limiting free trade.

Jagdish Bhagwati (2002),ⁱⁱⁱ a strong defender of free trade today, also concedes that the market can not easily solve the problem of unemployment by itself. He believes that free trade is not a policy that depends on time, and he views unemployment as a market failure phenomenon, and will influence the overall demand. Marshall (1922)^{iv} from classical perspectives believes that his new classical theory of international trade is pure theory and believes that it does not exhibit the currency factors that lie behind its representatives and commercial credit.

Singer (1950)^v considers "The principle of specialisation along the lines of static comparative advantage has never been generally accepted in the underdeveloped countries, and not even generally intellectually accepted in the industrialised countries." As can be seen from the above literary pieces, scholars perceive that free trade will have protectionist tendencies which are combined in the four main reasons: employment problems, the problem of capital, comparative advantages and productivity problems. However, instead of presenting problems of free trade, is there any theoretical way to explain the problems? This is the paper that intends to bring out and it hopes that it can contribute to the consistency of policy making in terms of free trade.

3. Methodology

This paper is currently being developed and experimented and follows Merton^{vi}'s conception of science being a public policy, upholding the spirit of scepticism, rigorously following the systematic and objective study methods to achieve a credible and effective understanding.^{vii} Most importantly highlights that we can use what we understand to fully comprehend unclear facts and history, to understand the meaning behind it and provide a coherent and comprehensible explanation.^{viii}

The facts that are known are the literature, especially the original texts of economics, unknown or unclear realities are what this paper aims to explore. Such questions are: Why protectionists incline to use more protective methods? What is a tradeoff between market liberalisation and employment? What has employment to do with free trade? What does free trade and employment have to do with a nation's wealth? What is the relationship between

comparative advantages and free trade? How comparative advantages are affected by government interventions? How the trade is developed from money to the economy and how does this have to do with comparative advantages?

Due to the wide scope of study, belonging to the many arguments of theories, this paper has used multicollinearity studies,^{ix} which is the value of labour, to explain and answer the conceptual questions throughout the paper. It uses simplified models to restore^x the most important concepts, such as the relation of market and labour value and related questions with money are also explained.

4. The Findings

4.1 Origin of the Market

From the beginning of ancient communities, people have worked. A simple example of this is when a woman remains at home to take care of household chores and looks after the kids while the man forages outside for food. Initially the main purpose for the value of labour is to provide for the family, however, there is often a product surplus or a deficiency in supply. In the case of a surplus, the people of the ancient ages had many ways to deal with it. Firstly, they could save it up for later use. Secondly, people can help each other; giving away the surplus to relatives or friends and later on this favour can be returned – this is to exchange goods with those close to you. Thirdly, they could exchange with strangers, my celery in exchanged for your carrots – the market is then created. For example: if one person produces potatoes and owns one hectare of land with an average daily work of 3 hours, 30 days later, after 90 hours of labour, produces one hundred kilograms of potatoes – this will be on average 1.1kg of potatoes per hour.

After the person retains the potatoes he needs, the remaining potatoes can be sold at the market. If upon arriving at the market that the person discovers that there is a shortage of potatoes and those who lack food are willing to use a piece of cloth that took approximately five hours of labour to swap with the one kilogram of potatoes – assuming that everyone's value of labour per hour is equal, then the producer of the potatoes would be very happy to conduct such an exchange. However, the person who exchanged the cloth, upon arriving home and realising that their cloth, worth five hours of labour can only exchange for potatoes worth 1.1 hours of labour would believe that it wasn't a good deal, would think that selling cloth is no longer economically savvy and no longer produce cloth. In doing this there will be an increasing amount of people who sell potatoes and the cloth supply will then diminish and after a while, the value of labour would slowly creep towards a real price (one piece of cloth in exchange of 4.55kg of potato). In the short term, according to market supply and demand, the situation of the peoples' preferences towards the better products and the marketing skills will create a market price.^{xi} From this, there is a distinct emphasis on a basic principle of trade from Adam Smith(1776) "Labour, therefore, is the real measure of the exchangeable of the value of labour of all commodities."^{xii}

In practice, product exchange is not very convenient. If an exchanger can not be found, the product may go bad and result in a waste of product. To convenience market exchange, currency appears. In the olden times, currencies have many forms. Shells, iron, gold and silver were the main forms of trade. Gold and silver needed labour and mining for a supply. People then began to use the fruits of their labour to exchange for gold and silver. Gold and

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silver, therefore, according to Ricardo (1911)'s description, becomes a part of the economy, with a relative labour value of gold and silver respectively of 15 to 1. ^{xiii}

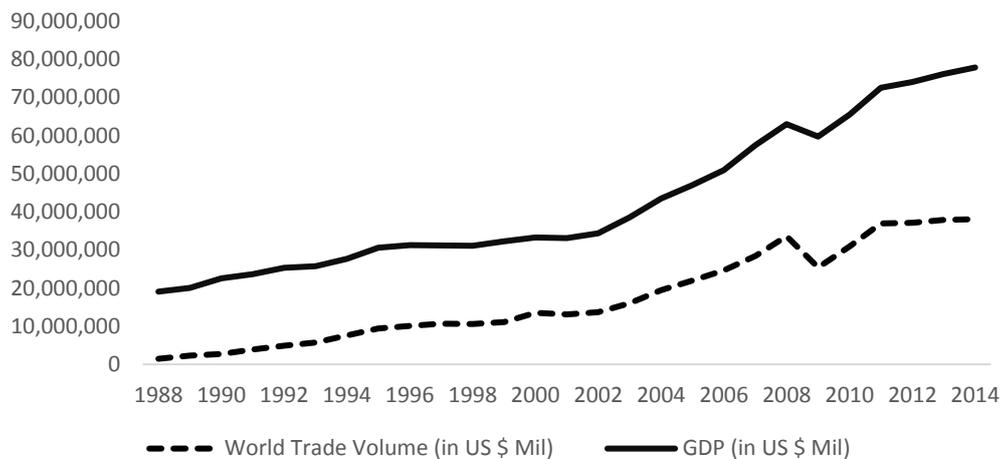
With the inclusion of currency, the aforementioned trade barriers started to diminish. Due to the benefits of the currency on the exchange, more and more labourers will use their value of labour to exchange for currency, and to use this currency to purchase necessities. Wages calculated by the currency, will not increase or decrease labour value. Market produces a "marked price", no longer a barter market and market exchange increases. However, using gold to trade in the market still has its' barriers. If we use private means of casting gold, then the purity of the gold is not guaranteed. The currency's exchange of labour value is therefore uncertain, and due to its possibility of many barriers in trade, the positions of the banks and governments become increasingly important to guarantee the purity of gold – this is all a sign of credit, an important value of labour that possessed by the banks and governments.

There are disadvantages using gold to trade: once gold enters the markets, it will be consumed, and there is the issue of the supply of gold. If the supply of gold can not match the speediness of the demand for gold, as aforementioned, the price of gold will increase exponentially. Though it will not affect the aggregate value of labour, due to the lack of gold supply making the prices of goods and services drop, originally one product for one ounce of gold, will require the same amount for less than one ounce of gold. This will cause a deflationary phenomenon. ^{xiv}

After paper currency appears, paper currencies similarly act as a medium of exchange and eliminate the trade barriers of using gold as a medium. Ricardo agrees with Smith's proposal of using paper currencies: "the issue of paper currencies can reduce the number of coins in circulation and increase the capital in business cycles." ^{xv} The popularity of paper currencies increases. However, when the price of the currency pins down a price of gold, the fate of currencies will inevitably be the same to gold. The demand for gold will increase with the increasing trade and output; the paper currency will collapse.

It is the initiatives towards the trade that people would want for currencies. People remain in need of currencies that they can trust and be the measurement of their production of goods and services. The currency of the American dollar owns similar characteristic of gold. One of the characters is like Smith's valuation in gold and other coins/currencies. "in reality, during the continuance of any one regulated proportion between the respective values of the different metals in coin, the value of the most precious metal regulates the value of the whole coin."^{xvi} The American dollar is not only likely to regulate the value of other currencies, with its wide circulation and stable price, but it has also replaced gold and become the common use currency worldwide.

Free trade barriers are therefore diminished further. Today's American currency is not pinned down by a price to gold and other currencies, either, so it doesn't matter how large the market is, it will not encounter the past issues of exchanging currency into gold.^{xvii} It is because of this reason that the world's market does not have to account for the problem or restrictions that result from exchanging gold. It can be seen from Table 1, the growth of world trade volume and GDP increase concurrently. In addition to the use of money to remove barriers to trade outside usefully, from the GATT to the establishment of the World Trade Organisation, many countries, bilateral or multilateral trade agreements have after the removal of barriers, contributed to pushing up production and trade.

Table 1: World Trade Volume and World GDP

Resource: World Bank

Therefore, people in trade face fewer barriers. People are trading more freely and exchange becomes more frequent. There is a waste reduction, labour value increases and for the national economy, once the economy grows, so does the nation's wealth.

4.2 Changes of the Market

In the previous section: the origin of the market, people in the olden times could go for fishing and hunting for food. If food is scarce, people can cooperate for mutual assistance. For instance, sharing with those around you, relatives and friends for a return in favour later on – these people had the opportunity to work at any time, in addition to helping with their own lives and the lives of their friends and family. Classical economists believe that free trade can have trading parties based on comparative advantages, allowing the value of labour to reach its highest potential, even though this is under the premise that there is full employment. With the evolution of history and economic developments, naturally having a full employment is rarer. Nowadays, if the economy is developing, these people who go out to fish and hunt will have less and less opportunities, especially those in developed areas.

People are not commodities; they are not sold today, they can't wait for a long time to be exchanged without any change of their labour value. Normal products such as tables and chairs can be placed in the storage for a substantial amount of time and then taken out to be sold with no difference to the product over time. However, people are different, they cannot be placed into storage and there until someone would willingly use/hire them. Also during this time, people change. People may contract illnesses; people's skills will also change over time. So once unemployment occurs, it is not only that the value of labour has diminished but also that the value of labour could be facing possible "extinction." Therefore, a country should not let unemployment occur because the skills of labour will reduce and the entirety of the value of labour would also decrease along with it. ^{xviii}

The society has changed to a more competitive environment; the interactions with close family and friends will also change. Living with mutual assistance and cooperation from outside along with the ability to maintain a suitable environment for the family without a job, becomes less likely. In terms of an economy, once people are unemployed, demand will

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decrease, and those with a job do not have enough demand to support their production; the economy will be in crisis. The aggregate value of labour will go down, and the wealth of a country will also decrease.

The above are the changes of the environment that affect employment. The following will discuss the changes and characters within humans and societies that influence the employment. Scholar Richard Brecher (1973) in his studies by using the econometric model states that the characteristics of wages, salaries are contrived to a degree. " Much of the standard (flexible-wage) theory needs revision when the real wage is constrained on a floor."^{xix}The rigidity of the wages has many reasons. For highly developed areas or those living in the city will realise that the cost of living is high, therefore, if the wage appears lower to a certain point, it cannot be accepted.

The rigidity of the salaries/wages is also a societal phenomenon. Scholar Jon Elster (1989) pointed out the idea of social norms: "Social norms are highly rigid, regardless of extenuating circumstances or that better options are on the table."^{xx} When people are living in the society, people do not want to do things that people would dislike or be overly insensitive to other people or groups. Because of the necessity of living in the society, if people are doing the same job, purposely lowering the wages to have more work, then people in the same group would not like them. Similarly, cares from friends and family can also be a concern for a person to accept a job with low wages. These sort of occurrences are an intrinsic part of the society. In Adam Smith's time, he has already observed this and addressed that people hope that they themselves are being beloved but are afraid of being disliked.^{xxi} Under these circumstances, the shift in the labour market is very gradual. Even though as said by the economists "Good job may be lost here in the short run. But still total U.S. net national product must, by the economic laws of comparative advantage, be raised in the long run (and in China, too). The gains of winner from free trade, properly measured, work out to exceed the losses of the losers."^{xxii} However, the reality is that the shift in the labour market is unable to return to equilibrium quickly and the loss of the value of labour should not be ignored.

Therefore, many economists advocate government interventions such as the welfare state schools allocating government income for those who are unemployed to maintain the basic needs. This does not consider the issue of the diminishing of the value of labour from the unemployed. Keynes (1936)'s notions to create jobs by increasing government spending might result in blind investment and inefficiency. Therefore the government should correspond its interventions with the comprehension of the country's culture, society, geography, education, and other areas so that governments' investments could be utilised efficiently.

4.3 Changes of Government Regulations

The government interventions do not play a role in the free trade model, which assumes markets balance by themselves; nevertheless, the interventions such as monetary management, environmental law and labour law from the governments may cause the changes of comparative advantages. The flow of currency has been increasing under the realm of freedom, the trade volume is increasing, and the influence on comparative advantages is also enhanced. An uneven distribution may occur at the nooks and crannies of a market. When a government lowers its interest rate, this will help with the businesses that are struggling; but for those healthy ones that may induce unnecessary investment and

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therefore affect the quality of labour value, which is directly associated with comparative advantages. Another example could be the price of housing in the markets. When the quantity of currency increases, the price will rise however when there is less currency, the price will not necessarily plummet – especially in places that people think are good investments. The uneven distribution may dissatisfy people whose properties float with the price corresponding to the money supply. When class is produced, people would think that they do not reap the benefit of economic growth. If people give up their faith towards pursuing “a better necessities or conveniences of life,”^{xxiii} this may result in a negative impact on their value of labour.

On the other hand, assume a country “A” changes its labour working hours from 40 per week to 35 per week and the countries trade with A does not have any move on the regulation of labour hours. The companies in A country, in order to maintain the businesses, will require a more effective production, which might include the purchase of machines. The machines are in fact exchanged from capital that comes from the value of labour. Therefore, comparative advantages change. Another similar example is the regulation of the environment. If a country’s businesses shift its production between trading countries due to the changes of pollution requirements, this does not affect the aggregate pollution. However, jobs may be lost because of the movements. Jobs lost reduce the value of labour and then comparative advantages. This is opposed to the principle of reciprocity that free trade pursues.^{xxiv}

5. Conclusion

It is evident that there are dissents in many sections of the economy. The paper attempts to explain the dissents through the value of labour. The reason why it centres on the necessity of the value of labour is based on the economy which is run as a collective and human being’s participation. The paper returns to the origin of economics and presents the trade up to today. It discovers that it is the society that has economically developed that has gradually changed and therefore shape the way that humans behave. A quick balance to the equilibrium of full employment is becoming increasingly difficult.

The paper puts forward a theoretical framework to explain the changes. Many factors including government interventions that affect the value of labour and therefore comparative advantages are discussed. The findings show that the theory of free trade is not challenged; however, it is suggested that the government should look at the regulations of its country, the characters of the people and reciprocity of trading parties when it evaluates the policies between protection and liberalisation in terms of free trade.

Endnotes

ⁱ See Paul A. Samuelson. 2004. “Where Ricardo and Mill Rebut and Confirm Arguments of Mainstream economics Supporting globalisation”.p135

ⁱⁱ See Richbourg John Hicks. 1959. Essays in World Economics, Oxford at the Clarendon Press. p48

ⁱⁱⁱ See Jagdish Bhagwati. 2002. Free Trade Today. p17

^{iv} See Alfred Marshall. Fluctuations of Industry, Trade and Credit.1922. book IV, p234

^v See Hans Singer. 1950. U.S. Foreign Investment in Underdeveloped Areas: The Distribution of Gains between Investing and Borrowing Countries. p476

^{vi} Robert K. Merton. Social Theory and Social Structure , Reprint, New York: Free Press.1949/1986.p71-72

^{vii} See Stanley Lieberson. 1992. Einstein, Renoir, and Greeley: Some Thoughts about Evidence in Sociology.” American Sociological Review 56, February: p4 ; John Wood, and Douglas Walton.1982. Argument: The Logic of the Fallacies. New York: McGraw-Hill Ryerson Ltd. Gary King, Robert O. Keohane,

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- Sidney Verba, 1994, *Designing Social Inquiry: Scientific Inference in Qualitative Research*. Princeton University Press. p33; Norman K. Denzin and Yvonnas S. Lincoln (Eds.) 2005. *The Sage Handbook of Qualitative Research (3rd.)* London: Sage Publications.
- viii See Harry Eckstein. 1969. "Authority Relations and Government Performance" *Comparative Political Studies* 2, p269-325
- ix See Gary King, Robert O. Keohane, Sidney Verba, 1994, *Designing Social Inquiry: Scientific Inference in Qualitative Research*. Princeton University Press. p119-123
- x See Gary King, Robert O. Keohane, Sidney Verba, 1994, *Designing Social Inquiry: Scientific Inference in Qualitative Research*. Princeton University Press. P48-50
- xi See Hui-Chin Lai. 2015. *Money and Labour Value*. p6-7
- xii See Adam Smith. *The Wealth of Nations*, p133
- xiii The value of labour to currencies of gold and silver; two classical texts are viewed. "Gold and silver, like all other commodities, are valuable only in proportion to the quantity of labour necessary to produce them and bring them to market. Gold is about fifteen times dearer than silver, not because the supply of silver is fifteen times greater than that of gold, but solely because fifteen times the quantity of labour is necessary to produce a given quantity of it." Ricardo, David, *The principles of Political Economy and Taxation*, ch17, p238, Also Adam Smith " In the market of Europe, in the French coin and in the Dutch coin, an ounce of fine gold exchanges for about fifteen ounces of fine silver. In the English coin, it exchanges for about fifteen ounces. " *The Wealth of Nations*. Ch5, p146
- xiv See Adam Smith " Any increase in the quantity of commodities annually circulated within the country, while that of the money which circulated remained the same, on the contrary, ...the quantity of production labour which it could maintain and employ would be increased, and consequently the demand for that labour. Its wages would naturally rise with the demand and yet might appear to sink." *The Wealth of Nations*. Book II. Ch IV. p456
- xv See David Ricardo. *The Principles of Political Economy and Taxation*. ch27. p206
- xvi See Adam Smith. *The Wealth of Nations* . p146
- xvii " Any increase in the quantity of silver, while that of the commodities circulated by means of it remained the same, could have no other effect that to diminish the value of that metal. The nominal value of all sorts of good would be greater, but their real value would be precisely the same as before." Adam Smith. *The Wealth of Nations*. p455, Even though the quantity of a currency is multiple, it will not affect the value of labour behind it including the value of gold it preserves. Nevertheless, the speediness of circulation may vary and affect the economy (this will be discussed in the paper page 8). The currency represents the value of labour of a country. *Money and labour Value*. Hui-Chin Lai. 2015
- xviii See Hui-Chin Lai. 2015. *Free Trade and Employment*
- xix See Richard A. Brecher. 1974. *Minimum Wage Rates and the Pure Theory of International Trade*, p114
- xx See Jon Elster. 1989. *Social Norms and Economic Theory*. *Journal of Economic perspectives*, 3 (4):p99
- xxi See Adam Smith. *The Theory of Moral Sentiments*, Part III: of the Foundation of Our Judgements.
- xxii See Paul A. Samuelson. 2004. "Where Ricardo and Mill Rebut and Confirm Arguments of Mainstream economics Supporting globalisation" Here is a fair paraphrase of the argumentation that has been Jon or Jane Doe spread widely throughout academia." p135
- xxiii See Adam Smith. *The Wealth of Nations* p104
- xxiv Hui-Chin Lai. 2015. "Free Trade and employment in the ASEAN –from Theory to Empirical ". Conference paper. Presented at Thammasat University. October.

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