



Munich Personal RePEc Archive

Free Trade under Contractual Development Area (FTCDA) - A First Examination of a Third Way Facing the Dilemma: Free-Trade vs Protectionist Policy

Rodolphe Buda

Université de Paris Ouest Nanterre-La Défense

9. April 2012

Online at <http://mpra.ub.uni-muenchen.de/38047/>

MPRA Paper No. 38047, posted 12. April 2012 12:52 UTC

Free Trade under Contractual Development Area (FTCDA)
A First Examination of a Third Way Facing the Dilemma:
Free-Trade vs Protectionist Policy

Rodolphe BUDA¹,
University of Paris Ouest-Nanterre La Défense

April 11, 2012

¹I would thank professeur Pierre-Henri Derycke for his comments, and my colleague, English teacher, Mrs Michèle Irdor, who has checked the paper. I remain responsible for any errors or omission.

Since 1973 (the first oil crisis) the industrialized countries have known a slow and irreversible mutation of their productive structures – some spoke about a deindustrialization – while in the same time, the interdependence between nations has deeply increased. The international hierarchy has been also overturned by the appearance and then the reinforcement of the emergent economies (China, India, Brazil etc.) and the fall of the Soviet communist regime. The appearance of some new competitors in the markets of the manufactured goods has involved a price decrease but it has simultaneously called into question the sustainability of the industrial sites in industrialized countries. The economic and social life conditions have deteriorated in advanced economies without those of the emergent economies has significantly progressed for all kinds of people, because of the increase of the social inequalities in both kinds of countries. The social needs have increased due to unemployment and the social inequalities while the economic growth was not enough to satisfy them and, recently, the room for manoeuvre has considerably decreased for the states because of the sovereign debt crisis in the summer 2011.

Facing such upheaval individually very heavy to live – the number people who look for help to charity, who give up the healthcare (dental or ophthalmologic treatment etc.), who give up their sick leave, who live under very bad conditions, is significantly increasing – so that a lot of people consider that the globalization is responsible for all the economic and social trouble and that protectionism policy would be the solution. The free trader doctrine – which explains that the international free trade improve social welfare because of the decrease of the price of commodities and the increase of their quality – presented as one of the main principle of economic and social development, especially since the settlement of the G.A.T.T. in year 1947 (and the W.T.O. in year 1994) has been called into question by some intellectuals, social and political officials. The latter have promoted protectionist policy – policy which consists in preventing the national domestic markets against international competition in settling taxes, quota or administrative norms – as the solution to the various crises (financial, debt etc.).

The reality is more complex and such solutions are often simplistic even counterproductive. Globalization – economic, financial, social, political and cultural interdependence of the nations (economies) – is an irresistible and irreversible phenomenon. It seems more relevant to find the conditions under it would be collectively profitable rather than to oppose it especially when the protectionist policies are based on erroneous analysis¹ The analysis of the industrial revolutions has taught us that the living conditions hadn't immediately improved in Great Britain and France, especially the workers', then after the second world war, the industrial economies (the United-States, western European countries, Japan etc.) have known a period of high economic growth (The Post-war economic boom) which has implied an economic and social development and a significant improvement of the individual welfare. During this period, the economies have generated some goods which increase the conditions of life but in the same time, the economies were able to finance the infrastructures so that it makes sustainable economic and technical progress.

It's doubtful that an equilibrium should be reached compatible with an increase of the living conditions in the both economies (industrialized and emergent one). So, if it seems that free trade shouldn't be settled without any protection and if a generalized protectionist policy would deteriorate the national welfare and economic activity more than it prevent against the inconvenient of globalization, is a third path possible – a mix policy: free trade and international regulation –, consisting in the settlement of a Free Trade Area under Contractual Development ?

1 – How far could Free Trade be applied ?

The Free trade doctrine is historically associated to the name of two economists, Adam Smith and David Ricardo. The Scottish A.Smith (1776) thought up the *absolute advantage* principle that it's profitable for all if each nation be specialized (produce and trade) the lowest cost commodities. Then, the English D.Ricardo (1817) thought up the *comparative advantage* principle that it's profitable for a couple of nations to determine the commodities they should produce and trade mutually according to

¹The national economic difficulties are often more linked to internal troubles than external one (international trade) [7].

their respective cost prices. Intuitively, everybody would understand that it's more profitable to buy a commodity from the country which is able to produce it in the lowest price and the highest quality. The improvement of the transportation and the end of the second world war has involved a better supply of commodities to the consumers. The agricultural goods supply has become wider (with an access to exotic products), while the price of manufactured commodities has decreased on the long run. During the last fifty years, the variety of goods has widely increased.

However, during the 1980s, the consumers of the industrialized economies have not only observed the benefits of international trade described by the theory – A.Smith and D.Ricardo's theory then the E.Heckscher, B.Ohlin and P.Samuelson's (H.O.S. model). The international competition has involved a slowdown of the wages – convergence of the wages – some industrial sites relocations, and unemployment. In the same time, the emergent economies have organized the rural exodus to get a manpower which has known (and knows) the same living conditions of the workers of our first industrial revolution (XIX-th century) while the developing economies have known a dual development – the development of a sector disconnected from the local economy – or no development, and deteriorating climatic conditions. Why such a gap between theory and facts ? It seems that the official theory (H.O.S.) has failed in its assumptions, in overestimating the role played by the states, in underestimating the role played by the multi-national firms and in overestimating the perfection of the competition – as remarks professor Paul Krugman.

Such difficulties in the industrialized economies has reinforced the weight of the policy makers who advocate a protectionist policy.

2 – Is the Protectionist Policy Relevant ?

The protectionist policy consists in closing the entry into the national markets to some of all the foreign commodities to protect the national sectors from international competition. To lead such a policy, the authorities usually settle taxes, of quota or exaggerated administrative and sanitary norms.

Are those policies profitable to the economies which apply them ? It depends on the size the economy, on its productive structure and on its weight among its trade partners. A little economy specialized in only one good risks to be deprived of some foreign goods, that it doesn't produce itself, or obtain expansive one in producing them locally. Moreover the other economies could make trade reprisals against it. A great economy including a great number of various economic sectors could decide to live in autarky. However, the quality and the level of prices of the goods it produces could be deteriorated. The national firms indeed couldn't be supplied with goods by foreign firms inside the production process – according to the International Production Process Decomposition (IPPD) linked to the international division of work (IDW) proposed by A.Smith – that has been settled before the protectionist policy application. Moreover only the great economies which have a high weight among their trade partners could avoid reprisals from them.

In any case, without any national or international competition, the national firms would increase their prices and give up their innovation effort and the satisfaction of the consumers would be deteriorated. In the current globalization context, such protectionist policy would involve in a short term increase of the price, a middle term decrease of the quality of goods (except if a real national competition remains). The variety of the goods would decrease due to the impossibility to be supplied by foreign firms inside the production process (IPPD).

If the borders of international trade were to be closed, the satisfaction of the national consumers would be deteriorated because some goods would no longer be available. The strategy of the national firms which wish to export their goods would be deteriorated. Inside each closed economy, a risk of technical stagnation would exist while the prices of commodities never decrease.

So, if free trade without protection or the generalized protectionist policy – we don't speak about some necessary and legitimate protectionist temporary and limited measures to protect a starting economic sector or an economic one in difficulties [7, 1] would deteriorate the economy of most of nations in the

world – the pure Free trade is a second best solution and the protectionist policy is a third best solution – see [5] and [6] (resp.) –, does another way exist ?

3 – Could we Mix A Free Trade and a Contractual Regulation ?

As professor Paul Krugman said, international trade is not a zero sum game. Free trade doesn't work according to the logic that what is won by someone is necessary lost by another one. While the international GDP is not deteriorated, it means that some wealth is created somewhere in the world. The real challenge of a fair globalization would consist in the reallocation of a part of these created wealth. In fact, we can observe that since the last twenty years, the highest annual GDP rates have appeared in the emergent economies. It means that the emergent economies are catching up with the developed countries. However there are high inequalities in these countries and social protection is very embryonic². We think it would be more judicious and legitimate to allocate a part of the created wealth inside each national economy to systematically develop infrastructures (health, education, transportation, etc.) and social protection. We don't say that nothing is done [4, 9, 10], but we advocate that a part determined in advance should be allocated to these kinds of expenses. Such a measure, in accordance with the purposes of sustainable development and fair trade [2], should not be applied to isolated countries, whatever the country.

We suggest to settle a **Free Trade under Contractual Development Area (FTCDA)**. It means an area where national economies would respect the current existing rules of the W.T.O. which would add the rule that each national economy would use a part (specified in advance) of the created wealth to develop infrastructures and social protection³.

Such a measure would support the actual recommendation of W.T.O. [8]. To apply it, the states should ask to W.T.O. to insert this measure in priority in the agenda of the negotiations.

What could we expect from this kind of measure ? It's difficult to appreciate its consequences precisely. Some valuation have to be led especially to assess the relevant contractual part of created wealth. Nevertheless if the major part of the main economies would integrate such an area, we could expect an improvement of the living conditions of the workers of the emergent economies, which would create a new domestic market (for the emergent economies themselves) and an export market (for the industrialized economies). We could expect a stabilization of the level of wages in the industrialized countries and a drying up of the international economic migrations from the developing to the advanced economies. Furthermore the middle term convergence of the living conditions in the industrial and the emergent countries won't necessarily involve a fratricidal competition due to the high variety of goods in the both kinds of countries. If a convergence would appear between wages in industrialized and developing (especially emergent) countries, let's wish it appears under a level compatible with the existence of an efficient social protection system in both kinds of countries.

Unless one proves that such a measure would involve a deterioration of the industrial and/or the developing economies, who really could go against it ? The unions of employers in industrialized economies ? They usually consider the competition from emergent countries as an unfair competition because of the gap of the wages and because of the social security contributions. The policy makers of the emergent countries ? Unless they aren't be sensitive to the legitimate aspirations of their people, they should be for this measure. In the developing countries (especially the least developed ones) could know an improvement of the living conditions of the people because a better connection between the activity of the multi-national firms and the local activity. The policy makers of the industrialized countries ? They could decrease their budget deficit because of the decrease of the national social expenses – in the United states a cultural opposition would appear from the people who are attached to the American way of life.

²The ILO preconizes a generalization of social protection [3].

³In the industrialized countries, especially the France, the actual system should be improves: let's consider the concept of "*Médicaments de confort*" (comfort medicine) or "*Journées de carence*" (deficiency days) to understand that the actual system is perfectible.

Conclusion

The globalization has to be considered a chance – or as said professeur Paul Krugman "*the export must be considered as a means to pay the import*" – under the condition to be regulated. Such a regulation must necessarily be initiated from an international level, the W.T.O.

This paper is a first examination of the impact of a new international trade area settlement. It remains to study the new equilibrium according to a static and to a dynamic point of view ; according a static one, to establish whether the solution is or not a first best and to a dynamic one, to establish whether the way to reach the new international trade configuration would deteriorate the optimality of the solution (if it's an optimal one).



Summary

This paper proposes the qualitative examination of a new international trade area configuration. It suggests to settle a wide Free Trade under Contractual Development Area (FTCDA) to give up the dilemma Free-Trade vs Protectionist Policy which are second and third best (resp.). In such an area national economies would respect the current existing rules of the W.T.O. which would add the rule that each national economy would use a part (specified in advance) of the created wealth to develop infrastructures and social protection Some new investigations are obviously necessary to check whether such a configuration is optimal.

Key-Words – Economic and Social Development ; Free-Trade ; International Economics ; Protectionist Policy ; Regulation ; Social Protection ; W.T.O.

J.E.L. Codes – F02, F13, F42, F53

References

- [1] Allais M., (1999), *L'Union européenne, la mondialisation et le chômage*, Paris, Clément Juglar.
- [2] Fair Trade, (2008), *ACTES du 1er Salon Européen de Commerce Equitable*, Villeurbanne, 1,2 et 3 février.
- [3] ILO, (2011), : "Social protection floor for a fair and inclusive globalization", *ILO Report*, 2011.
- [4] IPEA, "Sobre a Recente Queda da Desigualdade de Renda no Brasil", *Nota técnica*, 2006. 59 p.
- [5] Krugman P., (1993), "The Narrow and Broad Arguments for Free Trade", *American Economic Review*, Papers and Proceedings, 83(3), may.
- [6] Krugman P., (1994), *Peddling Prosperity: Economic Sense and Nonsense in the Age of Diminished Expectations*, New York, W.W. Norton & Company, 1994.
- [7] Krugman P., (1997), *Pop Internationalism*, Boston, MIT Press, 237 p.
- [8] Mitra D. & Ranjan P., (2011), "Social Protection in Labour Markets Exposed to External Shocks", *in : Vers une modialisaton socialement durable*, M.Bacchetta & M.Jansen (Eds), OMC-BIT, pp.199–231.
- [9] World Bank, (1997), *A Age Security: Pension Reform in China – China 2020*, Washington, World Bank, 89 p.
- [10] World Bank, (2011), *Social Protection: For a Changing India (2 vol.)*, Washington, World Bank.