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Understanding the Balance of Trade through the "Iowa Car Crop" concept.

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The story of the “Iowa Car Crop" is a brilliant story very simply explaining the complete concept of International Trade. In Professor Landberg’s words, it is “*economics at its best*”.

International trade in its barest form explains that economies tend to specialize in the production of products based on the resources that are available to them & for the rest of the products they trade even if they have an absolute advantage in those products.

In other words, each nation, therefore, has a comparative advantage in producing something, no matter how small or large. David Freidman in his thought experiment, the Iowa Car Crop argued that these nations should.

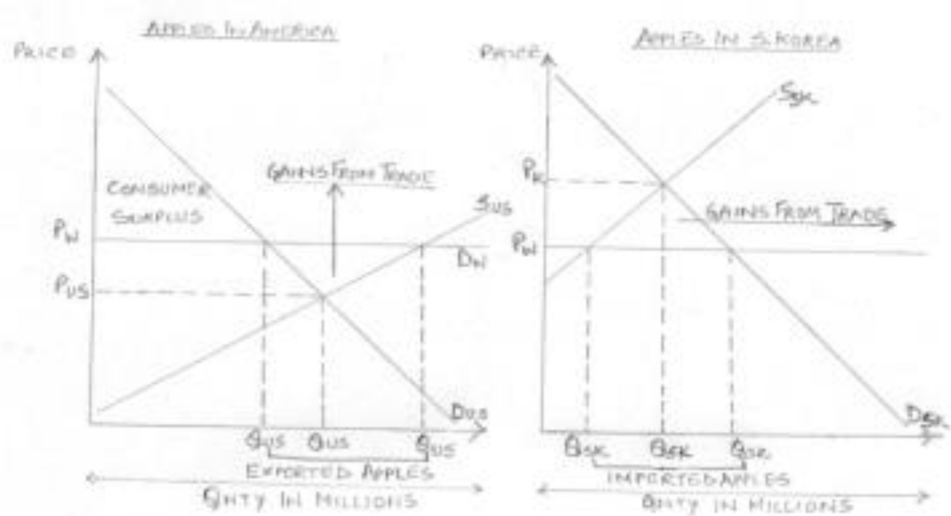
- Specialize in the production of that good or service.
- Trade for what they are missing or lacking.

David Friedman best explains this phenomenon through the “Iowa-grown” Camry vs the Detroit-built Taurus example. According to Friedman, there are two ways of building these cars in America. One way is to build locally like Detroit does the Taurus. The other one, in Iowa, is to plant the seeds, in this case, the raw materials for making the car. Once these raw materials are ready, in other words, the wheat is harvested, they are shipped off to Japan & a few months thereafter these ships return with Toyotas on them. This explains the basic process of International Trade. America has designed policies based on this to ensure that the Iowa-grown cars are as cost-effective as the homegrown Camry’s as it would be unnecessarily expensive to have all cars be manufactured in Detroit or to grow cars in Iowa. This allows healthy balanced competition within the industry and prosperous international trade.

Exhibited below shows the Gains from International Trade explained through the Demand & Supply model:

Assumption: The USA has a comparative advantage in growing apples & thereby exports apples to the rest of the world, including South Korea where apple producers are less efficient.

The above is an ideal environment in which Governments aim to maintain equilibrium through policies that protect the Domestic Industry as well as encourage international trade in products in which the country has a comparative advantage.



For protecting the Indigenous industries governments impose trade barriers, like tariffs and quotas. While these barriers can lead to inefficiencies and increased waste these are nonetheless done. This essay explores the reasons behind the imposition of trade barriers and proposes solutions to promote free trade. Additionally, it considers the impact of global changes in the procurement process following the COVID-19 pandemic and the recent Ukrainian invasion by Russia.

How & why does the Government protect the indigenous Industry?Protecting domestic industries

Governments impose trade barriers to protect their domestic industries from international competition. By implementing tariffs or quotas, they make imported goods more expensive or limit the quantity imported into the country thereby providing a competitive advantage to domestic manufacturers. This protectionism aims to protect domestic industries from their inefficiencies and higher cost of production, especially in sectors that are strategically important to the Nation or face challenges due to low-cost imports. Trade Barriers come in several other forms like Import & Export licenses, Subsidies, Embargoes, Currency Devaluation & Trade Restrictions.

● China is reducing its import tariffs on Luxury goods from 10% to 5% to encourage consumer spending.

● With the exit of the UK from the Single Market they will encounter customs forms & regulations for their exports & imports which will be significant trade barriers.

● The EU gives about Euro 29 billion as subsidies to their farmers to be able to make their agricultural exports more competitive internationally.

● The US imposed trade embargos on Cuba when Fidel Castro came into power for political reasons.

● The US has imposed tariffs of 50% on the import of washing machines from South Korea to prevent them from dumping their surplus.

● In India, export earnings are exempted from local manufacturing taxes to be able to make them more competitive in the world market.

Employment protection

Trade barriers are often used to safeguard employment in specific industries or a particular region in a Country. By restricting imports, governments can maintain jobs in sectors that might otherwise be threatened by foreign competition. This approach tends to be a short-lived strategy however it hurts overall efficiency and productivity in the long run.

National Concerns

Governments may impose trade barriers on certain goods or technologies due to national security reasons. These restrictions are imposed to prevent the flow of information, critical goods, or technologies that could pose risks to the country's defense, infrastructure, or sensitive industries. Protecting national security usually takes precedence over maximizing economic efficiency in these cases.

● India put a complete ban on personal protection equipment such as masks & clothing amid the global coronavirus outbreak in 2020 to be able to protect the country's interests at that time.

● In May 2022 India announced a ban on wheat exports due to a spike in global wheat prices & resulting food security risk to India.

Protection for Start-Ups

Developing countries use trade barriers to protect their emerging industries until they become competitive on a global scale. By protecting domestic industries from international competition, governments provide them with time and support to grow, transform, and gain a competitive edge. The government aims to create self-sustaining industries that can contribute to the country's long-term economic growth.

● India, under their Start-Up India Initiate, aids new start-ups by giving them a host of tax benefits, easier compliances, and help funding options.

Unfair trade practices

Governments impose trade barriers as a response to perceived unfair trade practices by other countries. These trade practices can include dumping (selling goods below cost), subsidies that affect competition, intellectual property violations, or non-compliance with international trade agreements. The barriers serve to correct the perceived imbalances and encourage fairer trade practices.

● India has appointed a Committee (Mahalanobis Committee) on the distribution of incomes & levels of living to promote a more equitable distribution of wealth & economic power.

Political considerations

Trade barriers can be motivated by political factors, such as protecting industries that have significant political influence or fulfilling promises made during election campaigns. These actions are often driven by short-term political gains rather than long-term economic benefits.

How & why does the Government promote Free Trade?

While trade barriers achieve short-term objectives, they often result in economic inefficiencies and unforeseen consequences. Often higher costs for imported goods can lead to increased prices for consumers, reduced competition, and less incentive for domestic producers to improve efficiency. However, governments try to balance the trade-offs between protectionism and the benefits of free trade to promote sustainable economic growth.

Promoting free trade is, therefore, crucial for promoting economic growth, improving efficiency, and maximizing the benefits of globalization. Where governments have enforced trade barriers, several possible solutions can be pursued to foster and promote the principles of free trade.

Trade agreements

Governments can engage each other to establish trade agreements that can reduce or eliminate trade barriers. Governments can engage in bilateral or multilateral negotiations to establish trade agreements that lower or eliminate trade barriers. These agreements normally deal with issues like tariffs and
quotas, making it easier for goods and services to flow between countries. Organizations like the World Trade Organization (WTO) facilitate such negotiations and provide a platform for resolving trade disputes.

● India currently has 12FTA's with various countries & the latest one being the India-UAE CEPA

Diplomatic efforts

Diplomacy plays a crucial role in reducing trade barriers. Governments can hold talks and negotiations with each other to promote understanding and resolve conflicts related to trade. By building strong diplomatic relationships, countries can work towards removing barriers and promoting free trade.

● Japan is India's one of India's greatest friends both spiritually as well as in conducting business.

Encourage regulatory coordination.

Since regulations and standards can act as obstacles to trade. Governments can work together harmonizing regulations and standards, making it easier for businesses to comply with requirements across borders. This can helps facilitate smooth flow of trade between countries.

Countries helping each other.

Developing countries often face challenges in developing nascent industries. Offering assistance and capacity, build programs to help countries enhance their infrastructure, regulatory frameworks, and their products and services. By improving their ability to meet global standards, countries can participate more effectively in free trade.

Promoting information sharing

Governments can encourage openness on trade laws, rules, and practices. Businesses may find it easier to comprehend and follow trade requirements as a result. Businesses can also find new trade opportunities and get around obstacles by exchanging information on market access possibilities and trade rules.

Promote public-private partnerships.

Promoting free trade necessitates collaboration between the public and private sectors. To identify trade barriers and consider their elimination, governments can cooperate with industry associations, chambers of commerce, and trade promotion organizations.

Economic incentives

Governments can promote exports and import substitution by offering financial incentives like tax breaks and subsidies. These rewards make companies more competitive in global markets and lessen the need for protectionist policies.

Encourage entrepreneurship and innovation.

Governments may encourage innovation and entrepreneurship in their respective economies. Governmental organizations may create an atmosphere that promotes innovation and helps businesses to be successful globally by investing in R&D, education, and infrastructure.

Governments can gradually lower trade barriers, encourage free trade, and benefit from a more open and integrated global economy by implementing these policies.

Impact of Global Changes on International Trade-Post-COVID 19Changes in the procurement process

The COVID-19 pandemic exposed vulnerabilities in global supply chains, prompting countries to reassess their procurement processes. An exemplary case is that of the shift to Domestic manufacturing of PPE kits in India after understanding the critical need for the same during COVID-19. The Indian Government adopted policies that prioritized the domestic production of this critical item for self-consumption, leading to potential trade barriers for the export of the same to be able to fulfill the domestic requirements. Once India achieved the comparative advantage in manufacturing these kits locally the Government made the policies more export friendly to be able to gain from its international trade.

Impact of Military Intervention by Russia in Ukraine on InternationalTrade

Geopolitical tensions

The recent invasion by Russia has heightened geopolitical tensions and strained international relations. Governments resorted to trade barriers and sanctions as a political tool to express solidarity with Ukraine. It is essential to separate political conflicts from trade relations to prevent unnecessary trade barriers that harm global economic growth.

Conclusion:

In conclusion, the "Iowa Car Crop" story demonstrates the benefits of international trade through comparative advantage and specialization. Governments adopt trade restrictions for a variety of reasons, but fostering free commerce is crucial for long-term economic expansion. Barrier-lowering tactics include trade agreements, diplomatic initiatives, coordinated regulatory actions, and financial incentives. The necessity for a balanced trade policy is highlighted by global changes, especially the COVID-19 effect and geopolitical conflicts. International collaboration and an emphasis on long-term economic gains are necessary for removing trade obstacles. By doing this, nations may fully realise the promise of global trade and maximise its benefits for all parties.

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