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ECONOMIC FREEDOM FREEDOM OF TRADE IS CRUCIAL FOR DEVELOPMENT

BY

Francesco Felis

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Introduction

"Adventure is the soul of commerce!" (*Kingdom Hearts Birth by Sleep, 2010*) is a line from the video game *Kingdom Hearts Birth by Sleep*, part of the *Kingdom Hearts* series. Despite its popular origin, the phrase captures an important truth: commerce has historically been one of the principal drivers of economic development.

Perhaps more clearly than many academic quotations or theoretical discussions, the line suggests that commerce depends on more than economic theorems or mathematical models. Initiative, exploration, and the willingness to take risks—elements often associated with the idea of "adventure"—have always played a fundamental role in commercial activity.

Commerce is therefore essential to development. As Robert Louis Stevenson observed, at some level everyone lives by selling something. Trade generates economic growth, but it also fosters relationships, exchanges, and networks of contact that contribute to a country's development beyond purely economic dimensions. For these reasons—many of which are extra-economic in the strict sense— the freedom of trade remains a fundamental principle.

Accordingly, the present discussion combines an economic perspective with a broader cultural and historical one. The analysis develops around two main themes. The first concerns the well-known Ricardian theory of comparative advantage. The second places commerce within the broader framework of macroeconomic and institutional issues.

Commerce is both an adventure and the product of human action—above all that of merchants, though not exclusively. It is driven by visionary individuals, yet it is also shaped by specific institutional arrangements. In general, households benefit from the possibility of exchange because it allows individuals to specialize in the activities they perform most efficiently, whether cultivating the land, producing clothing, or constructing houses. Through exchange, households can obtain a wider variety of goods and services at lower cost. Nations, like households, likewise benefit from their capacity to engage in trade.

Historically, the study of trade and finance lies at the origins of modern economic theory. Debates surrounding British trade policy in the nineteenth century helped transform economics from a largely discursive discipline into a far more formalized analytical science.

Increasing interdependence among national capital markets has further expanded the scope of International economics. Many of its central issues arise from interactions among sovereign states. Recurring themes include the gains from trade, the structure of international commerce, protectionism, balance-of-payments adjustments, the determination of exchange rates—together with monetary policy—the coordination of economic policies, and the functioning of international capital markets. In this sense, discussing trade often means discussing a large part of economics itself.

Consider, for example, trade between Mexico and the United States. Shipments of coffee from Mexico could be disrupted if the United States were to impose an import quota. Conversely, Mexican coffee would become more attractive to American consumers if the peso were to depreciate relative to the dollar. Such dynamics cannot occur within the United States itself, where the Constitution prohibits restrictions on interstate commerce and all states share the same currency.

One of the central propositions of international trade theory is that two countries can trade to their mutual advantage even when one of them is more efficient in the production of all goods and producers in the less efficient country can compete only by paying lower wages. Exchange generates gains by enabling countries to export goods whose production makes intensive use of resources that are relatively abundant domestically and to import goods whose production relies on resources that are relatively scarce within the country.

International trade therefore allows countries to specialize in a narrower range of goods, achieving greater efficiency through large-scale production. Moreover, the benefits of international exchange are not limited to the trade of goods. International migration and international lending represent additional forms

*Corresponding Author: **Francesco Felis..**

of mutually beneficial exchange: the former can be interpreted as an exchange of labor for goods and services, while the latter represents an exchange of present goods for claims on future goods. Likewise, the international exchange of risky financial assets—such as equities and bonds—can benefit countries by enabling them to diversify their wealth and reduce the volatility of their income.

Many of the assumptions underlying these theoretical frameworks have been subject to criticism, particularly when applied in extreme or simplified forms. Nevertheless, free trade remains a fundamental principle of economic analysis. At the same time, trade dynamics are often influenced by broader macroeconomic variables that extend beyond the traditional models of comparative advantage.

With regard to the benefits of free trade, as implied by Ricardo's theory of comparative advantage, neither Ricardo nor Adam Smith believed it would be sensible to divide the stages of production of goods such as pins or textiles among different nations. Both economists were, of course, products of their historical context. Their analyses reflected a world in which trade largely involved raw materials and finished goods—even between distant countries—while the exchange of intermediate goods and services, characteristic of the contemporary era of globalization, was largely absent.

Moreover, in Ricardo's time the available means of communication were extremely limited. Information moved slowly, often through couriers traveling by horse or ship, making the coordination of geographically dispersed production stages virtually impossible. It is therefore plausible that Ricardian theory reflected economic conditions that today would appear relatively primitive. Capital was far less mobile, and the fragmentation of production across international supply chains was extremely difficult. Relocating stages of production to Portugal at that time was not nearly as straightforward as relocating them to China today.

Consequently, aside from cultural factors such as nationalism, entrepreneurs would likely have accepted lower profits at home rather than seeking more profitable opportunities abroad. Ricardo himself was probably aware that his theory depended, at least in part, on the limited international mobility of capital, and that large-scale relocation of production could generate negative consequences in terms of employment and economic growth.

Historical conditions changed significantly after 1870 with the spread of the telegraph, the steamship, the limited liability company, and the emergence of an increasingly global financial system. These developments progressively weakened the assumptions underlying classical trade theory. Great Britain had benefited from these conditions during the earlier stages of industrialization, yet Ricardian theory implicitly assumed that investors were unwilling—or at least very cautious—about transferring capital abroad. Meanwhile, the United States surpassed Great Britain as the leading industrial economy, partly as a result of protectionist policies. At the same time, technological progress, declining communication costs, and the expansion of international finance increasingly challenged the classical framework.

Today, the production of goods and services can be fragmented across multiple locations, with digital technologies capable of monitoring and coordinating every stage of the process. In many cases, digital products can also be replicated at virtually zero marginal cost. International exchange therefore no longer resembles the classical example of Portuguese wine traded for English cloth; instead, entire industrial sectors can be relocated across continents.

For reasons of economic security and strategic resilience, however, it may still be desirable for countries to retain a certain range of industries and productive capabilities domestically. In the contemporary global economy, economic growth and job creation frequently occur in locations different from those in which innovation originates, as research and production become increasingly geographically separated.

Globalization itself is not a recent phenomenon. A significant wave of international economic integration occurred between 1860 and 1914. After the Second World War, the Bretton Woods system established the institutional framework for a new phase of globalization, characterized by stronger state regulation, powerful labor unions, and strict rules governing banking and capital markets —many of which had been introduced in response to the Great Depression.

Today, however, a different configuration prevails. Global production networks often involve exchanges between advanced economies and emerging ones—for example, between the United States and Asian economies—where lower labor costs are combined with investment flows and technological transfers. This pattern has been reinforced by the liberalization of international trade and the institutional framework established by the World Trade Organization.

The tensions inherent in such a system were captured by Isaiah Berlin's well-known observation that "*freedom for the wolves often means death for the lambs*", a phrase that highlights the potential risks associated with unrestrained economic freedom.

In the late twentieth century, several advanced economies adopted policies of financial liberalization. In the United States, the Clinton administration supported important deregulatory reforms in the financial sector, including legislation that reduced restrictions on banking activities and limited government oversight of derivative financial instruments. Similar policy orientations were adopted in other countries, including the United Kingdom under the Blair government after 1997. These reforms extended the deregulatory agenda that had begun under the Reagan administration.

Many analysts argue that these developments contributed to the financial vulnerabilities that culminated in the global financial crisis of 2008. Financial deregulation expanded the freedom of financial institutions while often shifting risks onto households, investors, and other economic actors.

*Corresponding Author: **Francesco Felis..**

These structural transformations have also been accompanied by significant changes in the organization of production. For example, by 2017 the share of U.S. farms with fewer than 1,000 acres—most of them family-operated—had declined from 57 percent in the 1990s to 36 percent. This trend reflects the growing concentration of economic activity in large multinational corporations, even within sectors traditionally characterized by smaller producers.

Such developments have contributed to broader political reactions in many advanced economies, including the rise of political movements critical of globalization.

Critiques of the Theory of Comparative Advantage

The theory of comparative advantage was developed on the basis of several simplifying assumptions:

- Trade between two countries concerns goods that both countries are capable of producing.
- The factors of production—labor and capital—are perfectly mobile within the domestic economy but immobile internationally.
- Production costs are determined by the number of labor hours required to produce goods.
- Transportation and insurance costs are negligible.

Although these assumptions provide a powerful analytical framework, many economists have questioned their empirical realism and their applicability to contemporary economic conditions.

Several factors may influence trade patterns beyond relative production costs. One of the most important is geographical proximity; others include cultural ties and institutional relationships. Canada, for example, has an economy comparable in size to Spain's, yet it trades far more intensively with the United States than with European economies of similar size. Indeed, Canada alone trades with the United States almost as much as the entire European continent.

Empirical evidence suggests that geographical distance has a measurable impact on trade flows. An increase in distance between two countries is associated with a reduction in trade between them of approximately 0.7 to 1 percent. This decline partly reflects higher transportation costs, but it also results from less tangible factors. Trade tends to be more intense when countries maintain close personal and institutional connections, which often weaken as geographical distance increases. Even in the digital age, for example, an American business representative can easily make a short trip to Toronto, whereas traveling to Paris or Tokyo is considerably more demanding.

For this reason, geographical and cultural proximity often play an important role alongside economic size in determining trade flows, a relationship captured in the so-called gravity model of international trade.

The Netherlands, Belgium, and Ireland provide illustrative examples. These countries trade with the United States more extensively than would typically be predicted by the size of their economies alone. In Ireland's case, cultural affinity plays an important role: the country shares a common language with the United States, and tens of millions of Americans are of Irish descent. For the Netherlands and Belgium, geographical factors are particularly important.

Both countries are located at the mouth of the Rhine, the longest river in Europe, which flows through the Ruhr, Germany's major industrial region. The Ruhr maintains substantial trade relations with the United States, a pattern that can be explained by the size of its economic output within the framework of the gravity model. As a result, the Netherlands and Belgium function as major gateways to north-western Europe. Rotterdam, in the Netherlands, is the largest European port in terms of cargo throughput, while Antwerp, in Belgium, ranks second.

Global Value Chains

Contemporary globalization is increasingly shaped by the emergence of global value chains. A prominent example is the transformation of Apple's production system under Tim Cook, who was recruited by Steve Jobs in 1998 to reorganize the company's supply chain. Manufacturing activities were relocated largely to Asia—particularly Taiwan and China—while design and innovation remained concentrated in California.

Cook became widely known for his mastery of supply-chain management. Under his leadership, Apple dramatically reduced inventory levels and achieved extremely rapid inventory turnover, reportedly rotating iPhone inventories approximately every five days despite selling millions of units annually. His well-known principle was that "inventory is fundamentally evil," meaning that warehouse stocks should be minimized as much as possible.

Production networks structured in this way allow firms to operate with very low inventory levels by relying on tightly coordinated international supply chains.

A similar observation was made about Dell, whose production system depended heavily on suppliers located near Taipei. At one point, the Texas-based company was described as functioning essentially as a distribution channel for products manufactured in Taiwan.

The high degree of interdependence within global production networks became particularly evident during the financial crisis of 2008. Following the collapse of Lehman Brothers, the CEO of Ford requested that the U.S. Congress rescue Chrysler and General Motors—even though they were direct competitors. The reason was that the three companies were deeply interconnected through shared supplier networks. Many component suppliers were located in countries such as Mexico or northern Italy, particularly in the Lombardy region. If Chrysler and General Motors had collapsed, many of these suppliers would have gone bankrupt, which would in turn have disrupted Ford's own production.

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A similar pattern emerged in 2011 following the earthquake and nuclear disaster in Fukushima, Japan. Industrial production declined not only in Japan but also in countries closely integrated into global supply chains, including South Korea, China, Taiwan, France, and the United Kingdom. The closure of a German company operating in Japan that produced specialized automotive components disrupted supply chains for major manufacturers such as Ford, BMW, Volkswagen, and Toyota.

These examples illustrate how deeply interconnected modern production systems have become. When a region such as Lombardy or a major industrial city experiences disruptions—as occurred during the COVID-19 lockdowns—the consequences extend far beyond local services or tourism sectors. entire production chains may be affected.

Despite the experience of the 2008 financial crisis and other systemic shocks, global firms have generally continued to rely on just-in-time production models characterized by minimal inventories. One might therefore have expected companies to reconsider the strong aversion to holding inventories that had become common in global supply-chain management, particularly in light of the systemic vulnerabilities revealed by these crises.

Yet this has largely not occurred. In February 2020, when it was still widely believed that COVID-19 would remain largely confined to China, Apple announced that global supplies of iPhones would be limited because of disruptions in its Chinese supply chain. Similar warnings were issued by Microsoft and other multinational firms. These events highlighted the degree to which global production networks had become concentrated geographically and vulnerable to localized shocks.

At the same time, industrial policy has played a very different role across countries. In many advanced economies, industrial policy has been relatively limited, while China has pursued a more explicit and coordinated strategy. Although China possesses a domestic oil industry, it still imports roughly three quarters of its oil requirements. Anticipating the transition toward a greener economy, however, China has developed a leading position in renewable energy technologies.

China also occupies a dominant position in the supply chains associated with electric vehicles. Lithium—an essential component in electric vehicle batteries—is heavily concentrated in global supply chains controlled or influenced by Chinese firms. More broadly, China controls a very large share of global battery manufacturing capacity, estimated at roughly four-fifths of total production.

As a consequence, China is likely to exercise considerable influence over the value chains shaping the development of electric vehicles, including those produced by European manufacturers. These outcomes are partly the result of political decisions taken over many years. The opening of international trade often occurred without fully considering the long-term implications of integrating a major state-led economy such as China into the global trading system.

More broadly, the expansion of globalization has been closely linked to the role of international institutions. As Mattei and Nader argue, international organizations have increasingly assumed functions resembling those of global legislators, exercising authority that states themselves have gradually transferred to these institutions.

The International Monetary Fund (IMF) was originally created to provide short-term financial assistance to countries facing balance-of-payments difficulties. The World Bank was established both to assist postwar reconstruction and to promote long-term economic development in poorer countries through targeted lending programs.

Although the transfer of authority to these institutions originally reflected the national interests of sovereign states, critics argue that their policies have sometimes produced outcomes that disproportionately affect disadvantaged social groups within those same states. In particular, economic reforms associated with international financial institutions have often emphasized financial and trade liberalization, while encouraging reductions in welfare policies and state intervention.

As some observers have noted, these organizations do not function as democratic political institutions. Instead, they often operate according to governance structures similar to those of large corporations, in which strategic decisions are taken by executive leadership and governing boards and implemented through hierarchical administrative systems.

Changes in global production structures have also altered the effects of trade policy. As Marco Losani has observed, tariffs once functioned primarily as taxes on finished goods, raising their final prices for consumers. Today, however, tariffs frequently affect the exchange of intermediate goods within complex global value chains.

When a finished good moves directly from country A to country B, the effects of a tariff are largely confined to those two economies: production increases in the tariff-imposing country and declines in the exporting country. In contrast, when production is fragmented across multiple countries, tariffs may generate very different outcomes. Instead of encouraging domestic production, firms may simply relocate stages of production to third countries in order to circumvent the tariff barriers.

Consequently, tariffs imposed on a broad scale tend to reduce international trade more generally. Because global value chains structure contemporary production and exchange, the effects of tariff wars extend beyond the countries directly involved, leading to a broader contraction in global trade flows.

Conclusions

Free trade is generally beneficial. Although it has a number of drawbacks, tariffs are rarely an appropriate remedy for its negative effects. At the same time, however, the adverse consequences of an unregulated system of globalization cannot be ignored. The question therefore arises whether the

*Corresponding Author: **Francesco Felis..**

institutional framework of the Bretton Woods era—particularly the presence of controls on capital movements—offered a more balanced approach to international economic integration.

Paul Krugman addressed this issue in an editorial published in *The New York Times* on December 28, 2007 ("Troubles with Trade"). For developing countries, the expansion of trade between high-wage and low-wage economies can be highly beneficial, as it provides poorer economies with an opportunity to move up the income ladder. However, the same process may generate less favorable outcomes for certain groups of workers in advanced economies such as the United States.

Trade between countries with similar economic structures—for example, the United States and Canada—can be broadly advantageous for both sides. When trade occurs between countries with very different wage levels and production structures, however, the distributional consequences become more complex. Some groups benefit, particularly highly educated workers, while others may face increased competition.

During the 1990s, many economists argued that imports from developing countries exerted downward pressure on U.S. wages, but that the magnitude of these effects remained relatively modest. Over time, however, scale matters. Quantitative changes can eventually produce qualitative transformations. Consequences that initially appear limited may become more significant as their magnitude increases. For instance, if imports of manufactured goods from emerging economies rise from 2.5 percent of GDP in 1990 to 6 percent in 2006, the broader economic landscape—and the distributional effects on wages—may change substantially.

Highly skilled workers are therefore likely to benefit from expanded trade, yet they constitute a smaller group than those who may be adversely affected. Trade may also influence the position of the so-called median worker. For this reason, a realistic assessment must consider not only strictly economic variables but also broader social and institutional factors.

Krugman does not advocate restricting international trade. Instead, he argues for policy measures aimed at mitigating its distributional effects, including the strengthening of social safety nets. Additional measures could include greater regulation of international capital movements, in line with the institutional arrangements that characterized the Bretton Woods system.

Dani Rodrik has formulated a related argument in what he describes as the "globalization trilemma". According to Rodrik, it is impossible to simultaneously maintain full economic globalization, democratic politics, and complete national sovereignty. Only two of these objectives can be fully achieved at any given time. The arguments of Krugman and Rodrik—both economists generally associated with liberal economic thought—therefore highlight the tensions inherent in a system of largely unregulated globalization.

The policy implication is not that globalization should be reversed through protectionist measures. Tariffs are unlikely to address the underlying structural challenges. At the same time, a system characterized by the near absence of rules—particularly with respect to capital mobility—can generate significant economic and social imbalances.

Free trade remains one of the fundamental drivers of economic development. This is particularly true for economies such as Italy or Japan, whose industrial structures depend heavily on international trade. However, recognizing the importance of free trade does not preclude acknowledging the role of industrial policy in shaping long-term economic development.

International trade has historically been closely associated with productivity growth and technological progress. Countries with access to maritime trade routes, for example, have generally experienced higher levels of economic development than landlocked economies.

Geography therefore plays an important role in shaping long-term economic outcomes. Countries without direct access to the sea tend to face greater difficulties in international trade and often exhibit lower income levels than economies connected to major maritime routes. Empirical evidence suggests that countries in which more than 80 percent of the population lives within 100 kilometers of the coast have, on average, a per capita GDP roughly four times higher than countries where fewer than 20 percent of the population lives near the coast.

Historical patterns of economic development further illustrate the interaction between geography, natural resources, and trade. The British development model benefited from the availability of key raw materials during successive historical periods: wool during the medieval era, iron and coal during the Industrial Revolution, and North Sea oil in the twentieth century.

By contrast, Italy historically lacked many of the natural resources that were central to industrial development in different periods. As a consequence, Italian economic development followed a different trajectory, relying heavily on commercial and financial intermediation. This pattern can be observed from the medieval fairs and the maritime trade of the Italian republics to the financial expansion of Florence.

In the manufacturing sector as well, Italian economic activity often focused on processing industries. Merchants and bankers established manufacturing enterprises aimed primarily at foreign markets, frequently relying on imported raw materials that were transformed into higher-value goods for export.

Italy's long-term economic fluctuations were closely connected to international trade. During the seventeenth century, for example, a sharp decline in exports contributed to economic stagnation. Around 1620, exports from Genoa fell from approximately two million to roughly half a million *pani serici*—units used to measure silk production in Genoese

*Corresponding Author: **Francesco Felis..**

currency—while Venice exported only about one hundred units of woolen cloth.

Conversely, periods of economic expansion in Italy were often closely linked to export performance. The economic growth observed in the early twentieth century and again during the 1950s and 1960s was largely driven by export-oriented industrialization, which also stimulated technological progress and scientific research.

For an economy such as Italy—characterized by limited natural resources—international trade has therefore historically represented a structural necessity. Policies that significantly restrict exports would run counter to these structural characteristics.

Indeed, during long periods of economic difficulty—from the seventeenth century until much of the nineteenth century—Italy resembled many underdeveloped economies in that it exported primarily agricultural goods and similar products. Even under relatively favorable conditions, average income levels remained far below those of more advanced economies.

These historical experiences highlight the importance of international exchange in economic development. As Joseph Schumpeter famously remarked in the 1950s, Ricardo's theory of comparative advantage is an elegant analytical framework, yet its practical implications must always be interpreted in light of historical and institutional realities.

In practice, no modern economy can achieve complete self-sufficiency. All countries depend on imports of goods produced abroad and finance those imports through the export of their own products. International trade thus remains an essential feature of the global economic system.

Preventing the international exchange of goods would therefore impose significant costs on modern societies. Trade involves not only the exchange of products but also the transmission of knowledge, technologies, and cultural practices embedded in those goods and services. Contemporary economies are characterized by deep mutual interdependence among nations through international production networks, a condition that may also reduce the likelihood of sustained geopolitical conflict.

A country that is deeply integrated into the international division of labor could find its economic stability strongly affected by disruptions to trade flows. Interruptions to imports of key inputs or commodities may rapidly affect domestic production and economic activity. Conversely, a deliberate attempt to withdraw from the international division of labor and rely exclusively on domestic production would likely lead to a substantial reduction in national output, accompanied by declines in living standards and overall welfare. Such outcomes would arise not only from reduced economic efficiency but also from the loss of the exchange of knowledge and practices that international trade facilitates.

At the same time, the concerns raised by Paul Krugman regarding the distributional consequences of globalization remain highly relevant. Protectionism is often justified by the argument that tariffs should equalize differences in production costs between domestic and foreign producers. However, such a policy assumes that countries can simultaneously reduce imports while expanding exports—an outcome that is difficult to sustain in practice. The likely consequence would instead be a reduction in the international division of labor and a broader decline in productivity.

Nevertheless, the challenges associated with globalization should not be underestimated. The mobility of workers across countries with different languages and institutional frameworks remains limited, and the rapid movement of capital across borders can generate significant economic volatility. These factors complicate the adjustment processes associated with international trade.

Ricardo's theory of comparative advantage suggested that even a country with less favorable production conditions in every sector could benefit from international trade. Countries with more efficient production structures would still find it advantageous to import goods from less efficient countries if their own comparative advantage lay elsewhere. In this framework, trade allows each country to specialize in activities in which its relative productivity is greatest.

However, historical experience also suggests that persistent patterns of specialization may produce asymmetric outcomes. In many cases, developing economies have specialized in the production of agricultural goods or raw materials, while advanced economies have concentrated on manufacturing and technologically intensive industries. Although this pattern may be consistent with comparative advantage, it can also limit long-term development prospects if it reinforces structural imbalances in productivity and technological capabilities.

Economic growth rates may therefore diverge between countries specializing in sectors characterized by diminishing returns and those specializing in industries with increasing returns to scale. Historical experience provides several examples in which successful industrialization required policies that departed from strict adherence to existing comparative advantages. Both the United States and Italy, for instance, pursued development strategies that involved expanding manufacturing capacity rather than relying exclusively on their initial resource endowments.

This historical evidence highlights an important methodological issue. Economic theory cannot be assumed to apply uniformly across different historical contexts characterized by distinct institutional and social structures. Moreover, understanding the functioning of economic systems may require analytical approaches that extend beyond the behavior of individual consumers or firms.

Human economic behavior itself is shaped by cultural and institutional environments. As anthropological evidence demonstrates, patterns of economic organization vary significantly across societies. Consequently, economic systems must be analyzed within their broader historical and cultural contexts.

*Corresponding Author: **Francesco Felis..**