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ECONOMIC PERSPECTIVES

THE BENEFITS OF FREE TRADE
Addressing Key Myths

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The most recent debate over providing the US president fast-track trade-negotiating authority raises the perennial catalog of questions and concerns about free trade. This is understandable: the benefits of free international trade are often diffuse and hard to see, while the benefits of shielding specific groups from foreign competition are often immediate and visible. This illusion fuels the common perception that free trade is detrimental to the American economy. It also tips the scales in favor of special interests seeking protection from foreign competition. As a result, the federal government currently imposes thousands of tariffs, quotas, and other barriers to trade.

However well intended, restrictions on foreign trade harm the very people they aim to protect: American consumers and producers. Trade restrictions limit the choices of what Americans can buy; they also drive up the prices of everything from clothing and groceries to the materials manufacturers use to make everyday products. Moreover, it is lower-income Americans who generally bear a disproportionate share of these costs.

Below, Mercatus Center senior research fellow Donald J. Boudreaux reviews the benefits of freeing and increasing international trade and addresses some of the most pervasive myths that surround the free trade debate.

THE TRUTHS OF FREE TRADE

Free trade increases prosperity for Americans—and the citizens of all participating nations—by allowing consumers to buy more, better-quality products at lower costs. It drives economic growth, enhanced efficiency, increased innovation, and the greater fairness that accompanies a rules-based system. These benefits increase as overall trade—exports and imports—increases.

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- Free trade increases access to higher-quality, lower-priced goods. Cheaper imports, particularly from countries such as China and Mexico, have eased inflationary pressure in the United States.[1] Prices are held down by more than 2 percent for every 1 percent share in the market by imports from low-income countries like China.

- Free trade means more growth. At least half of US imports are not consumer goods; they are inputs for US-based producers, according to economists from the Bureau of Economic Analysis. Freeing trade reduces imported-input costs, thus reducing businesses' production costs and promoting economic growth.

- Free trade improves efficiency and innovation. Over time, free trade works with other market processes to shift workers and resources to more productive uses, allowing more efficient industries to thrive. The result is higher wages, investment in such things as infrastructure, and a more dynamic economy that continues to create new jobs and opportunities.[2]

- Free trade drives competitiveness. Free trade does require American businesses and workers to adapt to the shifting demands of the worldwide marketplace. But these adjustments are critical to remaining competitive, and competition is what fuels long-term growth.

- Free trade promotes fairness. When everyone follows the same rules-based system, there is less opportunity for cronyism, or the ability of participating nations to skew trade advantages toward favored parties. In the absence of such a system, bigger and better-connected industries can more easily acquire unfair advantages, such as tax and regulatory loopholes, which shield them from competition.

MYTH VS. REALITY

Myth: More exports mean more wealth.

Reality: It is the total level of trade—exports and imports—that most accurately reflects American prosperity. Prosperity is defined by the breadth and variety of what Americans are able to consume. More exports increase wealth only because they allow Americans to buy more imports and give non-Americans greater incentives to invest in America, helping the US economy grow. Restricting imports leaves Americans worse off.

- Poorer Americans suffer more from tariffs than higher-income people. Not only do they spend more of their income on consumption goods, many of the goods they consume are subject to higher tariffs than more expensive goods of the same type.[3]

- For example, imported cheap sneakers can face a tariff as high as 60 percent, while men's leather dress shoes are subject to an 8.5 percent tariff. Similarly, plain drinking glasses face a tariff of nearly 30 percent, while expensive crystal glasses are taxed at 3 percent.

Myth: Free trade means jobs go overseas.

Reality: Free trade does not create more jobs, but neither does protectionism.[4] Free trade may reduce jobs in inefficient industries, but it frees up resources to create jobs in efficient industries, boosting overall wages and improving living standards. Protectionism, in contrast, attempts to protect jobs that the market will not sustain; it does so at the expense of more innovative industries.

- Much of the change in the labor force is not the result of free trade but of innovation. New technology, such as apps on mobile devices, has displaced a staggering variety of products, including radios, cameras, alarm clocks, calculators, compact discs, DVDs, carpenters' levels, tape measures, tape recorders, blood-pressure monitors, cardiographs, flashlights, and file cabinets.

- Using protectionist policies to "save" a job comes at enormous cost, as opportunities shrink and input costs swell for industries downstream.

Myth: Restrictions on trade help Americans.

Reality: The only beneficiaries of trade restrictions are the inefficient firms and special interests that secure these protections against competition.

- Despite receiving protection from foreign competition for many decades, large firms have steadily left the US steel industry due to high fixed costs and competition from smaller firms. Tariffs on steel increase costs in steel-consuming industries, which employ 12 million Americans, compared to the 190,000 Americans employed in the steel-making industry.

- The United States' recent imposition of tariffs on Chinese-made solar panels resulted in China imposing tariffs on American polysilicon, raising the cost of solar equipment and reducing employment opportunities in both nations.

Myth: US trade deficits are bad for Americans.

Reality: US trade deficits generally are good for Americans.[5]

The trade deficit is not debt. A growing trade deficit, despite its misleading name, is good for the economy. It is typically a signal that global investors are confident in America's economic future. The US trade deficit might be larger than it would otherwise be if a trading partner chooses to keep the price of its currency artificially low, but this practice harms the trading partner, not the United States.

- America's trade deficit increases whenever non-Americans choose to increase the amount they invest in the United States. This is why another name for the trade deficit is the "capital account surplus"—that is, the net investment funds flowing into the United States. More investment means expansion of existing businesses, more new businesses, higher worker productivity, and more output enhancing activities, such as research and development, all of which increase prosperity.

- So-called "currency manipulation" by a trading partner does not harm the American economy. For example, a lower price of the yuan makes Chinese goods cheaper for American consumers, conferring a real benefit for the United States. Keeping the price of the yuan lower through monetary policy, however, does not lower the real costs of the resources and outputs exported by the Chinese people, who also face higher prices for American imports. An undervalued yuan benefits Americans at the expense of the Chinese.

NOTES

1. Raphael Auer and Andreas M. Fischer, “The Effect of Low Wage Import Competition on US Inflations Pressure,” *Journal of Monetary Economics* 57, no. 4 (2010): 491–503. The “results of a panel covering 325 manufacturing industries from 1997 to 2006 show that imports from nine low wage countries are associated with a strong downward pressure on prices. When these nations captured a 1 percent share of the US sector, the sector’s producer prices decrease by 2.35%.”

2. Donald J. Boudreaux, *Globalization* (Westport, CT: Greenwood, 2008), 55–67.

3. Edward Gresser, *Freedom from Want* (Brooklyn, NY: Soft Skull, 2007), 167.

4. Boudreaux, *Globalization*, 55–67.

5. Boudreaux, *Globalization*, 100–16.