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*Free trade, one of the greatest blessings which a government can confer on a people, is in almost every country unpopular.*

—Thomas Babington Macaulay (1824)

## Introduction

Nearly two centuries after Macaulay made it, this observation by one of Britain's great historians still rings true. Growing world trade has helped lift standards of living around the world, and yet today, as in Macaulay's time, free trade does not win many popularity contests. Indeed, public opinion surveys in the United States and Europe reveal increasing skepticism about the benefits of international trade and trade agreements. Trade policy remains a highly controversial subject, a source of never-ending public debate.

In almost every country, international trade brings out anxieties and insecurities. With each passing decade, some of the old fears about trade recede and new ones take their place. In the 1980s, many Americans were convinced that Japan would achieve economic dominance by wiping out industry after industry in the United States, from automobiles to semiconductors to supercomputers, and thereby diminish America's position in the world. In the 1990s, many feared that the North American Free Trade Agreement (NAFTA) would result in a "giant sucking sound" of jobs lost to Mexico due to its low wages. Others protested in the streets of Seattle in late 1999 against the World Trade Organization (WTO) for its promotion of free trade and alleged indifference to the world's workers and environment. Now, in the first decade of the twenty-first century, concern has shifted to China and India. China has become a goliath in the production of manufactured goods, and—it is often argued—responsible for stagnant wages in the United States. Meanwhile the offshoring of white-collar jobs (from call centers to software

programming) to India has sparked new worries of a “service sector sucking sound.”<sup>1</sup>

Fears of trade exist in good times and in bad. The 1990s were a period of robust economic growth and the lowest U.S. unemployment in thirty years, yet NAFTA and the WTO generated heated debates. And economic downturns invariably bring out cries that foreign countries are stealing our jobs and therefore protectionist trade policies are required. Furthermore, the trade agreements of the past are still very controversial. NAFTA was signed long ago, in 1993, but during the 2008 Democratic primaries, Hillary Clinton called NAFTA a mistake and proposed a “time out” on further trade agreements. Meanwhile, to the consternation of Canada and Mexico, candidate Barack Obama promised to renegotiate the agreement. Yet the NAFTA-bashing is puzzling because U.S. tariffs on imports from Mexico had been at very low levels for many decades prior to NAFTA; what NAFTA really did was abolish Mexico’s high tariffs on U.S. exports to that country.

The many vociferous critics of free trade believe that it brings pervasive harm. A wide range of groups, from environmentalists to religious organizations to human rights activists, have joined in protesting against free trade. These groups rail against trade agreements and the WTO as benefiting corporations, harming workers, decimating manufacturing industries, sweeping aside environmental regulations, and undermining America’s sovereignty.

In his recent book, *Myths of Free Trade*, Senator Sherrod Brown, an Ohio Democrat who has opposed trade agreements, writes: “An unregulated global economy is a threat to us all—to the child in Avon Lake, Ohio, who eats raspberries grown in Guatemala by poorly paid farmers who use pesticides banned in the United States; the unskilled, minimum wage worker in Los Angeles who loses her job to an unskilled, five-dollar-a-day worker in Yucatan; the machinist in New York who takes a wage cut because of his company’s threat to move to China; the Chinese prison camp laborer; the tomato grower in Florida who has to sell his farm; and the peasant in Chiapas who must fell the native village where

<sup>1</sup> Perhaps not surprisingly, many people in Japan, Mexico, China, India, and the rest of the world have seen things very differently. They fear economic domination by the United States and wonder how local producers can ever compete against large, wealthy, and technologically sophisticated American companies.

his family had made its home for dozens of generations. But our national leaders—particularly Republican congressional leaders and Presidents Clinton and Bush, economists and newspaper editors, business executives and tenured economics professors—continue to ignore the uncomfortable consequences of free trade, hoping the American public will not take notice.”<sup>2</sup>

Opponents of free trade are not confined to one segment of the political spectrum. From Patrick Buchanan on the right to Ralph Nader on the left, trade skeptics can be found everywhere. And the litany of complaints placed on the doorstep of free trade goes well beyond the perennial objection—emphasized almost every night by CNN’s Lou Dobbs—that trade forces painful economic adjustments such as plant closings and layoffs of workers. Ralph Nader charges that “the Fortune 200’s GATT and NAFTA agenda would make the air you breathe dirtier, and the water you drink more polluted. It would cost jobs, depress wage levels, and make workplaces less safe. It would destroy family farms and undermine consumer protections.” Patrick Buchanan chimes in with the claim that “broken homes, uprooted families, vanished dreams, delinquency, vandalism, crime—these are the hidden costs of free trade.”<sup>3</sup> The organization Public Citizen says that “the real-life devastation being caused by the implementation of the WTO’s terms—and the growing social and political backlash this pain is generating worldwide—is the reason the WTO is wracked by the severe crisis that burst into view in Seattle and Cancún.”<sup>4</sup>

Why is such hostility directed at free trade policies and the World Trade Organization? The rapid increase in international trade in recent decades may have unleashed a “globalization backlash.” In this view, increased global integration has accelerated the pace of economic change and has brought with it painful economic adjustments. Meanwhile, the reach of world trade rules has gone beyond trade barriers to encompass internal regulatory policies regarding health, safety, and the environment. As a result, groups disturbed by these changes, whether directly in terms of their jobs or indirectly in terms of the community values they believe are at stake, have questioned the effects of integration and the institutions associated with it. These groups have raised legitimate concerns

<sup>2</sup>Brown 2006, 4.

<sup>3</sup>Nader 1993, 1. Buchanan 1998, 286.

<sup>4</sup>Wallach and Woodall 2004, 283.

about commerce and the community and about whether sovereignty has shifted from elected representatives at home to faceless and unaccountable bureaucrats abroad.

Clearly, the debate over trade policy is intense and shows little prospect of abating. The debate has raised many fundamental questions. Why is free trade considered to be a desirable policy? Do the most frequently made criticisms of free trade, such as its adverse impact on employment and the environment, have merit? Do the economic circumstances of developing countries qualify the case for free trade in any way? What is the World Trade Organization, and do world trade rules erode a country's sovereignty and undermine its health and environmental regulations?

This book aims to address these basic questions and demystify some of the complex issues that arise in discussions of trade policy. These questions will be examined mainly through the lens of economics. Despite widespread skepticism about free trade among the public at large, economists generally take a positive view of international trade and believe that reducing government-imposed trade barriers is desirable. In the eyes of economists, trade between countries is mutually beneficial, just like the exchange of goods within a country, even though the goods happen to cross national boundaries. While some groups lose from trade, people around the world are generally much better off with trade than they would be without it.

Trade skeptics often accuse economists of having a religious faith in free trade, of blindly clinging to the doctrine in the face of contrary evidence. In fact, the economic case for free trade is based not on faith, but on logic and evidence. As Paul Krugman has written, "The logic that says that tariffs and import quotas almost always reduce real income is deep and has survived a century and a half of often vitriolic criticism nearly intact. And experience teaches that governments that imagine or pretend that their interventionist strategies are a sophisticated improvement on free trade nearly always turn out, on closer examination, to be engaged in largely irrational policies—or worse, in policies that are rational only in the sense that they benefit key interest groups at the expense of everyone else."<sup>5</sup>

<sup>5</sup> Krugman 1995, 31.

Still, the logic and evidence behind the case for free trade deserve to be put under searching scrutiny, as do the logic and evidence behind alternative policies. Even advocates of free trade need to be reminded of the case, lest they simply restate stale arguments that fail to persuade. As John Stuart Mill argued, “even if the received opinion be not only true, but the whole truth; unless it is suffered to be, and actually is, vigorously and earnestly contested, it will, by most of those who receive it, be held in the manner of a prejudice, with little comprehension or feeling of its rational grounds.” Consequently, “however true [a proposition] may be, if it is not fully, frequently, and fearlessly discussed, it will be held as a dead dogma, not a living truth.”<sup>6</sup>

So the views of economists deserve critical scrutiny, but first they deserve a fair hearing. Economists have studied trade for a very long time and have noticed that the same worries and fears about trade tend to get repeated generation after generation. “With America’s high standard of living, we cannot successfully compete against foreign producers because of lower foreign wages and a lower cost of production.” This claim is heard today, but this particular quote comes from President Herbert Hoover in 1928 as he urged Congress to pass what became known as the Hawley-Smoot tariff. (Such statements can be found in abundance in the nineteenth century as well.) Among the claims heard yesterday and today are that trade will destroy jobs and lead to unemployment and falling incomes, and that trade deficits will siphon away a country’s wealth. To economists, these are economic fallacies that history and experience have refuted time and again. One observer has quipped that “free traders are trapped in a public policy version of [the movie] *Groundhog Day*, forced to refute the same fallacious arguments over and over again, decade after decade.”<sup>7</sup>

Chapter 1 in this book, “The United States in a New Global Economy?” sets out basic facts about international trade and the U.S. economy. World trade has expanded rapidly in recent years, and this development provides the context in which to consider questions of trade policy. This chapter discusses the reasons for the increase in trade and the state of public opinion on the question of globalization.

<sup>6</sup> Mill [1859] 1982, 116, 97.

<sup>7</sup> Sanchez 2003.

Chapter 2, “The Case for Free Trade: Old Theories, New Evidence,” examines the economic logic of free trade and recent empirical evidence reinforcing the case for it. Ever since Adam Smith and David Ricardo described the gains from trade in a systematic way, economists have stressed the higher income that results from improved resource allocation as the main advantage of trade. But economists have found mounting evidence that trade not only helps to allocate existing resources properly, but also makes those resources more productive. These productivity gains from trade, overlooked in the standard calculations, appear to be substantial. The welfare benefits of a greater variety of products as a result of trade have also been ignored until recently, and yet mounting evidence suggests that they are also quite important.

Chapter 3, “Protectionism: Economic Costs, Political Benefits?” considers the flip side of the case for free trade—that trade interventions are usually misguided and often costly. Tariffs and quotas on imports redistribute income from consumers to producers, but do so inefficiently. That is, trade barriers produce a net economic loss because the costs to consumers far exceed the benefits to producers. In addition, trade barriers reduce exports and harm downstream user industries. The chapter also raises the question of why, despite its costs, trade protectionism is often politically attractive. Finally, the chapter examines situations in which protection may be justified in theory, even if governments are often ill equipped to take advantage of those situations.

Chapter 4, “Trade, Jobs, and Income Distribution,” focuses on the most frequent argument in favor of limiting trade—that jobs will be saved in industries that compete against imports. As we shall see, reducing trade saves those jobs only by destroying jobs elsewhere in the economy. Opponents of free trade have also argued that imports have replaced good, high-wage jobs with bad, low-wage jobs. The truth turns out to be quite the opposite: jobs in industries that compete against imports are mainly low-skill and consequently low-wage jobs. This chapter also examines the extent to which trade with low-wage developing countries can be held responsible for the rise in economic inequality within the United States.

Chapter 5, “Relief from Foreign Competition: Antidumping and the Escape Clause,” describes the legal framework that allow firms to petition the government for the imposition of tariffs on competing imports.

The antidumping law is the most commonly used measure to block so-called unfair imports. The government's definition of "dumping" is a lower price charged in the United States than in a foreign exporter's home market, but it is not clear that this is a problem requiring trade restrictions, or that the government calculates the dumping margin in a fair manner. This chapter also examines the case for providing domestic industries with temporary relief from imports so that they can adjust to the competition.

Chapter 6, "Developing Countries and Open Markets," takes a look at the special circumstances of developing countries. Is free trade always beneficial in the case of poor countries? What type of trade policy is most likely to promote economic development? Did countries such as Japan and Korea grow rich by rejecting free trade and instead pursuing closed markets and industrial policies? The chapter also addresses how rich-country agricultural subsidies and import tariffs harm developing countries, as well as how developing countries harm themselves with their own antitrade policies.

Chapter 7, "The World Trading System: The WTO, Trade Disputes, and Regional Agreements," focuses on the current controversies about the multilateral trading system, particularly the World Trade Organization. Since its inception, the WTO has come under intense criticism from nongovernmental organizations (NGOs), which attack it as an anti-democratic institution that has struck down domestic environmental regulations by ruling them inconsistent with world trade laws. This chapter examines the WTO's rules and dispute settlement system, as well as the environmental cases that have come before it. Finally, it considers the Doha Round of trade negotiations and the rise of regional trade arrangements such as NAFTA.

As Macaulay so aptly noted long ago, there is a fundamental incongruity about free trade: despite its palpable benefits, it is frequently the object of condemnation rather than approbation. That condemnation is often the result of misconceptions about the benefits of international trade, the impact of trade policies, and the role and function of the WTO. This book seeks to dispel these misconceptions and is offered in the modest hope that it may improve our understanding of the issues of trade policy that confront us.