

INVESTOR'S BUSINESS DAILY®

Is Free Trade Dead?

Terry Jones

July 2, 2016

Once upon a time, free trade was the one thing almost everyone could agree on, an enlightened policy that brought economic growth, better jobs, growing incomes and higher standards of living.

Not anymore. Today, it's a pariah, with even some of its one-time champions raising doubts about its ability to deliver on the promise of a better life for all.

With the U.S. economy growing at just 2% a year -- the worst expansion since the Great Depression -- fear of job losses and almost two decades of stagnant incomes fuel opposition to free trade. And that's understandable. The costs of free trade -- closed factories in some industries, unemployed workers, troubled communities -- are easy to see. Less obvious are the benefits in lower prices, higher quality goods, more choices and a better standard of living.

The anti-trade anger and bitter debate over its benefits are not confined to the U.S. Some tie the U.K.'s recent Brexit vote to dissatisfaction among developed nations with globalism and free trade. Even the June 29 "Three Amigos Summit" of the U.S., Mexico and Canada largely dealt with solving problems still felt from the controversial 1992 North American Free-Trade Agreement.

In the U.S., trade could well be the defining issue of the 2016 election -- and perhaps for years to come. Both parties are fielding presidential candidates who believe not in free trade, but managed trade -- "fair trade," as some call it. They blame our current ills on bad past trade deals and ongoing cheating by major trade partners.

"Regardless of who wins the presidential election in November, the 2016 campaign has already dramatically undermined a major pillar of post-World War II American economic and foreign policy — free trade," said Clyde Prestowitz, who worked on trade issues in both the Reagan and Clinton administrations, in a widely quoted Washington Monthly piece recently.

As far back as the 19th century, economist and trade theorist David Ricardo warned that, while free trade makes countries better off overall by exploiting their comparative advantages, some people will inevitably suffer. His ideas were prophetic.

Free-trade opponents say it's time to rebalance our chronic trade deficits by "getting tough" with our trading partners, weakening the dollar to boost our own exports and even imposing tariffs and nontariff barriers on some imports.

Clinton, Sanders Bash Trade

Both Hillary Clinton and Bernie Sanders made free-trade bashing a linchpin of their respective presidential candidacies, blaming trade deals like NAFTA and the World Trade Organization for factory job losses, stagnant worker wages and income inequality.

And both came out against the Trans-Pacific Partnership (TPP) with Asia and the Transatlantic Trade and Investment Partnership (TTIP) with Europe, the centerpiece of Obama's trade agenda - even though Clinton, as secretary of state, ardently supported both.

"I don't believe (TPP is) going to meet the high bar I have set for creating jobs and advancing national security," Clinton said last year, reversing her support for the 12-nation TPP trade deal, which she once had called the "gold standard" of trade deals. "I am also worried about currency manipulation not being part of the agreement, and that pharmaceutical companies may have gotten more benefits from the deal than their patients."

Bernie Sanders, on the other hand, has never wavered: "Let's be clear," he recently said, "one of the major reasons that the middle class in America is disappearing, poverty is increasing and the gap between the rich and everyone else is growing wider and wider is due to our disastrous unfettered free-trade policy."

Trump Trade Trash Talk

But it would be unfair to say only the left is protectionist. Like Hillary Clinton, Donald Trump has come out against the Asian and European trade deals, and has repeatedly promised to pursue "fair trade" rather than free trade.

Just two weeks ago, Trump warned in a speech of a "wave of globalism that wipes out our middle class and our jobs along with it." In another speech just last week called "Declaring American Economic Independence," he again inveighed against free trade, especially TPP, which he termed "another disaster done and pushed by special interests who want to rape our country, just a continuing rape of our country."

The free-trade smack-talk doesn't stop at the boundaries of the two major parties.

"Even among libertarian-leaning conservatives and free-market liberals (there are a few left), trade pacts such as NAFTA and the WTO are in bad odor," wrote the National Review's Kevin Williamson recently.

In short, the very idea of free trade is struggling. Funny, since it's one of the few things that economists of all stripes agree on.

Economists Still Hail Free Trade

Gregory Mankiw, Harvard economist and former head of the president's Council of Economic Advisers, conducted a poll of economists for his book, "Principles of Economics." He found that 93% agreed that "tariffs and quotas reduce economic welfare."

Likewise, a 2012 poll from the University of Chicago business school's Initiative on Global Markets found a whopping 96% either agreed or agreed strongly that "Freer trade improves productive efficiency and offers consumers better choices, and in the long run these gains are much larger than any effects on employment."

That's about as sweeping an endorsement for free trade that exists.

So, case closed? Hardly.

Not Everybody Is A Winner

Because while the argument may be sound that the nation as a whole benefits from free trade, it's quite clear that particular industries and regions can be hit hard by sudden unfavorable shifts in trade -- leaving thousands of workers stranded and making billions of dollars worth of plants, machines, equipment and worker training and know-how obsolete. That can destroy whole communities, as businesses crumble, home values plummet and jobs disappear.

For these reasons, most countries, including the U.S., manage their trade -- through tariffs, quotas, subsidies, local content rules, labor standards and regulations. It's just too difficult to tell voters that they'll just have to suffer dislocation and job losses that sometimes come from free trade because, in the long run, everyone will be better off.

Protectionism Now

And while tariffs and other trade barriers have been lowered, protectionism still exists in almost all areas of trade and the economy. Most Americans don't even know it exists.

As Cato Institute trade economist Daniel J. Ikenson notes: "There are 'Buy American' rules limiting government procurement spending to local firms and U.S.-made products, heavily protected service industries, seemingly endless incarnations of agriculture subsidies, shipbuilding and shipping restrictions, the Export-Import Bank, anti-dumping duties and regulatory protectionism masquerading as public health and safety regulations." That's just a few.

A now-famous 2013 study by economists David Autor, David Dorn and Gordon Hanson studied U.S. trade with China. Looking at the years from 1990 to 2007, they found that competition from China's fast-growing economy -- they termed it "China shock" -- had destroyed jobs and reduced wages in a number of U.S. industries, in particular manufacturing. And many of the people who lost those jobs weren't re-employed in higher-skilled positions, but rather became enmeshed in the elaborate U.S. unemployment and welfare systems.

Higher Prices, Fewer Jobs

That study, while accurate, has been used to justify trade protection, in particular against the Chinese. That's unfortunate, because while protectionist policies might sound good, they always fail to deliver the goods, say economists.

"The historical record of American protectionism is one of chronically declining domestic industries, higher consumer prices and destroyed jobs," wrote economists Lee Ohanian of UCLA and Jesus Fernandez-Villaverde in IBD last April. "Protecting the U.S. auto and steel industries, which began in the 1970s, did not allow them to succeed."

More recently, economists at Moody's estimated that tariffs proposed by Donald Trump could cost 3.5 million jobs and throw the U.S. into recession. Protectionism, by shrinking markets and killing competition, is an economic dead end.

And yet, as proponents claim, the benefits of freer trade over the long run are overwhelmingly positive. To increase trade is to increase our well-being by making it easier to buy and sell goods around the world -- as the data clearly show.

The late economic historian and statistician Angus Maddison noted that increased trade helped fuel both the Industrial Revolution and the subsequent unparalleled expansion in wealth and incomes that took place across the world. Since the mid-1800s, Maddison said, the world's population grew roughly six times, while world GDP grew 60 times and world trade by 140 times. Trade is largely responsible for the rise of the West.

The Anti-Poverty Policy

In recent years, trade has replaced aid as a development tool in what used to be called the Third World. And it has been a remarkable success. In the last three decades, global trade has grown at about 7% a year -- roughly twice the rate of GDP. From 1980 to 2011, according to IMF data, developing world nations raised their share of world exports from 34% to 47%, and their share of imports from 29% to 42%.

The upshot? Over the last 25 years more than 1 billion people around the world -- but especially in China and India -- have been pulled out of poverty, largely due to freer trade and globalization.

U.S. Manufacturing Still Strong

Meanwhile, here in America, the idea common among many that "we don't make anything anymore" proves to be utterly false. True, in 1953, manufacturing accounted for 28% of the U.S. economy, its highest share ever. By last year, that was down to 12%.

But the reason had nothing to do with "losing jobs" to other countries or "deindustrialization." It was mostly due to booming service and leisure industries. Last year, manufacturing added some \$2.1 trillion to GDP -- more than six times what it added in 1953, and that's after adjusting for inflation. We are the world's No. 2 exporter of goods.

Remember that "giant sucking sound" from all the jobs that were going to be lost due to NAFTA? Since 1980, the U.S. has created nearly 54 million new jobs, more than any other developed nation by far, notes Scott Lincicome, a trade attorney and lecturer at Duke University. He adds that more than 30 million of those jobs came after the creation of NAFTA and the World Trade Organization in the mid-1990s, the two events that set off much of the current anti-free-trade movement.

The benefits of these and other free-trade moves since World War II have been immense.

According to the Peterson Institute's study of trade, "The Payoff to America from Global Integration," trade liberalization has created \$2,800 to \$5,000 in added income for every American -- or roughly \$7,100 to \$12,900 for each household. And the benefits of free trade, contrary to the rhetoric, go overwhelmingly to those in the lower and middle incomes -- largely because much of their purchasing comes in the form of traded goods like clothing, shoes and food.

Since World War II, one free-trade action in particular has had a huge impact on average Americans -- the reduction in tariffs on goods. The Council of Economic Advisers estimates that just reducing tariffs over the last 70 years has added 7.3% to U.S. GDP, or about \$1.3 trillion in 2014. That's roughly \$10,000 more in income for every household.

Higher Standard Of Living

When people shop at Big Box stores like **Wal-Mart** (WMT), **Costco** (COST) and **Target** (TGT), they are often buying foreign-made goods. Is that a bad thing? From TVs to cellphones to clothing, Americans' standard of living has largely been driven by foreign goods being sold cheaply here -- while U.S. companies focus on higher-end goods and services.

Yes, trade deals are complex and often embody things that make free traders blanch -- like local content rules, labor restrictions, and currency controls. Each deal should be judged on its merits, and not every trade deal deserves to be signed.

But criticizing trade deals because they make trade freer is a little like criticizing the Indy 500 because the cars go fast.

All the way back in 1776, Scottish economist Adam Smith, in his classic "Wealth of Nations," devastated the idea of mercantilism -- that is, that countries get rich by running trade surpluses and accumulating gold. And yet today, as the presidential contenders show, a kind of neo-mercantilism has become increasingly popular.

Too bad. Because, as Smith pointed out, free trade makes us wealthier by letting us specialize in producing the things we have a cost advantage in, while buying the things from others that we don't have an advantage in. In doing so, both parties to the trade are made better off. It's an idea that has never been successfully disproved.

So free trade isn't really dead, even if it isn't respected as much as it should be. As long as Americans know that free trade has helped this country climb that ladder of prosperity since the 1800s, they will continue to support it.