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The Case for Free Trade

By Richard W. Rahn

COMMERCE GROWS BEST UNENCUMBERED BY HIGH TARIFFS OR TAXES

Do you support free trade? Many business people, politicians and workers say they are in favor of free trade, "but with conditions" — because they can see and feel the job losses but not the job and income gains.

Consumers benefit from free trade — in terms of lower prices and more products of better quality. Think of the empty shelves and higher prices in Wal-Mart stores if there were no foreign-made goods. Trade lowers the costs of production, because of economies of scale (as the founding father of modern economics, Adam Smith, well explained back in 1776). The bigger the market, the lower the cost per unit. The second big reason for trade is "comparative advantage," where one producer has a relative cost advantage in one product while another producer has a relative cost advantage in another product. (In 1817, David Ricardo wrote the classic explanation of comparative advantage.) Modern trade theory is built on these basic insights, but also deals with multiple goods and services among many competing jurisdictions and enterprises, along with the effects of fluctuating exchange rates, tax differences, and labor and safety standards.

Florida can produce oranges much cheaper than Vermont, and Vermont can produce preferred (real maple) sugar syrup over Florida, so they sell to each other. Each state sells not only these products to each other but also into the global market place, allowing for great economies of scale, resulting in lower prices and better products for the consumers of the world. Larger markets also enable Florida orange producers and Vermont maple sugar syrup producers to make higher profits and hire more workers at higher wages. Such trade is a win-win for everyone.

In 2003, the United States and Chile signed a free trade agreement. Chile, being in the Southern Hemisphere, has the opposite growing season of the United States, but as a result of free trade and low-cost global transportation, U.S. consumers can buy Chilean fresh fruits and vegetables in their supermarkets all winter long at low cost. The revenue from the sales of agricultural products, copper and other goods and services to the United States enables Chile to buy advanced U.S.-made agricultural machinery, Boeing aircraft and other products, making the U.S. richer. By each country specializing in what they do best, more workers at higher wages are employed in both countries. Free trade is one of the key factors in Chile having gone from a relatively poor country 40 years ago to a developed country today.

When governments impose trade restrictions in the form of tariffs, quotas and other taxes or regulations, the cost of goods and services rises for consumers, producers tend to make lower profits and thus hire fewer workers at lower wages. At some point, the burdens become so heavy that a win-win situation becomes a lose-lose situation.

Many countries want to export to others without restrictions but limit the access to their own markets. The United States imposes very low duties on most Japanese products, while Japan has very tight restrictions on the ability of U.S. farmers to sell them rice. The U.S. produces high-quality rice at a much lower cost than Japanese producers (who tend to be small farmers with a strong political lobby).

The Japanese produce very advanced industrial robots, which are valuable to U.S. manufacturers in reducing their own production costs. Would it make sense for the United States to put high tariffs or quotas on these robots because Japan has refused to open their rice market to American producers? The U.S. can argue that the Japanese restrictions are unfair both to American rice producers and Japanese consumers — which is true. The importation of Japanese robots into the U.S. is a win for not only the Japanese but also for the U.S. — by being able to buy better tools at lower cost. A retaliatory tariff by the United States would be destructive for both parties.

State-owned or subsidized firms in some countries are able to sell into the international market place at prices below costs — for long periods of time — which competing privately owned firms believe is unfair, causing them to incur losses or even go out of business. Countries that artificially reduce the value of their own currency, causing their exports to be sold at less than true free-market prices, are also considered to be engaged in unfair competition. Such actions by countries reduce the incomes of their own people, while benefiting consumers in foreign countries with lower prices — but at the cost of destroying jobs in the targeted countries.

Many blame the loss of U.S. manufacturing jobs on free trade, but the real reason has more to do with the automation of global manufacturing and destructive U.S. tax and regulatory policy. The single most effective thing the United States can do to bring jobs back to the U.S. is to cut the corporate tax rate — which is the highest in the world — and remove excessive regulation. Tariffs and other trade restrictions will only make prices higher for consumers, causing them to buy less and thus kill jobs. The job losses from foreign trade can easily be seen, but the many more jobs created by free trade are most often unseen.

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