

CHAPTER 1

Trade Theory

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WHO GAINS FROM TRADE?

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Classical economic theory favors free trade among nations. Each country specializes in what it makes most efficiently, so that everyone can buy goods as cheaply as possible. Imagine two countries, Riceland and Beanland. At first, each grows its own rice and beans. Riceland is blessed with a wet climate ideal for growing rice, but its bean fields require constant, backbreaking work to drain the soil and keep the beanstalks from rotting. Beanland's climate is ideal for beans, but the people sweat and strain hauling water to the rice fields.

Then the countries discover each other and start trading. Riceland is delighted to make just rice, selling half of it to Beanland, while Beanland makes just beans and sells half to Riceland. The people save the time they used to spend draining and watering. Now they have leisure to sing, dance, and compose odes to free trade, plus energy left to make other things. Some Ricelanders start dabbling in vegetables, and some Beanlanders develop ways to build stronger huts. The economy flourishes, and everyone gains.

The theory of "comparative advantage" claims, moreover, that the two countries would benefit from trade even if Riceland is better at producing *both* rice and beans than is Beanland. Each country should still specialize in whichever crop it is *relatively* more efficient at producing, so Beanland would keep growing beans and selling them to Riceland.

In reality, however, trade is not always so simple or blissful, especially among capitalist economies. Sometimes one group benefits at another's expense. And sometimes countries compete on grounds less admirable than efficiency.

Suppose that unemployment increases in Riceland due to the decline of its bean industry, and in Beanland due to the end of rice production. In a primitive system, perhaps people would spread the work and enjoy more free time. But not in the contemporary world of the 9-to-5 job.

Defenders of free trade concede that some people may lose out, but they argue that the benefit to society outweighs the loss to any one group. In addition, it is possible to tax the winners in order to compensate the losers, offering financial aid to dislocated

workers while they look for other jobs, as well as retraining for other occupations. In reality, though, the losers have rarely had the political clout to get what they deserve. The U.S. government has set up such "trade adjustment assistance" programs, but they have been inadequate.

There is another pitfall to free trade. Suppose one country produces relatively expensive goods because employers offer decent pay and working conditions for labor, and take pains to protect the environment. If that nation suddenly has to compete with one where companies treat workers poorly and pollute with abandon, it will be forced to sacrifice either its standards or its jobs. This has been a major point of protest against the North American Free Trade Agreement (NAFTA) among the United States, Canada, and Mexico.

THEORY VERSUS POLITICS

Governments pursue free trade when it suits them. England frowned on barriers when it held sway in the 19th century, whereas its struggling former colonies, the United States, had an interest in sheltering its fledgling producers from world competition. Had the United States followed the prescriptions of free trade theorists, it would have specialized in furs from early colonial days. Instead, the United States established tariffs (taxes on imported goods) to protect its infant manufacturing industries while it developed the capacity to make tools and machinery at compet-

itive prices. Protectionism served a strategic role, as it can today for many developing countries.

After World War II, the United States was in a stronger position and pushed to erode trade barriers through the General Agreement on Tariffs and Trade (GATT), founded in 1948. For the next two decades, trade liberalization was on balance a benefit to workers and consumers in the United States. The economy was growing rapidly and new jobs proliferated, easily compensating for the few jobs lost to foreign competitors. U.S. exporters reinvested their profits at home, helping to create new jobs and boost incomes. And a variety of cheap foreign goods became available. In general, capital and labor both supported free trade.

Then sales abroad got tangled up with something else: investment abroad. Increasingly, companies based in the United States were setting up plants overseas and hiring workers there. Free investment coupled with free trade frequently meant freedom for corporations to hire low-wage labor elsewhere and sell their products back to consumers at home. While U.S. residents benefitted as consumers, they suffered as workers. Not only did certain industries suffer job losses; more unemployment in the economy at large also meant less bargaining power for workers overall. A whole community can be devastated when a plant shuts down, spurring divorce, alcoholism, crime, and suicide. As more and more jobs were exported, especially to overseas auto plants, the AFL-CIO abandoned its longstanding support for free trade. By 1970, the union was pressing for protections. The interests of labor and multinational capital diverged.

FAIR TRADE

✓ If free trade and investment have their problems, so does protectionism. True, it can save jobs in targetted industries. Import quotas have kept the U.S. textile industry in business, for example. But wherever tariffs or quotas save jobs, consumers pay more for goods. The Federal Trade Commission estimated that each \$27,000 auto industry job saved by Japan's voluntary export limits costs U.S. consumers \$241,000 in higher car prices. Whatever the accuracy of such estimates, free traders argue, with some reason, that protectionism means higher prices.

✓ In addition, protective measures often fail, because other countries simply retaliate with their own barriers. And protectionism often comes packaged with a narrow-minded, racist nationalism. Consider the recent wave of anti-Asian sentiment and Japan bashing. Such ugly attitudes

can lead to violence, even war. And a protectionist stance by wealthy nations can punish developing countries striving for a higher living standard. A pillar of South Korea's development strategy, for example, has been exporting to the huge and lucrative U.S. market.

Labor advocates have at times urged us to simply "buy American." But with the spread of international investment, the concept of American versus foreign goods is slowly losing meaning. It is no longer nations, but companies, that trade. GM and Toyota own a plant together in Fremont, California where they build Geo Prizms and Corollas. Which car is more American? In 1988, the hottest selling imported car in Japan was the Honda Accord, a "U.S. export" produced by Honda in Ohio. Even autos built domestically by GM, Ford, and Chrysler are full of components from all over the world.

Instead of debating tariffs and quotas, we should work for fair trade — standards for wages, working conditions, and environmental safeguards that all countries must meet. In Europe, labor and community leaders knew that hard-won protections for labor, the environment, and consumers would be threatened when poorer countries such as Spain and Portugal joined the European Community. They drew up a social charter setting minimum standards in these areas that all members would have to meet. Following that lead, a coalition of groups in the United States is developing the idea of a social charter to apply to any free trade area that the country joins.

Trade is a tough issue. We want U.S. workers to keep their jobs and incomes without fostering the racism that often accompanies protectionism. We want the rest of the world to get the good life, without losing it ourselves. Free trade offers the potential for more efficient production and lower prices. But it also poses dangers. If companies compete on wages, the real gains from trade could be minimal, compared to the shift from wages to profits. When coupled with free investment, free trade often means huge dislocations as shops run away. These threats will disappear only when wages and working conditions are similar around the world. We help ourselves by working to raise standards everywhere. Trade can benefit all, if only people unite across borders.

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