



The Benefits of Free Trade: Addressing Key Myths

Donald J. Boudreaux and Nita Ghei

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The growing rhetoric about imposing tariffs and limiting freedom to trade internationally reflects a resurgence of old arguments that stay alive in large part because 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.

Restrictions on foreign trade all too often 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, lower-income Americans generally bear a disproportionate share of these costs. Trade treaties increase freedom to trade and do not result in loss of sovereignty; they are part and parcel of wider international relations and they are not new.

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.

- Free trade increases access to higher-quality, lower-priced goods. Cheaper imports, par-

ticularly 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, which leaves more income for Americans to spend on other products.

- 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.² 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 results are higher wages, investment in such things as infrastructure, and a more dynamic economy that continues to create new jobs and opportunities.³
- 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

1. 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.⁴
- 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.

2. Myth: Free trade means jobs go overseas.

Reality: Free trade does not create more jobs, but neither does protectionism.⁵ 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, 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.⁶
- Using protectionist policies to “save” a job comes at enormous cost,⁷ as opportunities shrink and input costs swell for industries downstream.

3. Myth: Restrictions on trade help Americans.

Reality: The only beneficiaries of trade restrictions are the inefficient firms and special interests that lobby for these protections against competition.⁸

- Despite receiving protection from foreign competition for many decades, large firms have steadily left the US steel industry because of high fixed costs and competition from smaller firms. Tariffs on steel increase costs in steel-consuming industries, which employ almost 13 million Americans,⁹ compared to the 140,000 Americans employed in the steelmaking industry.¹⁰
- Other countries often retaliate against US tariffs. Tariffs on Chinese-made solar panels between 2012 and 2015 resulted in China imposing tariffs on American polysilicon,¹¹ raising the cost of solar equipment and reducing employment opportunities in both nations.

4. Myth: US trade deficits are bad for Americans.

Reality: US trade deficits generally are good for Americans.¹²

The trade deficit is not debt.¹³ 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.¹⁴ Dollars that leave the United States as part of the trade deficit must come back as a “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.¹⁵ For example, a lower price of the yuan makes Chinese goods cheaper for American consumers, conferring a real benefit on 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—assuming this undervaluation to be real rather than fanciful—benefits Americans at the expense of the Chinese.

5. Myth: Trade treaties require a surrender of sovereignty.

Reality: Trade treaties enhance freedom.

Nation-states routinely ratify treaties on a range of issues, including human rights, treatment of prisoners, and territorial waters, as well as international trade and financial transactions. Such cooperation is the basis of public international law. Trade treaties are particularly valuable because they contain provisions that help governments avoid the worst damage that protectionism could inflict on their people.

- The “most-favored nation” and “national treatment” clauses of the General Agreement on Tariffs and Trade require that nations treat all trading partners alike and do not discriminate between domestic and imported goods. This requirement of reciprocity helps assure governments that gains from trade will be available for everyone.¹⁶

ABOUT THE AUTHORS

Donald J. Boudreaux is a senior fellow with the F. A. Hayek Program for Advanced Study in Philosophy, Politics, and Economics at the Mercatus Center at George Mason University, a Mercatus Center Board Member, and a professor of economics and former economics department chair at George Mason University. He holds the Martha and Nelson Getchell Chair for the Study of Free Market Capitalism at the Mercatus Center. He specializes in globalization and trade, law and economics, and antitrust economics.

Nita Ghei is the Director of Policy Editing for the Mercatus Center at George Mason University. Before coming to Mercatus, Nita Ghei was at the Cato Institute. Previously, she was on the faculty of George Mason University School of Law and Northwestern University Law School, following a clerkship at the Maryland Court of Appeals (the state’s highest court). Before going to law school,

Nita was a member of the editorial board at the *Economics Times* in New Delhi, after working at the World Bank in Washington DC.

NOTES

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