

SPEAKING ABOUT TRADE TO THE OPEN-MINDED SKEPTIC

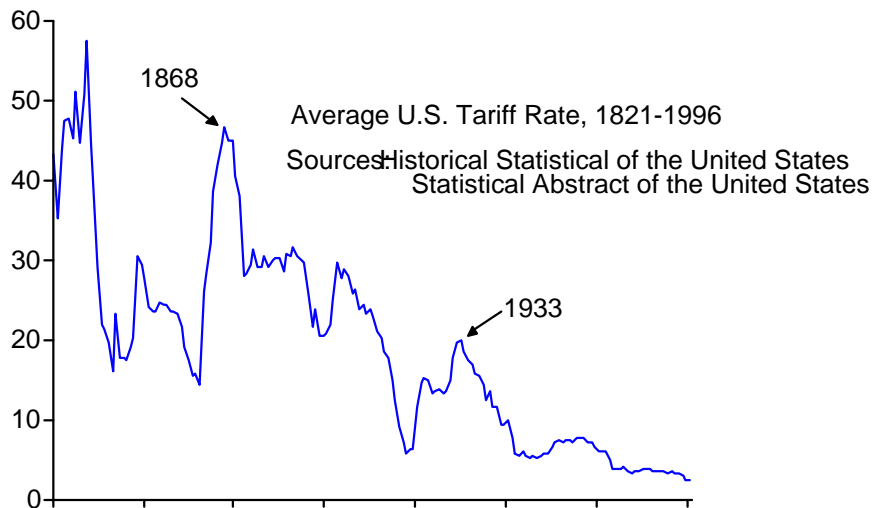
Russell Roberts
Center for the Study of American Business
Washington University in St. Louis
roberts@mail.olin.wustl.edu

Prepared for the Cato Institute's Center for Trade Policy Studies Conference, "Seattle and Beyond: The Future of the WTO," November 17, 1999, Washington, D.C.

In the United States, free trade receives nearly unanimous support from economists while remaining quite controversial among the public. This gap suggests there is a long way to go in making the case for free trade. And yet, there are a number of signs suggesting that the situation is far brighter.

To begin with, Presidential candidates from either party who have made protectionism their signature issue (see Gephardt and Buchanan) have fared poorly. Perot made a splash but trade was just one of his issues. The novelty of his act has faded.

Then there is the indirect but more tangible evidence, the long-term trend toward free trade as evidenced by the success of the previous GATT rounds and the unmistakable secular trend toward lower tariff rates:



By 1996, the average import faced duties of only 2.5%. The proponents of free trade may lose the occasional battle, but they are winning the political war.

That having been said, there are two discouraging trends. The first is the reluctance of Congress and the President to act quickly and decisively when trade issues arise. Since NAFTA,

no movement toward freer trade has come easy. Trade agreements that were once non-issues have become political minefields. The explosiveness of trade issues is particularly alarming given the healthy state of the economy. When the economy falters, the demand for protectionism will be that much stronger. The second disturbing trend is the use of non-tariff barriers, particularly dumping penalties, to advance the cause of protectionism. So the trend in tariff rates is not quite as rosy as it seems.

Is the glass at least half-full? Probably. But we can always do better. Our best opportunity for improvement lies with the open-minded skeptic. I once debated NAFTA with a union spokesman at a local public library event. It didn't go very well. He claimed that all Mexicans live in mud huts and make 50¢ a year. His estimate of the manufacturing wage in the United States was half of the true value. Worst of all, numerous members of the audience were his family members who hooted and mocked anything I said.

One of the reasons I fared poorly was that I thought the point of the debate was to convince my opponent that free trade is good. In fact, the union spokesman was not my audience. His family members were not my audience. I had no chance of convincing them; their minds were made up. My audience was the woman in the crowd who was worried about foreign goods but was open-minded enough to hear me out. Call her the open-minded skeptic. I would have had a chance with her if I had tailored my comments accordingly.

This paper suggests ways of speaking to the open-minded skeptic. I have four suggestions:

- Don't Lie
- Speak Plainly
- Illuminate the Unseen
- Bring Trade to Life

Don't Lie

Trade is a complicated matter. Because of its complexity, there is a tendency to simplify when making the case for free trade. Unfortunately, this sometimes leads to lying, or half-truths.

Lying is a poor way to win friends and influence people, yet in Washington, the dominant argument for free trade is that it creates jobs. OK, it's not exactly a lie, but it's terrible economics. The argument is that free trade means greater exports and every \$1 billion of exports creates 20,000 jobs.

This numerical impact of exports on job growth is based on Department of Commerce data that tries to count the numbers of jobs that involve exports. The U.S Trade Representatives office takes the dollar value of exports, measured in billions, and divides it by the estimated number of jobs. This number is then used by policy advocates as a kind of export multiplier. While the Department of Commerce and the USTR talk about the number of jobs "supported" by exports or that "depend" on exports, many free trade proponents use the phrase "created" by exports. The number (and various variations on it) is invoked by reputable economists and reputable think tanks. (I will drop no names here, but if you're curious, get out your favorite search engine and have a look around.)

It is bad economics because it makes exports sound like they have a life of their own independent of imports and capital flows. It implies that if we could increase exports by a billion dollars we could have 20,000 more jobs. Neither statement is true or has any real meaning. In reality, the number of jobs in the American economy is roughly independent of trade, either exports or imports.

The best way to see the emptiness of “trade is good because it creates jobs” is to look at the debate over NAFTA. At the center of the NAFTA debate was whether it would create or destroy jobs. Proponents said NAFTA would expand exports and thereby create jobs.

Opponents said that NAFTA would increase imports from Mexico and thereby destroy jobs.

Actually, we don't trade with Mexico to create jobs. We trade with Mexico because there are some things Mexicans can make more cheaply and effectively than we can. To get those goods and services we have to trade things (goods, services, assets or currency) that Mexicans value.

In hindsight it was an absurd debate, but incredibly, it still continues. Fans of NAFTA argue that it has created jobs because our exports have increased. Anti-NAFTA folks complain that since NAFTA was put in place, our trade balance with Mexico has gone negative. That means imports exceeds exports. And that means (because of that job multiplier that people like to bandy about) that every billion dollars of the trade deficit with Mexico costs America 20,000 jobs. Both sides go out and actually try and count the jobs gained and lost. Each side adds up the job losses from companies that have closed factories and relocated to Mexico or companies that have opened or expanded factories that sell to Mexico.

But this is the wrong way to count the employment impact of trade with Mexico. To see why, suppose Mexico, out of sheer goodness, decides to give away its exports for free to the United States. Suppose Mexico picks a particular industry, metalworking equipment, to be its only export. As a result, the American metalworking equipment industry, unable to compete with their altruistic Mexican counterparts, has to shut down all its factories. What would be the effect on American jobs of this Mexican benevolence?

Using the naïve method of counting jobs produced or lost in industries directly related to the U.S. and Mexico, we would lose the jobs in the American metalworking equipment factories. Because the Mexicans are giving away the metalworking equipment for free, let's assume there will be no Mexican demand for American imports and therefore, no American factories expanding production to Mexico.

The lost metalworking jobs in America would be a terribly misleading measure of the impact on the economy and on the labor market of the Mexican gift. If our metalworking industry shut down, the capital and resources that feed that industry would now be free to go elsewhere to create new opportunities. The laid-off workers would look for new jobs. Some would take a long time to find them. Some wouldn't find new jobs. Others would find new jobs and some would even pay well. As the laid-off workers look for opportunities and as the capital flows to new uses, all kinds of jobs are going to be created that are not directly related to metalworking. So looking just at expansion and contraction related to Mexico is a grossly inaccurate way to account for the job impact.

Counting up lost jobs directly related to Mexican imports and exports is bad economics. But it's worse public policy; it allows the enemies of free trade to demonize trade deficits as job destroyers by invoking the Commerce Department number.

My favorite reminder of why trade deficits are usually irrelevant is adapted from an example of the 19th century French writer, Frederic Bastiat. If you want balanced trade, build a factory on the shores of California. Load boats with the factory's output and send them off to Asia. Before they actually get there, before there are customers, sink the boats in international waters and have them return for more. The cargo of the boats will be classified as exports. So exports will increase and our trade deficit will get smaller.

Bastiat's example illustrates the foolishness of focusing on the trade deficit. But it also shows us the foolishness of the job accounting measures that look at export and import employment alone. Will the fake factory in California increase employment in America?

It will increase employment in that wasteful factory in California, making it appear that American employment has increased. But those workers will have to come from somewhere. Many, if not all of them, will quit other jobs to come work in the factory. To attract them, the fake factory will have to offer a good enough package of wages and benefits to draw workers away from other industries and factories. It will appear that the "export" jobs created by the fake factory pay more than other jobs in the same industry. It will appear that the factory will have created jobs. But both conclusions will be false. And it will be impossible to measure the true impact unless we know each industry where those workers used to work or would have worked in the absence of the factory.

Trade determines the kind of jobs we have in America, not the total number. This is not a slogan to go to war for, nor does it compare to the inspiring "Trade creates jobs." But at least it's true. Below, I will attempt to make the tepid job-composition argument into something more inspiring.

Finally, there is a variation on lying that is almost as dangerous. That is the whitewash. It is common for free trade proponents to claim that trade is good for everybody. Free trade is not good for everybody. The transition to free trade is not good for everybody. We are better off admitting that free trade harms some people and can harm them a great deal. Rather than claiming that free trade is flawless, we should point out the harm caused by protectionism.

Speak Plainly

Speak plainly. Give the public arguments that a human being, not just an economist can actually understand. In particular, never make the argument that free trade is good because it is efficient. This makes the economy sound like the engine of a car, or a complicated distribution system in a warehouse. It's a lousy metaphor, it is incomprehensible to a non-economist and it is morally deceptive as well.

For years, when I taught microeconomics to undergraduates, I always discussed the distortion caused by tariffs. I had nice pictures with triangles of deadweight loss. By the end of class, students believed that all kinds of well-meaning policies had significant costs. But if you asked them why such-and-such a law was costly they would say, "It's inefficient." And if you asked them why that was bad, the most compulsive members of the class would be able to parrot back the mantra: some people could be made better off without making others worse off. I eventually realized that if I wanted my students to advance beyond bird status, I would have to explain something about the effects of trade beyond efficiency.

There is a virtue to Pareto optimality. But it is a total failure as a short-run convincer of a skeptic.

Imagine the following dialogue between the economist and the skeptic:

E: "Free trade is good.

S: "Why's that?"

E: It's efficient.

S: What's that mean?

E: It means no one can be made better off without making someone worse off.

S: Huh?

After a lot of confused conversation, the economist explains to the skeptic that if we got rid of tariffs and quotas and forms of protectionism, then the people who benefit would be better off by enough so that they could actually compensate those who would be made worse off and leave them indifferent. (For the purpose of brevity, I will ignore the problem that it takes 4-6 hours of lectures to convince the skeptic that this is true. Assume that the skeptic accepts it as true.)

S: So if we get rid of tariffs, will this compensation take place?

E: Oh no! But it doesn't have to. The point is that if we don't have free trade, we're in an inefficient situation.

S: Huh?

Invoking efficiency fails to persuade the skeptic. But it also confuses. The argument paints proponents of free trade as nothing more than soulless technocrats who care only about the smooth performance of the economy rather than the people in it. Don't invoke efficiency in defense of free trade.

Illuminate the Unseen

When a steel mill closes, the misery is obvious and leads the nightly news. When a factory doesn't get built because we protected the steel mill, no one notices because it can't be seen. It can't be covered on the news. The people who won't be able to work in the factory because it doesn't get created aren't aware of the lost opportunity.

If we are going to make the case for free trade tangible, we have to do a better job illuminating what Bastiat called the unseen. The fundamental challenge at the heart of making

the case for free trade is that the costs are visible while the benefits are harder to see. I want to suggest a few ways to make the unseen impact of free trade and protectionism visible.

In the case of the steel mill, there are two ways to make steel. There is the direct way we are all familiar with: you build a steel factory, add people, machines and raw materials and steel is the result. Then there is the roundabout way: build something that the Japanese want and ship it to Japan in exchange for steel. In one case, you have steelworkers making steel. In the other, you have Boeing workers or Merck workers or Disney workers making products we export to Japan in exchange for steel. We don't see this exchange because it is masked by the currency flows that make it happen. Or because sometimes we export the Boeing plane to Germany and Germany exports something to Japan.

If we let the steel mill die, the capital and talent and raw materials are free to flow elsewhere. They will flow to Boeing and Merck and Disney but they will also flow to unknown, unseen uses that we cannot predict in advance. This is another example of the dynamism of the labor market discussed above.

Critics of free trade demand to know how we can be sure that new jobs will be created. Looking to the past we can offer some comfort and illuminate the unseen.

At the beginning of the 20th century, total employment in the United States was about 25 million. About 11 million of that total, or 44%, were agricultural jobs. Over the last 100 years, agricultural employment has shrunk to just over three million, or less than 3%. If you had told a farmer in the year 1900 that over the next 100 years, employment in agriculture would go from over 40% of economy-wide employment to less than 3%, he would have been horrified. What could possibly replace all of those jobs? Surely, there would be massive unemployment and famine.

It turns out that his fear was misplaced. While farm jobs were getting scarce, we managed to create over 100,000,000 new jobs in the past century. We replaced those agricultural jobs with other kinds of jobs, jobs that people preferred over working in the fields at five in the morning and slopping the hogs. Talking to a farmer in 1900, we would have no way of predicting what kind of jobs would come along that would replace the agricultural jobs that would not be created in the first place. With the benefit of hindsight, we can see that millions of jobs were created as America's resources were devoted to activities other than farming.

Bring Trade to Life

It is not enough to illuminate the unseen. To have it make an impact on people, we have to bring trade to life. The common way trade advocates try to make trade come to life is a variation on the Commerce Department job creation argument: "Trade is good because your job depends on it. You work in an industry that sells to foreigners. Exports help pay your salary." Like the "exports creates jobs" argument, this encourages people to think that the best trade policy is one that opens markets abroad at any cost. It gives people the uneasy feeling that they are somehow dependent on foreign consumers. It also teaches the wrong lesson that the goal of trade is exports.

There is another argument that is commonly used to give people a feeling that they have a stake in trade: free trade leads to lower prices. People like low prices. But low prices alone, may not convince the skeptic.

For example, a large proportion of America's broom production comes from a few small towns in Illinois. One of them, Arcola, population 2700, is the home of the Libman Broom Company, a major producer of America's brooms and one of the top two employers in town. Arcola was the poster child for NAFTA. Over time, NAFTA lowers tariffs on brooms from over 32% in 1994 to zero. Because of the decrease in tariff rates, American broom companies will have trouble competing with Mexican broom companies. A lot of broom jobs, maybe all of them, are going to end up in Mexico rather than in Arcola.

Is it worth destroying the town of Arcola so Americans can have cheaper brooms?

For most Americans, the answer to this question is no. You can argue that it is the wrong question. But it doesn't matter. Free trade can produce heart-rending results. They may be few and far between. It may be that there are good reasons for tolerating these results. But if we are to convince the open-minded skeptic, we are going to have to go beyond efficiency and beyond the pocketbook and speak to the heart in the same way our opponents do. And we must speak to the heart in a way that shows people that free trade is good for you, yes, but it also helps others in inspiring ways.

The people of Arcola may suffer because of NAFTA, there is more at stake than just cheap brooms. Somewhere in Arcola there is a high school girl whose parents work in that broom factory. She can stay in high school, go on to college and begin a career. Another option is to stay in Arcola, maybe finish high school, maybe not, and go work in the broom factory with her parents.

NAFTA destroys one of those options. Let's assume that because of the lower tariffs on brooms, Mexican brooms push American-made brooms off the shelves and the Arcola broom factory closes. That high-school girl and her classmates will have lost an option. They will be

pushed out into the world. Most will choose to leave Arcola and the Arcola of the year 2010 will struggle and do poorly.

That girl's parents are going to have a tough time. But is NAFTA good for that girl? A simple answer would be that if she had planned to work at the factory, she will be worse off; if she planned to leave the town anyway, losing the factory won't matter. But the simple answer is wrong. Because of NAFTA and free trade generally, we will import some things that we used to make for ourselves. That will allow capital and resources and energy and know-how to flow into other uses. New opportunities will be created.

The girl who enters the world without a broom factory in Arcola will inherit a different world outside of Arcola because we have the courage to let Arcola suffer. It will be a world designed around the skills and aspirations of her generation. It is a world that will let that girl express herself in ways she could never do in the broom factory. The hardship of her parents will pose challenges for her. But like every generation, many will overcome those challenges to thrive in the new economy.

What ways will those be? We have no way of knowing. I only know that when I speak with high school kids they rarely speak of working in the same jobs their parents do. Free trade lets those kids achieve their own dreams by letting capital and skills accumulate to serve new ends, new markets and new opportunities.

And Arcola? The Arcola of 2010 may look run-down and miserable. But it fails to tell us the effect of free trade on the inhabitants of 1999. To understand the impact of free trade, we would have to do the mental experiment of bringing back all the children who left town and prospered elsewhere. They will be unseen in 2010 when Arcola struggles. But to assess the true impact of trade on Arcola, we have to illuminate the fate of the next generation that will choose

to live elsewhere and who because of free trade, will be able to find new opportunities elsewhere and who will thrive.*

Trade determines the kind of jobs we have in America, not the total number. As mentioned earlier, this is not exactly a romantic slogan to go to the barricades for. But it is true, and when fleshed out with a little bit of analysis of the unseen, it can begin to make a case for free trade that may speak to the open-minded skeptic.

Conclusion

Given the level of economic literacy in the United States, it often amazes me how free trade thrives given the ability of protectionists to tell anti-trade stories that pull on the heartstrings. We need our own stories. We need stories that inspire, that illuminate the unseen and that speak in the language of everyday Americans. We've won the debate in theory. To win the applied debate, we have to find better ways of bringing the theory to life, making it sing and getting it heard.

* There is a postscript (or maybe a pre-script) to the Arcola story. I called the Chamber of Commerce the other day to find out how Libman Broom is doing. To my surprise, they're *expanding*. Puzzled, I found out that a Presidential order of 1996 delayed the implementation of the broom tariff reduction. Presumably they will eventually fall and Arcola will have to cope with change.