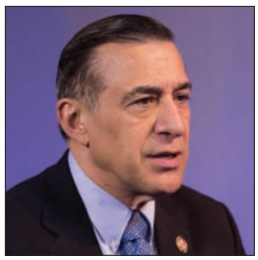
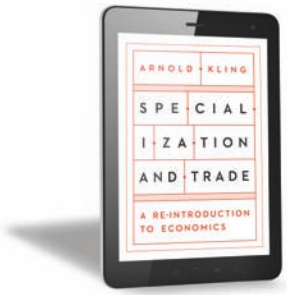


DARRELL ISSA
Podcast on Operation Choke Point
PAGE 4

RAMESH PONNURU
Was there a libertarian moment?
PAGE 9



NEW EBOOK
A new way to look at economics
PAGE 16

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Trade on Trial, Again

BY DANIEL J. IKENSON

Not long ago, a group of Cato scholars entertained the question of whether the intellectual debate for free trade had been won. There was near consensus that it had—in 1776 with publication of *The Wealth of Nations*. In the 240 years to follow, efforts to poke substantive holes and refute Adam Smith's treatise failed and, today, nearly all economists agree that free trade, by expanding the size of the market to enable greater specialization and economies of scale, generates more wealth than any system that restricts cross-border exchange.

What that Cato confab failed to produce was agreement about whether the question under consideration was even pertinent. After all, how much does it really matter whether the intellectual debate has been won when, in practice, free trade remains stubbornly elusive, and the process of U.S. trade policy formulation is distinctly anti-intellectual?

Consider trade agreements. At the heart of negotiations that produce these deals rests the fallacy that domestic trade barriers are assets to be dispensed with only if reciprocated, in roughly equal measure, by negotiators on the other side of the table. That's not Adam Smith. That's neo-mercantilism, which posits that policy should aim to maximize exports and minimize imports. Yet Smith is credited with vanquishing mercantilism, which held sway in his day—and apparently still does today.

If the free trade consensus were truly meaningful, trade negotiations would be unnecessary. If free trade were the rule, trade policy would have a purely domestic orientation and U.S. barriers would be removed without need for negotiation because they would be recognized for what they are: taxes on consumers and businesses that impede the global division of labor and the creation of wealth. Apparently, the intellectual consensus for free trade coexists with an absence

Continued on page 6

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At the 28th Annual Benefactor Summit, PENN JILLETTE told the story of how he became a libertarian. See page 4 for more pictures from the Benefactor Summit, and see *Cato's Letter* or the Cato website for his complete talk.

Continued from page 1

of free trade and a persistence of protectionism in practice.

For example, in the United States, there are "Buy American" rules that restrict most government procurement spending to U.S. suppliers, ensuring that taxpayers get the smallest bang for their buck; heavily protected services industries, such as transportation and shipping, that drive up the cost of everything; apparently interminable farm subsidies; quotas and high tariffs on imported sugar; high tariffs on basic consumer products, such as clothing and footwear; energy export restrictions; the market-distorting cronyism of the Export-Import bank; antidumping duties that strangle downstream industries and tax consumers; regulatory protectionism masquerading as public health and safety precautions; rules of origin and local content requirements that limit trade's benefits; restrictions on foreign investment, and so on.

If an intellectual consensus for free trade exists, policy doesn't reflect it and politicians appear to abhor it. If anything, the 2016 presidential election season reveals an American public—pitchforks and scythes in hands—ready to storm the ivory tower.

"If an intellectual consensus for free trade exists, policy doesn't reflect it and politicians appear to abhor it."

TRADE IS RIPE FOR DEMAGOGUERY

To cheering crowds, Donald Trump promises to slap duties on imports from China and Mexico and to use the tax code to punish U.S. companies that outsource parts of their operations abroad. Bernie Sanders vows to tear up NAFTA and other free trade agreements, calling them "a disaster for American workers." Hillary Clinton, a co-architect of the Trans-Pacific Partnership trade agreement (TPP), now opposes that deal, while promising to disregard certain U.S. treaty obligations with China. Ted Cruz, projecting the pain of workers who have been displaced by import competition and outward investment (but, apparently, not those displaced by technology, changing consumer tastes, or poor business management), says trade has been "unfair" and pledges to "bring our jobs back from China."

Scapegoating trade for problems real and imagined is nothing new. Blaming the Japanese, Mexicans, Chinese, and other foreigners for domestic woes ingratiates politicians to excitable elements of the electorate and helps them direct voter anger away from their own records. It has become a kind of quadrennial tradition ever since the NAFTA debate took center stage in the 1992 election.

Throughout the 2012 campaign, Mitt Romney assailed President Obama for failing to label China a "currency manipulator," and the candidates exchanged accusations about who was more "culpable" for "shipping jobs overseas." Promising to bring manufacturing jobs back home, Rick Santorum resonated with trade-skeptical voters, and even won the Iowa caucus that year.

In 2008 Senators Obama and Clinton vied to be seen as the supreme trade-rules enforcer, each pledging to force U.S. trade partners back to the table to renegotiate NAFTA and various World Trade Organization agreements to make the terms "fair" for American workers. Demonization of trade was also a major component of John Edwards's divisive "Two Americas" message that year.

John Kerry tapped into the same vein of public anxiety in 2004, referring to U.S. businesses that outsource call centers to places like India as "Benedict Arnold" companies. Blaming Mexico, Japan, and inside-the-beltway complicity for U.S. manufacturing decline and the erosion of American power, Pat Buchanan promised to punch back with force. His populist message energized the feisty "Buchanan Brigades" and helped him win the New Hampshire primary in 1996.

Trade-bashing became popular during the 1992 election, as books about the United States "trading places" with an ascendant Japan flew off the shelves and Ross Perot warned of the imminence of a "giant sucking sound" coming from south of the border.

So campaigning politicians denigrating trade is nothing new. It seems to be inextricably woven into the fabric of our presidential elections. But something seems different this year. The tone is harsher. The digs are coming from across the political and ideological spectra. Two of the candidates—Sanders and Trump—seem genuine in their antipathy and their resolve to act. And their messages resonate especially well with primary election voters, who tend to hail from the extremities of the major parties, where trade and globalization are viewed with the greatest skepticism. But, again, these constituencies and their concerns aren't particularly new either.

What is new—at least for the first time since NAFTA loomed large 24 years ago—is that a major trade agreement (indeed, the largest preferential trade agreement in U.S. history) is being debated and possibly considered for ratification by the U.S. Congress this year. Trade policy has featured prominently in the public square since January 2015, when the president and the new congressional leadership began their push to secure passage of Trade Promotion Authority (TPA) to facilitate completion and ratification of the TPP and, eventually, the Transatlantic Trade and Investment Partnership.

Although the TPA debate itself was short-lived, with the legislation passing in June of last year, anti-trade lobbies such as the Sierra Club, the AFL-CIO, and Public Citizen have been mobilizing for several years in anticipation of an epic battle over the TPP. Their anti-trade campaigns, with assertions

and slogans evoking fantastical worst-case scenarios about the relationship between trade and climate change, trade and cancer rates, and trade and joblessness have played to popular fears, and have succeeded in winning more people to their cause. Protectionist ranks have been augmented by those with other kinds of economic grievances in a way that evokes *New York Times* columnist Thomas Friedman's 2001 description of the anti-globalization movement as the "well-intentioned but ill-informed being led around by the ill-intentioned and well-informed."

Though they are not necessarily well-informed, the 2016 presidential candidates are complicit in creating this climate of misinformation.

> "One of the most frequently invoked trade myths is the portrayal of trade as a competition between 'us' and 'them.'"

UNSEEN CREATION

The case for free trade is not obvious. The benefits of trade are dispersed and accrue over time, while the adjustment costs tend to be concentrated and immediate. To synthesize Schumpeter and Bastiat, the "destruction" caused by trade is "seen," while the "creation" of its benefits goes "unseen." We note and lament the effects of the clothing factory that shutters because it couldn't compete with lower-priced imports. The lost factory jobs, the nearby businesses on Main Street that fail, and the blighted landscape are all obvious. What is not so easily noticed is the increased spending power of the divorced mother who has to feed and clothe her three children. Not only can she buy cheaper clothing, but she has more resources to save or spend on other goods and services, which undergirds growth elsewhere in the economy.

Consider Apple. By availing itself of low-skilled, low-wage labor in China to produce small plastic components and to assemble its products, Apple may have deprived U.S. workers of the opportunity to perform that low-end function in the supply chain. But at the same time, that decision enabled iPods and then iPhones and then iPads to be priced within the budgets of a large swath of consumers. Had all of the components been produced and all of the assembly performed in the United States—as President Obama once requested of Steve Jobs—the higher prices would have prevented those devices from becoming quite so ubiquitous, and the incentives for the emergence of spin-off industries, such as apps, accessories, Uber, and AirBnb, would have been muted or absent.

But these kinds of examples don't lend themselves to the political stump, especially when the campaigns put a premium on simple messages. This is the burden of free traders: Making the unseen seen. It is this asymmetry that explains much of the popular skepticism about trade, as well as the persistence of often repeated fallacies.

THE MYTHS

One of the most frequently invoked trade myths is the portrayal of trade as a competition between "us" and "them." Central to this perception is that exports are Team America's points, imports are the foreign team's points, and the trade account is the scoreboard. Since that scoreboard shows a deficit, the United States is losing at trade, and it's losing because the foreign team cheats—too often with impunity. Sound familiar?

This fundamental mercantilist fallacy about the nature of trade has a nationalistic appeal, where America is some monolithic entity best served by policies that strengthen her stature vis-à-vis some foreign monolith. But trade does not occur between countries. Trade is the culmination of billions of daily transactions pursued by individuals seeking value through exchange.

When we transact at the local supermarket, we seek to maximize the value we obtain by getting the most for our dollars. We strive to "import" more than we "export." But when it comes to trading across borders or when our individual transactions are aggregated at the national level, we tend to forget these basic principles and accept the fallacy that the goal of trade is to achieve a surplus. But, as Adam Smith put it: "What is prudence in the conduct of every private family can scarce be folly in that of a great kingdom." Never mind the intellectual consensus: This is common sense.

The benefits of trade come from imports, which deliver more competition, greater variety, lower prices, better quality, and new incentives for innovation. Arguably, opening foreign markets should be an aim of trade policy because larger markets allow for greater specialization and economies of scale, but real free trade requires liberalization at home. The real benefits of trade are measured by the value of imports that can be purchased with a unit of exports—our purchasing power or the so-called terms of trade. Trade barriers at home raise the costs and reduce the amount of imports that can be purchased with a unit of exports.

And as a result of globalization—the proliferation of cross-border investment and transnational supply chains—trade is more of a collaboration than ever before. Typically, about half of the value of U.S. imports is composed of intermediate goods and capital equipment—the purchases of U.S. producers. How can imports be viewed as the other team's points under those circumstances? Who, in fact, are "we" and who are "they"?

The claim that the trade deficit means we are losing at trade—"losing billions of dollars every year to China and Mexico," as Trump characterizes it—is another commonly invoked trade myth, which reflects a fundamental misunderstanding of international economics. By purchasing more goods and services from foreigners than foreigners purchase from Americans—trade deficit

scolds claim—U.S. factories, farmers, and service providers are deprived of sales, which reduces domestic output, value added (GDP), and employment. That conclusion relies on the assumption that the dollars sent to foreigners to purchase imports do not make their way back into the U.S. economy. The dollars that go abroad to purchase foreign goods and services (imports) and foreign assets (outward investment) are matched nearly identically by the dollars coming back to the United States to purchase U.S. goods and services (exports) and U.S. assets (inward investment). Any trade deficit (net outflow of dollars) is matched by an investment surplus (net inflow of dollars).

This process helps explain why GDP and the trade deficit rise and fall in tandem, and why 41 consecutive years of trade deficits have had no adverse impact on the economy.

The fallacy that trade killed U.S. manufacturing has long been a pretense for protectionism or industrial policy. Trump follows in these footsteps when he writes:

> One of the factors driving this economic devastation is America's disastrous trade policies. Throughout history, at the center of any thriving country has been a thriving manufacturing sector. But under decades of failed leadership, the United States has gone from being the globe's manufacturing powerhouse—the envy of the world—through a rapid deindustrialization that has evaporated entire communities.

U.S. manufacturing is not only alive, it's thriving. By all relevant metrics—output, value-added, revenues, exports, imports, investment, R&D expenditures—U.S. manufacturing remains a global "powerhouse." With respect to most of those measures, year after year the sector sets new records.

U.S. manufacturing attracts more foreign direct investment (FDI) than any other country's manufacturing sector. In 2014 the stock of FDI in U.S. manufacturing surpassed $1 trillion, more than double the value of FDI in China's manufacturing sector (and eight times the value in per capita terms).

> "Protectionism benefits producers over consumers; it favors big business over small business."

If by "rapid deindustrialization" Trump means that manufactured goods account for a smaller share of U.S. output than in the past, he's right about the statistic, but not the interpretation. Manufacturing's share of the U.S. economy peaked in 1953 at 28.1 percent, whereas today manufacturing accounts for only 12.1 percent of GDP. But in 1953 U.S. manufacturing value added amounted to $110 billion, as compared to a record $2.1 trillion in 2015—more than six times the value in real terms.

Bernie Sanders is wary of capitalism and in favor of equality of outcome. He perpetuates another common myth: Trade only benefits multinational corporations and the rich. But nothing could be further from the truth. Just like during the Gilded Age, the tariff remains the mother of the trust. And, like then, free trade should be the progressive position.

Protectionism benefits producers over consumers; it favors big business over small business because the cost of protectionism is relatively small to a bigger company; and, it hurts lower-income more than higher-income Americans because the former spend a higher proportion of their resources on imported goods.

The United States has relatively low tariffs on average—less than 2 percent. But tariffs on clothing (18 percent), footwear (14 percent), and food products (10 percent) are especially high. Meanwhile, U.S. antidumping restrictions on steel, lumber, cement, appliances, flooring, nails, and paint elevate the material costs of home building. Imports of life's basic necessities—food, clothing, and shelter—are subject to some of the highest taxes. Why isn't that too regressive for a progressive like Sanders?

WHAT DOES THE RHETORIC PORTEND?

Demagoguing trade has become an election year pastime. But trade issues tend to be of marginal concern to voters in the general election, and history suggests that cooler heads will prevail. Despite the abundance of antitrade rhetoric on the campaign trail, it is difficult to imagine an actual president of the United States supporting policies commensurate with the bluster. Every president since FDR, regardless of political party, has embraced or promoted trade liberalization.

While candidates might rail against unfair trade practices and unlevel playing fields on the stump, they change their tunes after taking the oath. Presidents prioritize broader, national interests over regional and parochial issues, and tend to see merit in projecting global economic leadership. They also view trade policy through the prism of foreign policy, and recognize the contributions that trade makes to economic growth and international stability.

Even if there were a President Trump or President Sanders, rest assured that the Congress still has authority over the nuts and bolts of trade policy. The scope for presidential mischief, such as unilaterally raising tariffs, or suspending or amending the terms of trade agreements, is limited. But it would be more reassuring still if the intellectual consensus for free trade were also the popular consensus.

What matters most is that Americans have realized progressively greater freedom to transact with people in other countries over the years. Many barriers still remain. But when the evidence of the economic benefits of liberalization is weighed against the myths and political aspersions, trade is exonerated on all counts. ■