In Defense *of* Free Trade

By Gary Clyde Hufbauer

Trump's tariffs are not backed by serious analysis.

Today's fashion—in politics, the media, and the academy—scorns free trade. U.S. presidential candidate Kamala Harris welcomed selective tariffs, while Donald Trump advocated something akin to comprehensive Smoot-Hawley tariffs. The *Financial Times* features two columnists who regularly denounce "neoliberal" policies. Esteemed professors are eager to find fault with the market economy, especially the trade piece. Public Citizen and the Coalition for a Prosperous America reliably chime support for trade-skeptic politicians.

In a new book, *Pax Economica: Left-Wing Visions of a Free Trade World,* Marc-William Palen tells the "forgotten history" of radicals, feminists, and socialists who once championed free trade as the path to peace and prosperity. Today, progressives and right-wing populists unanimously reject free trade. But the breadth of scorn is not matched by the depth of analysis. Anti-trade policies are seldom examined for their cost to the economy at large, or their doubtful success in reaching ambitious goals.

Before cataloging the benefits of free trade, it's worth dissecting four contemporary neo-protectionist claims: free trade worsens inequality; free trade destroys manufacturing jobs; free trade is an illusion—all trade is unfair; and free trade undermines U.S. national security, particularly with respect to China.

NEO-PROTECTIONIST CLAIMS

Inequality. Escalating inequality is a staple argument of progressives such as Senator Elizabeth Warren (D-MA), Senator Bernie Sanders (I-VT), and Representative Alexandria Ocasio-Cortez (D-NY). In their telling, big

Gary Clyde Hufbauer is a nonresident senior fellow at the Peterson Institute for International Economics.

THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
220 I Street, N.E., Suite 200
Washington, D.C. 20002
www.international-economy.com
editor@international-economy.com

corporations get rich from free trade, ordinary workers get poor. To support this thesis, they sometimes cite pre-tax, pre-transfer U.S. Gini coefficients. Recall that a Gini coefficient of 0.0 indicates perfect income equality among households (Jeff Bezos and Joe Sixpack have the same income); a coefficient of 1.0 indicates perfect inequality (Elon Musk takes it all).

The first problem with the income inequality argument is that pre-tax, pre-transfer Gini coefficients do not monotonically rise. Between 1965 and 1980, a period of robust trade growth, the U.S. coefficient dropped from 0.38 to 0.35; between 1980 and 2006, it rose from 0.35 to 0.41; then the coefficient went sideways for several years, before dropping to 0.40 in 2021. Only the period 1980 to 2006 accords with the rising income inequality thesis.

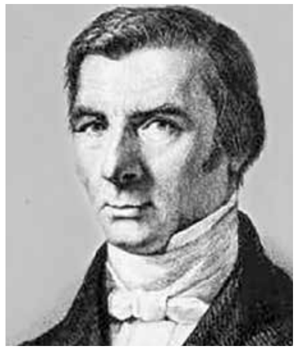
The second problem is that, when taxes and transfers are taken into account, the picture of rising income inequality simply disappears. In *The Myth of American Income Inequality* (2022), authors Phil Gramm, Robert Ekelund, and John Early plough through the data. If free trade somehow raises yachts more than row boats, then U.S. tax and transfer policies have restored the uniform effect of a rising tide (recalling John F. Kennedy).

But the third, and most serious, problem is the absence of any connection between national trade policies and income inequality. To cite a few extremes, South Africa and Brazil—two countries known for severe trade restrictions—have quite high Gini coefficients (0.63 and 0.53), while Norway and Netherlands—almost free traders—have very low Gini coefficients (0.23 and 0.26).

Progressives and right-wing populists unanimously reject free trade.

To be sure, wealth inequality has clearly escalated at the pinnacle of American life. In 1990, the United States had sixty-six billionaires; in 2023, Statista reported 748. But the names of new billionaires reveal that technology is the driving force of great wealth, not inheritance, and definitely not trade. The top ten American billionaires on the latest *Forbes* list: Elon Musk, Jeff Bezos, Mark Zuckerberg, Larry Ellison, Warren Buffet, Bill Gates, Steve Ballmer, Larry Page, Sergey Brin, and Michael Bloomberg.

Manufacturing Jobs. Politicians regularly celebrate manufacturing as the foundation of the American economy, and tariffs as the sure route to more manufacturing jobs. In 2016, these messages were key to Donald Trump's victory, and in 2024 steep tariffs led his pitch for re-election. Once in the White House, Joseph Biden subscribed to Trump's tariffs, while Kamala Harris gives no indication of different views. Seldom in today's polarized political scene can such bipartisan agreement be found.



Nineteenth-century French economist **Frederic Bastiat:** *"When goods do not cross borders, soldiers will."*

Even if manufacturing truly provided the foundation of the American economy, the consensus is wrong in portraying manufactured imports as the enemy of manufacturing jobs, and in characterizing tariffs as the panacea. Zero-sum thinking underlies both errors: a car made in Detroit supports American jobs; the same car made in Hermosillo supports Mexican jobs. Ergo, so the political story goes, restricting auto imports from Hermosillo will create jobs in Detroit. This sort of zero-sum thinking ignores indirect channels by which manufactured imports boost manufactures production: cheaper inputs, learning from foreign competitors, greater exports. It also ignores technological gains that, over time, account for the vast majority of manufacturing job losses.

Despite its flaws, the zero-sum fallacy enjoyed a terrific boost in 2013 from the "China Shock" paper published by scholars David H. Autor, David Dorn, and Gordon H. Hanson. Imports from China were blamed for destroying one million manufacturing jobs in affected communities.

The Autor, Dorn, and Hanson paper sparked a cottage industry of academic criticism. But the bigger political problem was that the authors reported cumulated job losses over seventeen years, 1990 to 2007. A million manufacturing jobs strikes most readers as a large number. But between 1990 and 2007, total manufacturing employment declined from 17.8 million to 13.7 million, some 4.1 million jobs. At most, the China Shock can be attributed with a quarter of total manufacturing job losses. But even the celebrated one million number was subsequently reduced to under 600,000 (about 15 percent of total losses) by critics and the authors themselves.

Accepting the 15 percent figure, what explains the other 85 percent of manufacturing job losses? Technology. In most countries, as Robert Lawrence of Harvard University persuasively shows, the manufacturing share of employment has declined, owing to rising worker productivity—meaning better tools and more sophisticated equipment. Technological gains are coupled with the economic response that a 10 percent decline in the price of manufactured goods (owing to higher productivity) generally boosts the quantity demanded by only 10 percent, leaving total expenditure on manufactures broadly unchanged—despite falling average prices. Moreover, as Lawrence documents, the balance in manufactured trade—whether surplus or deficit—has little long-term effect on the share of workers engaged by manufacturing firms. To illustrate, the manufacturing share of employment has fallen over time in Germany and Japan, despite their persistent trade surpluses in manufactured goods.

Lighthizer and Trump simply ignore the macroeconomic origins of trade deficits.

Autor, Dorn, and Hanson did not advocate a tariff solution, to their credit. But among less astute political acolytes, tariffs became the sure route to more manufacturing jobs. Even if tariffs might nudge the balance in manufactures trade, Lawrence's research showed that a rise in the manufactures share of employment could not be assured. This finding was reinforced by Federal Reserve analysis which found that Trump's tariffs actually decreased U.S. manufacturing employment. By inflating input costs, and by provoking foreign retaliation, Trump's tariffs exerted a stronger negative impact on employment than the positive impact from limiting the quantity of imports. In fact, the more Trump's tariffs protected a particular U.S. industry, the greater was its employment loss.

Unfortunately, sad economic experience has not quenched political appetites for tariffs on manufactured imports.

Unfair Trade. After serving as President Trump's protectionist trade ambassador, Robert Lighthizer summarized his thoughts in *No Trade Is Free: Changing Course, Taking on China, and Helping America's Workers.* His 2023 book elaborates three themes: foreign countries take unfair advantage of American goodness through mercantilist policies; they cheat by stealing American technology; and "our citizens are first producers and only second consumers." In combination, these three themes justify—to Lighthizer and Trump—almost any restriction on trade, especially on imports.

Large and persistent U.S. trade deficits are offered as proof of unfairness claims. Lighthizer and Trump simply ignore the macroeconomic origins of trade deficits—large U.S. budget deficits and low household savings—and blithely attribute U.S. trade deficits to malevolent foreign trade practices.

The practical application of Lighthizer's worldview became apparent in the 2024 presidential campaign. Influenced by Lighthizer, Trump made steep tariffs the centerpiece of his economic agenda: additional 10 percent (or maybe 20 percent) tariffs on U.S. imports from all countries, allies and adversaries alike, and 60 percent tariffs on all imports from China. Conservatively, this agenda would cost the typical American household $2,600 annually. But the cost to households does not concern Lighthizer. The view that the purpose of production is to enable consumption carries no weight with the former trade ambassador.

More telling to Lighthizer should be general equilibrium analysis by Warwick McKibben, Megan Hogan, and Marcus Noland. When direct and indirect consequences are taken into account, Trump's 10 percent tariff on all imports would actually decrease U.S. employment, even without foreign retaliation. If foreign countries retaliate, U.S. employment would initially drop by 1.4 percent, and only gradually return to normal full employment.

If high tariffs delivered prosperity, Indian workers today would be far better off than Chinese workers—but of course the opposite is true. And Brazilian workers would be gaining on American workers, but again the opposite is true. Historically, high U.S. tariffs may have benefited steel workers, but they harmed far more workers employed in steel-using industries, such as machinery, hardware, construction, and autos. As a general proposition, tariffs selectively enrich preferred industries but impose costs on all others.

Trump's 10 percent tariff on all imports would actually decrease U.S. employment, even without foreign retaliation.

Existing statutes address proven unfair trade. U.S. firms can seek penalty duties on imports of subsidized or dumped merchandise, and they can ban imported products that embody stolen intellectual property. Procedural features of these statutes favor the U.S. petitioners over foreign respondents. "Trade remedy" laws were extensively invoked by Lighthizer when he was in private practice, and they can adequately answer demonstrated unfairness claims. There is no need for blockbuster tariffs that disrupt the U.S. economy and trigger foreign retaliation to answer alleged, but unproven, claims that foreign partners are dedicated mercantilists and commercial cheaters.

Moreover, existing laws bar imports from countries that do not observe minimum social norms. In 1947, GATT Article XX General Exceptions allowed the ban of imports made with prison labor. In 1993, the original NAFTA was amended to include labor and environmental "side agreements." In 2007, the revised U.S.-Peru Free Trade Agreement obliged parties to enforce both the ILO Declaration on Fundamental Principles and Rights at Work and multilateral environmental agreements they had signed. These conditions then became standard in U.S. trade agreements. In 2021, Congress passed the Uyghur Forced Labor Prevention Act, creating a rebuttable presumption that merchandise originating in China's Xinjiang province was made with forced labor and thus barred from the U.S. market. Future legislators will no doubt add targeted bans against other goods produced in violation of minimum social norms. There is no call for steep across-the-board tariffs to enforce social norms.

National Security. No less an authority than Adam Smith, in book IV of *The Wealth of Nations* (1776), acknowledged that national security trumps free trade, because "defence is of much more importance than opulence." To this proposition, everyone now subscribes. The critical question, often not examined by those in authority, is what limitations on

Tariffs selectively enrich preferred industries but impose costs on all others.

commerce strengthen national security, and what limitations actually weaken national security. In times of war, it is customary for belligerents to suspend all commerce without much thought. But in times of adversarial relations short of war, more careful analysis seems prudent. Yet in the third decade of the twenty-first century, the United States is now suspending a great deal of commerce on unexamined claims of national security.

Daniel Drezner's perceptive essay in *Foreign Affairs* recounts, as the title says, "How Everything Became National Security, and National Security Became Everything" (September/October 2024). During the First Cold War with the Soviet Union, the scope of trade covered by national security controls was confined to military items and a few dual-

Donald Trump advocates something akin to comprehensive Smoot-Hawley tariffs.

use products (such as computers). Prohibited items were agreed by the United States and its allies in the Coordinating Committee for Multilateral Export Controls (CoCom).

The Second Cold War, with China as the principal adversary, has enormously expanded the scope of national security trade controls. Everything exported to, or imported from, China is now suspect. The Wassenaar Arrangement, successor to CoCom, fosters consultation between the forty-two Participating States as to military and dual-use items subject to export restrictions, but does not require agreement on prohibited items. With respect to China, the United States restricts far more exports than other participants, and it also restricts imports, which are not covered by the Arrangement. However, the United States did persuade the United Kingdom, Germany, Japan, and several other countries not to use Huawei telecom equipment.

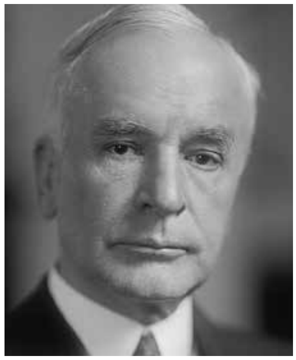
Restricting exports of advanced dual-use goods and technology seems like a plausible way of obstructing China's climb on the technology ladder. Before prohibiting U.S. exports, however, the U.S. Department of Commerce should seriously estimate lost revenue to U.S. firms and evaluate whether those firms will suffer relative to firms based in friendly countries that do not prohibit exports.

Restricting imports from China on national security grounds is far more doubtful than restricting exports. Limiting imports of Chinese solar panels or electric vehicles for national security reasons seems far-fetched. If the United States fears that China will cut off supplies in the future, it should add the product to the strategic stockpile, as already done with petroleum and medical goods. If stockpiling is impractical, the United States should subsidize local production, as it is now doing with semiconductors,

Continued on page 55

Continued from page 47

before restricting imports. Subsidies are preferable for two reasons: first, unlike tariffs, they highlight the cost and thus invite public scrutiny; and second, they do not enable existing domestic producers to mark up prices.



Cordell Hull *recalled in his memoir: "… toward 1916 I embraced the philosophy that I carried throughout my twelve years as Secretary of State. ... From then on, to me, unhampered trade dovetailed with peace; high tariffs, trade barriers, and unfair economic competition, with war." Hull served as U.S. Secretary of State during World War II and received the Nobel Peace Prize for his role in establishing the United Nations.*

FREE TRADE PAYOFF

Economic Gains. In material terms, the half-century following the Second World War was the best half-century in human history. Billions of people in poor countries escaped poverty, while citizens of advanced countries enjoyed prosperity. World GDP per capita (expressed in 1990 dollars) grew 2.9 times, from $2,082 in 1950 to $5,957 in 2000, about 2 percent per year. U.S. GDP per capita (expressed in 2017 dollars) grew 3.2 times, from $15,559 in 1950 to $50,190 in 2000, about 2.4 percent per year. Spectacular expansion of world trade made a major contribution to these income gains. World imports and exports were about 20 percent of world GDP in 1950; by 2022, they reached 51 percent. Trade expansion was delivered both by innovations in transportation and communications—standard containers, bulk cargo

Neo-protectionism pays off for preferred firms and workers.

ships, telephone and internet connections—and by a sharp decline in trade restrictions. World average tariffs were slashed from 22 percent in 1947 to 5 percent in 2000, and many non-tariff barriers were eliminated.

Between 2000 and 2020, neo-protectionist headwinds slowed the pace of globalization. World imports and exports expanded, but only reached 56 percent of world GDP. Not surprisingly, the growth of world GDP per capita also slowed, to about 1.5 percent per year, while the growth of U.S. GDP per capita slowed to 1.2 percent per year. Anemic growth triggered a vicious cycle of populist nostrums that further dampened world trade.

Trade brings prosperity through at least five channels. First, but probably not foremost, Ricardian comparative advantage enables each country to concentrate on goods and services it can produce most cheaply, given its endowments of labor, capital, natural resources, and technology. Second, and probably more important, international trade and investment stimulate learning that improves the technology of all partners. Third, competitive pressure forces weaker firms to shrink, thereby releasing resources that enable stronger firms to expand. Fourth, access to the world market fosters economies of scale, a critical benefit for small countries. Fifth, trade greatly expands the variety of goods and services, giving consumers and firms more choice.

Neo-protectionism pays off for preferred firms and workers. Identifiable payoffs carry an obvious political appeal. By contrast, free trade pays off for the broad population. Overall benefits far exceed neo-protectionism but are spread thin and thus provide less grist for political campaigns.

Trade expansion since World War II has enlarged the U.S. economy by about 10 percent. That's considerable—almost $20,000 per household. When neo-protectionism loses its appeal, more gains will be realized. Emerging countries that embraced the world market—South Korea, Taiwan, Chile, Costa Rica, and others—owe much more than 10 percent of their economy to the payoff from trade. The East Asian miracle was only possible in a world of open markets.

Trade and Peace. Frederic Bastiat, the famous nineteenth-century French economist, is attributed with saying, "When goods do not cross borders, soldiers will." If not Bastiat's actual words, they were certainly his sentiment. Cordell Hull, the great American statesman, recalled in his memoir: "… toward 1916 I embraced the philosophy that I carried throughout my twelve years as Secretary of State. ... From then on, to me, unhampered trade dovetailed with peace; high tariffs, trade barriers, and unfair economic competition, with war." Bastiat and Hull are not alone. Through the ages, many eminent thinkers have subscribed to the positive connection between trade and peace.

Today, given the contrary example of Russia's invasion of Ukraine, no one believes that trade guarantees peace. But as former World Trade Organization deputy director-general Alan Wolff has written, many illustrations can be found of trade promoting peace. Even if trade makes only a marginal contribution to peaceful relations, the payoff far exceeds what a neo-protectionist world will deliver. ◆