# Free Trade: Problem or Solution?

**by Andrew Brod**

**Greensboro *News & Record*, August 25, 2002**

The debate over international trade is heating up again.

The Raleigh *News & Observer* ran a series of articles this week about free trade and its effects on North Carolina, and its overall appraisal of those effects was clearly negative. For example, the series' author criticizes as too low a U.S. Labor Department estimate that North Carolina has lost nearly 87,000 manufacturing jobs as a direct result of free trade since 1994.

Elsewhere, the *New York Times Sunday Magazine* ran an article last weekend on globalization that was only slightly more hopeful. And when Congress recently approved "fast track" authority for the President in negotiating trade agreements, the margin was razor-thin in the House of Representatives. It appears that the forces arrayed against free trade go beyond people who dress up as sea turtles to protest meetings of the World Trade Organization.

The Bush administration itself may have broadened the debate a few months ago when it imposed a tariff on imported steel, without even trying to justify it as retaliation for something another country had done, such as harming the environment or violating health standards. That a Republican president would institute such a baldly protectionist measure may have signaled that something new was afoot.

It has always been difficult to sell free trade. When Adam Smith advocated it in the 18th century, he confronted the conventional wisdom of the time, mercantilism, which held that accumulating gold through the sale of exports was the highest goal. Among other things, this required that domestic industry be protected from foreign competition.

Over 200 years later, the conventional wisdom still finds it easier to discern the costs of free trade than its benefits. The benefits come in the form of lower prices for all consumers, as well as greater employment in the export sector (because the surest way to squeeze out exports is to bar imports). The benefits tend to be spread out among millions of people, and it's difficult to attribute them to a particular policy.

In contrast, the costs of free trade are concentrated and vivid. Workers in many industries are told that their jobs are in jeopardy because of foreign competition (sometimes even when the truth is more complicated). To such employees, the connection between trade policy and their employment situation is clear. And as a rule, the news media tend to adopt this simplified view.

For example, trade in apparel has lowered the price of men's clothing in the U.S. as compared to a few years ago. This is obviously good for all men who wear clothes, and yet such stories rarely make the news. Instead, we see and read troubling accounts of specific people who have lost their jobs as apparel companies relocate manufacturing facilities to other countries.

So let's get a couple of things straight about free trade. Once we do, there will still be room for honest disagreement, but first things first.

• Free trade is not an excuse to end government regulation: There is a common misconception about all market-oriented policies, of which free trade is just one example. The misconception is related to the alternative term for such policies, *laissez-faire*, which essentially means to leave alone. A philosophy of laissez-faire holds that an economy is best managed according to the catchphrase of that annoying Ronco infomercial: "Set it and forget it!"

Unfortunately, a market economy isn't like a rotisserie oven. Free-market policies don't relieve a government of having to continue to pay close attention to the marketplace. For example, when the U.S. deregulated fares on passenger airlines, it needed to shift its regulatory focus to other aspects of that industry, notably antitrust. Instead, it tried to run away from regulation entirely.

Because of this, the benefits of airline deregulation have been positive but uneven. The absence of government oversight over the distribution of landing slots and gates has led to a series of local monopolies. Where airlines have been able to hoard slots and gates, fares are higher than at more competitive airports. The elimination of price regulation simply created the need for another kind of regulation.

The need for continuing regulation is present in trade policy as well. Trade issues are notoriously sensitive, and they must be managed carefully and in close cooperation with other countries. It's not easy, and it's no coincidence that free-trade agreements tend to generate big bureaucracies.

In addition, because changes in a country's trade regime generally causes dislocations and job losses, a country needs to use a portion of the increased national income that results from freer trade to deal with those problems. Otherwise, it will appear that opening the economy has helped only rich people, harmed the environment, etc. But if that happens, the problem isn't free trade *per se*, it's the lack of sensible social programs. The *New York Times* article quoted an Argentine economist who contrasted this view with that of 15 years ago: "Now we know you need infrastructure, institutions, education. In fact, when the economy opens, you need more control mechanisms from the state, not fewer."

• Free trade is not a cure-all: This is sort of a corollary to the first point. Policy-makers cannot go to sleep once they open up an economy to international trade precisely because freer trade cannot cure all of society's ills. A closed economy with dramatic income inequalities will likely face the same problem after it opens up to free trade, unless it addresses the inequalities head-on. A closed economy with a tradition of corrupt government is unlikely to shed that tradition just because it has opened up to free trade.

• Globalization doesn't create poverty: That it does is a charge often leveled against free trade, especially as regards developing countries. But one thing we know about free trade is that it raises national incomes. The federal government estimates that the North American Free Trade Agreement achieved this in the U.S., though the amount was small (as it was expected to be). It's been harder to calculate the effect of NAFTA on Mexico's economy, because there have been so many other events in the international arena in the decade since the treaty's passage.

You might be skeptical of the claim that trade raises national incomes, but you shouldn't be. That's not where the potential problems lie. A higher national income is fine, but it doesn't translate into a better life for a country's citizens unless specific steps are taken. Fortunately, the higher national income provides the means to do just that.

That's what happened in Chile during the 1990s. The country used its gains from trade to invest in schools, housing, and other programs for the poor and working classes. Other countries in Latin America haven't enjoyed the same success as Chile's. Is the problem with free trade everywhere, or with the specific policies pursued by those other governments?

So globalization and free trade can actually be a tool to fight poverty. Whether that tool is wielded effectively depends on individual governments and how they manage the effects of trade. Ultimately, as the old maxim goes, all politics is local.

And that brings us back to North Carolina. Some will argue that free trade is ravaging our state's economy. Others will claim that the on-going deterioration of the state's manufacturing sector is merely making the effects of globalization happen more quickly and painfully. I'm inclined to side with the second group. Remember that federal-government estimate of 87,000 lost manufacturing jobs in North Carolina due to free trade since 1994? Well, during that time North Carolina employment in textile manufacturing *alone* has fallen by about 140,000. Clearly, something else is going on.

But regardless of which group is right, our path should be clear. The future is for the well-trained and the nimble, for people and companies that can innovate and adjust to change. On the people side of this equation, the long-term answer is education and infrastructure. In the short term, we should do what we can to retrain and educate our workers. But retraining doesn't work for everyone. We may not be able to retrain every 55-year-old textile worker, and for some people we may just have to provide financial compensation for reduced wages.

As grim as that sounds, the alternative is much worse. For years, North Carolina has lucked out by being able to depend on mature industries with low rates of capital formation and labor productivity. Those times are over. The future is bright, but it will take hard work and smart policies to get there, with foreign competition or without it.

The choice shouldn't be between free trade and no trade, between an open economy and a closed economy.  There's always room for reform, for example to allow trade agreements to incorporate more environmental considerations.  But the fundamental point is that as economic policy, free trade is only a beginning.