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# The Case against Free Trade

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America’s establishment remains clueless why stimulus after stimulus is failing to revive our economy, which continues to limp through the feeblest recovery on record. A big part of the problem, which our globalist rulers won’t admit, is that so much stimulus is leaking abroad due to our trade deficit, thus stimulating the economies of foreign nations, not our own. Barack Obama may well lose the 2012 election because of this, so it’s worth looking a little deeper into America’s slow-motion trade disaster.

Make no mistake: our trade is in crisis. Our trade deficit now runs about $50 billion a *month*. Every dollar of that represents production and wages happening somewhere else, not here. Every dollar is a dollar we have to borrow from some foreign nation, or a dollar of our existing assets—our national wealth—that we must sell off to pay for imports.

Why is this happening? Largely because the U.S. is competing under self-imposed free-trade rules against foreign nations with aggressively mercantilist trade strategies. Free traders act as if we are operating in a global free market, but we are not. We are instead in a contest with various types of state capitalism just as real as the contest we once fought against communism.

Trade is rigged. Foreign governments subsidize their exports. And they block American exports: the Congressional Research Service once identified 751 different types of barriers to American exports worldwide. In fact, thanks to the many ways governments manipulate trade, it has been estimated that only about 15 percent of world trade is genuinely free.

More free-trade agreements, the establishment solution to the problem, will not solve it. These agreements simply do not work. The World Trade Organization (WTO) does virtually nothing, for example, to get our exports through Chinese trade barriers. And it stacks the deck against America by allowing foreign nations to use value-added tax (VAT), which we don’t have, as a form of protectionism.

Trade agreements sign away democratic control over our health, safety, labor law, immigration law, fiscal policy, financial stability, national security, environmental policy, and other things. And—not to indulge in

WTO conspiracy theory but in the interests of calling a spade a spade—they are also a possible back door to eventual world government, or at least global governance intrusive enough to cripple national sovereignty. We already have a North American Free Trade Agreement (NAFTA), a Central America Free Trade Agreement, and many others. Coming down the pike is one even worse, the Free Trade Area of the Americas or FTAA. This would put us in a tariff-reduction and trade-control system involving virtually the entire Western Hemisphere. When we entered NAFTA, the average industrial wage in the United States was $14.30/hour, with Mexico at $2.20/hour. It was sold as a measure that would reduce America's trade deficit, but in reality, our trade balance worsened against both Canada and Mexico.

Don't misunderstand any of this as a plea to end trade. Trade is a good thing, and the case against free trade does not entail autarky. But trade, and *free* trade, are not the same thing, any more than love and free love. The right policy is an economy reasonably, but not absolutely, open to the rest of the world: strategic, but not unconditional, global economic integration.

Think back to the economy America had in 1970. Then, imports were just over five percent of GDP, rather than the 17 percent they are now. Yet we somehow didn't seem to need very many imports to have the world's highest living standard. Imports were mainly a matter of oil, products that don't grow here like bananas, luxury goods like Swiss watches, and a few odds and ends like Volkswagens. So the benefits of trade are at best a layer of icing on our economic cake, not a fundamental basis of our standard of living.

Why has America so disastrously chosen free-trade extremism instead? First, because the "American" multinational corporations that call the shots in Washington don't care about America's trade performance. Many of these companies are now so dependent on their overseas operations, and thus so vulnerable to pressures by foreign governments, that they have become outright Trojan horses with respect to American trade policy.

Second, because of the intellectual arrogance of academic economists who lost touch with the real world decades ago. They tell us free trade is beneficial because it enables us to have low-cost imports. But this ignores the other side of the equation: wages. Imports cause a trade-off between wages and prices, and there is no good reason to suppose that free trade necessarily hits the sweet spot of this trade-off. The idea that there is, is pure theoretical mythology.

Because we don't have real free trade today, even if the theoretical case for free trade were valid, it wouldn't apply to our present circumstances. The case here for reasons too technical for this article but explored elsewhere by the author at book length, is a weak one, riddled with giant loop-holes and exceptions. It shows that free trade is only a good thing if a long list of assumptions are true which are often false in the real world. Capital mobil-ity, persistent deficits, short time horizons, externalities (an economists' term for when prices don't fully reflect economic reality)…the list of glitches in the free-trade model goes on and on.

Above all, the U.S. has virtually nothing to gain from pushing even further in the direction of more free trade—the agenda of every administration since Reagan. Ironically, our government actually knows this perfectly well: the U.S. International Trade Commission periodically releases a report, *The Economic Effects of Significant U.S. Import Restraints,* which recently put the gain from eliminating all remaining American trade barriers at just $2.6 billion dollars. This is just over two one-hundredths of one percent of GDP—about what Americans spend on Halloween and Easter candy every year.

**Many popular arguments for free trade sound persuasive—until actual facts intrude. For example, free trade is good for America because it means a billion Chinese are now hungry consumers of American products.

But America is running a huge *deficit*, not a surplus, with China. ($245 billion in 2011, about 41 percent of our total). The dream of selling to the Chinese functions primarily as bait to lure in American companies, which are forced by China to hand over key technological know-how as the price of entry. They then build facilities which they discover they can only pay off by producing for export.

A related myth is this: "Other nations are rapidly catching up to American wage levels. India, for example, has a middle class of 250 million people."

But middle class in India means the middle of India's class system, not ours. That means a family income about a tenth of what it would take here. India's average income is only about $1,500 a year.

This myth is calculated to soothe American anxieties: "Offshoring is a tiny phenomenon."

Offshoring, of course, is just trade in services. But it's just getting started and will be big soon enough, thanks to 15 percent per year compound growth. Economist Alan Blinder, former vice chairman of the Federal Reserve, once estimated that offshoring will ulti-mately affect up to 40 million American jobs.

Here's a hopeful dream some people console themselves with: "Cheap foreign labor is not a threat to American wages because increasing prosperity will drive up wages overseas."

While this *may* be true in the long run (or not), at currently observed rates of income growth it will take decades at best.

"Free trade costs America low-quality jobs but brings high-quality jobs in their place."

But the hard data actually show America losing *both* kinds of jobs. For example, according to the Bureau of Labor Statistics, the U.S. lost over 270,000 engineer and architect jobs between 2000 and 2010.

Here's a myth popular among conservatives: "Free trade is the American way."

Sorry, but the United States was a protectionist nation from its founding until we threw open our markets in the Cold War as a bribe for foreign nations not to go communist. That's why Article I, Section 8 of the Constitution explicitly authorizes tariffs. America's economic tradition derives not from Ayn Rand but from founding father Alexander Hamilton—the man on the $10 bill and the intellectual architect of American capitalism. He was a protectionist. So were Abraham Lincoln, Teddy Roosevelt, and most of the other greats of American history.

Free trade is rotting away America's industrial base as foreign nations target and conquer industry after industry.

When American producers are pushed out of foreign and domestic markets, it is not just immediate profits that are lost. Declining sales undermine their scale economies, driving up their costs and making them even less competitive. Less profit means less money to plow into future technology development. And when an industry shrinks, it ceases to support the complex web of skills, many of them outside the industry itself, upon which it depends.

The same goes for specialized suppliers. For example, the famous Boeing aircraft company, America's largest manufacturing exporter, has been relentlessly hollowing itself out of real manufacturing for decades. It has been morphing into a Lego-brick assembler of European, Japanese, and increasingly Chinese components. The ripple effects have hurt the entire aviation sector: in the words of the *Financial Times's* James Kynge,

The more Boeing outsourced, the quicker the machine-tool companies that supplied it went bust, providing opportunities for Chinese competitors to buy the technology they needed, better to supply companies like Boeing.[1]

America is now being invisibly shut out of future industries which dying or already-lost industries would have spawned. For example, in the words of former tech CEO Richard Elkus,

Just as the loss of the VCR wiped out America's ability to participate in the design and manufacture of broadcast video-recording equipment, the loss of the design and manufacturing of consumer electronic cameras in the United States virtually guaranteed the demise of its professsional camera market....Thus, as the United States lost its position in consumer electronics, it began to lose its competitive base in commercial electronics as well. The losses in these related infrastructures would begin to negatively affect other downstream industries, not the least of which was the automobile.... *Like an ecosystem, a competitive economy is a holistic entity, far greater than the sum of its parts*.[2] (Emphasis added.)

Case in point: the U.S. is inexorably losing its position in computer chips. America now has virtually no position in photolithographic steppers, the ultra-expensive machines, among the most sophisticated technological devices in existence, that "print" these chips on silicon wafers. Our lack of a position in steppers means that close collaboration between the makers of these machines and the companies that use them is no longer easy in this country. This collaboration traditionally drove both the chip and the stepper industries to new heights of performance. American companies had 90 percent of the world market in 1980, but have less than 10 percent today.

The decay of the related printed circuit board (PCB) industry tells a similar tale. Consider this 2008 excerpt from *Manufacturing & Technology News*:

The state of this industry has gone further downhill from what seems to be eons ago in 2005. The bare printed circuit industry is extremely sick in North America. Many equipment manufacturers have disappeared or are a shallow shell of their former selves. Many have opted to follow their customers to Asia, building machines there. Many raw material vendors have also gone.

What is basically left in the United States are very fragile manufac-turers, weak in capital, struggling to supply [original equipment manufacturers] at prices that do not contribute to profit. The majority of the remaining manufacturers should be called 'shops.' They are owner operated and employ themselves. They are small. They barely survive. They cannot invest. Most offer only small lot, quick-turn delivery. There is very little R&D, if any at all. They can't afford equipment. They are stale. The larger companies simply get into deeper debt loads. The profits aren't there to reinvest. Talent is no longer attracted to a dying industry and the remaining manufacturers have cut all incentives.

PCB manufacturers need raw materials with which to produce their wares. There is hardly a copper clad lamination industry. Drill bits are coming from offshore. Imaging materials, specialty chemicals, metal finishing chemistry, film and capital equipment have disappeared from the United States. Saving a PCB shop isn't saving anything if its raw materials must come from offshore. As the mass exodus of PCB manufacturers heads east, so is their supply chain.[3]

All over America, other industries are quietly falling apart in similar ways. And every few years, there emerges an entire new industry, like hybrid cars, which has no strong American players—"strong" meaning not dependent on repackaging imported key components or licensing foreign technology. Over time, the industries of the future become the industries of the present, so this is a formula for automatic economic decline.

As long as this country can borrow money, much of it from abroad, to keep spending, we can ignore our industrial decay, but sooner or later, our underlying weakness will tell.

*****What policies should we embrace as the alternative to free trade? We have some choices. If we applied a flat tariff—the same rate on all imports—this would take care of the deficit, if the rate were high enough, and it would be simple to administer. There wouldn't be any political mischief about what the tariff on this or that product or country would be.

The nice thing about a flat tariff is that it would tend to bring back the kind of industries we want. For example, a 30 percent tariff wouldn't bring the t-shirt industry back to the U.S. This is a low-wage industry whose production cost is mainly unskilled labor. But it *would* tend to relocate the capital-intensive high-tech industries, where unskilled labor isn't such a big factor. These are the industries with a future and the ones that can support middle-class wages.

Of course, the rub with a flat tariff is that it would force us to treat all nations alike. So we'd have to treat relatively honest players like Canada the same as outright bandits like China. This could cause political headaches and cut back too much of our trade with the honest players. So maybe we need a tariff varying by country. That would be more political effort, but it is still doable. There just needs to be a consensus in the U.S. government to set trade policy in the national interest again.

You'd be surprised what the government can do when the special interests that pull its strings really want it done. Indeed, perhaps the greatest benefit of protectionism is ultimately not directly economic but political. If capital must turn a profit mainly by selling goods made *by* Americans *to* Americans, then this *forces* *capital to care* about Americans' capacity to produce and consume, a combination practically identical with prosperity.

Some argue that a tariff would trigger a downward spiral of retaliation and counter-retaliation with our trading partners, resulting in a collapse of global trade. But this doomsday scenario is unlikely. Above all, our trading partners know that *they* are the ones with the huge trade surpluses to lose, not us. Foreign nations would probably raise their tariffs somewhat, but there is no reason to expect the process to get out of control.

It is sorely tempting to take the political difficulties as an excuse to do nothing at all. The dangers of a special-interest takeover are not imaginary. But we can't afford to quail at the challenge of making the politics work, as we are competing with rivals who have already done so. For the U.S. to concede that there exists an area of national policy this important that our rivals can master and we cannot is a decision in favor of voluntary national decline.

**Endnotes**

1. James Kynge, *China Shakes the World*
(New York: Houghton Mifflin, 2006), p. 112.

2. Richard J. Elkus, *Winner Take All: How Competitiveness Shapes the Fate of Nations*
(New York: Basic Books, 2008), p. 75.

3. "Commentary: Manufacturers Know All About Economic Collapse," *Manufacturing & Technology News*, September 30, 2008, p. 4.

## About the author

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