The Negative Effects of Trade Barriers on the United States Economy

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ABSTRACT
The advantages and handicaps of international trade have led to ardent debates throughout the nation and the world. The numerous protests and demonstrations that accompanied the World Trade Organization meetings in Seattle last November (1999), proved how salient the issues of trade and globalization are to Americans. This paper elaborates on some of the benefits of free trade, while exploring and challenging the arguments for protection. Conclusive findings suggest that by increasing productive export jobs, promoting efficient utilization of resources, and increasing competition, international trade strengthens the economy and aids consumers.

"Since the end of World War II, the United States has been perhaps the leading advocate among industrialized nations of liberalized international trade" (Litan and Suchman 216). Officials are now realizing how the elimination of trade barriers will improve the economy and benefit American consumers. One of the most destructive tariff enactments was the Smoot-Hawley Tariff Act of 1930. This bill raised tariffs against imports to extreme levels, which in turn forced other nations to retaliate with high tariffs of their own. Because of these high tariffs, trade dropped, money stopped flowing, and businesses renounced claim to their debts. Banking systems were destroyed and democracies collapsed all over Europe. Many economists agree that the Smoot-Hawley Tariff Act was a major contributing cause of the Great Depression (Archibald and Feldman 857-860). Since then, the world's nations have been working to lower tariffs. Evidence shows that through free trade, the world economy can increase its productivity, therefore raising living standards of all citizens.

Free trade allows countries to utilize the principle of comparative advantage and specialize in goods they are most efficient at producing. Comparative advantage occurs when one country can produce an item at lower cost than another country. There are many reasons for differences in production costs. The availability of natural resources is greater in some parts of the world than others. Technology is much more advanced in industrialized nations. Lacking education and technological machinery, the labor forces of most developing countries are not very productive (Espana 48). These factors, along with many others, lead to differences in domestic opportunity costs.

According to Janet Yellen, chairperson of the Council of Economic Advisers in Washington, D.C., even if one country, such as the United States, is better at producing most goods, it can still benefit from trade:

We all know the story of Robinson Crusoe, who, alone and isolated had to do everything for himself. . . But if a group of Robinson Crusoes can trade amongst themselves, each can specialize in the production of what he or she is best at doing, thus producing more than would be possible were their attentions divided among goods that they are less skilled at making. (27)

For example, the United States is not very efficient at producing coffee and bananas; we simply lack the needed resources. It would be profitable for us to import these products from a country like Brazil, for it produces them at lower cost. The United States, in turn, could provide Brazil with corn and soybeans. This would result in more efficient distribution of resources and a larger output of products. According to Hufbauer and Schott, when we specialize in producing one product, all of our money and labor goes into making that product, therefore making our money and labor much more productive (5). Through specialization, companies are able to take advantage of economies of scale and significantly reduce their production costs. Workers who previously performed four or five different jobs now only perform one. Renowned economist, Adam Smith, believed that when workers specialized in the production of one product, they saw ways in which the product or assembly process could be improved. They became experts at their jobs (Yellen 27). When companies specialize, they only have to purchase equipment needed to produce a specific product. As a result, they are able to obtain equipment of the highest quality. This adds to worker productivity. Lastly, many products have start-up costs that must be paid regardless of anticipated output. These costs decline with each successive unit produced. All these factors combine, which leads to increased profits for the company, as well as the nation.

Despite the advantages of specialization, many people believe that trade barriers are necessary in order to protect domestic jobs and wage levels. This is a view shared by possible Reform Party presidential candidate, Pat Buchanan. In his opinion, unrestricted trade hurts American workers by eliminating domestic jobs and depressing wage levels (Buchanan Reform). Several labor unions and other special interest groups aggressively lobby for tariffs in order to protect domestic jobs from foreign competition. While
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this idea may sound convincing, it is based on several fallacies. Tariffs and quotas do safeguard import jobs in the United States, but are a detriment to highly productive export jobs. Nations cannot restrict their imports, while maintaining their same level of exports. The purpose of exporting goods is to acquire funds in order to purchase imports from other countries. The imports are obtained at less cost than if they were produced domestically. Consequently, when the United States restricts imports, we make our trading partners poorer. They are unable to purchase our exports. Productive export industries, in which we have a comparative advantage, are forced to decrease production and layoff workers. In terms of the United States and Mexico, if the North American Free Trade Agreement (NAFTA) were not passed, Mexico would not be able, financially, to import goods from the United States. As a result, Americans who produced the exports would lose their jobs:

Mexico imports a minimum of $800 million more in merchandise for each 1 percent increase in GDP, and U.S. exporters secure more than $500 million of this. The richer Mexico becomes, the more trade will take place with the United States to the benefit of both. (Weintraub 39)

Janet Yellen believes that as the United States capitalizes on comparative advantage and starts to specialize, some industries will be shut down (27). The retraining of import sector employees, which the government is committed to providing under the terms of NAFTA, will allow these workers to move to export industries where they will be more productive and earn higher wages. According to economist David Walters, export jobs pay 16.7 percent more than import jobs (Hufbauer and Schott 23). As a result of trade, citizens will be able to spend their incomes on a greater variety of products, thereby spurring economic growth. In reality, the United States can enjoy full employment, efficiently using all available resources, with or without international trade. International trade simply allows us to specialize and use our resources in the most productive way possible, thus increasing our standard of living.

In order for the nation to engage in economic growth, some people insist that trade barriers are needed to protect developing industries from foreign competition. Without protection from large international firms, small domestic industries run a greater risk of floundering. The infant-industry argument states that industries that have potential to succeed, such as good transport facilities and well-trained workers, should have the chance to grow and expand under a protective tariff. The tariff would enable the firm to upgrade their products and create greater efficiency in production. Once the industry is firmly established, the tariff can be removed.

Even though this argument appears valid, it contains several flaws. It is very difficult at the outset to determine which new companies are going to prosper and which ones will fail. Often, firms with high potential have been turned down after asking for protection from the government (Perlman 33). Why should one industry be denied protection from competition and another be given the opportunity to expand and grow? If given a fair chance, even companies that do not initially appear strong may indeed flourish and prosper under the right circumstances. Another problem with protective tariffs is the length of time that they are imposed. Once a tariff is placed on a product, it is not easily removed. When companies mature and reach full potential, they are still able to take advantage of protective tariffs (Kreinin 302). This enables the mature companies to monopolize. It is easy to see why protected companies are reluctant to have tariffs removed, for this gives them definite advantages over their competitors.

Most economists believe that there are better ways to help infant industries than imposing tariffs. For example, direct subsidies from the government help industries to expand without harming consumers. Subsidies are distributed by the government to domestic producers. This cuts down on production costs, and enables producers to charge lower prices for their goods. This allows domestic producers to compete with foreign firms selling cheaper merchandise. The government is also able to oversee production, and make sure subsidized companies are using the money wisely. This makes direct subsidies more economical and efficient compared to tariffs.

In addition to the infant-industry argument, individuals often claim that trade barriers are necessary to protect against dumping. Dumping occurs when identical products are sold on the foreign market at below cost, meaning less than they are sold for domestically. Many nations, including the United States, explicitly prohibit dumping. If a foreign producer is found guilty of dumping, a duty will be imposed. This extra cost prompts the producer to raise the price of the item in question, bringing it up to fair market value. It is interesting to note that the issue of dumping arises even in free-trade zones. Article 1902 of NAFTA states that “Each Party reserves the right to apply its antidumping and countervailing duty law to goods imported from the territory of any other Party” (qtd. in Weintraub 89).

There are three main types of dumping: predatory dumping, persistence dumping, and sporadic dumping. Predatory dumping occurs when foreign firms sell their products at below cost abroad, in order to eliminate competition. These firms usually enjoy a monopoly at home and hope to establish, one overseas. Of course, once they have driven out domestic producers, prices will be increased. The greater the inelasticity of the product, the greater the price increase. Since the demand for inelastic products, such as clothing and food, remains relatively constant regardless of price changes, sellers can raise the prices of these goods without lowering their sales volumes. This makes predatory dumping particularly harmful, hurting consumers in the long run. However, as the Supreme Court stated in 1986, “There is a consensus among commentators that predatory pricing schemes are rarely tried, and even more rarely successful” (qtd. in Bovard 83).

When a company possesses a monopoly at home but faces competition overseas, it may also participate in persistence dumping. Lack of domestic competition allows the company to sell its product at high cost at home. Once the product enters the international market, it faces competition from both the host country, as well as other countries. In order to sell the product and earn a profit, the producer must lower the price. This is considered dumping, because a lower price is being charged abroad than at home. Yet, unlike predatory dumping, businesses that engage in persistence dumping are not focused on eliminating the market shares of domestic
The third type of dumping, sporadic dumping, occurs when companies run a surplus and try to sell the excess product over the foreign market. If they charge a lower price abroad than they do domestically, they are guilty of sporadic dumping. On the other hand, if they lower their domestic price, they are simply having a sale. For example, if a department store in Chicago charged a higher price than a store in Miami for the exact same dress, would it be accused of dumping? As Fred Smith of the Competitive Enterprise Institute said, "If our antidumping laws applied to U.S. companies, every after-Christmas sale in the country would be banned" (qtd. in Bevard 81).

Many trade groups, including the World Trade Organization (WTO), have enacted laws and provisions aimed at eradicating the practice of international dumping. However, several problems exist with current antidumping legislation and its use of duties and tariffs as punishment for violations. While no economist would argue the negative effects of predatory dumping, sporadic and persistence dumping actually benefit consumers. By breaking up monopolies and increasing competition, these forms of dumping lower prices. Janet Yellen believes that, "Trade liberalization might adversely affect a small fraction of American workers in their role as producers, but it benefits all workers in their role as consumers" (27). It is unfortunate that most trade laws and provisions are written exclusively to aid producers, ignoring the damage done to consumers.

In the long run, tariffs and duties will not eliminate the practice of dumping goods on the foreign market. A more effective prevention method is to strictly enforce domestic antimonopoly laws. This not only prevents dumping, but also helps consumers. If monopolies did not exist, producers would be unable to charge high prices domestically. There would be no need to sell goods cheaper abroad; therefore, dumping duties and tariffs would be unnecessary.

Besides dumping, many people fear that the elimination of trade barriers will lead to dramatic increases in immigration. While this may be true in the short run, long-term decreases will make up for initial transition periods. The question of how free trade will affect immigration has been pondered and questioned by a large number of economists. The removal of trade barriers allows for increased movement of workers to various countries. Most workers will migrate to countries where job opportunities are greater and wages are higher than those in their home country. In the short term, this increase will be substantial. Most of the immigrants are poor or working class people who are striving to rise above poverty level in their country. For most of these people, the hardships of living in a foreign country will prove too great. Most of them will eventually return to their home country. According to Lynn Martin, Secretary of Labor under the Bush administration, only 10 percent of Mexican workers that migrate to the United States remain for extended periods of time (Hufbauer and Schott 26).

There are several reasons why unskilled immigrants have trouble adapting to life in a foreign country. Language barriers, climate changes, and family commitments prove to be difficult for them to communicate and make acquaintances. Climate adjustment is another factor that must be considered before deciding to move to another country. However, the major reason most immigrants return to their home country is because they miss family and friends (Kreinin 407).

Immigration has been an intense topic of debate since NAFTA was approved in 1992. The number of both legal and illegal immigrants coming to the United States has increased over the years. In the short term, immigration has increased because of the availability of jobs and more advanced technologies in the United States. The number of immigrants will decrease over the long term as a result of strong growth in Mexican per capita income, due in part to NAFTA (Hufbauer and Schott 26). As Mexico gains in prosperity, the level of immigration will reduce considerably. As economic growth accelerates in Mexico, there will be no need for its citizens to migrate to the United States to find adequate employment. The immigrants that return to Mexico will take with them the job skills they have acquired, along with the capital they have earned. This will enable them to start new businesses and make a substantial contribution to economic development in Mexico. On average, 60 to 70 percent of Mexico's imports originate from the United States (Weintraub 39). Mexican prosperity, resulting from migration, will allow Mexico to purchase U.S. exports in larger volumes. Therefore, in the long run, migration will lead to growth patterns in both the United States and Mexican economies.

Perhaps the leading benefit of free trade is increased competition in domestic, monopolized markets. By eliminating trade barriers, firms from other countries will have greater access to United States' markets. Foreign competition is clearly beneficial to consumers in a variety of ways. It breaks up monopolies and oligopolies, resulting in lower prices and a larger variety of goods from which to choose. Competition also motivates companies to improve product quality through technological advancements. Although a few domestic producers may be hurt by free trade, gains to consumers more than compensate for these temporary losses (Yellen 27).

When one or two companies control the entire market for a certain commodity, they become stagnant in production (Kreinin 289). This is especially true if the commodity is inelastic, and has no close substitutes. The monopolistic company sees no reason to upgrade the quality of the product, for it faces no competition. Demand for the product remains high, regardless of quality. Consumers must purchase the good from the monopolist, for no other choice is available. However, by allowing foreign products to enter concentrated domestic markets, the elimination of trade barriers aids consumers by increasing competition. While such competition tends to destroy inefficient monopolies, ingenious companies can survive and even profit in the long run. Businesses that previously enjoyed monopolies are forced to improve upon the quality of their products if they hope to compete in the global marketplace. Fierce rivalry among firms leads to technological advancements and innovations. New products are created, and more efficient production methods are implemented. These improvements enable companies to cut production costs, increasing revenue dramatically. Excess funds can then be put towards research and development,
which fosters new innovations. This is very important, for these discoveries allow companies to produce greater quantities of goods, while using fewer scarce resources. These resources can then be used to produce other valuable products.

Free trade not only improves product quality, it also lowers prices. When tariffs are imposed on imported goods, the costs of those goods tend to increase. Foreign producers must compensate for the losses they sustain as a result of added taxes. They do this by charging higher prices for their products. This results in increases in the cost of all goods, including those produced domestically. The high prices of foreign goods give domestic producers freedom to raise their prices, although not to the same level as their international competitors. Even though prices have increased, consumers will continue to purchase domestic goods, for they are still cheaper than imported goods. Price inflation not only harms consumers, but also harms businesses that use these expensive goods in their production operations. These added costs cause businesses to be less competitive, both in domestic and overseas markets.

Eliminating trade barriers is essential in the quest to achieve world prosperity and harmony. By engaging in international trade, nations can substantially increase their productivity and living standards. For instance, the United States is currently enjoying great economic prosperity, while concurrently engaging in large amounts of trade with other nations. Clearly, open trade practices have benefited the United States in recent years. Since the passage of NAFTA in 1994, employment has risen in U.S. automotive, manufacturing, electronics, and industrial machinery sectors (Ponuru 74). Today, America is experiencing full employment, low interest rates, and a booming stock market. According to John Whitehead deputy secretary of state under the Reagan administration, "Global integration is the best way for all countries - rich and poor, large and small - to become wealthier together" (34). When countries unite and utilize each other's resources through free trade, the world and all its citizens prosper.

References


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