

Notes for Atlanta Talk

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Good morning. My name is Ian Fletcher, and I'm going to talk to you today about why free trade is actually bad for the U.S.

Now we're not here to debate **trade**. We're here to debate **free** trade, and they're not the same thing. Trade, and free trade, are like love, and free love. The one is often used as an excuse for the other. [Pause for laughter.] I'm sure my opponents can give you a long, long list of all the wonderful things about trade, and you know what? I agree with them. But it's not trade we're debating, it's **free** trade, that is trade without regulation.

Now some economists, by their own admission, simply **don't care** about the economic interests of Americans, because they believe in an ideology that says it's morally wrong to do so. I'm talking about libertarians here. So they are, by their own admission, pursuing another objective, and it's not rational for Americans to take their advice. If they want to offer policies that are good for the whole world, at the expense of the U.S, that's fine, but they're answering a different question.

Libertarians have a related **factual** premise, which is mistaken, namely that there's no difference between what's good for foreigners, and what's good for Americans. Because there's **no such thing** as international economic rivalry. But the fact is that economic rivalry is something you can see every day. It's not some giant **illusion** that people hallucinate and need to be disabused of. We don't live in a zero-sum world, in which our loss is always someone else's gain and vice-versa, but there **is** still rivalry over income and wealth that either **they** get or **we** get. This is true in your personal life, in your career, and it's true in international economics, for similar reasons.

Prof. Boudreaux just said, "Political borders are economically meaningless." But the reality is, you and I **live** in America. So if you want to be indifferent to the economic success of the U.S., you can just go take that nice job in Singapore the next time you're unemployed. I'm sorry, but it **does** make a difference where you live. Nations **haven't** become economically irrelevant, and they **won't** become

irrelevant as long as they're relevant to the economic fates of the people who live in them.

America's trade deficit, the difference between our exports and our imports, is around 500 billion dollars a year. Because the deficit is the single best measure of our trade problems, this means that free trade is a **big** problem. It's a number comparable to Federal budget deficits. Some of the aspects of this problem sound technical, so it's tempting sometimes to let your eyes glaze over. But it underlies a lot of more-visible problems. When you look at poverty, for example, and drive through run-down cities and towns, free trade is part of that. Not the whole thing, but it's part of it. When you look at family breakdown because of poverty, free trade is a part of that, too.

The first thing free trade is doing to America right now, is destroy jobs. When goods are produced abroad and imported, rather than here, the jobs are abroad. Now obviously this **would** be OK if America were gaining other jobs due to our exports. But we're **not**, because we're running a huge trade deficit. So we have a **net loss** of jobs.

Free traders will tell you that's OK, because the unemployed will eventually go work somewhere else. Which is true, but it means people losing \$28/hr jobs producing cars and taking \$8/hr jobs flipping hamburgers. It's a decline in the **quality**, not just the quantity, of jobs.

The second thing free trade is doing to America right now, is deindustrialization. This means not just job loss, but the loss of entire plants and then entire industries. There's a myth being promoted that we're only losing quote-unquote **primitive** industries like basic steel manufacturing, but that's just not true. Boeing is losing the manufacture of aircraft wings to Mitsubishi of Japan. Does that sound primitive to you?

This is a big national-security problem. Free trade means we have no defense against militarily important industries being stripped away from us. There is not a single plane in the U.S. Air Force today that isn't dependent upon components manufactured by potentially hostile nations. And the military and civil industrial bases are related, so if you weaken one, you weaken the other. China knows this

perfectly well. They have a strategy, documented in considerable detail, to use trade as a weapon of long-term military advantage against the U.S.

Remember that when we say “free trade,” we really mean quote-unquote “free” trade, because trade **isn’t** really free. It’s basically free on America’s side, because we have very few barriers to imports anymore, but it’s not free in the other direction, because foreign nations **manipulate** their trade in a million ways. America’s tariffs are well under one percent of the volume of our trade, so we’re basically free traders. But many foreign nations practice something called **mercantilism**, which is an economic strategy going back hundreds of years of **gaming the system** in international trade. This gets done in a blatant and cynical way by nasty, hard-edged governments like China, and it gets done in a polite, disingenuous way by politically correct governments like Germany. But it gets done. They even admit it, when they’re talking to their own people and don’t think anyone else is listening.

So **how** is trade manipulated? Well, for a start, governments engage in currency manipulation to control the price of their currencies. If you make a nation’s currency artificially cheap, you’ll increase that nation’s exports and reduce its imports. China did this for years and years. Japan is still doing it. The entire euro currency is, to some extent, a giant currency manipulation scheme for Germany, because it blends Germany’s natural currency, the Deutschmark, with the currencies of a lot of nations, like France and Italy, that don’t have Germany’s strong export performance and thus naturally have cheaper currencies.

Trade gets manipulated **inside** the economies of foreign nations, too. For example, in Korea, if you buy a foreign car, it’s well known that this tends to trigger a tax audit by the Korean equivalent of the IRS. So people get the message and don’t buy foreign cars. In Germany, the major banks tend to hold the shares of both companies and their suppliers. So if, for example, BMW tried to buy tires from an American firm, rather than a German one, their bank would say, “You idiot. This company we part own will go bankrupt. Knock it off.” So people get the message. There are a lot of understandings. Gentleman’s agreements. There’s cronyism and national governments are all for it. It’s part of how the system **works** there. And given that they’re doing **well** in trade, and we’re in a state of crisis, **why** should they

give it up? The reality is that the U.S. right now being forced to compete with foreign **state capitalism**. And some people will tell you that state capitalism can't work, but I'm sorry. That's just empirically false. State-capitalist countries are getting very rich, and they're kicking our butts in trade.

Why doesn't the U.S. do anything about its trade problem? In large part, this is because quote American multinational corporations simply aren't American companies anymore. They get given this pass, because they may be headquartered here, and are allowed to roam the halls of Congress as if they were Americans, but frankly, that's just the location of the CEO's office. And they like this situation just fine. As I mentioned before, you really have to ask, whether the person you're dealing with even **cares** about **America's** economy.

Free traders will often tell you that the trade deficit doesn't matter. This is a tempting story to believe, because everybody likes a free lunch, and ultimately, the idea that the trade deficit doesn't matter amounts to the idea that America can get **free stuff** somehow, by magic. So it's important to just think through the basic logic of this. The trade deficit basically means that we **consume** more than we **produce**, and we **import** goods to make up the difference. Now when America imports goods from abroad, we have to pay for those goods in one of three ways. First, we can export goods, and **that's** what foreigners get in return. Second, we can transfer ownership of goods we produced already, and that's when we give foreigners **existing assets**, like shares in Google. Third, we can give foreigners goods we promise to produce **later**, and that's when we borrow money and go into debt to foreigners. So it's either goods we produce today, yesterday, or tomorrow, and **that's it. One** of these three things **must** be happening, else we must be trading with the North Pole, because Santa is the only person who gives away things for free. As a result, when America runs a trade deficit, it **intrinsically** makes us poorer over time, simply because we **owe** more and we **own** less. Our net **worth** is lower. This is just accounting. Any contrary view is a magical free lunch theory. So the trade deficit basically amounts to America living beyond its means. If it's a sustained thing, it's a form of decadence.

One thing you need to watch out for, when arguing free trade, is when people fake-simplify the analysis. Prof. Boudreaux, for example, just said that, quote, "The

economics of trade are straightforward.” Now I’m sorry, but managing my 401-K isn’t straightforward. So trillions of dollars, hundreds of countries, thousands of industries, and billions of people certainly aren’t. Free traders oversimplify because they don’t want you to hear what the details might tell you. His argument was basically, “any act of trade that is a voluntary exchange **must** have been good for both parties.” Well, by that standard, it’s good for a starving man to sell his shoes. Maybe in the moment it is, but you’re ignoring the question of how he got into the circumstances that forced him into that trade in the first place. The policy question we face is not just whether to do one particular trade, but what **circumstances** we want ourselves to be in, when we do, what **bargaining position** we want to have. Because that will determine whether or not our trades are less advantageous than they could have been.

Sometimes, free traders will try to intellectually intimidate you with economic arguments that sound too technical for you to understand and pick apart, but the key is this: it’s usually not the argument **itself** that’s the problem. It’s usually the **hidden assumptions** underlying it. The conclusions follow from the premises, but the premises are either wrong, or at best questionable.

The key economic theory here is the **Theory of Comparative Advantage**, which goes back to the 19th century British economist David Ricardo. And I identified **eight** hidden assumptions, in my book, that it has. Assumptions like, trade is broadly balanced over time. That is, there’s no chronic huge trade deficit. Another assumption is that capital isn’t mobile between nations. Which it certainly **is** today, and which Ricardo **himself** admitted would constitute an exception to his argument. Another assumption is that capital and labor flow freely between industries in **this** country. So if trade kills one industry, workers can just easily shift to another. But they can’t. Another assumption is that there are no so-called externalities, which means when the price of something doesn’t accurately reflect its value. So nobody’s gaining a price advantage by ignoring environmental problems. No industries are special because they lead to the industries of the future and if you lose them, you can’t get that future. Another assumption is that free trade has no effect on income inequality. Which it does. Another assumption is that free trade won’t build up your foreign competitors and make them more potent rivals. But it will.

If you cease to grant all these dubious hidden assumptions, the math underlying free trade ceases to work. You lose the purported proof that free trade is **always best**, and arrive at the conclusion it's **sometimes** good for you, **sometimes** not. So a nation needs strategic, not unconditional, integration into the world economy. It needs protectionism as part of its tool kit, some of the time.

America used to understand this perfectly well. Free traders will often tell you that free trade is somehow “the American Way,” sweet land of liberty *et cetera*. So it comes as a shock to a lot of people to learn that in fact, if you look at the real history, **protectionism** is actually the American Way. All of the Founding Fathers were protectionists – explicitly so. And Lincoln was a protectionist. Teddy Roosevelt. The U.S. had a tariff-protected economy from its founding until after WWII. During this time, we grew from being a Third World backwater to being the greatest industrial economy the world had ever seen. Which is kind of inexplicable if protectionism is this **terrible** policy that ruins economies.

The great protectionist among the Founders was Alexander Hamilton, the guy on the \$10 bill, the first Treasury Secretary and the intellectual architect of American capitalism. So we have here some evidence from economic **history** that there might be something wrong with economic **theory**. Economic history has this amazing way of putting purely theoretical constructs to the test and telling you things people don't want you to know. Now in fairness, there are economists, and economic theories, that have the right idea about this stuff. In fact, a lot of economists are considerably less stupid about these issues than the kind of economists who get on the editorial page of the *Wall Street Journal*. Plenty of economists know free trade has serious problems. But they tend to clam up about it in public because they're afraid the public will get the wrong idea and impose some stupid kind of protectionism.

The really interesting thing is, there's **nothing** special or exotic about America's protectionist history. **Every** country that has become a major economic power has done this. Starting with England in the 17th century and continuing on to China and other countries today. There are variations between countries, of course, but it's a standard playbook. We used to understand it, then we forgot. After WWII, we threw our markets open to the rest of the world for **purely political** reasons, to **win**

the Cold War. We wanted to prop up foreign nations' economies and bind them to ourselves so they'd be dependent on us and not get close to the Soviet Union. But there was never a point when economists suddenly figured out, "Hey, protectionism that we've had for 150 years is now wrong and free trade is right." It was **all politics**, rationalized as economics after the fact. So the consensus in favor of free trade is really a political construct. It's not an economic truth. Which is precisely why it's crumbling under political pressure today.

I'm the last guy on earth to deny there **can** be stupid forms of protectionism. I'm just not in favor of those kinds. For example, free traders will tell you that a tariff intrinsically leads to political interference in the economy. That's not necessarily so. For example, I said in my book that I favor a **flat** tariff, which would be the same on all imports. So there's no opportunity for political mischief.