## 20.5 The Tradeoffs of Trade Policy

### Learning Objectives

By the end of this section, you will be able to:

* Asses the complexity of international trade
* Discuss why a market-oriented economy is so affected by international trade
* Explain disruptive market change

Economists readily acknowledge that international trade is not all sunshine, roses, and happy endings. Over time, the average person gains from international trade, both as a worker who has greater productivity and higher wages because of the benefits of specialization and comparative advantage, and as a consumer who can benefit from shopping all over the world for a greater variety of quality products at attractive prices. The “average person,” however, is hypothetical, not real—representing a mix of those who have done very well, those who have done all right, and those who have done poorly. It is a legitimate concern of public policy to focus not just on the average or on the success stories, but also on those who have not been so fortunate. Workers in other countries, the environment, and prospects for new industries and materials that might be of key importance to the national economy are also all legitimate issues.

The common belief among economists is that it is better to embrace the gains from trade, and then deal with the costs and tradeoffs with other policy tools, than it is to cut off trade to avoid the costs and tradeoffs.

To gain a better intuitive understanding for this argument, consider a hypothetical American company called Technotron. Technotron invents a new scientific technology that allows the firm to increase the output and quality of its goods with a smaller number of workers at a lower cost. As a result of this technology, other U.S. firms in this industry will lose money and will also have to lay off workers—and some of the competing firms will even go bankrupt. Should the United States government protect the existing firms and their employees by making it illegal for Technotron to use its new technology? Most people who live in market-oriented economies would oppose trying to block better products that lower the cost of services. Certainly, there is a case for society providing temporary support and assistance for those who find themselves without work. Many would argue for government support of programs that encourage retraining and acquiring additional skills. Government might also support research and development efforts, so that other firms may find ways of outdoing Technotron. Blocking the new technology altogether, however, seems like a mistake. After all, few people would advocate giving up electricity because it caused so much disruption to the kerosene and candle business. Few would suggest holding back on improvements in medical technology because they might cause companies selling leeches and snake oil to lose money. In short, most people view disruptions due to technological change as a necessary cost that is worth bearing.

Now, imagine that Technotron’s new “technology” is as simple as this: the company imports what it sells from another country. In other words, think of foreign trade as a type of innovative technology. The objective situation is now exactly the same as before. Because of Technotron’s new technology—which in this case is importing goods from another county—other firms in this industry will lose money and lay off workers. Just as it would have been inappropriate and ultimately foolish to respond to the disruptions of new scientific technology by trying to shut it down, it would be inappropriate and ultimately foolish to respond to the disruptions of international trade by trying to restrict trade.

Some workers and firms will suffer because of international trade. In a living, breathing market-oriented economy, some workers and firms will always be experiencing disruptions, for a wide variety of reasons. Corporate management can be better or worse. Workers for a certain firm can be more or less productive. Tough domestic competitors can create just as much disruption as tough foreign competitors. Sometimes a new product is a hit with consumers; sometimes it is a flop. Sometimes a company is blessed by a run of good luck or stricken with a run of bad luck. For some firms, international trade will offer great opportunities for expanding productivity and jobs; for other firms, trade will impose stress and pain. The disruption caused by international trade is not fundamentally different from all the other disruptions caused by the other workings of a market economy.

In other words, the economic analysis of free trade does not rely on a belief that foreign trade is not disruptive or does not pose tradeoffs; indeed, the story of Technotron begins with a particular disruptive market change—a new technology—that causes real tradeoffs. In thinking about the disruptions of foreign trade, or any of the other possible costs and tradeoffs of foreign trade discussed in this chapter, the best public policy solutions typically do not involve protectionism, but instead involve finding ways for public policy to address the particular issues resulting from these disruptions, costs, and tradeoffs, while still allowing the benefits of international trade to occur.

Bring It Home

What’s the Downside of Protection?

The domestic flat-panel display industry employed many workers before the ITC imposed the dumping margin tax. Flat-panel displays make up a significant portion of the cost of producing laptop computers—as much as 50%. Therefore, the antidumping tax would substantially increase the cost, and thus the price, of U.S.-manufactured laptops. As a result of the ITC’s decision, Apple moved its domestic manufacturing plant for Macintosh computers to Ireland (where it had an existing plant). Toshiba shut down its U.S. manufacturing plant for laptops. And IBM cancelled plans to open a laptop manufacturing plant in North Carolina, instead deciding to expand production at its plant in Japan. In this case, rather than having the desired effect of protecting U.S. interests and giving domestic manufacturing an advantage over items manufactured elsewhere, it had the unintended effect of driving the manufacturing completely out of the country. Many people lost their jobs and most flat-panel display production now occurs in countries other than the United States.