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Free-Trade Theory No Longer Applies?

It Just Ain't So!

In an op-ed in the January 6 *New York Times*, "liberal" U.S. Senator Charles Schumer and conservative economist Paul Craig Roberts tapped into the anxiety felt by many Americans about their changing roles in the global economy. The authors argued that new economic conditions undermine the classic argument for free trade:

> The case for free trade is based on the British economist David Ricardo's principle of "comparative advantage"—the idea that each nation should specialize in what it does best and trade with others for other needs. . . .
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> However, when Ricardo said that free trade would produce shared gains for all nations, he assumed that the resources used to produce goods—what he called the "factors of production"—would not be easily moved over international borders. Comparative advantage is undermined if the factors of production can relocate to wherever they are most productive: in today's case, to a relatively few countries with abundant cheap labor. In this situation . . . some countries win and others lose.

For many advocates of liberty, the primary argument for free trade is a moral one, succinctly captured by FEE founder Leonard Read in the title of his book *Anything That's Peaceful*. They contend that if two people voluntarily enter into an exchange of goods, then no one else has a right to aggressively disrupt it. The moral status of such interference does not depend on whether the people live in different countries.

But those who argue for free trade on moral grounds are usually pleased to hear that it *also* leads to prosperity. Furthermore, there are many people who are swayed chiefly by utilitarian arguments: Will policy A make their nation's residents better off than policy B? Therefore it's worth examining the claim that, under modern economic conditions, Americans are being hurt by free trade with low-wage countries such as China.

Schumer and Roberts assert that they are not "old-fashioned" protectionists. They favor free trade in goods. But Roberts claims that there is a fundamental economic difference between an American's purchasing clothing from a Chinese manufacturer and his purchasing it from another American who has opened a factory in China. In the first case only the clothing moves internationally, while in the second case capital also moves.[1]

However, if China is more suited to clothing production than America is and if there is free trade in goods, then capital *value* will move to China, however mobile American capital is. Clothing-related capital goods in China will increase in value while those in America will decrease. The difference between Roberts's two cases is who will own the appreciating capital goods.

When an American capitalist moves a factory to China, factory jobs *do* leave the country, but the profits still return to the United States. Not only does the American capitalist benefit, but so also might many other Americans. It is true, as critics of free trade often point out, that some of the beneficiaries may hold low-wage service jobs, such as gardeners, maids, waiters, and nannies. While their pay may not be impressive by American standards, they no doubt appreciate having a job. In fact, many teachers, engineers, and managers from poorer countries eagerly seek such jobs here. Furthermore, the American capitalist is also likely to employ higher-wage workers, such as accountants, architects, massage therapists, chefs, and chiropractors.

If American capitalists are denied opportunities overseas, foreign capitalists will take advantage of them. If, say, a Swiss capitalist does so, those jobs will be in Switzerland instead of the United States. How, exactly, would that benefit Americans?

Resource Immobility

Schumer and Roberts are wrong in contending that the case for free trade depends on productive resources being relatively immobile between countries. As Ludwig von Mises said in *Human Action*:

> People cavil much about Ricardo's law . . . [because it] is an offense to all those eager to justify protection . . . from any point of view other than the selfish interests of some producers. . . .
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> It has been asserted that Ricardo's law was valid only for his age and is of no avail for our time which offers other conditions. [But] if one assumes that capital, labor, and products are movable . . . then it is superfluous to develop a theory of international trade as distinguished from national trade. . . .
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> The teachings of the classical theory of interregional trade are above any change in institutional conditions.[2]

In other words, international trade is different from trade within a nation only when national borders restrict the movement of productive resources. But Ricardo's law of comparative advantage applies among *all* people, whether or not they live in different countries. Mises preferred to call it "the law of association," since it is the foundation of all interpersonal exchange.

Because each person differs from everyone else in his relative ability at different tasks, any individual will always have some comparative advantage over any other person. Therefore, any two individuals always have some mutually beneficial way to cooperate. And since trade between nations always boils down to trade between individuals living in those nations, any two countries also will have mutually beneficial trade available to them.

Of course, Schumer and Roberts are not merely imagining that some Americans are having a difficult time because of the greater ease with which certain jobs, such as high-paying high-tech jobs, can now be moved overseas. An honest advocate of free trade must admit that there will often be people who are made worse off, at least in the short run, by the freedom to trade internationally. But the same is true of trade *within* the borders of a country: If you open a restaurant near to and better than mine, my business will suffer.

It might be pleasant to live in a world of unlimited resources, where everyone who wanted to run a restaurant could do so without having to compete for customers' scarce dollars. But since we don't, the fact that my situation might worsen because of your business activities is an unavoidable consequence of the freedom to buy from and sell to whomever one wishes. If we try to prevent all such unpleasant outcomes, we will eliminate the market economy and regress to a hand-to-mouth existence.

Those who find that scenario enticing are welcome to retreat to the wilderness and live that way today, without trying to impose their vision on others. The rest of us should realize that freedom *necessarily means* that we can't pre-arrange social affairs to guarantee every outcome we desire. The result of voluntary interactions among free people will not always be to the liking of every interested party. The alternative to a market economy is not an economy in which someone can control all outcomes, but a "non-economy," or, as Mises called it, "planned chaos."

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1. Paul Craig Roberts, Mises.org Blog, http://www.mises.org/blog/archives/2004_01.asp.
2. Ludwig von Mises, *Human Action*, Scholar's Edition (Auburn, Ala.: Ludwig von Mises Institute, 1998), pp. 160–63.