Free Trade and the Climb Out of Poverty

BY STEVEN HORWITZ

Over the thousands of years of human history, poverty and early death have been the norm, with comfort and longevity the exceptions. The improvements in the human condition, at least on average, seen over the course of the twentieth century dwarf the improvements of the previous centuries combined. By virtually any measure one can imagine, human beings are living longer, better lives than at any other time. However, the wonders of the last century certainly did not touch all humanity equally. The clear majority of the world's population, though better off than 100 years earlier, still have lives a far cry from those of even the poorest in the West and North. One of the most pressing questions of this century is how we can extend the bounty of last century to those who have not yet been able to enjoy fully the fruits of human improvement.

At center stage in the debate over this issue is the role of "free trade" in generating or retarding human improvement. The concern, and protests in the streets, over "globalization" reflect the perceived centrality of international economic activity in understanding what makes people better off. As trade across national borders continues to grow, there are those who see in that growth the attempt by Western corporations and quasigovernmental institutions such as the International Monetary Fund (IMF) and World Bank to extract resources from the rest of the world for their own use, leaving those who already have a long hill to climb even farther from the top.

In addition, recent "free trade" agreements like NAFTA and the proposed FTAA (Free Trade Area of the Americas) complicate matters even more by simultaneously opening up trade and heavily regulating the trade now opened. Critics of free trade and so-called "profit-led" globalization are sometimes correct in pointing to the harmful effects of the IMF and World Bank, and the clear corporate special interests that are embodied in particular agreements. However, when those criticisms are extended to genuine free trade rightly understood, they miss the mark. Attempts to restrict such trade, or to "direct it from below," are bound to worsen the condition of those people who can afford it least. Although free trade is not sufficient to ensure economic and social well-being, it is a necessary means to that end.

The key to free trade's liberating role is that those who possess capital are able to bring it to workers who lack it, which in turn raises their productivity and enhances their earning power. Underlying the argument for free trade is the principle of comparative advantage, which argues that all parties are better off when each producer does what he or she does *comparatively* best and trades the results with others. Specialization by comparative advantage enables each person, or state/province, or country to find what they do at least cost and to benefit from the ability to exchange for what others can produce cheaply. Just as it makes more sense for me to specialize at being a college professor and trade for my food, clothing, and housing (rather than making them myself), it makes no sense to struggle to grow citrus in the American Midwest, when residents of those states can grow grain much more cheaply and trade for citrus with Florida, which has the comparative advantage at the latter.

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The same principles apply across nations. When individuals are free to trade across national boundaries, producers in each area will specialize in the things they can do most cheaply, to the benefit of themselves and their trading partners.

For many Third World countries, their comparative advantage is the cheapness of their labor and the availability of some natural resources. For Western firms, this presents an opportunity for profit by reducing labor and resource costs. When Western firms open up shop in the Third World, they bring capital to those places. This creates jobs for citizens there and provides the West with cheaper goods. It is the classic mutual benefit of all exchange: the developing country gets jobs; the home country gets cheaper goods. The jobs created by Western firms in low-income countries average about eight times the per capita wages of the local area, providing a significant benefit to those who take such jobs in comparison to their other options.

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Seizing Opportunity

This explains why people seek jobs in Western-owned factories despite conditions that we in the West might find seriously unpleasant: They need to support their families, and these jobs offer a much better alternative than scraping a living off the land or collecting bottles and cans on the street or turning to prostitution. No one holds a gun to the heads of workers in Thailand or Indonesia when Nike or other folks come to town. They are smart enough to realize a better opportunity when they see it, and they take it. The result is the clearly observed correlation between per capita income and the degree of openness to international trade, all else equal. The increased wages of people working in Western-owned factories also permit greater demand for local products (such as food and clothing), enhancing employment opportunities and income, and causing another rise in the income-expenditure cycle elsewhere in the economy.

Meanwhile, back in the West, the cheaper imported goods enable Western consumers to have more income left over to spend on things they otherwise could not buy. If my shoes cost $15 less by being made overseas, I have $15 to spend on something else. That expenditure also creates employment opportunities in the West, normally for higher-paying capital-intensive manufacturing jobs or service-sector work. Consider how the cheapening of food costs thanks to mechanized agriculture has enabled the Western world to have considerable excess income to spend on nonagricultural goods and a variety of services. All those newly created jobs pay much better than the agricultural jobs displaced by mechanization. And some of those jobs may be created overseas, if the excess income is spent on other imports. Any time that consumers can purchase goods more cheaply because producers cut costs, there follows the creation of new, better-paying jobs elsewhere. In the last century the number of Americans employed in agriculture dropped from about 50 percent of the workforce to under 3 percent. That change was accompanied by a tremendous increase in per capita income (not to mention non-economic measures of well-being).

Free trade enables capital to come to those who need it most. In addition, the very profits that Western firms make in developing countries can be a long-run source of growth for those countries. Firms that operate there frequently "recycle" their profits back into investment in better technology and equipment in those countries. It is often cheaper for the firms to invest their own profits than to use formal banking institutions because the rate of indigenous savings is low and the financial institutional structure is often weak or nonexistent. Despite the claim of anti-globalization forces that free trade "puts profit before people," there is not a choice between "profits" and "people." Profits legitimately made in the market are a symbol of having created value and served people, and those same profits can be used in the future to make others better off. None of this assumes that Western firms are angelic, only self-interested. What the critics of globalization fail to recognize is that markets generate beneficial results as *unintended* consequences of the self-interested behavior of firms and individuals. Under a regime of free trade, self-interest is harmonized with the public interest, as the latter emerges as an unintended consequence of the former.

A further concern of many opponents of free trade and the globalization process is that they lead to the destruction of the environment. Two points need to be made with respect to that concern. The first is that the oft-cited "race to the bottom" is largely a myth. Environmental regulations are not one of the major factors that determine where firms locate (although very restrictive ones can push them up the list). Firms are much more concerned about secure property rights, a sound legal system, political stability, and access to communications and transportation than environmental regulations in and of themselves. The scenario where countries continually lower their standards to attract new firms is farfetched.

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Second, and perhaps more important, is the overwhelming empirical evidence of what is called the Environmental Kuznets Curve. In country after country we see a U-shaped relationship between per capita income and environmental quality. As growth takes place, measures of environmental quality fall, but at about $5,000 per capita GDP this turns around, with almost all categories of environmental damage showing improvement at about $8,000. Although there will be short-run costs, in the long run the path to environmental protection is paved with economic growth. Free trade promotes that growth and thus will create the wealth necessary for clean technologies. To burden the developing world with Western-style environmental standards is to condemn its citizens to a longer stay in the poverty they wish to escape and would appear to replicate the paternalistic colonialism that anti-globalists decry. As former Mexican president Ernesto Zedillo put it: "A peculiar alliance has recently come into life. Forces from the extreme left, the extreme right, environmentalist groups, trade unions of developed countries and some self-appointed representatives of civil society are gathering around a common endeavor: to save the people of developing countries from—development."

Promotes Peace

One further benefit of free trade is that it promotes international peace. Countries that trade with one another create mutual interdependence, which raises the cost of armed conflict. If one country depends on another for cheap goods and services, what gain is there to a military invasion? Where interdependence is the nature of the relationship, fates are tied and war makes little sense. International conflict flows out of the sort of nationalism that results from restrictions on free trade. Just as democracies do not go to war with other democracies, so it is that countries with open trading relationships do not go to war. Peace and free trade have a long and storied history, and the very same thinkers who have argued for free trade, and have been excoriated for it by the antimilitarist left, did so because they believed it would promote international harmony and peace. The critics of free trade need to re-read both economic history and the history of ideas, and realize that their opposition to free trade is likely to *increase* international military activity, not reduce it.

What the critics of globalization have right, but not right enough, is the pernicious role of the IMF and World Bank. For those who support true free trade, these two institutions represent a step backward. The critics are correct, for example, in identifying many of the ways in which they, through their loans to various governments, have caused unnecessary environmental degradation through the inappropriate application of Western agricultural techniques over superior indigenous ones.

Just as important are the ways in which the strings attached to loans and aid from those institutions lead developing countries to adopt polices antithetical to long-run development. Many of the economic theories used by the IMF and World Bank are outdated and cause more harm than good. Moreover, they are overly focused on macroeconomic variables, such as investment rates or budget deficits, when the real problems facing many developing countries are microeconomic (such as overregulation of markets) or institutional (lack of well-defined property rights, political and legal instability, and more). Many anti-globalization protesters argue for reforming the IMF and World Bank to make them more responsive to local needs. However, they will always respond to those who have political power at the national level. Rather than reforming them, advocates of truly free trade should seek to close the doors of both and reduce the impoverishment of the developing world in the process.

Those who wish to improve well-being in the developing countries need to support the expansion of free trade. The recent agreements aimed at doing so (NAFTA and the proposed FTAA) are hardly ideal for this purpose. Although they clearly increase the flow of goods and services across borders, they also introduce a heavy dose of regulation into the process that undoes some of the benefits the trade would create. In addition, the documents are often not made public or are so difficult to read and understand that citizens have little idea of just how much special-interest influence has affected the final outcome.

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That having been said, an imperfect free-trade agreement is better than none at all, and certainly better than one burdened with even more labor and environmental regulations that would prevent the developing world from taking advantage of the benefits of access to Western capital.

Finally, all sides involved in the globalization issue need to take a step back and recognize that a country's "external" policies (its policies concerning international trade and relations) are only half the equation. Free trade is necessary but not sufficient for development. A country's "internal" policies (regulation, monetary stability, and reliable political institutions) are at least as important for economic development. A country open to international trade but with highly restricted markets, high rates of inflation, weak legal and financial institutions, and political instability is unlikely to grow because it is not an attractive place even for those who can relocate there. An agenda for encouraging the spread of wealth to all humanity should support freedom not only across national borders but within them as well. Restrictions on free trade are no more noxious than misguided economic policies put in place by postcolonial leaders, who imported those ideas from economically ill-informed Western elites. The fight to reduce human poverty must take place on many fronts.

Despite their attempts to monopolize it, the anti-globalists' views are not the only ones to lay a legitimate claim to the word "progressive." The more than 200-year-long attempt to open up the world to the free flow of goods, services, and people, and to make the wealth of the West available to the rest of the world, is one of the most progressive projects in human history. It has already resulted in previously unimaginable increases in wealth in those parts of the world most open to trade, and there is no reason to believe those benefits will not be extended to those who have yet to experience them.

Those who wish to slow down, stop, or politically control that process are the true reactionaries, standing atop the wave of human progress yelling "stop" simply because they cannot understand how an uncontrolled, spontaneously ordered process can possibly benefit everyone. Progress is not synonymous with intentional human control. Progress comes from good policies that let individuals use their local knowledge to their own benefit, and in doing so, unintentionally benefit others. The path toward development requires free trade. To restrict it is to condemn to prolonged poverty those who most need to escape it.