EconoFact Chats: A Brief History of International Trade (and Why It Matters Today)

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Michael Klein:

I'm Michael Klein, executive editor of EconoFact, a non-partisan web-based publication of the Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies. Publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

Michael Klein:

There are likely fewer areas in which popular opinion and the views of economists diverge as much as the issue of international trade. Economists tend to overwhelmingly favor free trade between countries. For example, in a poll of leading economists by the University of Chicago, 85% agreed with the statement, freer trade improves productive efficiency and offers consumers better choices. And in the long run, these gains are much larger than any effects on employment. And none of the other 15% disagree, they either said they were uncertain or did not answer. Contrast this with what we hear from both democratic and Republican politicians about protecting American companies from unfair international competition and promoting buy-American policies. There's a long history of debate over free trade.

Michael Klein:

My guest today on EconoFact Chats, Doug Irwin of Dartmouth College, is the foremost scholar of that history. Among his books are, Free Trade Under Fire: Against The Tide, An Intellectual History Of Free Trade and Clashing Over Commerce: A History Of US Trade Policy, which both The Economist and Foreign Affairs magazines recognized as one of their best books of the year. Doug, welcome to EconoFact Chats.

Doug Irwin:

Thanks for having me, Michael.

Michael Klein:

It's great to have you on. Doug, as you know, there's a quote that's attributed to Abraham Lincoln, although it might be apocryphal, in which he said, "I do not know much about the tariff, but I know this much, when we buy manufactured goods abroad, we get the goods and the foreigner gets the money. When we buy the manufactured goods at home, we get both the goods and the money." You disagree with Honest Abe?

Doug Irwin:

Well, first of all, you're absolutely right. There's some debate about whether he actually said that and it probably is apocryphal, but certainly a lot of people during his time in the mid 19th century believed that. This was a time when the US was largely an agrarian country. We were exporting agricultural products to buy imports of manufactured goods. And the question arose, well, why can't we just make these manufactured goods at home? Wouldn't that be better? We still see that sentiment today in terms of the buy-American policies that the Biden administration has wanted. And I think what it misses out, well, there are two elements to it. One is, how do you get the goods and what happens with the money? I think what that logic sort of doesn't take into account is that trade is actually a way of getting the goods.

Doug Irwin:

So we can either produce things directly ourselves. We could produce our smartphones here in the US, we could ask the question at what cost could we do that? But another way of getting goods is to export something and trade for them, buy them through imports. We as individuals make this decision every day of our life. For most of us, fortunately, we know we're going to have dinner. The question is, do we make it ourselves or do we go out to a restaurant? Well, when you go out to a restaurant you're indirectly acquiring those goods, in some sense. You're just doing it through trade. You worked all day, you earned the income and you buy that food. So that's the first part about how do you get goods. Trade is an indirect way of getting those goods.

Doug Irwin:

The second point is, what happens with the money? Do we keep the money at home when we just buy at home? Well, as you know, as an international finance economist, when we buy, say goods from China, we're handing them a whole bunch of dollars to buy those goods, but they don't have much use for dollars in China. So those dollars actually come back to us. They come back to us in terms of buying US goods, or often in terms of buying US assets and treasury bills and things of that sort. So the dollars do come back to us. So I think the whole quotation is sort of a false distinction.

Michael Klein:

When you mentioned that we could also produce goods on our own, you and I are both in New England. We could make pineapples in New England. We could grow them here, but they'd be fantastically expensive. And maybe it's better that we export educational services.

Michael Klein:

So while we're quoting great historical figures, let's move on to John Maynard Keynes. In 1933, at the nadir of The Great Depression, he made a more sophisticated argument against free trade. He wrote, "A considerable degree of international specialization is necessary. But over an increasingly wide range of industrial products and perhaps of agricultural products, also, I have become doubtful whether the economic loss of national self-sufficiency is great enough to outweigh the other advantages. Most modern processes of mass production can be performed in most countries, and climates with almost equal efficiency." Do you also disagree with one of the 20th century's greatest economists?

Doug Irwin:

Well, maybe in terms of that quote, yes, I will. But let me, first of all, just say that I have enormous respect for Keynes, and actually it's true, during The Great Depression, he was sort of pessimistic about trade and free trade in particular. And he made another argument against free trade at this time, saying that if we have sort of fixed exchange rates and we have unemployment, a tariff might be a way of reflating demand and getting the economy going again. But prior to The Great Depression in the 1920s and before, he was vociferously in favor of free trade, he dismissed the employment argument against free trade. So he changes his view depending on the circumstances, which is in many cases appropriate. But in terms of this particular quote, we actually have actual evidence, empirical evidence, that it was factually false.

Doug Irwin:

Yes, there's been a convergence of productivity levels in manufacturing, across countries, but it's just not the case that you can produce anything, anywhere in the world with equal efficiency. Just think about how great Toyota has been in terms of improving the productivity of so many auto producers around the world. And so the basic insight is that there's tremendous variation in productivity levels within an

industry and competition is the force that sort of drives firms to improve themselves. And if you pursue this policy of national self-sufficiency, which Keynes sort of very quickly says, well, won't have really any efficiency effects, well, just think about some countries that have done that in the past, whether it's India for much of the 1950, 60s and 70s, when they cut themselves off from world markets and they had a lot of manufacturing, but it was very inefficient.

Doug Irwin:

So we know that if you limit trade, you limit competition, and when you limit competition, you're going to limit the pressure on firms to improve their productivity. So it's not the case that every country can produce things equally efficiently. And if you cut yourself off from trade, that won't have an impact on the efficiency with which you produce goods.

Michael Klein:

So you're bringing these 19th century arguments into the present day, by considering the arguments that we are hearing in the present day. Let me give you one more chance to disagree with a famous historical figure. Alexander Hamilton thought it was important to protect American manufacturing in the early days of the Republic, to give those companies in [inaudible 00:07:54] a chance to grow. This is often called the 'infant industry' argument for protectionism. So I take it you disagree with the person who's the subject of one of the most popular Broadway musicals in recent memory as well?

Doug Irwin:

Well, you want to set me up against these great figures. So let me just begin by saying I'm actually a huge fan of Hamilton and have been so for a very long time, well before he became fashionable with Lin-Manuel Miranda and the musical. In fact, when that Broadway musical came out, I was one of the first to get tickets at face value. I didn't wait until the popular demand drove those ticket prices up, and saw it in one of the first few months. It was a great musical. And of course a great figure.

Michael Klein:

Maybe you should have gotten lots and lots of tickets, and then you could have sold them at a great profit. That would have been the economist thing to do.

Doug Irwin:

That's right. Well, unfortunately, I didn't anticipate that some historical figure would become so popular on Broadway. But at any rate, so I have great respect for Hamilton. And what's interesting about him is, he wrote in 1791, this very report on manufacturers that had been requested by Congress. And he was Treasury Secretary at the time. It was very early on in US history. We didn't really have much manufacturing in the US. He wanted to build it up to some extent. And his argument for doing so was very sophisticated. He had incredible intellect and he makes one of the best arguments you could make for building up manufacturing. I think it's important to remember the context in which he was writing, but one of the things he says is, yes, America has this disadvantage in producing manufactured goods, say, compared to Europe, but he said the biggest problem is we don't have a level playing field that other countries, primarily in Europe, support their manufacturing industries. So our industries can't compete on equal terms.

Doug Irwin:

So it's almost sort of a reciprocity argument that we have to help out our manufacturers because other countries are helping out theirs. And it wasn't directly an argument for protection, because he does say in his report, if other countries didn't have these sort of industrial policies or these subsidies, then we

wouldn't need them either. But he did say we needed to help out our domestic manufacturers. But he did say two interesting things. He never wanted protection through tariffs. He wanted to encourage those industries through subsidies. And the argument of using tariffs versus subsidies is a very subtle one, but an important one. When you use tariffs, you're sort of cutting yourself off from world markets to some extent, and those domestic protected firms may not be internationally competitive. But when you provide subsidies, you're providing encouragement for more production and the chance that those industries will become competitive, maybe a little bit higher, because you're not insulating them from competition quite as much.

Michael Klein:

So I asked you to disagree with Hamilton, Keynes and Lincoln. I'm not sure that was a fair way to start this out. So let's switch to someone you do agree with. Adam Smith is considered the founder of economics, and he makes the case for free trade in his book, The Wealth Of Nations. What are Smith's arguments?

Doug Irwin:

Well, Smith, once again, is in this pantheon with, I'd say, Hamilton Keynes, maybe Honest Abe in a different way, but The Wealth Of Nations is a tremendous book. Once again, very sophisticated and intellectually challenging. And he makes sort of two parts to the case for free trade. One is the positive case for trade, in which he talks about the division of labor specialization across countries, the efficiency gains that will come from that. So that's sort of a very standard way of thinking about it. But he also makes, this is not quite as appreciated, a negative case against protectionism. And what he says is that when you protect your domestic market from foreign competition, you're going to be limiting trade. And there's an opportunity cost to that. What he means by, in terms of opportunity cost is, you're not really creating new industries or creating new wealth for the country. You're diverting where those existing resources are going to be used.

Doug Irwin:

So to use the pineapple example in New England that you referred to earlier, yes, we could, here in New Hampshire and Massachusetts, devote some share of the labor force to trying to grow pineapples if you will, but we're going to be taking those workers away from other activities that they might be better suited to doing for the region as a whole. And therefore, we'll make New England poor.

Doug Irwin:

So he's once again, very sophisticated. And you mentioned a book that I wrote called, Against The Tide: An Intellectual History Of Free Trade. I really tried to push this idea that Smith was sophisticated in his argument against protectionism. And I'm gratified that when Paul Krugman reviewed the book for The Journal Of Economic Literature, he said that it convinced him that Smith was more important than Ricardo in terms of making the case for freer trade. And that exactly was my view and I tried to state that in the book.

Michael Klein:

David Ricardo, of course, the early 19th century, great British economist. So you talked about sort of productivity and at the heart of the arguments for free trade is the idea of what's called comparative advantage. A mathematician challenged the Nobel laureate, Paul Samuelson, to name one idea in social sciences that was both true and not trivial. Samuelson said comparative advantage fit that mold because thousands of important and intelligent people have never been able to grasp the doctrine for themselves or to believe it after it was explained to them. Doug, can you explain comparative advantage so our important and intelligent listeners can both grasp it and believe it.

Doug Irwin:

I can certainly give it a try. But it is a tricky concept. In fact, I just mentioned Paul Krugman, he has this delightful essay, which you can find by Googling, called Ricardo's Difficult Idea. And the point of the essay is, why so many policy analysts can't seem to get this idea of comparative advantage. The way I sort of think about it is, this is a concept that applies both to countries as David Ricardo, who you mentioned, first came up with the idea, but also applies at sort of the household level or the individual level in terms of how we allocate our time and our efforts. We do so along the lines of comparative advantage, not necessarily absolute advantage.

Doug Irwin:

So I think about my household. My wife is better than me, more efficient than I am, in doing just about everything. In cooking, she's a better cook. When she goes to the grocery store, she is very efficient and just buys what we need. Whereas, I tend to put a lot of things in the cart that we don't necessarily need or want just cause I'm attracted to them. She probably is even better than me at mowing the lawn and other things.

Doug Irwin:

Now you might say, well, if we allocated our activity based on absolute advantage, she's better, she's more efficient, she should do everything.

Michael Klein:

That sounds good.

Doug Irwin:

It does. And I could reap the benefits of that. But just because I'm inferior in most activities, doesn't mean I shouldn't be doing anything. And so, the way I allocate my time is I do the things where, as I put it, my margin of inferiority is the least. And that's the idea of comparative advantage. So there's some things that I'm really bad at. And some things I'm just a little bit bad at, at least relative to her. And so I do the things where the outcomes may not be quite as bad as if I [inaudible] done them. So that's, in some sense, the idea.

Michael Klein:

So, in some ways it's kind of unfortunate that your wife understands the difference between competitive advantage and absolute advantage. Otherwise, you'd get more time off.

Doug Irwin:

Right? Exactly. But then again, I may not be married too long. [inaudible 00:15:36]

Michael Klein:

Consumption basket. Right. Right.

Doug Irwin:

Right. But just, this applies to countries as well. Countries don't have to be the most efficient at doing everything. There are many developing countries that are well behind the technological frontier, but once again, their margin of inferiority is least in certain activities, say, textiles. And so, they can do very well through trade by exporting those goods that they have a comparative advantage in.

Michael Klein:

So, so far we've been talking about what happens overall in an economy and the economic result that overall trade benefits an economy. But even David Ricardo, who we've referred to a few times, in the early 19th century, he recognized that trade creates winners and losers. The case for free trade is largely based on the benefits to the overall economy. But what about those who lose their jobs or lose out because of international competition?

Doug Irwin:

Well, it's certainly the case that some workers are going to lose their jobs because of imports coming in. Not all imports, some imports we don't produce at home or are necessary to keep our producers efficient in terms of intermediate goods. But workers are losing jobs all the time because of various factors, including technological change, shifts in demand, consumer tastes, the business cycle. And trade creates a lot of jobs as well. It's not just a job destroyer. So, the way I sometimes think about it is that trade both creates jobs and destroys jobs. If we take the steel industry, for example, imports of foreign steel have probably made the industry a little bit smaller than it otherwise would be and taken away some steel jobs. But those imports also create jobs in terms of keeping our downstream steel using firms much more efficient. So if we try to protect those steel jobs by raising tariffs, we may be losing jobs by raising the cost of steel to our downstream users.

Michael Klein:

Yeah. One of our most popular memos is by Kadee Russ of UC Davis and Lydia Cox. And they show what I found to be a really shocking result, that for every job in the United States involved in making steel, there are 80 jobs involved in using steel. So if you make steel more expensive, you might be helping some of those people who are making steel, but you're hurting lots and lots of people who need steel in the production process. And then also, as you were mentioning, a lot of what's going on is automation. It's not trade. So trade is a convenient scapegoat for these things, but it's not always the case that it's trade and trade alone or even majority trade that's affecting these things.

Doug Irwin:

Yeah. That's a great memo by Kadee that you mentioned. And just another fact on the steel industry, in the 1980s, it took about 10 worker hours to produce a ton of steel. Now it takes one worker hour to produce a ton of steel. So we're producing basically the same amount of steel as we did in the past, but the number of workers employed has gone way down, once again, as you pointed out, not because of imports but because of technological change. We've just become much more efficient in producing steel.

Michael Klein:

Yeah, we have one of the very first memos we posted was by David Deming at Harvard. And he was showing the difference between what's called value added, how much is being produced in manufacturing and employment. And employment was going down, but value added was very steady, and that's automation. So there are a lot of things going on besides international trade. But as you and I both know, trade policy is inherently very political and there's a lot of money in lobbying for provisions of trade rules that benefit particular industries or even particular companies. And the classic problem here is that there are concentrated costs and diffuse benefits of many aspects of trade and globalization more generally. Given this, Doug, what do you see as the chances for free trade?

Doug Irwin:

Well, another book of mine that you mentioned is, Clashing Over Commerce, A History Of US Trade Policy: where I go over 230 or 40 years of US trade policy history. And I have to say that the US now is

about as open as it's ever been in terms of international trade. We've had pretty high trade barriers in the past. 19th century, we had pretty high tariffs. And those tariffs have really come down a lot since World War II. We do have trade agreements such as the WTO and other free trade agreements that keep formal trade barriers at relatively low levels. So you'll never get to a zero tariffs or free trade in all likelihood. Adam Smith recognized that a long time ago. And it's always a political challenge too, to keep markets open when there's pressure to protect certain sectors jobs or production. But we're in a reasonably good place, I think, in terms of how open the economy is and how exposed to international competition we are that keeps our manufacturers and other producers on their toes and competitive and productive.

Michael Klein:

So we've covered a very long span of time here in talking about the ideas about trade and your book, Against The Tide: An Intellectual History Of Free Trade, traces out this thinking in a very nice way. To what extent, Doug, do you think that economic analysis on this most central of issues shaped [inaudible] events? And to what extent do you think events influenced the way economists thought about these issues?

Doug Irwin:

I think it's much more of the latter, that events drive the way economists view things. We had talked about David Ricardo earlier on. If we go back to the early 19th century Britain, parliament at that time, right after the end of the Napoleonic wars, when Britain was sort of reentering global commerce once again, having defeated Napoleon, they were worried about a lot of imports of grain. So they passed something called The Corn Laws, which are restrictive measures to keep out foreign grain. And that's actually what triggered David Ricardo and many other of the classical economists to write about trade issues and point out the benefits from trade. So those laws were eventually repealed, but it wasn't because of what the economists were writing, so much as different economic interest groups in Britain were trying to push policy in a different way.

Doug Irwin:

When you look at US trade policy too, for most of its history with relatively high tariffs, the views of economists were ignored. When The Great Depression came along, economists took a, as you quoted John Maynard Keynes earlier, took a little bit more of a dim view on trade. Once again, it wasn't that economists' views changed and therefore trade policies became more protective, say in the 1930s during The Great Depression, but The Great Depression had an impact on the way economists viewed things. So there's always an interaction between sort of events and the ideas of economists. But I think it's mainly that changing circumstances changes the way we view certain policies.

Michael Klein:

Well, we talked about Adam Smith, David Ricardo, Alexander Hamilton, Abe Lincoln, John Maynard Keynes, Paul Samuelson. This is clearly the widest swath of economists over the longest period of time in any EconoFact Chats episode. And what I think is really nice and interesting about what you've done is that, for a variety of reasons, these topics are still very relevant. Economists are still talking about these things. And it's been very useful, I think, for us to consider this in this kind of historical context. So thank you very much, Doug, for talking with me today. It's been a lot of fun.

Doug Irwin:

Well, you're welcome and thank you. It was a great pleasure.

Michael Klein:

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