

Economic Protectionism

No policy has failed as often, or been as widely applied and enthusiastically believed, as economic protectionism. Ever since the rise of the modern nation-state in 15th century Europe, and with it the birth of international trade, the doctrine economists call mercantilism has dominated the thinking of the majority of the world's peoples and, therefore, most of their political leaders. In spite of masterful dissections and refutations of mercantilism by Adam Smith, David Ricardo and Frédéric Bastiat, the protectionist dogma remains powerfully alluring for tens of millions of people around the world.

If economists made a list of things they generally agree on, free trade would likely be at the top of the list. Yet it remains a hard sell for the general population. And so we offer you this short primer by our colleague Dwight Lee on the costs of protectionism. Like Dracula, protectionism never really dies, and we who support free trade must always keep our intellectual wooden stakes sharp and ready.

— **Bob McTeer**
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The purpose of all productive economic activity is consumption. As the great 19th century French economic pamphleteer Frédéric Bastiat wrote, “Consumption is the end, the final cause, of all economic phenomena, and it is consequently in consumption that their ultimate and definitive justification is to be found.”¹

People work and invest to earn the money to buy what they want to consume, which requires producing (either directly or indirectly) goods and services others want to consume. Many people enjoy working, which can be a form of consumption itself. Accepting lower wages for the opportunity to perform more enjoyable work is no different than paying for consumption: Workers give up one type of consumption in exchange for on-the-job consumption. So all work is directed toward increasing the value of consumption. As Bastiat observed, “The

immediate self-interest of the consumer follows a line parallel to that of the public interest. He may extend his secret wishes to fantastic or absurd lengths; yet they will not cease to be in conformity with the interests of his fellow man.”²

As primary as consumption is, its influence is commonly secondary to production’s when it comes to trade policy.

To some degree, a strong emphasis on production is justified. After all, consumption comes before production only in the dictionary. Few things are more destructive than concentrating on grandiose redistribution schemes with no thought to their negative effect on incentives to produce. The supply-side movement focuses attention on the distorting impact high marginal tax rates have on production decisions. Lower marginal tax rates reduce the difference between what consumers pay and what

producers receive and make producers more responsive to consumer demands.

Unfortunately, political decisions aimed at promoting production typically make producers less responsive to consumers. Instead of seeing production as the means of serving consumer interests, producers’ interests are treated as ends in themselves. The result is a reduction in the value of what is produced, which is, since we are all consumers, a sure prescription for making most people worse off.

A Political Distortion

Why do politicians enact policies that supposedly favor producers but can sometimes have the effect of harming almost everyone? The answer lies in a distortion inherent in the political process. Relatively small groups organized around a common concern, such as producers in a particular industry, are well positioned and strongly motivated to communicate their wishes. On the other hand, the general consuming public is too large and too diverse to communicate a clear and consistent message through the political process. Elected and appointed officials constantly make decisions crucial to consumer welfare, but seldom in forums easily accessed by consumers. Every major industry, however, maintains an army of lobbyists whose full-time job is to access those forums and influence the decisions made there.

So when considering actions that would concentrate benefits on a particular industry while spreading the costs among all consumers, decisionmakers will hear much from industry but will hear little or nothing from consumers. As a result, producer interests invariably trump consumer interests. Policies that

serve the interests of producers are almost always harmful to consumers. According to Bastiat:

In so far as we are producers, it must be admitted, each of us has hopes that are antisocial. Are we vineyardists? We should be little displeased if all the vines in the world save ours were blighted by frost.... Are we the owners of ironworks? We want no other iron to be on the market but our own, whatever may be the public need for it.... Are we farmers? We say...let bread be costly, that is to say, scarce, and the farmers will prosper....

It follows that, if the secret wishes of each producer were realized, the world would speedily retrogress toward barbarism.³

But is the bias in favor of producer interests guaranteed to make most people worse off? Isn't it possible some producers will come out ahead because they gain more as producers from their political influence than they lose as consumers? It is possible but very unlikely. If the prices of only a few industries' products were raised, producers could, on balance, gain. The trouble is that the number of industries securing protections or subsidies will not be limited to a few. The process may start with a few, but their success will inspire others who see profit in diverting efforts from increasing productivity to seeking political advantage. Bastiat recognized this problem and its implications in writing: "The state is the great fictitious entity by which everyone seeks to live at the expense of everyone else."⁴

Such policies are obviously a losing proposition. A majority would be better off relinquishing protections and increasing productivity by responding more aggressively to consumer demands. But no one industry would benefit unilaterally from doing so. Piracy can be personally profitable if the pirates are few and the victims are many. But poverty is the unavoidable

The Folly of Trade Restrictions

What is prudence in the conduct of every private family can scarce be folly in that of a great kingdom. If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry employed in a way in which we have some advantage. The general industry of the country, being always in proportion to the capital which employs it, will not thereby be diminished, no more than that of the above-mentioned artificers; but only left to find out the way in which it can be employed with the greatest advantage. It is certainly not employed to the greatest advantage when it is thus directed towards an object which it can buy cheaper than it can make. The value of its annual produce is certainly more or less diminished when it is thus turned away from producing commodities evidently of more value than the commodity which it is directed to produce. According to the supposition, that commodity could be purchased from foreign countries cheaper than it can be made at home. It could, therefore, have been purchased with a part only of the commodities, or, what is the same thing, with a part only of the price of the commodities, which the industry employed by an equal capital would have produced at home, had it been left to follow its natural course. The industry of the country, therefore, is thus turned away from a more to a less advantageous employment, and the exchangeable value of its annual produce, instead of being increased, according to the intention of the lawgiver, must necessarily be diminished by every such regulation. ■

—From Adam Smith, *The Wealth of Nations*

result when everyone is a pirate and no one is shipping the prospective loot. Yet who is going to lower his Jolly Roger and get back to shipping goods when he is surrounded by pirates?

There is no better example of political piracy or of people attempting to live at the expense of each other than regulated international trade. Progress has been made in recent decades in reducing some barriers to international trade, both in the United States and other countries. But this progress is never safe from the dynamics of special-interest politics, and there is little evidence the real case for free trade is well understood even by politicians who say they favor it.

Free Trade Is for Consumers, Not Producers

Most politicians say they favor free trade but invariably add that their support depends on trade being "fair." At a minimum they mean we should open our markets to another country's products only if their markets are equally

open to ours.⁵ This qualification is generally an excuse for catering to the demands of organized interests, but it's usually accepted because people are easily convinced it makes economic sense. Why should we give other countries the opportunity to increase output and employment at the expense of ours? "We shouldn't," is the obvious answer, but it misses the primary advantage of international trade, which is increasing our ability to consume the products we value most. Furthermore, it reflects the political bias toward organized interests that distorts government decisions.

The advantage of trade with other countries is not that we can create domestic jobs by selling more to foreigners than they sell to us. Simply creating more jobs isn't the key to a successful economy. Since our desire to consume will always exceed our ability to produce, there will never be a lack of work. A successful economy redirects people into the jobs that make best use of their productive abilities—



that is, into the jobs that create the most value for consumers. This is the real advantage of international trade.

We create productive domestic jobs both when we sell and when we buy from other countries, and the more open the trade, the better for all countries. By creating more productive jobs through international trade, we expand our ability to consume, which is tantamount to raising real incomes. When country B restricts the import of U.S. products, it reduces its productivity as well as ours. But we only compound our productivity loss if we respond by restricting the ability of our citizens to buy products from country B.

Despite the prevailing rhetoric, we create American jobs when we buy from foreign producers. Politicians who favor free trade often make this point, which is true enough but misses the real advantages of free trade. It would be better for Americans if importing foreign products didn't create American jobs. When Americans buy products from, say, Japan, we end up with products we value more than what the dollars spent could have bought domestically and the Japanese end up with the dollars. (Actually, the party who sells yen to American importers to pay for the Japanese products ends up with more dollars, but this doesn't meaningfully alter the story.)

What do the Japanese do with the dollars? Wouldn't it be nice if they treated them as collectibles to be kept and admired? Then Americans could obtain products by doing nothing more costly than printing money. We would be making purchases with what amounts to checks that remain uncashed.

Unfortunately, the Japanese produce goods for Americans not because they want dollars but because they want what those dollars can buy. Those dollars eventually come back to America as claims on goods produced by U.S. workers or as investments in America that create domestic employment opportunities. They may not all come directly back from Japan, but

The Advantage of Comparative Advantage

Two men can both make shoes and hats, and one is superior to the other in both employments; but in making hats he can only exceed his competitor by one-fifth or 20 per cent; and in making shoes he can excel him by one-third or 33 per cent: will it not be in the interest of both that the superior man should employ himself exclusively in making shoes, and the inferior man in making hats. ■

—From David Ricardo, *The Works and Correspondence of David Ricardo*

they do eventually come back. In the long run, the checks always get cashed.

This is not to deny that restrictions on foreign imports can save some U.S. jobs. But because these jobs cannot survive the competition of international trade, they obviously don't create as much value as those that survive (and expand) against foreign competition. Foreign trade only eliminates jobs that produce goods domestic consumers can obtain more cheaply by shifting their efforts into more productive employment and then trading. Unfortunately, the general benefits from unrestricted imports (lower prices for consumers and a more productive economy) are largely ignored, and imports are seen as a threat to existing domestic jobs.

As discussed above, the existing industries and employees harmed by freer trade have an overriding concern with enacting protection against foreign competition and are easily organized to influence political decisions on the subject. This influence is often countered to some degree by industries that export much of their output and would be able to expand if trade barriers were reduced. But those who would be able to start new firms or secure higher paying jobs under liberalized trade are often unaware of what trade barriers

are costing them, and in any event, they generally aren't organized for political action. Further, the bulk of the benefits from freer trade go to consumers, who are too numerous, too dispersed and too varied in their interests to organize against trade restrictions.

This bias in favor of special interests explains a host of political tendencies. It explains, for example, the difficulty politicians have cutting spending programs because these programs tend to concentrate benefits on organized interest groups. Since the tax burden is spread across a large universe of taxpayers, none of them has much incentive to seek repeal. Additionally, the resources special interests expend attempting to secure these programs could have been more profitably employed elsewhere. This bias also explains the political perspective on free trade, which emphasizes the advantage in protecting existing jobs over the far greater, but much more general, advantages of better choices for consumers and improved economic productivity.

Bastiat understood this problem, both as it relates to trade policy and to government activity in general:

There is only one difference between a bad economist and a good one: the bad economist confines himself to the *visible* effect; the good economist takes into account both the effect that can be seen and those effects that must be *foreseen*.

Yet this difference is tremendous; for it almost always happens that when the immediate consequence is favorable, the later consequences are disastrous, and vice versa. Whence it follows that the bad economist pursues a small present good that will be followed by a great evil to come, while the good economist pursues a great good to come, at the risk of a small present evil.⁶

By Bastiat's definition, on most issues—and certainly on the issue of

international trade—almost all economists are good economists. Economists almost unanimously favor free trade because they recognize that the easily seen effects of higher prices and increased employment in protected industries are more than offset by the destruction of both consumption value and the potentially more productive jobs that are not created. These other effects are difficult to see because they are dispersed, delayed and often invisible.

Economists have a difficult time making their case politically because of the problem of the seen versus the unseen. Not only is it easier to rally public opinion in favor of seen benefits rather than unseen benefits, but interest groups are more likely to be organized in favor of seen benefits (those they currently receive) than unseen benefits (those they could have but currently do not).

It is easy for politicians and protectionists to point to existing factories and jobs that will be eliminated by foreign competition. What cannot be readily seen are the costs of trade protection: inefficient, second-best uses for capital and labor, higher consumer prices, fewer incentives for protected firms to innovate and improve quality, and an overall decline in welfare due to constricted consumer choices. Because these costs are difficult to see, they typically don't influence many votes. What can determine a politician's election or defeat are the votes of those whose jobs are lost to foreign competition. So officeholders' propensity to vote for protectionist policy is understandable in terms of their own, private welfare calculations. Unfortunately, such protection votes will lower the welfare of the majority of their constituents.

If the political process paid as much heed to the potential gains of unorganized consumers as it does to the current gain of organized producers, many government restrictions on our economic choices would be quickly eliminated. The first to go

would be restrictions on our ability to buy the best products at the lowest prices, whether produced at home or abroad. ■

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Notes

- ¹ Bastiat (1996), 36.
- ² Bastiat (1996), 13.
- ³ Bastiat (1996), 11.
- ⁴ Bastiat (1995), 144.
- ⁵ Other qualifications are commonly added as well. Increasingly, fair trade means that the countries we trade with have to provide pay and working conditions, and impose environmental standards, that don't offend the sensitivities of affluent Americans. These qualifications are unrealistic for all but a few wealthy countries and are seldom more than excuses for maintaining existing trade restrictions or even adding more. Generally, however, the imposition of such "humanitarian" restrictions harms the very people in whose name they are enacted.
- ⁶ Bastiat (1995), 1.

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