

Episode 398 – Free Trade and the Trans-Pacific Partnership

Guest Richard Ebeling

WOODS: I want to talk about the Trans-Pacific Partnership, but I also want to talk about the traditional arguments for and against free trade, some of which are the same as they were in the mercantilist period and some of which are new.

I want to immediately raise the objection that you get from Pat Buchanan, and not just from Pat Buchanan, there's a whole group of people, labor unions, a whole group of interest groups, that complain that under the regime of free trade, or let's say freer trade, in the United States, we've had a catastrophic decline in manufacturing jobs, and a hollowing out of the manufacturing base, and the jobs that remain are simply not good breadwinner jobs, and this goes to show that free trade is simply a phantom cooked up by economists who are out of touch with reality. How do you respond to that?

EBELING: Well, I think that you have to answer it at several levels.

First is that this idea that jobs are being lost needs to be first counteracted, that somehow the importing of goods means the loss of jobs per se in America, for instance. This goes back to the insights of Frederic Bastiat, the French classical liberal of the early 19th century, about what is seen and what is unseen.

It is absolutely true that when we import foreign goods it is because American consumers find those goods, either in terms of price, quality, or some combination of them, more attractive than the domestic version of that product, and the domestic American producer may lose sales. And if his sales decrease and his market share goes down, he may find it necessary to reduce his level of production and his labor force because he just can't match a more efficient and better-quality competitor.

But that is what is seen. What is not seen are two other aspects of this. First, just as we do not export goods to other countries for free as gifts to foreign recipients, foreign suppliers do not sell their goods for free. They wish to earn a money income from the sale of those goods in the international division of labor, so they then can proceed to use the money income they've earned to buy the things that

they desire, either to maybe expand their own business or as a consumer, to buy the goods that money will enable them to purchase in either their own national or the global marketplace. So part of those dollars that will have been received from selling goods in the United States will return to the United States as demand of payment in the form of American exports for the imports that Americans have purchased.

There's also the fact that some of those foreign-earned dollars will be reinvested in the United States. Interest rates or rates of profit may seem more attractive in the U.S. than in foreign countries, including the seller's own foreign nation. As a consequence, some dollars may be put into the financial markets and therefore will be adding to the savings pool that will enable American borrowers and investors to have a larger quantity of resources to undertake future-oriented capital improvements and expansions.

Then finally there is also the fact that if those foreign goods have been made available to American consumers at lower prices than before, this increases the real income of the American consumer.

How does that work? Suppose that a good had been purchased from a domestic producer in the past for \$10, and now the foreign seller, because of cost efficiencies for instance, can sell that good, even with his own transportation cost to America, can sell that good to the American consumer for \$5. This means that the American consumer has for \$5 what previously cost him \$10, and now has \$5 left over in his pocket to be able to demand goods or services that previously his income had not enabled him to be able to afford. And that increases the demand for other goods that previously were not available, and that means that some jobs that have been lost due to the foreign competition will then find alternative employments in making domestic products that now Americans, due to the increase in their real income, can afford for the first time.

So all things considered at the end of day, as long as markets are open, and competitive, and the price system is adaptable and flexible to changing supply and demand conditions, there is no reason to believe that jobs lost to a foreign importer will in any way hamper job creation or existence in general in the United States.

It is true the composition of the jobs will be modified. Instead of being employed in industry A, you may have to find employment in industry B. And to be fair and complete, it is true that some workers might have to learn some new skills, be retooled, in other words, to modify their human capital, if you will. But at the end of the day that is the price of all change.

Imagine if there was no foreign trade, and we were just talking about the domestic market, and some Californian producer had found a way to sell goods less expensively to someone in Ohio, and therefore Ohio consumers now found it attractive to buy more of the California product. Some jobs domestically would be lost in Ohio. Some Ohio workers might have to shift where they're working and what they do. But at the end of the day all of us will be better off by having more goods, a larger quantity of goods, better goods, and lower priced goods to raise our standard of living. And that means globally as well as nationally.

WOODS: Let me continue along this line and raise a further objection. There has been the complaint that what you say may well be true, but that when you say that the composition of jobs may change, that conceals a big unaddressed problem. And they claim that the problem is that free trade does indeed free up Americans to produce, let's say, much more advanced goods, high-tech goods, or to specialize in all kinds of high-level services, and this is great. And then other people in other countries specialize in the kinds of things that our blue-collar workers used to do.

The problem here is that maybe no matter how much training they get, our blue-collar workers can never make computers, or can never do the types of jobs that free trade now leaves us with, so that they suffer a net minus in terms of employment. How do you address that?

EBELING: Well, I think again we need to take a slightly longer view, again with the understanding that all change involves modifications in what people do and how they do it.

If I can just take sort of a digression analogy, imagine that if we looked at the U.S. economy 200 years ago, shortly after the United States was founded as an independent country, and we looked at the types of jobs, and the distribution of jobs, and the labor skills necessary. And now compare that to what people do for

a living, or even 100 years ago, or even 50 years after that comparison of 200 years ago. What one sees is that jobs were very different than they existed 100 years later, and now 200 years later, and therefore workers needed to learn new skills. Capital investments and new directions would have been undertaken that would have raised the productivity, that is the output per worker, over time in the new employments.

So it is true transitions have to be gone through. But in the longer run, for ourselves and our children, to freeze or prevent this type of market adaptation and adjustment which may have for individuals some short-run negatives, but is the price of freedom in general in certain free-market capitalism, would be freezing the economy or retarding the economy into a lower standard of living with a lower standard of development than otherwise would be the case.

Now having said that, in the current situation there's layers of problems here. Let me put this in this context, Tom. America held an unusually preeminent position in the world for most of the post-World War II era. And part of the reason for that was that every other major industrial country was basically destroyed in that war except the United States. And that resulted in a very lopsided and artificial pattern of international production, trade, and employment. It was inevitable that in the post-war period first Japan and then western Europe would recover. And that resulted in the loss of some American jobs as these countries found better and more productive niches in this now-emerging new global division of labor given post-World War II economic recoveries.

We are going through a similar type of transition, and that is the post-Cold War era. The fact is that for the last 25 years or so, since the end of the Soviet Union and the introduction of reforms already in China shortly after Mao Tse-Tung died in 1976, what had been the Third World countries of the Cold War are now the industrial developing countries of Asia, Africa, and Latin America. They are now finding new and more productive market niches in the global division of labor, and that means that what Americans can do, and specialize in best at, is going to be modified and changed, just as it was in the 1960s and '70s with the fuller recovery of Europe and Japan following the Second World War.

But at the end of the day, just as all of us considered that Japan, and western Europe, and the United States are better from having made those earlier

adjustments and adaptations, we've all gained from that, from the recovery of those areas of the world from the destruction of the war, we will now look back 50 years from now, even 20 years from now, and say that each country finding its better specialization, to produce what they're most efficient at relative to their trading partners, including America, will at the end of the day have raised the standards of living for all, and given all of us as consumers -- and that's why we produce, to have things to consume -- that all of us as consumers will have more goods, better goods, and more efficiently produced at lower cost goods, which raises everyone's standard of living.

Now having said that, we also have these layers of government intervention, regulation, and control, all of which hampers capital formation, capital investment, the hiring of workers, the expenses of adding to one's labor force, to having [audio cut out 12:19] of after-tax revenues, to be able to afford it and find it profitable to invest in improving new labor skills and existing labor skills. And all of this is being hampered, this adjustment process, which is real, by the government overlaying the process with its heavy hand of regulation, control, intervention, and taxation.

WOODS: Richard, what you've given us are, I think, persuasive answers. They look at the whole picture instead of just one sector. They're the classic answer that an economist would give. And yet I still feel like before I move on I still have to throw one more thing at you.

And in a way all these arguments against free trade, in some ways they all seem to be collapsible into the same argument. You find that you're kind of giving the same answer to all the different objections.

But another objection would be the one we hear so often today, which is a variant of the old low wages argument, how can Americans compete against people earning such low wages. There's no way they could ever be victorious. But the variant of that now, of course, is the slave labor in China argument, and that China is sweeping the boards in all kinds of areas of manufacturing because of slave labor. And unless we are, again, going to live in some type of laissez-faire cocoon, we have to acknowledge that this is a problem and that can't possibly be genuinely fair trade.

EBELING: Well, I think we have to look at it this way. The people who make those criticisms would find an ally in me at this level: China is not a free country. It is not as collectivist and strangled controlled by government as during the bad days of Mao Tse-Tung. But it is still a one-party state. The government still predominates in the heavy industries, in manufacturing, in central sectors of the economy. They manipulate, they give special favors. It is what on a huge scale has come to be called crony capitalism.

But it doesn't change the fact that to the degree that China has escaped from heavy-handed Mao-era socialist central planning, and has degrees of markets, okay, not free markets, but certainly compared to central planning freer markets, this has given literally tens of millions of Chinese, even in their hampered market, in their corrupted crony market, an opportunity to rise out of poverty, and to some extent find niches in their own domestic and in the international division of labor where they can offer something to others around the world to raise their standards of living.

To close that, to shut that, makes it easier for the rulers to control their own people.

If I can make an analogy which is slightly off the board but is sort of on the same point, there's a debate right now because of Obama's suggestion that we should normalize relations with Cuba. And this has bothered many people who have rightly been critics of the Castro brothers for well over half a century, that this is a totalitarian state manipulating and controlling and oppressing its people.

Yes. But it has always seemed to me that the sanctions against Cuba harmed the Cuban people far more than it made it difficult for the regime to survive. If trade had been allowed, if American goods could get into Communist Cuba, if even the Communist government could take advantage of partly paying for those American imports with their own exported goods in their command economy, it would have given to the Cuban people several things: an opportunity to see what greater freedom was like. Not just as ideas, but to see the goods, however controlled, was being allowed to come into the country, more than they've had the opportunity over these decades. And it would have made it more difficult for the state to maintain its power because people would have a better understanding intellectually, spiritually, and materially of what they were losing by at least even

having a Western-style welfare state instead of a totalitarian state. I hate the welfare state, but France is not as bad as living in a Communist country.

So as a consequence, all of that locked these people into this. And in the long run, when freedom is restored in Cuba, when hopefully more freedom exists in China, this will all rebound to our benefit. And it will not be from slave labor because to the extent that there's international trade, you're giving small opportunities to weaken the links in the slaves' chains.

WOODS: Let's turn now to the Trans-Pacific Partnership. You wrote an article partly on this and partly on the general case for free trade not long ago, and you were critical of this Trans-Pacific Partnership on the grounds that you said that it's not a genuine free trade agreement. And you noted also that that's not unusual with a post-war period. These trade agreements generally are all managed trade in one form or another.

Can you tell us, what is the Trans-Pacific Partnership and what's the status of it right now?

EBELING: Okay. Again, if I could just take a moment to offer a context.

WOODS: Please.

EBELING: In the 19th century, during the heyday of classical liberalism and a philosophy and a public policy of fairly free enterprise and free trade, the presumption was that governments either unilaterally as Britain had done, or through trade agreements for reciprocity, lower trade barriers, trade restrictions, and just allow private individuals to now freely decide whether they found it attractive or not to import, export, buy and sell, from their neighbors in other countries rather than just across the street. So in a sense it was lowering trade barriers to leave markets free, that is private individuals free, to go about the business of earning a living in an increasingly global economy.

The problem is that in the inter-war period, that is between the two world wars, we fell back into this worst form of economic nationalism, protectionism, and the ideology of government planning, which basically ended that era of private

enterprise, free trade, however imperfectly but to a great extent that really existed in the era before 1914, the beginning of the First World War.

Now when the war was ending, the Second World War was ending, everybody realized that a policy of such closing yourself up from your neighbor was cutting off your nose to spite your face. Even many of the interventionists and planners realized that that was an extreme form that was counterproductive to everyone, and at least helped created a climate in which conflict of war might occur.

So then, when they started arranging all of these post-war international organizations, the World Bank, the International Monetary Fund, the international trade arrangement organizations, they said we have to escape from the madness of economic nationalism of the 1930s. But they were not willing, and they have not been willing, for a variety of ideological and special interest reasons, to even give thought to returning to that pre-1914 era of where you lower the trade barriers and trade is a matter of private choice decision making and interaction.

Since World War II what we've had is trade arranged by governments. It's managed trade. What shall be imported, how much shall be imported, with what components or domestic content relative to imported component parts, what type of transportation has to be used, what pricing structure may be applied to sell your good in the other country compared to your own, and so on and so forth. It was the basis of the North American Free Trade Agreement.

In this article of mine that you referred to I said that a free trade agreement is very simple. For a country just to do it unilaterally, Congress passes a piece of legislation basically saying something like the following: that from the day this piece of legislation comes into effect, all barriers, restrictions, and controls by government over the free flow of goods and services between the United States and the rest of the world are eliminated and abolished. And as long as trade is peaceful, that is nonviolent, and not fraudulent, the government will not and has no basis to interfere in any way with the trade that people undertake. Or some wording like that that a lawyer would write up. That's it. It's like two or three sentences.

The North American Free Trade Agreement, and now this Trans-Pacific Partnership Agreement, are hundreds if not thousands of pages long. And why? Because it's all specified what interventions ... [audio breaks up 21:30]... controls, restrictions, commands, prohibitions, will exist between the trading of goods coming from Country X into Country Y and vice versa.

Basically governments influenced by ideological forces, as well as the spider's web of special interest groups that respectively exist in these different countries, all working to sort of manage the agreement to see that it is to their benefit more than some other nation, regardless of its effect on a respective country's own tax payers or their own citizens as consumers. And that's the problem with this treaty.

What is in this treaty? Well, in many ways we don't know, and this is part of the criticism, both misplaced criticisms as well as sound criticisms, that everything is being done behind closed doors. And a fast-track legislation is now going through Congress where it would a vote up or down, which sometimes may not be a bad idea because every congressman then tries to add, as they say, the ornaments to the legislative Christmas tree to benefit special interests.

But the fact is that we don't know what's in this. We have no idea who's being benefited, who is going to be hurt, how long certain regulations and control will be in effect, and how they could be modified or not.

So this is the main problem. It's governments behind closed doors, a smoke-filled room, if you will, guided by ideological reasons, environmentalists, and trade unions, and people who don't want the competition of foreign rivals, all playing games behind doors. And we don't know, we won't know until supposedly this agreement is offered to the public sometime during the second half of the summer as I understand the schedule. So we can't even criticize it, to decide well, what are the good points? Yes, tariffs are lowered, quota limits have been abolished. And what are not the good points: benefits here, special privileges there, a subsidy for somebody else. We don't know that because we don't know what's in the treaty. But what we can say is it a treaty or an agreement being made by governments and not free choices by private individuals and producers and consumers.

WOODS: I realize I'm asking you to speculate, but just for the sake of putting a little bit of meat on the bones for the listeners, can you speculate on what could be a specific example of the type of behavior that this treaty would give cover to, that might actually run counter to the principle of free trade?

EBELING: Well, for example, the media has been pointing out that the Japanese government for the entire post-World War II period has been very protective of the Japanese domestic rice producers. They are high-cost producers who have basically a locked-in market for Japanese consumers of rice. The Japanese government realizes that they may have to lose some ... [audio cuts out 24:33] ... to basically assure a protected market for their domestic rice growers.

In the United States, for instance, the automobile industry, even though it has had to accept the arrival of foreign-headquartered automobiles being sold in the United States including their plants in the United States, many foreign producers, Japanese producers, still bring in their own domestically made component parts. For example, I drive a Japanese car, and a large part of the driving components of it are made in Japan and imported from their factories and then assembled in the United States. But they want to limit that in various ways.

Then there's the trade unions. The trade unions are up in arms because they realize that in this, as I explained here earlier, this transformative change in the global division of labor, there are sectors and industries that will not at the end of the day, likely be able to stay the course, and American workers and some of these union sectors will have to shift jobs. And the unions are afraid of losing even more membership when they're historically at lows in the post-World War II period.

And they're calling for fair wages in these other countries, or environmental restrictions and controls, basically to impose higher costs on the rival producers who otherwise would be offering less expensive goods to American consumers, if not or likely to be some of the ifs, ands, or buts that will be imposed through this treaty.

Those are a few of the things that off the record the media have been able to get from some of the participants in the negotiations.

WOODS: Okay, in that case it reminds me of the debates in the 1990s of NAFTA, because the phrase there was upward harmonization of regulation. That countries involved in this agreement will not be trying to compete with each other by lowering regulations, but that regulation will always be moving upward together. And this was a reason that free-market people were concerned about this.

There were other free-market people who said yes, that's a problem, but the net benefit of lowering tariffs so much has just got to overwhelm that. And I guess with the Trans-Pacific Partnership it may be a matter of we have to see what the details are before we can really say. Or is your view that there's basically no chance that this thing is going to be worth approving?

EBELING: Well, part of the problem is the one you've just said. Since we don't know all of the details, the actual content of what will end of being these hundreds of pages in an agreement, it's difficult to say.

Some people have pointed out, quite rightly I suppose, from whatever leaked details, that there are some Asian partners in this agreement who will certainly benefit from it. America will lower some trade barriers or other tariff-related or trade-related restrictions, and those countries will have a greater and easier opportunity to import their country in the U.S.

To that extent Americans will gain from having those goods available to them at more attractive prices. And those poor producers in those countries will have the opportunity to earn better revenues than otherwise would be the case, which will raise their standards of living. So in those aspects of the treaty, to the extent that those are parts of it, all will benefit from it.

But there is the fact that there's these issues for example of intellectual property, and how much there will be barriers and restrictions and prohibitions from a flexible and competitive environment for new ideas to be taken by others and modified and improved upon from original developers.

And all of this is supposedly in the treaty, but again, we don't know the degree of the details in which markets will be hampered rather than assisted.

WOODS: Well, I'm going to urge people to check out your article on this subject. We will link to it on today's show notes page, this being Episode 398. The show notes page will be tomwoods.com/398. So if you're driving around in the car while you're listening to this, jot yourself a note that tomwoods.com/398 is where you can find a link to Professor Ebeling's article.

So you have an online presence where you'd like me to send people who want to read more of your material?

EBELING: Yes. The site where that article is, it is a news and commentary website called Epic Times, that's one word, epictimes.com. And if you put that in, then slash, Richard Ebeling, what you will find is an archive of the articles that I regularly publish on their site, in fact every Monday morning. And there's several dozens of my articles on these and many other free market critiques, criticizing various aspects and facets of virtually everything the government does.

WOODS: All right. Well, great. So on the show notes pages we'll also link to that archive of articles as well.

Well, Richard, I appreciate your time today in helping us clear this up. And I wanted the whet people's appetites to go and read your article and find out more, and I think we have succeeded. So thank you very much.

EBELING: Thank you, Tom.