Politics and Foreign Trade

By Dwight R. Lee

The case for free trade is overwhelming, both theoretically and empirically. My last two columns developed the theoretical case, which is based on the concepts of opportunity costs and comparative advantage. Even if the people of a country have an absolute advantage in producing everything, they still gain from foreign trade because they cannot have a comparative advantage in producing everything.

Ample empirical evidence backs up the theoretical arguments in favor of free trade. The more that countries permit international trade to direct their productive efforts into their comparative advantages, the more they prosper relative to those that restrict trade. Despite this evidence, almost no country has followed a policy of free trade. With rare, and typically short-lived exceptions, governments reduce economic productivity and their citizens' prosperity by either taxing or imposing quotas on imports. Why? Answering that question is the purpose of this column

Cooperation vs. Confiscation

Given the advantages of free trade, no government would erect barriers to imports if the political process allowed the same degree of social cooperation as the market process. When trade restrictions are eliminated consumers gain but some workers and investors lose, most temporarily but some permanently. Even those who would lose permanently from eliminating their industry's trade protections would still be better off living in an economy with completely free trade than in one where all domestic industries were protected. Even though individuals may benefit from their industry's protection, they would lose far more as consumers from the protections of everyone else.

Those in an industry subject to intense foreign competition will want government to protect them if they don't have to consider the costs it imposes on others. But protectionism would not occur if an industry had to pay these costs because the burden to consumers is always greater than the benefits to the protected industry.

Unfortunately, when people obtain benefits from government they do not have to pay prices reflecting their costs, as they do for benefits received in the marketplace. The cooperation of the marketplace comes from the market's ability to collect, aggregate, and communicate costs that are widely dispersed over many people so that they are taken into consideration by those responsible for them. In sharp contrast, when the costs from politically provided benefits are dispersed over many people, those costs are likely to be ignored. So government commonly becomes the means by which people can gain private advantage through confiscation rather than through cooperation.

Weakness of the Many

A trade restriction concentrates benefits on the few in the protected industry at costs that are thinly dispersed over the entire consuming public. With the cost of a trade restriction spread over millions of consumers, few if any will be aware of the little extra they are paying for the protected product. After all, consumers buy hundreds of different products, and a little increase in the price of one product typically has little impact on the well-being of any one of them. Even if a consumer is aware of the extra cost, she will seldom know that it is caused by a trade restriction.

And if by some chance she does know the reason for the extra cost, she has little motivation to respond politically. Even if she could eliminate the trade restriction, the effort might cost as much as or more than the restriction. While the total benefit from eliminating the restriction is huge, most of it would go to other consumers whether they took political action or not. But her political action is unlikely to do any good if she acts alone.

Of course, if a large percentage of the consumers act in unison they would surely have a decisive political influence. But because the number of consumers is so large, with each having such a small stake in the outcome, it is almost impossible to organize them for political action. As is often the case, the larger the number of people harmed by a policy, the weaker their political influence.

Power of the Few

On the other hand, because a relative few benefit from a trade restriction, they will be effective in lobbying for it. The benefit to each person will be significant, and each will be aware of both his own gain and the source of that gain. Also, because of the small number of beneficiaries, they are relatively easy to organize for political action. Indeed, they will generally be organized already through industry and occupational associations. So when a trade restriction is being considered, politicians will hear plenty from those favoring the restriction and little if any from those harmed by it. The result is a bias toward providing concentrated benefits and ignoring much larger, but dispersed costs. Therefore, it is often the case that the smaller the number of people benefiting from a policy, the more powerful their political influence in its favor.

With small, organized groups able to capture benefits at the expense of the general public through restrictions on trade (and many other special-interest policies), little social cooperation is achieved through the political process. For that reason, government is a constant threat to the social cooperation that comes from free-market activity.

Considering Some Costs

The costs of trade restrictions are more difficult to identify than indicated above. Consider restrictions on steel imports. Few people buy steel directly. Rather they pay for it indirectly when they buy products made from steel. Also, when an import restriction increases steel prices, employment opportunities are reduced in industries relying on steel as an input. Those who don't get jobs because of a trade restriction will seldom know the reason. It has been estimated that limiting steel imports to 15 percent of the U.S. market would cost American consumers $189,000 a year for each steel job saved, and that for every U.S. steel job saved, over 3.5 U.S. jobs would be destroyed because of higher steel prices.*

If such costs were revealed, rather than concealed, by the political process, we would never reduce our prosperity with trade restrictions. The advantage we all receive from free trade is that it forces industries to consider the full opportunity costs of their productive activity. It's too bad that they aren't required to consider the full cost of their political activity.

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*See Arthur Denzau, "American Steel: Responding to Foreign Competition," Center for the Study of American Business, Washington University, St. Louis, Mo., February 1985.

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