

ECONOMICS AND PROTECTIONIST PREMISES

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In their paper “Realism and Free-Trade Policy,” Professors Yeager and Tuerck have skillfully demolished the arguments of the so-called “new realist” and “new protectionist” schools and have marshaled eloquent arguments for the superiority of realistic market solutions over an impractical idealized interventionism. Yet I am struck by their statement that they are becoming rather “frustrated by the protectionists’ inattention” to the standard arguments used by free traders against protectionism.¹

This admission brings to mind the tale of the economist who was invited to dinner at the home of a certain captain of industry. They took to arguing about free markets and free trade, and the dispute became more and more heated. Finally, the industrialist pointed to the door and shouted, “Sir, get off my premises!” To which the economist replied in total frustration, “Sir, I *am* your premises.”

The Nature of the Conflict

Unfortunately, the person of affairs will seldom acknowledge that the premises articulated by members of the economics profession govern the day-to-day business environment. Yet the debate over protectionism is largely a conflict over basic premises. And we economists are likely to continue to be “frustrated by the protectionists’ inattention” until we can convince “practical” people of the relevance, power, and accuracy of the premises with which we approach issues of economic policy.

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¹Leland B. Yeager and David G. Tuerck, “Realism and Free-Trade Policy,” *Cato Journal* 3 (Winter 1983/84): 657.

At the heart of the protectionist case—be it the “new realism” that challenges the ethical basis of free trade or merely the familiar tenets of old-fashioned mercantilism—is a view of the world that differs sharply from that held, in the main, by those trained in economics. In Table 1, I list a series of simplified propositions, contrasting the basic premises of what I will call the “economist’s view” with those of the “non-economist’s view.” I recognize that the former is not entirely confined to economists and that (regrettably) some members of the economics profession may agree with one or more tenets of the latter. But in the main, the distinction strikes me as valid.

The Economist’s View

Let us take up in order the propositions listed in Table 1, starting with the economist’s viewpoint:

- A. The purpose of economic activity is to enhance the well-being of individual consumers and households. This is an absolutely basic premise of economics, from which all the other propositions follow.²

TABLE 1
TWO VIEWS OF THE WORLD

Concept	Economist	Non-Economist
A. The purpose of economic activity is . . .	consumer welfare	jobs and growth
B. The basic element of economic activity is . . .	exchange	production
C. Work is a . . .	cost	benefit
D. Imports are a . . .	benefit	cost
E. Exports are a . . .	cost	benefit
F. Cheap foreign goods are a . . .	benefit	cost
G. The objective of trade is to . . .	get goods cheaply	create jobs
H. Trade barriers hurt . . .	domestic residents and foreigners	foreigners only

²Adam Smith said it succinctly in 1776: “Consumption is the sole end and purpose of all production; and the interest of the producer ought to be attended to, only so far as it may be necessary for promoting that of the consumer. The maxim is so perfectly self-evident, that it would be absurd to attempt to prove it. But in the mercantile system, the interest of the consumer is almost constantly sacrificed to that of the producer; and it seems to consider production, and not consumption, as the ultimate end and object of all industry and commerce.” *The Wealth of Nations*, Modern Library ed. (New York: Random House, 1937), p. 625.

- B. The basic element of economic activity is the transaction or exchange, which, if informed and uncoerced, must necessarily augment the wealth—the utility, well-being, or satisfaction—of both parties to the transaction. If producers who are not parties to the exchange—“third-party producers”—are damaged, they can (in principle) be compensated out of the gains from the exchange. However, efficiency and general-welfare considerations suggest that these producers should reallocate their resources to higher-valued uses.
- C. Work is a cost or an obstacle to be overcome or endured in producing the benefits of consumption. Wants always exceed the ability of scarce resources to satisfy them, so there is always plenty of work to be done. Unemployment is thus a disequilibrium situation, resulting from a perverse incentive structure or from sluggish adjustments to changing labor-market conditions.
- D/E. Imports are the benefit for which exports are the cost.
- F. Cheap foreign goods are thus an unambiguous benefit to the importing country.
- G. The objective of foreign trade is therefore to get goods on advantageous terms.
- H. Trade barriers damage the economic well-being of both the protectionist country and its trading partners.

The Non-Economist's View

The economist's views will generally be disputed in every instance by persons untrained or only partially educated in economics, who tend to hold the following views:

- A. The purpose of economic activity is to foster employment and economic growth.
- B. The basic element of economic activity is production, which has as its purpose the well-being of the suppliers of the factors of production: land, labor, and capital. Transactions that damage third-party productive factors—those outside the exchange—are detrimental to economic well-being.
- C. Work is a benefit. Jobs are a “good” with positive utility, to be purchased at a cost, if necessary, by sacrificing some (presumably selfish, materialistic, hedonistic, or unneeded) consumption. The market economy tends to generate underemployment and unemployment. The government must therefore intervene through a variety of measures, including

trade barriers, in order to provide enough desirable jobs to accommodate everyone who wishes to hold one.

- D/E. Exports are the benefit for which imports are the cost.
- F. Cheap foreign goods are a disaster for the importing country, devastating its economy by destroying jobs.
- G. The objective of foreign trade is therefore to create more jobs at home through exports than are destroyed by imports.
- H. Trade barriers hurt only foreigners. Protection enhances the economic well-being of the populace of the home country.

Defending Free Trade

With this wide gap in perceptions and assumptions, it is small wonder that “practical people” listen uncomprehendingly to free-trade arguments based on premises they find preposterous. When one is listening, it counts for little that we can demonstrate the superiority of the economist’s point of view through rigorous internal logic. Rigorously derived conclusions are only as acceptable as the premises from which they proceed, and it is the body of premises supporting free trade—not the logic—that is under attack.

In this situation, it is an evasion for economists to retreat to the theoretical high ground, taking shelter and comfort in the rigor of our logic while complaining that our cogent arguments fall on deaf ears. We have a responsibility to make ourselves heard as professional economists, and we can do so only by mounting a frontal assault on the underlying premises of protectionism. This means taking the battle to the protectionists’ turf and confronting head-on their misconceptions about “realism,” job creation, and the content and purpose of economic activity. If economists’ premises can win acceptance, the free-trade case will prevail.³ I therefore propose a three-pronged attack:

- As Yeager and Tuerck have done so well, we must continue to hammer away at the impracticality of idealized interventionism. If the protectionists want to be “realistic,” let us by all means give them realism, by stressing at every opportunity the lack of operational validity of protectionist policies.
- We must confront and demolish the employment arguments that have become widely accepted by political leaders, members of

³Although Yeager and Tuerck are becoming somewhat frustrated with repeating the arguments for free trade, they recognize the importance of such repetition and encourage others to restate the arguments “in fresh and compelling ways.” Yeager and Tuerck, p. 657.

the press, and the general public. Take, for example, this unattributed assertion from a recent *Business Week* cover story: "The trade deficit is already costing 1.5 million jobs, shrinking the nation's industrial base, and sapping the economy's growth potential."⁴ But do exports really create jobs? Or, for that matter, do imports reduce domestic employment? For the economy as a whole, a "job-creating" increase in exports will tend to induce either an offsetting rise in imports or a capital outflow that, by forcing up interest rates, will promote an offsetting job loss in interest-sensitive sectors. In the long run, foreign trade only rearranges employment patterns, redistributing labor to more-productive occupations. The typical protectionist argument simply assumes (incorrectly) that the jobs gained from protecting a particular industry increase employment, output, and economic growth for the economy as a whole. This is a classic case of the fallacy of composition, since job expansion in the protected sector is normally offset by employment losses elsewhere in the economy. There is an abundant literature in macroeconomics attesting to the futility of trying to create jobs through trade barriers,⁵ and we must see to it that fallacious arguments in this vein are countered at every opportunity.

- Finally, we must continue to stress the purpose and content of economic activity. Consumers are shrewd judges of their own self-interest. Once they are disabused of the notion that their sacrifices serve to reduce unemployment, they are not likely to tolerate the unfairness of special interests profiting at the expense of the many.

A Re-education Problem

In this connection, we have a re-education problem within the economics profession, in the production and use of elementary teaching materials. The majority of college-educated citizens of the post-war generations learned their economics from textbooks that presented sterile microeconomic (perfect-competition) and macroeconomic (multiplier) models. Although it probably was not the intention of most instructors, their students took from these models the nonsensical propositions that (1) the case for free markets breaks down when

⁴"America's Hidden Problem: The Huge Trade Deficit Is Sapping Growth and Exporting Jobs," *Business Week*, 29 August 1983, pp. 66–77.

⁵See, for example, the discussion and references in Brian Hindley and Eri Nicolaidis, *Taking the New Protectionism Seriously*, Thames Essay no. 34 (London: Trade Policy Research Center, 1983), chaps. 3–4.

the assumptions of perfect competition are not perfectly met, and (2) exports stimulate a multiple expansion of output and employment while imports are a “leakage” that induces a multiple contraction. Even if some astute instructors stressed the robustness of market solutions under rivalrous behavior and the partial nature and dubious validity of multiplier analysis, such lessons generally failed to take.

Thus, we must point to our own teaching and textbooks in assigning responsibility for the failure of much of the population to see the world from the economist’s point of view. Until we improve our own teaching methods and free ourselves from the obsolete approaches to economic theory that permeate many of the popular textbooks, we will have only ourselves to blame for the public’s misconceptions about free markets and free trade.⁶

⁶There are several refreshing exceptions to the mechanistic sterility of the traditional principles textbooks. An outstanding example is Paul Heyne, *The Economic Way of Thinking*, 4th ed. (Palo Alto, Calif.: Science Research Associates, 1983).

PROTECTIONISM, THE WELFARE STATE AND THE THIRD WORLD

Melvyn Krauss

Introduction

American liberals and European social democrats appear to suffer from split personalities. With one exception, they believe government should intervene anywhere and everywhere in the economy. That exception is foreign trade. It is hard to meet a liberal-left economist these days who does not believe simultaneously in the welfare state and free trade.

How can the leftist support for free trade be explained? Are they “closet Ricardians” in left-wing drag? On the contrary, adherence to free trade for leftists has little to do with their belief in David Ricardo’s theory of comparative advantage. If it did, they would not be interventionists in the first place. Comparative cost theory applies as much to internal as international economic exchange.

“Internationalism” better explains the free trade sentiments of the left-leaning economists. Like anti-Semitism, protectionism no longer is quite respectable in intellectual circles. International cooperation has become the social democrats’ *sine qua non*, while protectionism and the beggar-my-neighbor policies of the 1930s are viewed as the nadir of what respectable foreign economic policy should be. So long as internationalism remains fashionable, the social democrats and their fellow travelers can be expected to suppress their interventionist instincts as far as foreign trade is concerned.

The intellectual inconsistency of free trade on the one hand and the welfare state on the other is obvious once one realizes that the welfare state is itself the major motivation for protectionism presently

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