Rethinking free trade

By Robert Kuttner | September 29, 2004
Boston Globe

WHEN PAUL Samuelson, the dean of American economists, begins questioning the benefits of free trade, it is a bit like the pope having doubts about the virgin birth. But Samuelson, a Nobel laureate and the author of America's best-known economics textbook, has reopened a debate on the most settled issue in economics. He's done it with a stunner of an article in the Journal of Economic Perspectives that has created immense controversy -- and an opportunity for Americans to rethink previously unchallenged assumptions.

Until now, any politician who questioned the universal benefits of free trade was ridiculed as a flat-earth type or a stooge for some declining industry or overpaid union whose work was best performed by lower-wage workers overseas so other US consumers could benefit. This foreclosed a whole range of policy questions from debate.

Ever since the economist David Ricardo offered the basic theory in 1817, economic scripture has taught that open trade, free of tariffs, quotas, subsidies, or other government distortions, improves the well-being of both parties. US policy has implemented this doctrine with a vengeance, and opponents are seen as self-serving losers.

Why is free trade said to be universally beneficial? The answer is a doctrine called "comparative advantage."

Here's a simple analogy. If a surgeon is highly skilled both at doing operations and performing routine blood tests, it's more efficient for the surgeon to concentrate on the surgery and pay a less efficient technician to do the tests, since that allows the surgeon to make the most efficient use of her own time.

By extension, even if the United States is efficient both at inventing advanced biotechnologies and at the routine manufacture of medicines, it makes sense for the United States to let the production work migrate to countries that can make the stuff more cheaply. We get the benefit of the cheaper products and get to spend our resources on even more valuable pursuits.

That, anyway, has always been the premise. But here Samuelson dissents. What if the lower-wage country also captures the advanced industry?

If enough higher-paying jobs are lost by American workers to outsourcing, he calculates, then the gain from the cheaper prices may not compensate for the loss in US purchasing power. In other words, the low wages at Wal-Mart do not necessarily make up for their bargain prices.

"Free trade is not always a win-win situation," Samuelson concludes. It is particularly a problem, he says, in a world where large countries with far lower wages, such as India and China, are increasingly able to make almost any product or offer almost any service performed in the United States.

If we trade freely with them, then the powerful drag of their far lower wages will begin dragging down our average wages. Our economy may still grow, he calculates, but at a lower rate than it otherwise would have.

Please indulge me in a moment of belated satisfaction. As a youngish economics writer in 1983, when worries about outsourcing first surfaced, I wrote a cover article for The New Republic, called "The Free Trade Fallacy," making some of the same arguments, though not with Samuelson's care. I was widely denounced. It's not news when some pup, without even a PhD in economics, offers a heterodox theory. But when Paul Samuelson, no less, challenges the whole paradigm, he can't be ignored.

Samuelson stops short of spelling out remedies. However, his blowing open of this debate has done a profound service.

But what, then, should Americans do to defend their living standard in the face of the ability of India and China to make almost anything we make at a fraction of the wage?

First, we might insist that everyone plays by the rules, which China emphatically doesn't. China both subsidizes and protects.

Second, we might try to get them to raise their domestic wages in proportion to their rising productivity and thus produce for a more affluent domestic market (which also might buy more of our products).

On the home front, the government could invest more in the creation of high-wage service jobs that America needs and that can't be exported -- like better-paid preschool teachers and nursing home workers -- and to raise the wages of all low-paid workers through higher minimum wage laws and enforcement of the right to unionize. We could also invest in advanced technologies that create lots of good domestic jobs and export winners, like universal broadband cable and energy independence.

At 89, Samuelson is more lucid and sensible than many economist colleagues half his age. Well done!

Robert Kuttner is co-editor of The American Prospect. His column appears regularly in the Globe.