

ECONOMICS USA
Program #27
“International Trade: For Whose Benefit?”

Learning Objectives

PURPOSE:

To illustrate the concepts of specialization and comparative advantage. The viewer is made aware that trade benefits society as a whole but that it can hurt certain groups. Conversely, tariffs, quotas and other trade restrictions can protect certain groups and industries but generally restrict the amount of goods available and raise prices.

OBJECTIVES:

1. If two countries have different opportunity costs in the production of a good, then the country with the lower opportunity cost has the comparative advantage.
2. It is more efficient from a world economic point of view for nations to specialize in the production of those goods for which they have a comparative advantage and to trade for other goods.
3. Free trade generally benefits society as a whole because it results in the least costly way of producing goods. However, in each country, there are industries that may not be able to compete effectively in world markets and, therefore, may decline. Thus free trade can hurt certain industries and certain groups in the economy.
4. Countries may decide to restrict imports in order to protect industries and jobs, and for national security reasons. Trade restrictions include tariffs and quotas. Protectionism benefits certain groups at the expense of the economy as a whole.

KEY ECONOMIC CONCEPTS:

economies of scale	product life cycle
specialization and trade	tariffs, quotas and other barriers to free trade
trade and efficiency	protectionism and national defense
opportunity	protectionism and job security

ILLUSTRATIVE EVENTS:

The principles of international trade are illustrated with examples such as the Hawley Smoot high tariff of 1930 which, along with other trade restrictions, aggravated the world depression. More recent examples include restrictions on Japanese automobile imports, international competition in high technology products, the multi-lateral cotton fiber agreement, and the steel industry's demand for protection.

Program Transcript
(Revised 6/6/02)

Annenberg/CPB Project (Logo and Music)

TEASER

DAVID SCHOUMACHER: Japanese cars brought low prices and high gas mileage to American drivers. What happened when political pressure forced import cutbacks? The American steel industry thought their foreign competitors were violating trade laws to make sales in the United States. How did the U.S. government try to make foreign governments and steel companies play fair? American companies manufacturing abroad and the North American Free Trade Agreement - would Americans hear a giant sucking sound of millions of jobs going to Mexico? International Trade - for whose benefit? With the help of Economic Analyst Richard Gill we'll find out on this edition of Economics USA. I'm David Schoumacher.

(MUSIC PLAYS - OPENING TITLES)

(INTERNATIONAL TRADE: FOR WHOSE BENEFIT? Appears on the screen)

PART I

DAVID SCHOUMACHER: Nobody worried too much about the first Japanese cars to reach the United States. It was the "heyday" of the "gas guzzler". As the nation's largest consumer of steel, glass and rubber, the auto industry drove the economy. Since the days of Henry Ford the American auto industry kept its hand on the wheel and its foot on the accelerator. Detroit sold the big car; American drivers bought it. High gas mileage didn't mean much to people used to 30-cent

gas. 1973 changed that. War in the Middle East and an oil embargo were followed by short supplies, gas lines and skyrocketing prices. Higher gas prices made Datsuns and Toyotas look a lot better. To some, importing Japanese cars meant exporting American jobs. So why not just cut imports to save jobs? For drivers, cars are transportation, but in Detroit, cars are jobs. . good jobs and lots of them. For autoworkers, more imports would mean layoffs, often permanent layoffs and a search for new work by men and women who had spent their lives on the assembly line. President Douglas Fraser of the powerful AutoWorkers Union took the workers' case to Washington. His members and their employers needed protection from their Japanese competitors. Protecting autoworkers and the auto industry made little sense to believers in free trade like economist Robert Crandell of the Brookings Institution, a Washington think-tank.

CRANDELL: "I rather think that the protection for workers in that industry defeats the purpose. To the extent that we protect those workers and protect that industry...and keep an umbrella over their prices, their profits and their wage rates. There's no incentive for them to reform."

DAVID SCHOUMACHER: But on Capitol Hill, worried workers swung more weight than eminent economists, especially with Detroit Congressman John Dingell, Chairman of the House committee which sets import rules.

DINGELL: "Almost every country has quotas on importation of Japanese automobiles. The French say that they can bring in any number, but only 2 or 3% will leave the dock. The Italians allow in 2300; the British allow in approximately 10%; the Germans approximately 10%. The Japanese, however, will set up automobile industries around the world in the full expectation that those automobile industries as well as their own are going to be exporting into the United States. So I felt it was absolutely necessary, in view of the grotesquely unfair trade practices of our trading partners...especially the Japanese...that real quotas, and domestic content requirements equal to those of other nations, should be laid in place by the United States."

DAVID SCHOUMACHER: John Dingell was one of the leaders of a building grumby of protectionist feeling in Congress and in the press. Free traders fought back. In the middle was the nation's chief trade official... Special Trade Representative, William Brock.

BROCK: "You know, they came to us...and Congress...and they said, 'You gotta protect us.' Congress started talking about passing a bill to hold imports to maybe half the present level at that time. We didn't like that because we thought by using the wrong action once, you protect something like that, you can't get rid of the protection. So we talked to the Japanese and we said - "Look, it takes 5, 6, 7 years to re-tool to a completely new market demand. You can't just dream up a new car and put it out for sale. You have to design and engineer it, build new plants for it, build new machines to produce it, and that's a long-term process. And we suggested that it would be appreciated if they restrained for a limited period of time...3 or 4 years. They did."

DAVID SCHOUMACHER: Voluntarily or not, the restrictions took hold. Japanese auto imports dropped by almost 8% in a year. Thousands of autoworkers were off unemployment and back on the job. Happy ending? Sure, if your livelihood depends on the auto industry, but if you're buying instead of making or selling cars, it might be a different story. In the wake of the voluntary restraints a new sticker appeared on Japanese cars... the ADM (Additional Dealer Markup).

TOYOTA SALESMAN: "Generally you are going to pay a little bit more for a Japanese car vs. an American car, but I think the level of quality that you find in a small car is worth it."

CAR SALESMAN: "Quotas bother me immensely. I wish they'd get rid of the import quotas. I think it's one of the biggest rip-offs of Americans I ever heard of. It's only to protect incompetent automobile manufacturers."

DAVID SCHOUMACHER: Bad news for buyers was good news for dealers, like Toyota dealer, Kay Jennings.

JENNINGS: “For the Japanese car business we sold fewer cars, but we had many many price increases because of the restrictions. Because if you have fewer cars the prices are going to go up but it did the same thing to the American cars. The only thing where the restrictions really hurt was the general public.”

DAVID SCHOUMACHER: And it wasn’t only the buyers of Japanese cars who were hurting. We paid more for American cars as well, as American car dealers discovered that they could raise prices, too, as long as they stayed under Japanese prices. In Detroit, employment was high, but at what cost to car buyers?

CRANDELL: “How much did it cost American consumers in terms of higher prices of automobiles in order to keep one additional job in and around Detroit? And the answer was, by my calculation, somewhere around 160 thousand dollars. That may sound high to you, but almost every calculation of the effective trade restraints on employment levels of the United States comes out with something around 100 or 200,000 per job. It’s not unusual.

DINGELL: This kind of a fellow looks at the problem that a consumer has in terms of paying a little more for the goods at this particular time. He doesn’t look at the future increases that are going to be loaded on once our American automobile industry and other industries are down the tube. Nor does he look at the economic consequences of being dependent on goods abroad. He doesn’t look at the other costs that are associated with this and, in consequence, he is breeding himself a splendid future and present disaster because he’s not looking at the world as it really exists.”

DAVID SCHOUMACHER” The competition that comes with trade means choices for society as well as consumers. The cost of saving thousands of American jobs may be fewer choices and higher prices for millions of American consumers. We asked economic analyst Richard Gill if the American jobs that were saved were worth the higher prices of cars that followed the restrictions.

(MUSIC PLAYS—COMMENT & ANALYSIS I)

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RICHARD GILL: It's a difficult question to answer because it has so many ramifications. Over the long run, exports and imports for a given country tend to balance out, as indeed they must for all nations considered together. Since imports, in a certain sense, "cost" us jobs, and since exports, in a certain sense, "create" jobs, there is, in principle, no long-run unemployment problem associated with free trade. Hence, economists say, let trade be free so that consumers can have lower car prices; that is, they can enjoy the gains from comparative advantage we discussed earlier. However, in the short-run, increases of particular imports, cars, textiles, whatever, can definitely cost jobs in those industries. Thus, against the gain of having cheaper goods for consumers, you can have painful dislocations in specific domestic industries. Also, the long run over which exports and imports are likely to balance may be a very long run. We have been running major deficits with Japan for years. Good news in terms of getting cheaper goods. Bad news in terms of a downward pressure on employment. Still, in total, the gains from comparative advantage tend to be so large that economists, unlike perhaps auto workers or textile producers, are willing to wait for the long-term adjustments to work out. Of course, if the other country is competing unfairly, then that is another matter!

DAVID SCHOUMACHER: America likes competition on the football field, in politics, before the law and in business. An even match on a level field seems to be the best way to decide the best team, the best candidate, or the best buy. But what happens when a foreign company, a company beyond the reach of American law, doesn't play fair? What happens when "free trade" isn't "fair trade"? The American steel industry, Modern America, its buildings, its bridges, its cars, was built on steel. For almost 75 years, the industrial giants which ran American steel played by their own rules. Lack of competition made price increases easy, easier than replacing old and inefficient factories and easier than risking costly strikes over pay raises. But in the 70's, the American steel industry found itself under competitive fire for the first time. And its historic complacency

stared coming home to roost. As U.S. Steel waned, Euro Steel waxed. Steel producers from countries like Germany and Britain undercut American companies on American buildings and bridges. Some suspected that German and British steel makers were dumping, selling steel in the United States for less than they were selling it at home, perhaps even less than it cost them to make it.

DINGELL: “There’s no way that this country, which has the only private steel industry in the world, can compete with government steel dumped over here. So, through a whole broad spectrum of devices and the clearest violations of GAT and other agreements, and also our laws, subsidy goes on. They bring it over at a subsidized price.”

DAVID SCHOUMACHER: But if foreign governments were willing to take losses selling below cost in the United States, why shouldn’t we just sit back and enjoy the low prices?

BROCK: “Another government could pick an industry, subsidize the dickens out of it, and give it enough money to buy into the U.S. market, and if they gave them enough, they could destroy the U.S. industry because our industry is just one or two or three companies competing with the whole government in some other country, with their whole treasury.”

DINGELL: “Well, the practical result of that is to simply dispose of your industry. And ultimately and probably not very far down the line, you will have disposed of your steel, your auto industry. You will have grotesquely hurt all of the industries of which the auto industry is the largest single consumer. That includes computers, textiles, steel, non-ferrous metals, glass, rubber, and a lot of other things. And you will find that you simply will have deindustrialized that part of your economy. You will find that you have lost a prodigious number of jobs and you will convert from high paying jobs to low paying jobs. Not on the basis of fair competition, but on the basis of subsidy. And all of a sudden, all of those consumers that you had been trying to benefit by seeing to it that they got

low prices on subsidized exports that come into the United States—they're not consumers anymore because they can't afford to buy anything.”

CRANDELL: “Congressman Dingell doesn't have enough faith. One of our greatest resources is our human capital stock. We have an enormously talented educated work force. The notion that somehow the only thing that we'll be able to find for them to do is to flip hamburgers at McDonalds I think is outrageous. I don't think that a society is likely to succeed for most of its citizens by trying to lean against the forces of technological and economic change. And it seems to me that that's what this debate's about.”

DAVID SCHOUMACHER: With industry and jobs on the line, pressure mounted on President Jimmy Carter. Americans deserve protection from predatory pricing practices from abroad, but Congressman Dingell might lead Congress to pass outright quotas, which could wreck the complex and delicate framework of world trade. As the crisis reached its peak, Carter turned to one of the country's experts on international trade and finance, Deputy Treasury Secretary Anthony Solomon. Solomon's solution – the “trigger price mechanism”. Use the Japanese production price as the trigger for starting dumping investigations.

SOLOMON: “Everybody in the world accepted the fact that Japanese cost of production were the lowest in the world. And, therefore, if you sold below that, then there was good grounds for suspicion that you were dumping. You were not covering your cost of production, which was the definition under the law. The idea was to meet their legitimate complaint about dumping in a way that would be less disruptive of imports that would be of some help to the steel industry, and at the same time maintain price competition, particularly in the zones above that of covering the cost of production of the most efficient producer in the world. I must tell you that a lot of economists have told me that it was a very elegant concept.”

DAVID SCHOUMACHER: Elegant it may have been, but did it work?

BROCK: “Trigger price mechanism was an effort to sort of soft-land the U.S. steel industry, to not totally protect, but to give them some assurance that they weren’t going to be undercut in prices and could continue to grow and to invest.

SOLOMON: “I’m rather pleased by, frankly, my ingenuity in coming up with it. It still preserved the basic comparative cost of advantage theory which underlies international trade. It solved, for a couple of years, the political problem, and avoided protectionist quota action. And all the key actors, both the domestic industry and labor on the one hand, the foreign exporters to our market on the other, all felt that it was a much better solution than what was happening without it.”

DAVID SCHOUMACHER: The international steel trade speeded up in the wake of the “Trigger-price mechanism”. While the TPM slowed down subsidized competition from Germany and Britain, Japan’s high efficiency steel industry, and low labor cost steel producers from Korea, Argentina and Brazil got into the game. The “trigger-price mechanism” was an effort to draw a line in a battle between fair and unfair trade practices. The war is much wider. It’s not confined to the steel industry or to dumping or to any one or two countries. After the “trigger-price mechanism” expired, there was a strong drift toward protectionism in many countries, including the United States. We asked Richard Gill to comment.

(MUSIC PLAYS---COMMENT & ANALYSIS)

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RICHARD GILL: There is little question that in the mid 1980’s protectionist sentiment was in the air. A suspicion arose in the United States that some foreign countries were using exports to the United States as a means of promoting the domestic growth of their own economies. They were flooding us with their goods while keeping ours out. If this suspicion were based on the existence of

very high tariffs abroad, it would be fairly easy to evaluate. Unfortunately, most of the obstacles that countries place in the way of foreign imports are more subtle than that, what economists call non-tariff barriers to trade. Government subsidies, as in the case of steel, are sometimes overt, sometimes hidden and complex: complicated licensing and import procedures; special regulations concerning the standards, specifications, and testing that imported products have to meet. The magnitude of such barriers is very difficult to assess. What can be said with some confidence is that countries who are running huge trade surpluses with the United States, like Japan, should take quite seriously the effort to open their economies to American goods as much as they can. For the alternative is very likely to be increased protectionism in the United States, higher tariffs, more quotas, special restrictions of our own. And, in this case, although we may suffer, our trading partners will suffer too, perhaps even more seriously. The correct path is as obvious as it seems difficult to follow.

PART III

DAVID SCHOUMACHER: Not too many years ago the words, “Made in Japan,” were synonymous with low prices and even lower quality, while imports such as French perfumes and fashions were only for the wealthy. Well, not anymore. Many of the people shopping here today came in Japanese cars riding on French tires. And while most of the products sold here are still “Made in America,” they compete for consumer’s dollars with products made in the Far East, Central and South America, and Europe.

The United States is still the world’s biggest economy. What good does it do us to trade with other countries? Many Mexicans unable to find good jobs in their own country were looking for work across the border in the United States. The problem for the U.S. – how to stem the flow of job-seeking Mexicans. What was keeping investment and jobs out of Mexico? Was there a way for Mexico to attract the good jobs that would encourage Mexican workers to look for work in

Mexico? Mexico's resume as a host to employers looked ideal. It had ready supplies of energy, access to the huge consumer markets of the United States. And, most important of all, a large labor force. But for years much of Mexico's labor force sat idle – the result of policies that excluded job creating for an investment. Policies followed by the governments of both Mexico and the United States. Was there a solution – one that would attract investments in Mexico and induce Mexican workers to look for work at home? The Maquiladora was one solution. Border factories in which Mexican workers assembled U.S. made components for export with reduced tariffs to the American market. What did the Maquiladora offer to the two sides of the border?

PATRICIA FERNANDEZ KELLY : It's a two-fold process which involves both Mexico opening its border originally only on an experimental basis, and creating a free-trade zone which would be an incentive for foreign companies to manufacture in Mexico. From the point of view of American companies, the interest was to be able to find more hospitable conditions of production including lower wages and also fewer impositions from the point of view of environmental protection, safety in work places, and other what they saw as bureaucratic impediments for production.

SCHOUMACHER: The Maquiladoras started small with new low-skill assembly operations. But by 1993 two thousand Maquiladoras were doing almost 6 billion dollars worth of business employing over half a million workers. Workers who didn't need to cross the border to get a job. A partly open door had attracted investment and jobs to the border area. Could opening the door wider draw more investment and better jobs into the heartland of Mexico? Policies begun under President Selinas and de la Madrid in the 1980's made Mexico more attractive to investment from abroad. Foreign ownership restrictions were loosened and government regulations were reduced. The result: a freshet of foreign investment.

Companies like U.S.-based Cummins Engine, whose engine plant in San Luis Potosi, north of Mexico City, combined technology and training to produce one of the company's most productive facilities.

STEVE KNAEBEL (Pres., Cummins-Mexico): "We've built up a cadre of very experienced and expert people. And that's our most important asset, our people are our most important asset. We've gone from pretty serious quality problems to achieving tolerances on our crankshaft machining line within 250 millionths of an inch. That's not bend-and-weld technology."

DAVID SCHOUMACHER: Mexico's new policy of openness to foreign investment had taken Mexico from the simple assembly work at the Maquiladoras to the full production and high technology at Cummins. What did the trend signify for the Mexican economy?

PATRICIA FERNANDEZ KELLY: "The Maquiladora program then stands as the blue-print upon which many of these deregulatory and privatizing strategies are. And the purpose is to make Mexico more attractive for foreign investment."

SCHOUMACHER: Many Mexican workers still crossed the U.S. border in search of better jobs. But the low-tech jobs at border Maquiladoras and the high-tech jobs at Cummins's San Luis Potosi plant were evidence that lowered barriers and less regulation could attract billions in investment, and allow hundreds of thousands of workers to find jobs without leaving home.

Evidence that paved the way for the gradual integration of Mexico into the continent-wide North American economy created in 1993 by the North American Free Trade Agreement.

The winners in the Maquiladora program were U.S. corporations, which gained access to cheap labor. Mexican workers who now found better job opportunities in their own country and U.S. consumers who could buy low-priced products produced by American-owned Maquiladora companies. The biggest losers were

low-skilled American workers who now found fewer job prospects. But even if the Maquiladora program had not been created, those jobs probably were lost anyway with the business going to foreign-owned businesses elsewhere. We asked economic analyst Nariman Behravesch for his thoughts on the Maquiladora program and free trade between the U.S. and Mexico.

COMMENT AND ANALYSIS

NARIMAN BEHRAVESH:

When a multi-national company from a developed country such as the U.S. chooses to produce goods in a developing country such as Mexico, the impact is very similar to international trade. Production moves to the country with a comparative advantage in producing those goods. As in the case of trade this benefits both the country making the investment and the country receiving the investment. While there are some job losses, typically low-skilled workers in the country making the investment, there are more winners than losers in both countries. Thus, investment, like trade has a positive sum gain rather than a zero sum gain. In the end the Maquiladora program turned out to be so successful that it was a major factor behind the establishment of the North American Free Trade Agreement or NAFTA. The combination of the Maquiladora program and NAFTA has helped Mexico to enjoy rapid growth during the last half decade. But not at the expense of U.S. jobs growth. Many analysts now talk about Mexico as the next tiger economy or leopard economy because there are no tigers in Mexico.

CLOSING STAND-UP

DAVID SCHOUMACHER: Economic principle tells us that “free trade” or at least “freer trade” will mean lower consumer prices and in the long-term job security and a stable competitive economy. But in the real world, the short-term world, all of us and our elected officials find it hard to turn away from the plight

of those whose jobs are threatened by competition from abroad – no matter how fair that competition. For Economics U\$A, this is David Shoumacher.

Economics U\$A (Logo & Music)

Closing Credits

