

15.12: The Tradeoffs of International Trade

Learning Objectives

- Analyze the tradeoffs of trade policy, identifying at least two benefits from reducing trade barriers

The Tradeoffs of International Trade

Economists readily acknowledge that international trade is not all sunshine, roses, and happy endings. Over time, the average person gains from international trade, both as a worker who has greater productivity and higher wages because of the benefits of specialization and comparative advantage, and as a consumer who can benefit from shopping all over the world for a greater variety of quality products at attractive prices. The “average person,” however, is hypothetical, not real—representing a mix of those who have done very well, those who have done all right, and those who have done poorly. It is a legitimate concern of public policy to focus not just on the average or on the success stories, but also on those who have not been so fortunate. Workers in other countries, the environment, and prospects for new industries and materials that might be of key importance to the national economy are also all legitimate issues.

The common belief among economists is that it is better to embrace the gains from trade, and then deal with the costs and tradeoffs with other policy tools, for example, retraining workers who lose their jobs to imports, than it is to cut off trade to avoid the costs and tradeoffs.

To gain a better intuitive understanding for this argument, consider a hypothetical American company called Technotron. Technotron invents a new scientific technology that allows the firm to increase the output and quality of its goods with a smaller number of workers at a lower cost. As a result of this technology, other U.S. firms in this industry will lose money and will also have to lay off workers—and some of the competing firms will even go bankrupt. Should the United States government protect the existing firms and their employees by making it illegal for Technotron to use its new technology?

Most people who live in market-oriented economies would oppose trying to block better products that lower the cost of services. Certainly, there is a case for society providing temporary support and assistance for those who find themselves without work. Many would argue for government support of programs that encourage retraining and acquiring additional skills. Government might also support research and development efforts, so that other firms may find ways of outdoing Technotron. Blocking the new technology altogether, however, seems like a mistake. After all, few people would advocate giving up electricity because it caused so much disruption to the kerosene and candle business. Few would suggest holding back on improvements in medical technology because they might cause companies selling leeches and snake oil to lose money. In short, most people view disruptions due to technological change as a necessary cost that is worth bearing.

Now, imagine that Technotron’s new “technology” is as simple as this: the company imports what it sells from another country. In other words, think of foreign trade as a type of innovative technology. The objective situation is now exactly the same as before. Because of Technotron’s new technology—which in this case is importing goods from another country—other firms in this industry will lose money and lay off workers. Just as it would have been inappropriate and ultimately foolish to respond to the disruptions of new scientific technology by trying to shut it down, it would be inappropriate and ultimately foolish to respond to the disruptions of international trade by trying to restrict trade.

Some workers and firms will suffer because of international trade. In a living, breathing market-oriented economy, some workers and firms will always be experiencing disruptions, for a wide variety of reasons. Corporate management can be better or worse. Workers for a certain firm can be more productive or less. Tough domestic competitors can create just as much disruption as tough foreign competitors. Sometimes a new product is a hit with consumers; sometimes it is a flop. Sometimes a company is blessed by a run of good luck or stricken with a run of bad luck. For some firms, international trade will offer great opportunities for expanding productivity and jobs; for other firms, trade will impose stress and pain. The disruption caused by international trade is not fundamentally different from all the other disruptions caused by the other workings of a market economy.

In other words, the economic analysis of free trade does not rely on a belief that foreign trade is not disruptive or does not pose tradeoffs; indeed, the story of Technotron begins with a particular **disruptive market change**—a new technology—that causes real tradeoffs. In thinking about the disruptions of foreign trade, or any of the other possible costs and tradeoffs of foreign trade discussed in this module, the best public policy solutions typically do not involve protectionism, but instead involve finding ways for public policy to address the particular issues, while still allowing the benefits of international trade to occur.

Low-income countries benefit more from trade than high-income countries do. In some ways, the giant U.S. economy has less need for international trade, because it can already take advantage of internal trade within its economy. However, many smaller national economies around the world, in regions like Latin America, Africa, the Middle East, and Asia, have much more limited possibilities for trade inside their countries or their immediate regions. Without international trade, they may have little ability to benefit from comparative advantage, slicing up the value chain, or economies of scale. Moreover, smaller economies often have fewer competitive firms making goods within their economy, and thus firms have less pressure from other firms to provide the goods and prices that consumers want.

The economic gains from expanding international trade are measured in hundreds of billions of dollars, and the gains from international trade as a whole probably reach well into the trillions of dollars. The potential for gains from trade may be especially high among the smaller and lower-income countries of the world.

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Flat-panel displays, the displays for laptop computers, tablets, and flat screen televisions, are an example of such an enduring principle. In the early 1990s, the vast majority of flat-panel displays used in U.S.-manufactured laptops were imported, primarily from Japan. The small but politically powerful U.S. flat-panel-display industry filed a dumping complaint with the Commerce Department. They argued that Japanese firms were selling displays at “less than fair value,” which made it difficult for U.S. firms to compete. After a preliminary determination by the Commerce Department that the Japanese firms were dumping, the U.S. International Trade Commission imposed a 63% dumping margin (or tax) on the import of flat-panel displays. Was this a successful exercise of U.S. trade policy?

Flat-panel displays make up a significant portion of the cost of producing laptop computers—as much as 50%. Therefore, the antidumping tax would substantially increase the cost, and thus the price, of U.S.-manufactured laptops. As a result of the ITC’s decision, Apple moved its domestic manufacturing plant for Macintosh computers to Ireland (where it had an existing plant). Toshiba shut down its U.S. manufacturing plant for laptops. And IBM cancelled plans to open a laptop manufacturing plant in North Carolina, instead deciding to expand production at its plant in Japan. In this case, rather than having the desired effect of protecting U.S. interests and giving domestic manufacturing an advantage over items manufactured elsewhere, it had the unintended effect of driving the manufacturing completely out of the country. Many people lost their jobs and most flat-panel display production now occurs in countries other than the United States.

From Interpersonal to International Trade

Most people find it easy to believe that they, personally, would not be better off if they tried to grow and process all of their own food, to make all of their own clothes, to build their own cars and houses from scratch, and so on. Instead, we all benefit from living in economies where people and firms can specialize and trade with each other.

The benefits of trade do not stop at national boundaries, either. The division of labor could increase output for three reasons: (1) workers with different characteristics can specialize in the types of production where they have a comparative advantage; (2) firms and workers who specialize in a certain product become more productive with learning and practice; and (3) economies of scale. These three reasons apply from the individual and community level right up to the international level. If it makes sense to you that interpersonal, intercommunity, and interstate trade offer economic gains, it should make sense that international trade offers gains, too.

International trade currently involves about \$20 trillion worth of goods and services moving around the globe. Any economic force of that size, even if it confers overall benefits, is certain to cause disruption and controversy.

Learning Objectives

[glossary-page][glossary-term]disruptive market change: [/glossary-term]

[glossary-definition]innovative new product or production technology which disrupts the status quo in a market, leading the innovators to earn more income and profits and the other firms to lose income and profits, unless they can come up with their own innovations[/glossary-definition]

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