

Production and Possibilities: The Benefits of Free Trade

Young Patriots Essay Contest

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Even before the founding of the United States as an independent nation, the peoples living in this region participated in international trade after the Columbian Exchange brought new goods and services to the area. This allowed local economies to facilitate the trade of their products for profit and hundreds of years later, in a highly competitive multilateral economy, the United States continues to benefit from open international trade. Free trade agreements are in the best interest of the United States because they propel price reduction and quality improvement, which results in higher productive efficiency and allows for both short-term gross domestic product increases and long-term economic growth.

An important aspect of any free trade agreement is the low import tariff it offers to both trading parties. Low tariffs drive competition, because there are more suppliers who are willing and able to produce domestically. For example, if Guatemala can supply shirts to the United States at a lower price than the United States can produce them for, U.S. consumers are more likely to buy the Guatemalan shirts. This is because U.S. consumer surplus is increased by the less expensive product, which raises purchasing power. While this may seem counterintuitive in the short-term, as U.S. consumers are buying foreign goods and thus contributing money to foreign companies, in the long-term it increases productive efficiency and causes “Real Cost Reduction,” because U.S. shirt producers will be driven to implement methods that allow them to compete favorably in the market (Harberger).

A perfect example of this healthy competition is the North American Free Trade Agreement, or NAFTA. While NAFTA affected many industries in the three countries involved (United States, Mexico

and Canada), it had a particularly desirable effect on the automotive industry, because it created “cross-border supply chains” (McBride). These chains shifted the production of various automotive parts to all three countries; previously, this production was mainly concentrated in the United States. But, because of the low tariffs involved with NAFTA, the parts could be sold back to the final assembly factories in the United States at a relatively low price. This drove down the overall cost of production for the United States. As a result, more cars could be produced at a lower cost and at a faster pace, which allowed the U.S. auto industry to compete more effectively with that of Japan and Germany. While this particular case is an example in only one industry, the overall effects of NAFTA also had benefits on the U.S. economy as a whole. The agreement increased U.S. GDP by “up to 0.5 percent,” which corresponds to billions of additional dollars cycling through the U.S. economy every year since NAFTA’s implementation (McBride).

However, free trade agreements are often imperfect; if some countries involved fail to meet the contractual obligations outlined in the agreement, other countries will suffer the consequences. Perhaps this is why “world trade is no longer dominated by free-trade economies” (Choate/Linger). However, not every country has a large, diversified economy like the United States. The countries that adopt mixed-market or command economies often have smaller populations and have the capacity to specialize in a few goods at a time. Because of this, the governments of these countries can implement protectionist tariffs at strategic times to control specific industries in a way that makes them more efficient. However, the United States does not have this luxury. We have a wide variety

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of goods to produce, and thousands of businesses who would be at odds with both each other and the government if protectionist tariffs were introduced to some groups and not others. The United States government instead helps struggling industries, such as agriculture, through subsidies. But, if that subsidy money was spent on increasing worker productivity, production costs would decrease and U.S. businesses would be even more competitive. Looking at the bigger picture, it is apparent that the healthy competition fed by American free-trade policies is more helpful than harmful in the global market. When the United States creates trade agreements that are mutually beneficial, opportunities are created that would not otherwise exist.

An important consequence of free trade agreements is “export-led growth,” which increases gross domestic product (GDP) and promotes overall economic growth (Harberger). It is important to define economic growth here as an increase in both the amount of goods and services produced per capita over time, and an increase in the capacity of a country to produce those goods. The amount produced pertains more to short-term growth, while the capacity to produce correlates to long-term growth. The low tariffs and import quotas associated with free trade are helpful in driving up the amount of goods produced domestically.

For example, let’s go back to the imaginary Guatemalan shirt company. If the United States and Guatemala have a free trade agreement regarding the production and sale of shirts, and Guatemala currently has the capacity to produce more shirts for a lower price, then more U.S. consumers will buy Guatemalan-made shirts, as established previously. But what if U.S. companies find a way to produce more shirts and drive their prices down? That would be great for U.S. shirt producers, but then the free trade agreement is less beneficial to Guatemala than before, because they don’t have the competitive edge anymore. In this way, Guatemala’s

comparative advantage in production is lessened. The only way to balance this is to further reduce the tariff, or lower the import quota so Guatemala can sell more shirts to the United States, and keep their advantage. This cycle where competition drives domestic companies to be more efficient for the sake of beating foreign companies could hypothetically continue indefinitely, as long as both parties keep benefitting from the agreement. If this type of agreement was implemented across many industries, the overall GDP would spike for a period of time for every decrease in the tariff – a short-term burst.

Where this behavior produces long-term economic growth is in the increased capacity for suppliers to make more goods, because consumer and producer surplus for both countries continue to increase over time. In order to compete in any market, sellers need to keep the cost of production low and the net output high. If they are forced to compete with companies that have met those challenges, they too will adopt methods that make their businesses more efficient in the long-term, thus increasing their overall capacity to produce goods. If the United States adopts the policies of “fair trade” and “assert[s] that access to American markets should be restricted until U.S. businesses are granted equal access to foreign markets,” the healthy competition that is so imperative to driving efficient business practices would be severely reduced (Choate, Linger).

Free trade agreements have been a cornerstone in American economic policy since the country’s founding, and have continued to benefit the U.S. economy in significant ways. While foreign competition has its downsides, and alternatives to a free market are appealing at times, the competitive nature of free trade keeps American businesses on their toes and drives them to be better. The United States must continue on the path to fiscal betterment for to expand the scope of trade, is to expand the realm of opportunities available to this great nation.

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