Protectionism and the Destruction of Prosperity

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Protectionism, often refuted and seemingly abandoned, has returned, and with a vengeance. The Japanese, who bounced back from grievous losses in World War II to astound the world by producing innovative, high-quality products at low prices, are serving as the convenient butt of protectionist propaganda. Memories of wartime myths prove a heady brew, as protectionists warn about this new "Japanese imperialism," even "worse than Pearl Harbor." This "imperialism" turns out to consist of selling Americans wonderful TV sets, autos, microchips, etc., at prices more than competitive with American firms.

Is this "flood" of Japanese products really a menace, to be combated by the U.S. government? Or is the new Japan a godsend to American consumers?

In taking our stand on this issue, we should recognize that all government action means coercion, so that calling upon the U.S. government to intervene means urging it to use force and violence to restrain peaceful trade. One trusts that the protectionists are not willing to pursue their logic of force to the ultimate in the form of another Hiroshima and Nagasaki.

Keep Your Eye on the Consumer

As we unravel the tangled web of protectionist argument, we should keep our eye on two essential points: (1) protectionism means force in restraint of trade; and (2) the key is what happens to the consumer. Invariably, we will find that the protectionists are out to cripple, exploit, and impose severe losses not only on foreign consumers but especially on Americans. And since each and every one of us is a consumer, this means that protectionism is out to mulct all of us for the benefit of a specially privileged, subsidized few—and an inefficient few at that: people who cannot make it in a free and unhampered market.

Take, for example, the alleged Japanese menace. All trade is mutually beneficial to both parties—in this case Japanese producers and American consumers—otherwise they would not engage in the exchange. In trying to stop this trade, protectionists are trying to stop American consumers from enjoying high living standards by buying cheap and high-quality Japanese products. Instead, we are to be forced by government to return to the inefficient, higher-priced products we have already rejected. In short, inefficient producers are trying to deprive all of us of products we desire so that we will have to turn to inefficient firms. American consumers are to be plundered.

How To Look at Tariffs and Quotas

The best way to look at tariffs or import quotas or other protectionist restraints is to forget about political boundaries. Political boundaries of nations may be important for other reasons, but they have no economic meaning whatever. Suppose, for example, that each of the United States were a separate nation. Then we would hear a lot of protectionist bellyaching that we are now fortunately spared. Think of the howls by high-priced New York or Rhode Island textile manufacturers who would then be complaining about the "unfair," "cheap labor" competition from various low-type "foreigners" from Tennessee or North Carolina, or vice versa.

Fortunately, the absurdity of worrying about the balance of payments is made evident by focusing on inter-state trade. For nobody worries about the balance of payments between New York and New Jersey, or, for that matter, between Manhattan and Brooklyn, because there are no customs officials recording such trade and such balances.

If we think about it, it is clear that a call by New York firms for a tariff against North Carolina is a pure ripoff of New York (as well as North Carolina) consumers, a naked grab for coerced special privilege by less efficient business firms. If the 50 states were separate nations, the protectionists would then be able to use the trappings of patriotism, and distrust of foreigners, to camouflage and get away with their looting the consumers of their own region.

Fortunately, inter-state tariffs are unconstitutional. But even with this clear barrier, and even without being able to wrap themselves in the cloak of nationalism, protectionists have been able to impose inter-state tariffs in another guise. Part of the drive for continuing increases in the federal minimum-wage law is to impose a protectionist devise against lower-wage, lower-labor-cost competition from North Carolina and other southern states against their New England and New York competitors.

During the 1966 Congressional battle over a higher federal minimum wage, for example, the late Senator Jacob Javits (R-NY) freely admitted that one of his main reasons for supporting the bill was to cripple the southern competitors of New York textile firms. Since southern wages are generally lower than in the north, the business firms hardest hit by an increased minimum wage (and the workers struck by unemployment) will be located in the south.

Another way in which interstate trade restrictions have been imposed has been in the fashionable name of "safety." Government-organized state milk cartels in New York, for example, have prevented importation of milk from nearby New Jersey under the patently spurious grounds that the trip across the Hudson would render New Jersey milk "unsafe."

If tariffs and restraints on trade are good for a country, then why not indeed for a state or region? The principle is precisely the same. In America s first great depression, the Panic of 1819, Detroit was a tiny frontier town of only a few hundred people. Yet protectionist cries arose—fortunately not fulfilled—to prohibit all "imports" from outside of Detroit, and citizens were exhorted to buy only Detroit. If this nonsense had been put into effect, general starvation and death would have ended all other economic problems for Detroiters.

So why not restrict and even prohibit trade, i.e., "imports," into a city, or a neighborhood, or even on a block, or, to boil it down to its logical conclusion, to one family? Why shouldn't the Jones family issue a decree that from now on, no member of the family can buy any goods or services produced outside the family house? Starvation would quickly wipe out this ludicrous drive for self-sufficiency.

And yet we must realize that this absurdity is inherent in the logic of protectionism. Standard protectionism is just as preposterous, but the rhetoric of nationalism and national boundaries has been able to obscure this vital fact.The upshot is that protectionism is not only nonsense, but dangerous nonsense, destructive of all economic prosperity. We are not, if we were ever, a world of self-sufficient farmers. The market economy is one vast latticework throughout the world, in which each individual, each region, each country, produces what he or it is best at, most relatively efficient in, and exchanges that product for the goods and services of others. Without the division of labor and the trade based upon that division, the entire world would starve. Coerced restraints on trade—such as protectionism—cripple, hobble, and destroy trade, the source of life and prosperity. Protectionism is simply a plea that consumers, as well as general prosperity, be hurt so as to confer permanent special privilege upon groups of less efficient producers, at the expense of more competent firms and of consumers. But it is a peculiarly destructive kind of bailout, because it permanently shackles trade under the cloak of patriotism.

The Negative Railroad

Protectionism is also peculiarly destructive because it acts as a coerced and artificial increase in the cost of transportation between regions. One of the great features of the Industrial Revolution, one of the ways in which it brought prosperity to the starving masses, was by reducing drastically the cost of transportation. The development of railroads in the early 19th century, for example, meant that for the first time in the history of the human race, goods could be transported cheaply over land. Before that, water—rivers and oceans—was the only economically viable means of transport. By making land transport accessible and cheap, railroads allowed interregional land transportation to break up expensive inefficient local monopolies. The result was an enormous improvement in living standards for all consumers. And what the protectionists want to do is lay an axe to this wondrous principle of progress.

It is no wonder that Frederic Bastiat, the great French laissez-faire economist of the mid-19th century, called a tariff a "negative railroad." Protectionists are just as economically destructive as if they were physically chopping up railroads, or planes, or ships, and forcing us to revert to the costly transport of the past—mountain trails, rafts, or sailing ships.

"Fair" Trade

Let us now turn to some of the leading protectionist arguments. Take, for example, the standard complaint that while the protectionist "welcomes competition," this competition must be "fair." Whenever someone starts talking about "fair competition" or indeed, about "fairness" in general, it is time to keep a sharp eye on your wallet, for it is about to be picked. For the genuinely "fair" is simply the voluntary terms of exchange, mutually agreed upon by buyer and seller. As most of the medieval scholastics were able to figure out, there is no "just" (or "fair") price outside of the market price.

So what could be "unfair" about the free-market price? One common protectionist charge is that it is "unfair" for an American firm to compete with, say, a Taiwanese firm which needs to pay only one-half the wages of the American competitor. The U.S. government is called upon to step in and "equalize" the wage rates by imposing an equivalent tariff upon the Taiwanese. But does this mean that consumers can never patronize low-cost firms because it is "unfair" for them to have lower costs than inefficient competitors? This is the same argument that would be used by a New York firm trying to cripple its North Carolina competitor.

What the protectionists don t bother to explain is why U.S. wage rates are so much higher than Taiwan. They are not imposed by Providence. Wage rates are high in the U.S. because American employers have bid these rates up. Like all other prices on the market, wage rates are determined by supply and demand, and the increased demand by U.S. employers has bid wages up. What determines this demand? The "marginal productivity" of labor.

The demand for any factor of production, including labor, is constituted by the productivity of that factor, the amount of revenue that the worker, or the pound of cement or acre of land, is expected to bring to the brim. The more productive the factory, the greater the demand by employers, and the higher its price or wage rate. American labor is more costly than Taiwanese because it is far more productive. What makes it productive? To some extent, the comparative qualities of labor, skill, and education. But most of the difference is not due to the personal qualities of the laborers themselves, but to the fact that the American laborer, on the whole, is equipped with more and better capital equipment than his Taiwanese counterparts. The more and better the capital investment per worker, the greater the worker s productivity, and therefore the higher the wage rate.

In short, if the American wage rate is twice that of the Taiwanese, it is because the American laborer is more heavily capitalized, is equipped with more and better tools, and is therefore, on the average, twice as productive. In a sense, I suppose, it is not "fair" for the American worker to make more than the Taiwanese, not because of his personal qualities, but because savers and investors have supplied him with more tools. But a wage rate is determined not just by personal quality but also by relative scarcity, and in the United States the worker is far scarcer compared to capital than he is in Taiwan.

Putting it another way, the fact that American wage rates are on the average twice that of the Taiwanese, does not make the cost of labor in the U.S. twice that of Taiwan. Since U.S. labor is twice as productive, this means that the double wage rate in the U.S. is offset by the double productivity, so that the cost of labor per unit product in the U.S. and Taiwan tends, on the average, to be the same. One of the major protectionist fallacies is to confuse the price of labor (wage rates) with its cost, which also depends on its relative productivity.

Thus, the problem faced by American employers is not really with the "cheap labor" in Taiwan, because "expensive labor" in the U.S. is precisely the result of the bidding for scarce labor by U.S. employers. The problem faced by less efficient U.S. textile or auto firms is not so much cheap labor in Taiwan or Japan, but the fact that other U.S. industries are efficient enough to afford it, because they bid wages that high in the first place.

So, by imposing protective tariffs and quotas to save, bail out, and keep in place less efficient U.S. textile or auto or microchip firms, the protectionists are not only injuring the American consumer. They are also harming efficient U.S. firms and industries, which are prevented from employing resources now locked into incompetent firms, and who could otherwise be able to expand and sell their efficient products at home and abroad.

"Dumping"

Another contradictory line of protectionist assault on the free market asserts that the problem is not so much the low costs enjoyed by foreign firms, as the "unfairness" of selling their products "below costs" to American consumers, and thereby engaging in the pernicious and sinful practice of "dumping." By such dumping they are able to exert unfair advantage over American firms who presumably never engage in such practices and make sure that their prices are always high enough to cover costs. But if selling below costs is such a powerful weapon, why isn't it ever pursued by business firms within a country?

Our first response to this charge is, once again, to keep our eye on consumers in general and on American consumers in particular. Why should it be a matter of complaint when consumers so clearly benefit? Suppose, for example, that Sony is willing to injure American competitors by selling TV sets to Americans for a penny apiece. Shouldn't we rejoice at such an absurd policy of suffering severe losses by subsidizing us, the American consumers? And shouldn't our response be: "Come on, Sony, subsidize us some more!" As far as consumers are concerned, the more "dumping" that takes place, the better.

But what of the poor American TV firms, whose sales will suffer so long as Sony is willing to virtually give their sets away? Well, surely, the sensible policy for RCA, Zenith, etc. would be to hold back production and sales until Sony drives itself into bankruptcy. But suppose that the worst happens, and RCA, Zenith, etc. are themselves driven into bankruptcy by the Sony price war? Well, in that case, we the consumers will still be better off, since the plants of the bankrupt firms, which would still be in existence, would be picked up for a song at auction, and the American buyers at auction would be able to enter the TV business and outcompete Sony because they now enjoy far lower capital costs.

For decades, indeed, opponents of the free market have claimed that many businesses gained their powerful status on the market by what is called "predatory price-cutting," that is, by driving their smaller competitors into bankruptcy by selling their goods below cost, and then reaping the reward of their unfair methods by raising their prices and thereby charging "monopoly prices" to the consumers. The claim is that while consumers may gain in the short run by price wars, "dumping," and selling below costs, they lose in the long run from the alleged monopoly. But, as we have seen, economic theory shows that this would be a mug s game, losing money for the "dumping" firms, and never really achieving a monopoly price. And sure enough, historical investigation has not turned up a single case where predatory pricing, when tried, was successful, and there are actually very few cases where it has even been tried.

Another charge claims that Japanese or other foreign firms can afford to engage in dumping because their governments are willing to subsidize their losses. But again, we should still welcome such an absurd policy. If the Japanese government is really willing to waste scarce resources subsidizing American purchases of Sony s, so much the better! Their policy would be just as self-defeating as if the losses were private.

There is yet another problem with the charge of "dumping," even when it is made by economists or other alleged "experts" sitting on impartial tariff commissions and government bureaus. There is no way whatever that outside observers, be they economists, businessmen, or other experts, can decide what some other firm s "costs" may be. "Costs" are not objective entities that can be gauged or measured. Costs are subjective to the businessman himself, and they vary continually, depending on the businessman s time horizon or the stage of production or selling process he happens to be dealing with at any given time.

Suppose, for example, a fruit dealer has purchased a case of pears for $20, amounting to $1 a pound. He hopes and expects to sell those pears for $1.50 a pound. But something has happened to the pear market, and he finds it impossible to sell most of the pears at anything near that price. In fact, he finds that he must sell the pears at whatever price he can get before they become overripe. Suppose he finds that he can only sell his stock of pears at 70 cents a pound. The outside observer might say that the fruit dealer has, perhaps "unfairly," sold his pears "below costs," figuring that the dealer s costs were $1 a pound.

"Infant" Industries

Another protectionist fallacy held that the government should provide a temporary protective tariff to aid, or to bring into being, an "infant industry." Then, when the industry was well-established, the government would and should remove the tariff and toss the now "mature" industry into the competitive swim.

The theory is fallacious, and the policy has proved disastrous in practice. For there is no more need for government to protect a new, young, industry from foreign competition than there is to protect it from domestic competition.

In the last few decades, the "infant" plastics, television, and computer industries made out very well without such protection. Any government subsidizing of a new industry will funnel too many resources into that industry as compared to older firms, and will also inaugurate distortions that may persist and render the firm or industry permanently inefficient and vulnerable to competition. As a result, "infant-industry" tariffs have tended to become permanent, regardless of the "maturity" of the industry. The proponents were carried away by a misleading biological analogy to "infants" who need adult care. But a business firm is not a person, young or old.

Older Industries

Indeed, in recent years, older industries that are notoriously inefficient have been using what might be called a "senile-industry" argument for protectionism. Steel, auto, and other outcompeted industries have been complaining that they "need a breathing space" to retool and become competitive with foreign rivals, and that this breather could be provided by several years of tariffs or import quotas. This argument is just as full of holes as the hoary infant-industry approach, except that it will be even more difficult to figure out when the "senile" industry will have become magically rejuvenated. In fact, the steel industry has been inefficient ever since its inception, and its chronological age seems to make no difference. The first protectionist movement in the U.S. was launched in 1820, headed by the Pennsylvania iron (later iron and steel) industry, artificially force-fed by the War of 1812 and already in grave danger from far more efficient foreign competitors.

The Non-Problem of the Balance of Payments

A final set of arguments, or rather alarms, center on the mysteries of the balance of payments. Protectionists focus on the horrors of imports being greater than exports, implying that if market forces continued unchecked, Americans might wind up buying everything from abroad, while selling foreigners nothing, so that American consumers will have engorged themselves to the permanent ruin of American business firms. But if the exports really fell to somewhere near zero, where in the world would Americans still find the money to purchase foreign products? The balance of payments, as we said earlier, is a pseudo-problem created by the existence of customs statistics.

During the day of the gold standard, a deficit in the national balance of payments was a problem, but only because of the nature of the fractional-reserve banking system. If U.S. banks, spurred on by the Fed or previous forms of central banks, inflated money and credit, the American inflation would lead to higher prices in the U.S., and this would discourage exports and encourage imports. The resulting deficit had to be paid for in some way, and during the gold standard era this meant being paid for in gold, the international money. So as bank credit expanded, gold began to flow out of the country, which put the fractional-reserve banks in even shakier shape. To meet the threat to their solvency posed by the gold outflow, the banks eventually were forced to contract credit, precipitating a recession and reversing the balance of payment deficits, thus bringing gold back into the country.

But now, in the fiat-money era, balance of payments deficits are truly meaningless. For gold is no longer a "balancing item." In effect, there is no deficit in the balance of payments. It is true that in the last few years, imports have been greater than exports by $150 billion or so per year. But no gold flowed out of the country. Neither did dollars "leak" out. The alleged "deficit" was paid for by foreigners investing the equivalent amount of money in American dollars: in real estate, capital goods, U.S. securities, and bank accounts.

In effect, in the last couple of years, foreigners have been investing enough of their own funds in dollars to keep the dollar high, enabling us to purchase cheap imports. Instead of worrying and complaining about this development, we should rejoice that foreign investors are willing to finance our cheap imports. The only problem is that this bonanza is already coming to an end, with the dollar becoming cheaper and exports more expensive.

We conclude that the sheaf of protectionist arguments, many plausible at first glance, are really a tissue of egregious fallacies. They betray a complete ignorance of the most basic economic analysis. Indeed, some of the arguments are almost embarrassing replicas of the most ridiculous claims of 17th-century mercantilism: for example, that it is somehow a calamitous problem that the U.S. has a balance of trade deficit, not overall, but merely with one specific country, e.g., Japan.

Must we even relearn the rebuttals of the more sophisticated mercantilists of the 18th century: namely, that balances with individual countries will cancel each other out, and therefore that we should only concern ourselves with the overall balance? (Let alone realize that the overall balance is no problem either.) But we need not reread the economic literature to realize that the impetus for protectionism comes not from preposterous theories, but from the quest for coerced special privilege and restraint of trade at the expense of efficient competitors and consumers. In the host of special interests using the political process to repress and loot the rest of us, the protectionists are among the most venerable. It is high time that we get them, once and for all, off our backs, and treat them with the righteous indignation they so richly deserve.

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