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POL 226: Approaches to Political Science

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06 December 2018

NAFTA Trumps Protectionism: A Neoclassical Liberal's Approach

For two centuries economists have continued to advocate the findings of David Ricardo and Adam Smith, arguing that protectionist policies produce a staggering deadweight loss and overall economic inefficiency for the nation. For the United States to implement tariffs and quotas on our North American neighbors with disregard to the benefits of free trade would be an injustice to individuals across our continent. From a neoclassical liberal perspective, in entering the social contract of the North American Free Trade Agreement (NAFTA) Canada, Mexico, and the United States access a mutually beneficial relationship that espouses the prosperity of individual liberty. In an effort to defend this position, this paper will analyze how the trade alliance preserves consumer utility, strengthens employment, encourages the efficient use of resources, and upholds a thriving, democratic state. To leave NAFTA would be an irreversible mistake.

To speak on the benefits of NAFTA requires a simple understanding of standard trade theory. In 1817, economist David Ricardo developed the principle of comparative advantage that states under free trade individuals, firms and nations reap greater benefits than under autarky. This process occurs when an agent can produce a particular good at a lower opportunity cost relative to their trading partner with regard to a country's factor endowments. Overall, under the classical theory of comparative advantage, a nation engaging in the free market will experience an increase in consumption (Pugel 58).

Ricardo developed these ideas from philosopher and economist Adam Smith who recommended policy that would allow individuals to compete in a free marketplace. In describing Smith's motives for a free marketplace Ball, Dagger, and O'Neil write, "In order to turn a profit, producers have to produce either a better or cheaper good than their competitors; otherwise, people will not buy their products. Private interests, set free, will thus indirectly promote the public good by making available more and better and cheaper goods," (Ball, Dagger, O'Neil 70). Smith, a proponent of mercantilist regimes, had the consumer at the forefront of his analysis as we all should, for we cannot all be owners of capital but are participants in the good's market every time we make a purchase.

Import barriers have two disadvantageous characteristics to consumer welfare: increased product price and scarcity. As written in the *Wealth of Nations*, Adams Smith explains, "Consumption is the sole and purpose of all production: and the interest of the producer ought to be attended to only so far as it may be necessary for promoting that of the consumers," (Irwin 78). In 2013 the US International Trade Commission calculated that the net cost of trade barriers set by the United States was \$1.1 billion. This measure is conceived as an efficiency loss due to restricting trade, a loss that falls mostly on consumers who pay more for the import good and domestic substitutes combined (Irwin 83). Thankfully, in the case of NAFTA, almost 70% of imports (by value) enter our country free of import levies; therefore, significantly reducing what the loss would have been without the agreement (Irwin 81).

The idea of short run job loss created through free trade might evoke fear in the everyday worker, though there are many situations in which firms have seen increased productivity, and therefore employment following the creation of NAFTA. Almost two years

after NAFTA was introduced, Key Tronic, a large manufacturer of computer keyboards, laid off 227 workers in Spokane, Washington while its assembly jobs were relocated to Ciudad Juarez, Mexico. While those opposed to NAFTA cling to these findings and short term unemployment as their basis to abandon the agreement, it seems as if they have disregarded the long run benefits. For instance, reports from the company's chief financial officer state that employment in Spokane increased following the worker relocation (Golub 7). In relocating, the company was able to conduct the keyboard assembly process for a lower cost in Mexico, simultaneously increasing the need for workers to manufacture keyboard components in Spokane therein lowering prices, increasing sales, and creating more jobs in the U.S. and Mexico. Ultimately, through this process the individual acquired greater social welfare through product variety and lower cost, "and in the long run these gains are much larger than any effects on employment," (Rodrik 73).

In addition, the establishment of NAFTA has been linked to hardening political alliance and empowering the individual for a more democratic state. Particularly in Mexico, "NAFTA has acted as a catalyst in raising mass demand for political democracy," (Maxwell, Wise 303). The presence of NAFTA sparked the interest of the international community to examine Mexican political and economic affairs. Voices of groups like the *Red Mexicana de Accion Frente al Libre Comercio* were heard in protest of Mexico's human rights policies. As the free market is a system of rational beings and accountability, "when applied to Mexico, the dramatic shift from a state-led and protected economy toward a market model created conditions conducive to democratization," (Maxwell, Wise 305). The Wharton School of Business cites that since 2000, 50% of accumulated foreign direct investment into Mexico has come from the U.S.

and as a result of NAFTA has reformed the country into a more modern economy and open society (“NAFTA's Impact on the U.S. Economy: What Are the Facts?” 2016).

Economic policy is a highly debated topic, though when it comes to free trade liberalization trumps protectionism in its ability to feed the free market. Thomas B. Macaulay regards free trade as the greatest endorsement of individual interests a government can provide, yet describes we are too foolish to recognize its welfare: “Free trade, one of the greatest blessing which a government can confer on a people, is in almost every country unpopular,” (McDonald 48). The opposition to free trade might argue that the \$1.1 billion calculated earlier in this argument is an insignificant number with respect to GDP. Yet, while this \$1.1 billion may have represented 0.007 percent of the GDP in 2013, it would likewise be equal to a \$3 increase in pay for a worker earning \$50,000 that year (Irwin 86). “In the long run, peaceful and unrestricted trade between countries benefits everyone,” and makes way for a thriving nation (Ball, Dagger, O’Neil 71).

Part of this benefit assures that government does not interfere with individual liberties, but instead acts as a “night watchman” for international transactions. In fact, the presence of protectionist policy amounts to wasted resources in the form of political corruption known as lobbying. “Expenditures on campaign contributions and legal fees may generate private benefits for those making the expenditures, if they can persuade policymakers to restrict trade on their behalf,” (Irwin 87). It’s no surprise that when confronted with NAFTA, many politicians ignore trade liberalization. The actions of interest groups brought on by trade barriers are socially unproductive as it redistributes wealth rather than creates it. In *Free Trade Under Fire*, Irwin explains that one study conducted

using 1985 data found that an account of political determinants for barriers to trade estimated a \$50 billion loss in manufacturing and waste in resources (Irwin 87).

The deadweight loss accumulated by domestic industries as a result of increasing protectionism is most prevalent in the current political climate of the United States. One might turn to economic policy under President Donald Trump to see its downfalls. Throughout President Trump's candidacy, he ran on the platform of taking a stern approach with our trading partners in order to revive American industries. The current administration believes the best way to accomplish this goal is through tariffs. Though, soybean farmers in the eastern Dakotas have taken a hard hit as the Chinese government has imposed tariffs on American soybeans in retaliation to threats of \$250 billion in Chinese tariffs. In the *New York Times* article, "Their Soybeans Piling Up, Farmers Hope Trade War Ends Before Beans Rot," author Binyamin Appelbaum states "The latest federal data, through mid-October, shows American soybean sales to China have declined by 94 percent from last year's harvest," (Appelbaum 2018).

In consideration of the current political economy, in an article published by the *Washington Post*, reporter Paige Winfield Cunningham writes that President Trump refuses to support NAFTA on the grounds that it "doesn't live up" to the President's promises of securing employment. However, within the past month the second largest automotive company in the United States, Ford, is preparing to layoff workers as tariffs on steel have cost the company \$1 billion ("Ford Prepares for Mass Layoffs After Losing \$1 Billion to Trump's Trade Tariffs, Report Says" 2018). A report from economists at Morgan Stanley estimate 24,000 of Ford's 202,000 workers worldwide will potentially lose their jobs ("Ford Prepares for Mass Layoffs After Losing \$1 Billion to Trump's Trade Tariffs, Report Says" 2018). One would think

with the repercussions of tariffs it would be the optimal decision to remain under a free trade agreement.

Participating in free trade is the perfect example of how in the state of nature we agree to a mutually beneficial social contract. Locke argues that through this contract we extract potential sovereignty of the community as a way to cultivate common wealth. As described in the *New York Times* article, “Why the US Should Drop All Tariffs,” writer Veronique de Rugy quotes Paul Krugman saying “The economist case for free trade is essentially a unilateral case: A country serves its own interests by pursuing free trade regardless of what other countries may do.” Furthermore, free trade agreements like NAFTA have “ushered in a period of openness in politics and economics that promised to unleash the limitless dynamism and creativity of individuals around the world,” (Anderson 451).

In summary, the North American Free Trade Agreement has been the strongest economic trade policy to be enacted across our continent. NAFTA in its present time has grown to encompass regulatory standards, health and safety rules, investment, banking and finance, intellectual property, labor, and the environment (Rodrik 74). It has liberalized trade by lifting import tariffs on textiles, agriculture, and automobile manufacturing as well as “created dozens of working groups designed to continue the progress initiated by the agreement and identify future areas of progress,” (Anderson 452). The accord aims to achieve a welfare optimum for all members involved. If our country along with Mexico and Canada wishes to continue acquiring the gains from trade, it would only be wise to remain under the free trade agreement.

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Research Question

Dr. Tajali presented to our class that a research question begins with something you have interest in or are curious about. As an economics major, I find the economy to be extremely political, and the perfect context to analyze how the individual takes part in a political system. More specifically, I am most interested in the consumer's welfare, and am curious to know if there could ever be a balance of efficiency and equity,

I was first introduced to this topic when reading scholarship by Dartmouth College Professor, Douglas A. Irwin. Irwin found that the sugar industry in the United States reaps billion dollar profits while consumers bear the burden of high priced goods. Irwin and other scholars attributed this inequity to the well-organized lobbying groups who are able to persuade policy makers to protect their industry with tariffs and gain a greater profit. However, many of the scholars failed to examine ways in which lobbying groups have been helpful to small businesses that more often provide lower prices to consumers. This led me to question ways in which lobbying could be used to simultaneously advocate for the individual consumer and established producers. Therefore, I pose my research question to be: Under what conditions could lobbying practices foster a more equitable share for consumers and producers alike? This question is policy based, and from my point of view is puzzling as very little research addresses how lobbying, typically regarded as a wasted resource, can work in the favor of consumer and producer equity.