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Free Trade

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North Dakota could produce bananas if it really wanted to. Build some greenhouses and bananas will grow. Dole meets Fargo! But at what cost? Common sense tells us that North Dakota should buy bananas from countries like Costa Rica.

Why? Costa Rica has a "**comparative advantage**" over North Dakota in growing bananas. With cheap labor and abundant sunshine, Costa Rica almost certainly can provide North Dakota with cheaper bananas. Most should agree North Dakota should buy its bananas from countries with warm climates and concentrate on activities for which it holds a comparative advantage, like producing oil.

Other examples of comparative advantages are less clear. Let's look at one such example that loomed large in the last Presidential election: U.S. automakers choices about where to locate plants. In theory, this too should be governed by the principle of comparative advantage. In practice, however, it's more complex. Let's have a look.

Imagine a U.S. auto manufacturer decides to close a plant in Michigan and build a new plant in Mexico. They cite cheaper labor and less regulation. They are following comparative advantage to Mexico. Obviously, however, the loss of jobs in Michigan is highly visible. Older workers who have devoted their lives to the company lose high-paying jobs with little prospect of finding replacement jobs of equal pay. Politicians accuse the automaker of "exporting jobs."

But wait. There is a counter-argument whose benefits reach well beyond the affected autoworkers. The cars now manufactured in Mexico will sell In the U.S. at lower prices, benefitting buyers nationwide. The total dollar savings to buyers is likely vastly greater than the wages lost by the displaced auto workers. Across the country, most benefit by a small amount, while a few in Michigan suffer big losses.

But wait again. We can't examine this single case in isolation. With our wide-angle lenses on, we see the obvious: International trade creates jobs in the U.S. Boeing, as one example, has gigantic factories in the U.S., chock full of engineers and highly skilled craftsmen. These factories supply the world with commercial airplanes.

During the Presidential campaign, President Trump focused on one side of the international trade equation, lambasting Mexico and China for their trade surpluses with the U.S. and labeling China a currency manipulator. As he likely knew but chose to ignore in the heat of a Presidential race, the pros and cons of free trade are much more complicated. Yes, American auto workers lose jobs. And yet consumers benefit and the Boeing engineer in aerospace has a high paying job.

So what is really happening? In 2015, the U.S. **exported** goods and services valued at 2,261 billion dollars, and **imported** goods and services valued at 2,762 billion dollars. The U.S. trade deficit -- imports minus exports -- was 525 billion dollars.   This means U.S. exports were 12.6 percent of Gross Domestic Product (GDP), its imports 15.4 percent, and its trade deficit 3.2 percent. Clearly, both exports (think Boeing) and imports (think the car made in Mexico) play a major role in the U.S. economy.

In that same year, Mexico ran a trade **surplus** with the U.S. of 61 billion dollars—the headline number. Less noticed, but even more important in a macro sense, was the fact that Mexico ran a trade **deficit** of 24 billion dollars aggregated over all of its trading partners. Countries will run surpluses with some countries and deficits with others.

President Trump attributed Mexico's surplus primarily to the automobile industry and has applied pressure on the U.S. auto industry to keep manufacturing at home. The important question here is whether or not Mexico is competing on a level playing field. Is Mexico subsidizing its auto industry or undertaking other actions to the disadvantage of the U.S.? If not, Mexico has a comparative advantage and should export autos to the U.S.—good for all consumers even though it means job losses in Detroit.

So is the playing field level for all? Though due to NAFTA virtually all tariffs between the U.S. and Mexico are zero or close to zero, there are still non-tariff trade barriers to a U.S. firm doing business in Mexico: "safety" regulations, ever-changing import regulations, loose enforcement of Intellectual Property laws, etc.

Most economists favor free trade as it leads to the most efficient allocation of resources worldwide. A country maximizes its welfare when it exports goods and services for which it has comparative advantages and imports goods and services for which it does not have comparative advantages. Again, this assumes that domestic and foreign producers compete on a level playing field. This is not always true and the U.S. goal should always be to eliminate barriers and level the playing field.

As comparative advantages change, there will be changes in employment across industries with some gaining jobs and others losing them. This holds even within the U.S. -- think GE moving its corporate headquarters from Connecticut to Massachusetts as Connecticut becomes more hostile to business and loses its comparative advantage. On the aggregate, free trade is good for the U.S. and the government can insert itself with training and unemployment benefits to help mitigate the losses experienced by those who lose their jobs.

North Dakota – stick to oil! To do otherwise would be bananas…..