

# Council for Economics Education



## Council for Economics Education

Illinois not-for-profit corporation

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<http://www.econcouncil.org>

# Free Trade: Important for Us All



DiIMAGE Xi



The Ultimate  
Driving Machine



An enormous number of the products we purchase everyday are imported.



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# Free Trade: Important for US All

- **13% of total purchases in the US are imports** (Federal Reserve, 2002)
- **26% of US companies' profits are a result of overseas sales** (Prudential Securities, 2003).
- **The US is the largest importer and exporter in the world** (Council of Economic Advisers, 1999).



# Benefits of Trade

## Summary of Benefits

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- **Improved productivity**
- **Higher wages**
- **Lower priced goods**



**Higher Standard of Living**

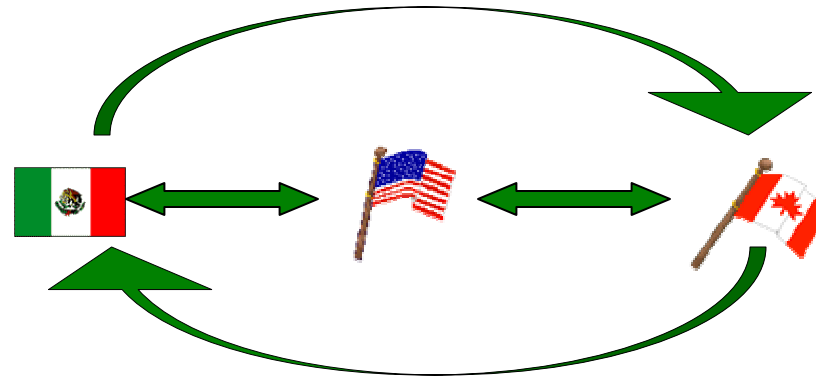
# Test your trade IQ?

## Test Your Trade IQ?

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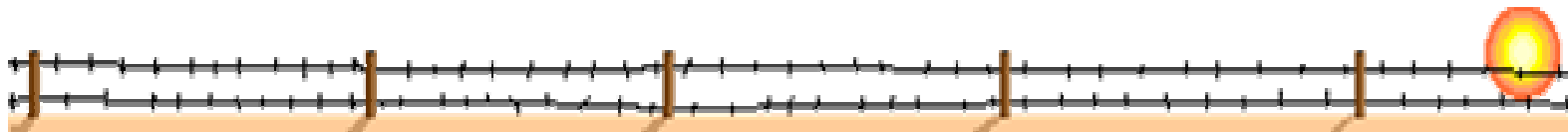
# But what is FREE TRADE?

- **Free Trade:** Freedom to trade internationally without excessive barriers.



# But what are Barriers to Trade?

- **Tariff:** A tax on an imported good.
- **Quota:** A limit on the quantity of imports.
- **Export Subsidy:** A government payment that enables a company to sell their goods at lower price.



# More Definitions

- **Imports:** goods or services purchased from other countries.
- **Exports:** goods or services sold to other countries.
- **Open Economies:** countries that allow free trade.
- **Closed Economies:** countries that do NOT allow free trade.

# Current Trends in Trade

- **Free Trade Grows & Grows**
  - **American tariffs have been reduced from an average of 40% in the 1930s to 3% in 2000** (Council of Economic Advisers, 1999).
  - **The global trade volume has increased 16x since the 1950s** (Council of Economic Advisers, 1999).
  - **The global economy has increased 6x since the 1950s** (OECD, 1998).



# Benefits of Trade

**What are the benefits  
of trade?**

# Benefits of Trade

## Labor Costs

**What country has the highest labor cost? Lowest?**

**Which has highest cost?**

- 1. Japan**
- 2. United States**
- 3. Norway**
- 4. Denmark**

**Which has lowest cost?**

- 1. Korea**
- 2. Mexico**
- 3. Brazil**
- 4. Sri Lanka**

# Benefits of Trade

## Highest Labor Costs

### Which country has highest cost?

- |                         |                 |
|-------------------------|-----------------|
| <b>1. Norway</b>        | <b>\$ 23.13</b> |
| <b>2. Denmark</b>       | <b>\$ 21.98</b> |
| <b>3. United States</b> | <b>\$ 20.32</b> |
| <b>4. Japan</b>         | <b>\$ 19.59</b> |

### Additional Information:

**Average labor cost of 29 foreign countries: \$ 13.61**

Source: U.S. Department of Labor Bureau of Labor Statistics, Sept. 2002

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# Benefits of Trade

## Lowest Labor Costs

Which country has lowest cost?

<b>1. Sri Lanka</b>	<b>\$ 0.48</b>
<b>2. Mexico</b>	<b>\$ 2.34</b>
<b>3. Brazil</b>	<b>\$ 3.02</b>
<b>4. Korea</b>	<b>\$ 8.09</b>

Source: U.S. Department of Labor Bureau of Labor Statistics, Sept. 2002

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# Benefits of Trade

## Job Movement

Barriers to job  
movement lowered



Low productivity jobs  
move to lowest cost area

**Sounds like high cost area loses jobs, right?**

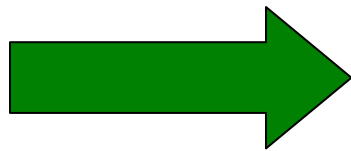
# Benefits of Trade

**Actually, yes and no...**

**High labor cost areas lose some low productivity jobs**

**But,**

**Global costs are lowered for everybody  
stimulating economic growth**



**Creates job growth in both  
low cost and high cost areas**

# Benefits of Trade

## What kind of job growth is created?

- **Low Labor Cost Areas**
  - Lower skilled, manual labor intensive job growth.
  - Typically see rise in wages paid as trade increases.
  - Examples are textiles and manufacturing jobs.
- **High Labor Cost Areas**
  - Higher skilled, higher productivity job growth with higher wages.
  - Examples are operating complicated automated assembly lines and IT jobs.



**Wages Increase Everywhere**

# Benefits of Trade

## Lower Prices

- **Prices of consumer goods are lower in nations without trade barriers due to lower manufacturing costs.**
- **Competition from imported goods limits the ability of companies to raise prices.**
- **Allows consumers to purchase more and have a higher standard of living even if wage growth is flat.**

# Concerns About Free Trade

**Why are some people  
concerned about free trade?**

# Concerns About Free Trade

## The Concern: US Job Loss

*“[NAFTA will result in]...a great sucking sound” Ross Perot, 1993*



### The Theory:

**US companies will move jobs abroad to take advantage of lower labor costs.**

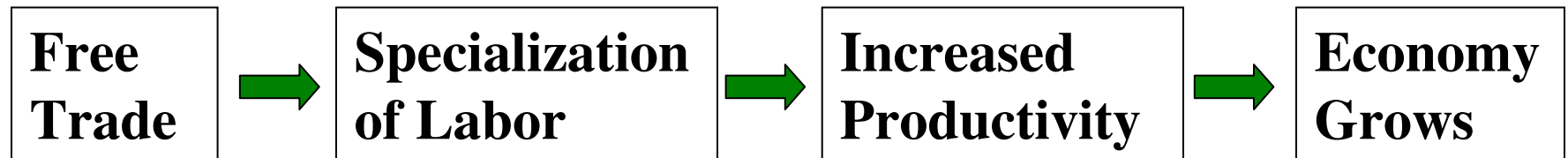


**Increased unemployment**

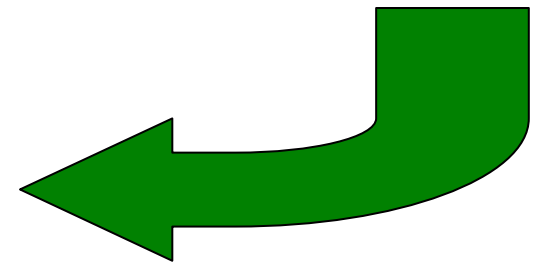
# Concerns About Free Trade

## Reality Check

- Some jobs have been lost to production abroad but ...
- As seen in the previous section on benefits:



**MORE  
JOBS!!!**



# Concerns About Free Trade

## Reality Check

- **Efficiency, Economic Growth, Employment Growth**
  - **Efficiency:** open economies produce more goods per person than closed economies (Gwartney & Larson, 2000).
  - **Economic Growth:** open economies grow 2x as fast as closed economies (Organization for Economic Cooperation and Development, 1998).
  - **Employment Growth: After NAFTA: 1993 –2003**
    - **17 million new jobs created in United States**  
(Bureau of Labor Statistics, 2003).

# Concerns About Free Trade

## The Concern: Lower US Wages

*“... America is becoming a nation of hamburger flippers.”*  
*Ross Perot, 1993*



## Reality Check

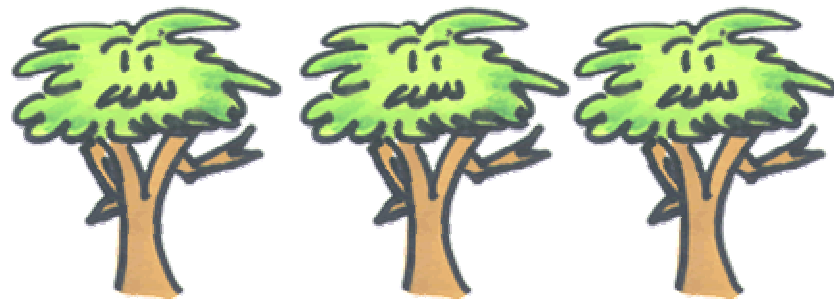
- **81% of new jobs created since 1993 pay above the median wage (US Dept. of Labor, 1999).**
- **From 1975 to 2002 average US wages rose from \$6 to \$20 per hour.**
- **The average pay for non-retail, service positions is 5% greater than that for manufacturing positions (Cox & Alm, 1999).**



# Concerns About Free Trade

## The Concern: Environmental Standards

- Without the threat of trade sanctions developing countries will lower environmental standards to attract foreign investment.
- Increased industrial production will harm the environment.



# Concerns About Free Trade

## Reality Check

- **Countries with lower environmental standards get less foreign investment** (World Economic Forum, 2001).
- **Environmental quality decreases with globalization until per capita (person) income reaches \$5000, then environmental quality increases** (Krueger & Grossman, 94).
- **Globalization spreads the use of pollution reducing technology** (OECD, 1998).



# Concerns About Free Trade

## The Concern:

## Working and Living Standards in Poor Nations

- **Removing the possibility of trade sanctions will allow companies to take advantage of workers in poor nations.**



# Concerns About Free Trade

## Reality Check

- Lower trade barriers increase real wage growth in poorer countries thereby increasing workers' standards of living.
- EXAMPLE:

Mexican wage growth in USD 5 yrs preceding NAFTA = **0.9 %**

Mexican wage growth in USD 5 yrs following NAFTA = **6.0 %**

USD = U.S. Dollars (\$)



Source: U.S. Department of Labor Bureau of Labor Statistics, Sept. 2002

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# Concerns About Free Trade

## More Facts

- Employees at US corporations in developing countries typically earn 8x more than the average salary in their country (Graham Institute for International Economics, 1998).
- A 1% increase in the share of the world's exports for each developing country would lead to a 12% reduction in poverty (Oxfam, 1998).
- “Trade has a much greater potential than aid to benefit the poor.” (Oxfam – an international aid agency, 1998).



# Concerns About Free Trade

## The Concern:

## Manufacturing Capacity will be Reduced

- Manufacturing will be moved abroad leaving the US with less manufacturing capacity hurting our ability for national defense.



# Concerns About Free Trade

## Reality Check

- The % of workers employed in manufacturing has decreased from 30% in 1950 to 14% in 1999 (Alperovitz, 2000).
- Since 1992 manufacturing output has increased 42% (Grizwold, 2000).
- The US is the top exporter of manufactured goods in the world = \$528 billion in 1998 (United Nations, 2000).

