Trade
The Benefits of Free Markets

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Globalization is the spread of human cooperation across the globe. If not hindered by government restraints, this cooperation spreads naturally and without much attention to political boundaries. Geographic and cultural differences, along with differences in currencies and other social institutions, sometimes slow the spread of cross-border economic cooperation. But the single largest obstacle to the spread of human cooperation across political borders is politics—in particular, the difficult-to-resist pressure on each government to protect local producers from the competition of external producers.

We typically think of cooperation as something done consciously, face-to-face, by people who know each other. In this sense, describing globalization as the cross-border spread of human cooperation might sound odd. But what else could we call the coordinated actions of millions of persons from around the globe, each of whom contributes a piece of the knowledge

and some of the effort required to bring to market an ordinary shirt, for example? Assembled in Malaysia using machines made in Germany, cotton grown in India, collar linings from Brazil, and thread from Portugal, and then retailed in Sydney, Montreal, or any other city, today's typical shirt is the product of the efforts of many people worldwide. And remarkably, the cost of a typical shirt is equivalent to the wages earned by an ordinary person in the industrialized world for just a few hours of work. Of course, what is true for a shirt is true for countless products available for sale in modern capitalist countries.

How is it that a typical worker today can easily afford a wide variety of goods and services, the production of which requires the coordinated efforts of millions of workers? The answer is that each of these workers is part of a market so vast that it is worthwhile for many entrepreneurs and investors to organize highly specialized production operations that are profitable only

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because the market for their outputs is large. This specialization of labour and production across different industries around the world is the phenomenon of globalization.

Suppose, for example, that shirts can be made in one of two ways. The first is by hand. It costs a shirt maker using this method—regardless of how many shirts he produces—$250 to produce each shirt. Working full-time producing shirts by hand, the shirt-maker can produce 10 shirts each month. The second way to produce shirts is in a highly mechanized factory. If the factory runs at a peak capacity of a million shirts monthly, each shirt costs $5 to make. But because building and equipping the factory requires a huge initial investment, operating the factory at less-than-full capacity causes the cost of each shirt to rise. The reason for this increase is that producing fewer shirts denies the shirt-maker the opportunity to spread the investment cost over maximum output. The smaller the factory's output, the higher the cost of each shirt.

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Which method of production would a shirt-maker use? The answer depends on the size of his market. If a shirt-maker expected to serve a market of millions of people, he would use the factory method. But if he expected to serve a market of only a few dozen potential customers, he would produce shirts by hand. If each shirt-maker had access only to small markets, the price of shirts would be higher than it would if shirt-makers had access to larger markets. This example provides one important justification for free trade: by expanding markets beyond political boundaries, firms can take better advantage of what economists call "economies of scale" and allow consumers to enjoy lower prices.

Another advantage of specialization is that it allows consumers to enjoy the fruits of resources and talents located far away. Canadians can enjoy pineapple grown in Hawaii while Hawaiians can enjoy maple syrup produced in Canada; the French enjoy financial expertise concentrated in the City of London while Londoners enjoy wines from Burgundy and Bordeaux. Although other factors are always in play, a region's geographical characteristics—for example, its weather, topology, and mineral deposits—and the special talents of its work force determine which goods and services can be produced in that region at the lowest cost—or, as economists say, "at a comparative advantage." The freer the trade, the more likely it is that regions will specialize in producing the goods and services they can produce most efficiently, and then import those things that are produced most efficiently elsewhere.

Free trade gives consumers the opportunity to buy goods and services from the best producers in the world. If shirts could be best produced domestically, then free trade would help to keep those producers profitably in business. Alternatively, if shirts could be best produced abroad, domestic consumers would only have ready access to those shirts through trade. Thus, free trade would encourage inefficient domestic shirt makers to use their talents for the maximum benefit of consumers by switching out of shirt-making and into other productive activities. By directing resources around the world into those tasks that each resource does best,

free trade arranges the world's resources so that they produce the greatest possible output while giving consumers maximum access to this output.

A more fundamental justification for free, globalized markets is that they reduce the number of workers required to produce most types of output and thus make possible the production of goods and services that would otherwise be too costly to produce. Globalized markets also contribute to rising living standards by freeing factory workers to seek higher value jobs and by making labour-saving products and services more affordable.

If every government blocked the importation of foreign-made shirts, each country would require more of its citizens to produce shirts than would be the case under freer trade. Able to serve only the domestic market (which in every case is smaller than the international market), no shirt maker could take advantage of the maximum possible economy of scale in shirt production. Without free trade, shirts would be more expensive and consumers would be denied the opportunity to buy the goods and services that would be available if some domestic shirt-makers were employed in other pursuits.

Free trade also keeps producers disciplined by creating maximum competition for their products. If governments protect domestic firms from the need to match foreign rivals' lower prices or improved quality, consumers suffer as domestic firms lose an important incentive to remain efficient, innovative, and responsive to consumer desires.

It is evident that free trade benefits all those involved, but what if some countries do not want to lower their trade barriers? Would it make sense for Canada, for example, to keep its trade with the world free even if some other governments protected or subsidized their domestic firms? The answer is yes. It always pays for a country to keep its trade free, regardless of other countries' policies. "Retaliating" against non-free trading countries with protectionism and subsidies would only make Canadians poorer, even if other countries did not respond by restricting their own trade even further.

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Unquestionably, the people hurt most by trade barriers are the citizens of countries where such policies exist. Forced to prop up their countries' inefficient producers, citizens of these countries end up paying higher taxes and consumer prices, while enduring reduced access to goods for sale on world markets. That's why restricting trade just because other countries restrict trade is bad policy.

Those who doubt the strength of the theoretical case for free trade should also consider that the empirical evidence in its favour is overwhelming. There is simply no credible evidence to support the belief that restricting trade increases the prosperity of ordinary citizens. All of the evidence points towards the benefits of free trade.

Suggestions for further reading

Boudreaux, Donald (2007). *Globalization*. Greenwood Press.

Irwin, Douglas (2005). *Free Trade Under Fire*. Princeton University Press.

Norberg, Johan (2003). *In Defense of Global Capitalism*. Cato Institute.

Wolf, Martin (2005). *Why Globalisation Work*s. Yale University Press.

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This article was originally published in Fraser Forum in June 2009.