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Op-Ed Contributor: Second Thoughts on Free Trade

By CHARLES SCHUMER and PAUL CRAIG ROBERTS

I was brought up, like most Englishmen, to respect free trade not only as an economic doctrine which a rational and instructed person could not doubt but almost as a part of the moral law," wrote John Maynard Keynes in 1933. And indeed, to this day, nothing gets an economist's blood boiling more quickly than a challenge to the doctrine of free trade.

Yet in that essay of 70 years ago, Keynes himself was beginning to question some of the assumptions supporting free trade. The question today is whether the case for free trade made two centuries ago is undermined by the changes now evident in the modern global economy.

Two recent examples illustrate this concern. Over the next three years, a major New York securities firm plans to replace its team of 800 American software engineers, who each earns about $150,000 per year, with an equally competent team in India earning an average of only $20,000. Second, within five years the number of radiologists in this country is expected to decline significantly because M.R.I. data can be sent over the Internet to Asian radiologists capable of diagnosing the problem at a small fraction of the cost.

These anecdotes suggest a seismic shift in the world economy brought on by three major developments. First, new political stability is allowing capital and technology to flow far more freely around the world. Second, strong educational systems are producing tens of millions of intelligent, motivated workers in the developing world, particularly in India and China, who are as capable as the most highly educated workers in the developed world but available to work at a tiny fraction of the cost. Last, inexpensive, high-bandwidth communications make it feasible for large work forces to be located and effectively managed anywhere.

We are concerned that the United States may be entering a new economic era in which American workers will face direct global competition at almost every job level - from the machinist to the software engineer to the Wall Street analyst. Any worker whose job does not require daily face-to-face interaction is now in jeopardy of being replaced by a lower-paid, equally skilled worker thousands of miles away. American jobs are being lost not to competition from foreign companies, but to multinational corporations, often with American roots, that are cutting costs by shifting operations to low-wage countries.

Most economists want to view these changes through the classic prism of "free trade," and they label any challenge as protectionism. But these new developments call into question some of the key assumptions supporting the doctrine of free trade.

The case for free trade is based on the British economist David Ricardo's principle of "comparative advantage" - the idea that each nation should specialize in what it does best and trade with others for other needs. If each country focused on its comparative advantage, productivity would be highest and every nation would share part of a bigger global economic pie.

However, when Ricardo said that free trade would produce shared gains for all nations, he assumed that the resources used to produce goods - what he called the "factors of production" - would not be easily moved over international borders. Comparative advantage is undermined if the factors of production can relocate to wherever they are most productive: in today's case, to a relatively few countries with abundant cheap labor. In this situation, there are no longer shared gains - some countries win and others lose.

When Ricardo proposed his theory in the early 1800's, major factors of production - soil, climate, geography and even most workers - could not be moved to other countries. But today's vital factors of production - capital, technology and ideas - can be moved around the world at the push of a button. They are as easy to export as cars.

This is a very different world than Ricardo envisioned.

When American companies replace domestic employees with lower-cost foreign workers in order to sell more cheaply in home markets, it seems hard to argue that this is the way free trade is supposed to work. To call this a "jobless recovery" is inaccurate: lots of new jobs are being created, just not here in the United States.

In the past, we have supported free trade policies. But if the case for free trade is undermined by changes in the global economy, our policies should reflect the new realities. While some economists and elected officials suggest that all we need is a robust retraining effort for laid-off workers, we do not believe retraining alone is an answer, because almost the entire range of "knowledge jobs" can be done overseas. Likewise, we do not believe that offering tax incentives to companies that keep American jobs at home can compensate for the enormous wage differentials driving jobs offshore.

America's trade agreements need to to reflect the new reality. The first step is to begin an honest debate about where our economy really is and where we are headed as a nation. Old-fashioned protectionist measures are not the answer, but the new era will demand new thinking and new solutions. And one thing is certain: real and effective solutions will emerge only when economists and policymakers end the confusion between the free flow of goods and the free flow of factors of production.

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