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Trade, education, and innovation: Prospects for the U.S. economy

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Abstract

This paper examines international trade issues as vital indicators of the economic prospects of the United States and other developed economies. In particular, it challenges misuses of the doctrine of mutual gains from trade and instead argues that comparative advantage does not guarantee increases in benefits to both trading partners—especially when one partner seeks to distort the market mechanism in its favor. In the face of such mercantilist or protectionist practices, efforts to advance innovation, without retaining manufacturing jobs, will not ensure continued prosperity, as the number of jobs entailed in the invention process is small compared with the number of jobs associated with manufacturing an innovative product for mass consumption. These matters call for the urgent rethinking of trade policy by the United States and other developed nations, if they are to balance their imports and exports and ensure continued economic growth.

Keywords: Globalization; Free trade; Comparative advantage; China; Innovation; Mutual gains; Trade policy; Mercantilism

1. Introduction

Any considered examination of the prospects for a major economy is dependant, as never before, on that economy's performance in the realm of international trade. In recent decades, traded goods and services have risen from a relatively minor consideration to a critical component

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of any economy, as evidenced by the share of exports in world GDP, which has risen more than thirteen-fold in the last 200 years (Maddison, 1995, p. 38). Considering how rapidly GDP itself has increased over this period, we can conclude that the absolute value of exports has exploded.[1] At the same time, breakthroughs, such as containerization, have drastically reduced the cost and time entailed in the global transportation of goods. Moreover, the Internet now makes it possible for many services to be outsourced to almost any location in the world. This paper, consequently, turns to international trade issues as vital indicators of the economic prospects of the United States and a number of other wealthy nations.

2. On rivalrous policies in international trade

Half a century has passed since the flowering of the literature on optimal trade tariffs. But it must not be forgotten that the tariffs in question were "optimal" not in terms of their contribution to the general welfare but, rather, in terms of their effectiveness in promoting the interests of the countries that adopted them—often at the expense of their trading partners. Today this observation remains pertinent, even though subtler instruments and even happenstance have replaced some of the cruder trade restrictions as the vehicles of choice for the delivery of added gains to one country, at the disadvantage of another. Nevertheless, many of our colleagues, having been nurtured on the doctrine of mutual gains from trade, seem to resist serious consideration of these possibilities and the threat they pose to the welfare of the United States and other countries.

The discussion that follows will raise questions that are clearly pertinent about a number of the received orthodoxies in the field of international trade economics—questions whose answers have profound implications for the prospects of the U.S. economy. Among other contentions, we will argue that comparative advantage does not imply that the gains from trade—or, more specifically, gains from the enhanced productivity of one of two trading partners—ensure increases in benefits that are *mutual*. Moreover, we will argue that U.S. efforts to counter trading partners' gains by dominating the field of innovation provide no guarantee against the threats to U.S. welfare posed by such trading partners. In particular, we will contend that a primary reason these matters are overlooked in much of the literature is inattention to the role of demand in comparative advantage theory and related analysis. Thus, as we will argue, these matters urgently call for the rethinking of U.S. trade policy, particularly where steps have been taken by some of America's trading partners to distort the market mechanism in their favor.

3. On comparative advantage and its misunderstandings: the fallacy of composition

The "law" of comparative advantage is unquestionably a brilliant contribution to the trade literature. Indeed, even now, a careful reading of Ricardo's discussion confirms that he understood the story quite correctly. However, some of his successors occasionally have gone either somewhat astray or, at best, have not recounted his ideas carefully, thereby introducing distortions and inaccuracies.

[1] Indeed, Angus Maddison (1995) has estimated that real world GDP underwent a 40-fold increase between 1820 and 1992, while the value of exports underwent something like a 550-fold increase during that period.