



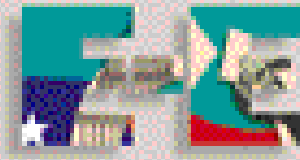
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Dwight R. Lee received his Ph.D. from the University of California, San Diego in 1972. He has been the Ramsey Professor of Economics and Private Enterprise since 1985. Professor Lee has published hundreds of articles in academic journals and magazines and has co-authored eight books. His research areas include economics of the environment and natural resources, political decision making, public finance, law, and labor economics.

ECONOMISTS ASSUME THAT PEOPLE ARE motivated primarily by the desire to improve their situations. But they also recognize that most people enjoy helping others, especially those less fortunate than they are. For example, Adam Smith began his first book, *The Theory of Moral Sentiments* with the sentence, “How selfish soever man may be supposed to be, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it.”

Given our desire to do well ourselves, and our noble concern for the well-being of others, most people should favor a policy that increases the prosperity of Americans and helps those in other countries, especially poorer ones. There is such a policy, but many oppose it because they don’t understand basic economics. The policy is international trade—letting Americans buy, without restrictions, products made in other countries.



Many people fear that unrestricted international trade would destroy American jobs as we began buying more products made by foreign workers who are paid much less than domestic workers. Either American jobs would be eliminated, or wages here would have to drop to foreign levels for our workers to keep their jobs.

The argument that high-paid American workers couldn't compete against low-paid foreign workers may seem plausible, but it cannot stand up to economic analysis. Trading with other countries, even those with very low wages, increases wages both here and abroad by creating more productive jobs everywhere. This result may sound surprising, but it follows directly from a fact of life with which we are all familiar—scarcity. Scarcity results from our inability to produce as many desirable things as we want. Our ability to produce more is limited, our ability to want more is not.

The implications of scarcity are directly relevant to understanding the value of international trade. Most obviously, producing more of one thing uses resources that could have been used to produce more of something else. We cannot do anything without sacrificing something else, which explains why economists are always saying, “There is no such thing as a free lunch.” Everything we do comes at a cost—an opportunity cost—which equals the value of what is sacrificed.

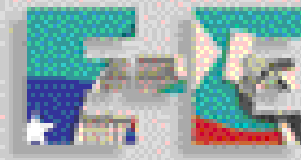
Another implication of scarcity is that we are better off getting more of what we value with less effort. This seems obvious, but many people have resisted technological advances that increase productivity by arguing that they eliminate jobs. However, we would like far more jobs done than we have people to do them. So when more can be produced with fewer jobs, more people are available to do other jobs producing valuable things we previously did without. For example, in 1900 almost half

the labor force was required to produce our food. Because of technological progress, our food can now be produced with about 3 percent of the labor force, and we are far better off as a result. The people no longer needed on the farm aren't unemployed. They are producing many valuable products we wouldn't have if they were still farming.

These implications of scarcity, as simple as they are, explain why international trade benefits all countries and improves employment opportunities everywhere. The concept of opportunity cost explains why all countries can have more when each specializes in producing some goods and exchanges them for goods produced in other countries. Trade has the same effect as technological progress, letting people have more for less; workers no longer needed in some jobs can create even more value in others.

The key concept for understanding the gains from international trade is comparative advantage, which follows directly from opportunity cost. A country has a comparative advantage in a product when it can produce it at less cost than other countries. This sounds simple, but it leads to a surprising conclusion—no matter how productive a country is, it cannot have a comparative advantage in producing everything, and no matter how unproductive a country is, it has a comparative advantage in producing some things.

To illustrate, let's make the unrealistic assumption that a country can produce all goods with fewer resources than can any other country. That country would have an absolute advantage in producing all goods. But it would still pay such a country to trade with other countries because, no matter how large its absolute advantages are, it cannot have a comparative advantage in producing everything. A simple example shows why.



Consider a two-good, two-country world, with America and India producing cars and computers. To keep it really simple, assume that labor is the only productive input. Assume 1,000 computers a month can be produced in America with 10 workers, and only 250 computers a month can be produced in India with 10 workers. Finally, assume 100 cars a month can be produced in America with 10 workers, and only 50 cars a month can be produced in India with 10 workers. This information is summarized in the following table.

	<u>Computers/10 workers</u>	<u>Cars/10 workers</u>
America	1,000	100
India	250	50

America obviously has an absolute advantage producing both computers and cars, but not a comparative advantage. The opportunity cost of producing cars in America is greater than producing them in India. As the table shows, it costs 10 computers to produce a car in America, but only 5 to produce a car in India. So India has a comparative advantage in making cars. But America has a comparative advantage in making computers since it costs only 100 cars to make 1,000 computers in America, while it costs 200 cars to make 1,000 computers in India.

Both America and India can do better by specializing in their comparative advantage and trading with each other. If America offers India computers at the price of

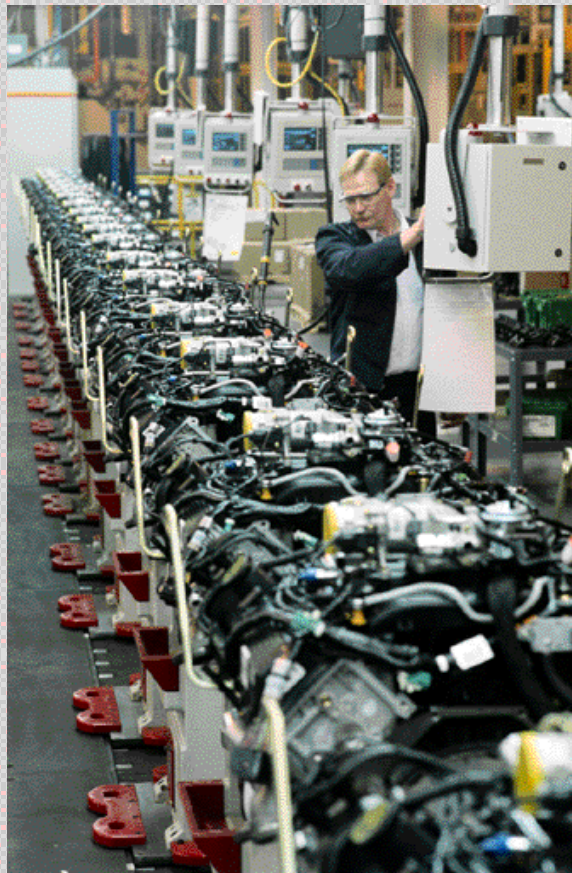
1,000 computers for 150 cars, America gets 150 cars by giving up 1,000 computers instead of only 100 cars if it doesn't trade. And India can get 1,000 computers by giving up 150 cars instead of only 750 computers if it doesn't trade.

While many people are surprised by the result of comparative advantage when applied to international trade, they understand it perfectly well at the individual level. For example, no one thinks it would make sense for Tiger Woods to moonlight as a caddy, even though he could be one of the best caddies in the world—who could give you better advice on which club to use, the right way to grip the

club, and how to line up a putt? But because he is the best golfer in the world, the opportunity cost of working as a caddy would be enormously high for him—his comparative advantage is in playing golf. Woods is better off specializing in golf and hiring a caddy who, though not as good a caddy as Woods, has a comparative advantage over him at caddying.

But when we buy products from other countries, don't we reduce job opportunities in America? Not unless scarcity has been eliminated and everyone has as much of everything as they want. But we all want more,

and when some American jobs are eliminated because we buy products that can be made more cheaply abroad, we release workers to





produce more of the products that we can make more cheaply.

So international trade directs workers into jobs in which they have a comparative advantage—in which they are most productive. The result is higher pay for American workers, not lower pay which many fear. Productivity and pay go together, so restrictions on international trade lower American wages because they keep our workers in jobs in which they are less productive.

It is not just Americans' demand for more that guarantees international trade improves job opportunities for American workers: People in countries we trade with also want more. They aren't selling us their products because they want our money, but because they want the things they can buy with that money.

Eventually the money we pay for foreign goods increases the demand for American goods. It's unfortunate for us that buying foreign-made goods doesn't eliminate American jobs, since this would mean that they kept our money instead of buying the products we have to make with our sweat and toil. That would be the equivalent of buying all we want with checks that are never cashed.

Uncashed checks are more than we can hope for from international trade. But Americans realize enormous benefits from such trade, and the fewer restrictions on that trade, the greater the benefits. Trade is even better for small countries that, unlike America, don't have a large internal market and a diverse and abundant resource base. They can produce efficiently only by specializing in a very few goods, and that is impossible without trade with other countries. So we can greatly help people in small, and often poor, countries with international trade, while improving our own well-being as well.

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