

David R. Henderson

Why Trade Should Be Free

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This ebook presents an economic case for free trade, originally written during the 2024 U.S. presidential election when both candidates Donald Trump and Kamala Harris advocated for trade restrictions and tariffs.

Henderson directly addresses common criticisms of free trade, particularly job displacement and trade deficits, by explaining how displaced workers find employment elsewhere, how trade deficits correspond to capital surpluses, and how technological change drives most employment shifts. The work explains fundamental concepts like comparative advantage, showing how countries benefit by specializing in goods where they have cost advantages while importing items other nations produce more efficiently.

The analysis establishes basic free market principles, demonstrating how voluntary trade benefits both parties and how tariffs primarily burden domestic consumers rather than foreign producers.

While the specific electoral context has passed, the fundamental economic principles and policy debates examined remain highly relevant to ongoing discussions about international trade policy.

ONE OF THE GLOOMIER ITEMS IN THE CURRENT

presidential election is the extent to which both major candidates, Donald Trump and Kamala Harris, oppose free trade and favor tariffs. Trump is much more extreme. He advocates a 60 percent tariff rate on goods from China and a 10 to 20 percent rate on goods from other countries. Harris wants selective tariffs to steer the US economy in directions that she and her advisers think are good.

Unfortunately, neither candidate seems to understand the case for free trade and the case against protectionism. They are not alone. Many of the candidates' supporters don't understand either. So, it's a good time to lay out the case for free trade.

I'll state it briefly here. Free trade causes us to produce the goods and services in which our producers have a comparative advantage, which is really nothing more than a cost advantage, and to buy the goods and services for which producers in other countries have a comparative (or cost) advantage. Moreover, those who worry about a trade deficit need to realize that the counterpart



is a capital surplus. The larger our trade deficit, the greater is the net amount of foreign capital coming into our country.

WHAT IS COMPARATIVE ADVANTAGE?

As noted above, a comparative advantage is the same as a cost advantage. If you or your company has a comparative advantage in producing cars, it means that the other person or firm is a higher-cost producer.

What do we in America have a comparative advantage at producing? We could do a detailed look at costs of producing various items. That would require getting lots of data both from the United States and from producers in other countries.

But there's a simpler way to do it. Look at the goods we produce and export. If we export them, that means that "we" (actually, our producers) produce at a lower cost than producers in other countries.

In 2023, [the top four categories of US exports](#) of goods were re-exports, which are goods that were imported and then exported (\$328.4 billion), chemicals (\$261.2 billion), transportation equipment (\$256.8 billion), and mining (\$204.5 billion.) Also substantial, although lower on the list than I had expected, were agricultural products at \$94.7 billion.

What goods and services do we have a comparative, or cost, disadvantage in? Again, all we must do is to look at the goods that we import.

In 2023, the [top four categories of US imports of goods](#) were



transportation equipment (\$484.6 billion), computers and electronic products (\$457.8 billion), chemicals (\$345.9 billion), and machinery other than electrical (\$243.4 billion.)

GAINS FROM TRADE

We can be confident that the people engaged in trade, whether as buyers or sellers, gain from it. Otherwise, they wouldn't trade. Everyone understands that at the local level. When you go to the supermarket to buy watermelon or steak and you actually buy it, you gain. If you didn't gain, you wouldn't buy it. And we don't count it a success if we consistently come back from the supermarket emptyhanded. Of course you would prefer that, for a given quality, the steak be cheaper, but you gain nevertheless. Almost everyone seems also to understand that if you, sitting in California, buy something produced and shipped from New York, you gain.

The same principle applies to buying goods from other countries. Both sides gain. Yet somehow, the existence of an international border seems to cause confusion for many observers. I hasten to add that they aren't typically confused in their own economic lives: many people who rail against imports still buy them. But they often think that there's a special problem when we buy from people in other countries.

Let's bring in Adam Smith, who pointed out the gains from trade in a way that still stands today. In *The Wealth of Nations*, Smith wrote:



What is prudence in the conduct of every private family can scarce be folly in that of a great kingdom. If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry employed in a way in which we have some advantage.

THE DOWNSIDE OF FREE TRADE—AND THREE RESPONSES

In the section above, I stated that people often think that “there’s a special problem when we buy from people in other countries.” In a sense, that’s true. If you buy a low-end toaster, [chances are that it’s made in China](#). Buying one from China means that you’re not buying one made anywhere else, including in America. So, Americans who might have produced toasters here, admittedly at a much higher cost, don’t get those jobs.

But there are three important responses to that point. First, workers who don’t produce toasters here produce other goods or services. Our current unemployment rate, U-3, which is a measure of people who are out of work and looking for work, is a low [4.1 percent](#). Moreover, the ratio of the number of job openings to the number of unemployed workers is [1.1](#). There are more jobs vacancies than there are unemployed people.

Second, there is nothing special about the fact that the



toaster is produced in another country. If I buy GAF shingles produced in Baltimore, Maryland, rather than Owens Corning shingles made in Portland, Oregon, I help to employ someone in Baltimore instead of someone in Portland. But we don't hear a lot of upset about that.

You might say that's because at least either way I'm employing a worker in America. So, it comes down to jobs. But then go back to my first point. American residents who don't have jobs producing toasters do get jobs producing other things.

The third point is that most people exaggerate the number of jobs lost to imports and fail to understand the number of jobs lost to technological innovation. Our manufacturing output is only [6.4 percent below its all-time high](#), which was in 2007. We aren't "deindustrializing." Instead, our industrial sector, due to improved technology, is becoming more productive. Manufacturing employment is [33.9 percent below its peak](#) in 1979. Moreover, manufacturing employment as a percent of all employment, which hit its peak in December 1943 at 38.7 percent and its postwar peak in September 1948 at 31.9 percent, is now 8.1 percent.

TECHNOLOGICAL CHANGE: WHY WE HAVE STARBUCKS

Indeed, most shifts in employment are caused by technological change. When I was a full-time economics professor at the Naval Postgraduate School, I taught this point by showing the students a table of the number of US long-distance phone



calls made in 1970 (9.8 billion) and 1996 (94.9 billion), along with the number of calls per day per operator (64 in 1970 and 1,585 in 1996). I told them that I wouldn't reveal the title of the table until we were finished. I also showed the amount of time a typical worker needed to work to pay for a five-minute call ($2/3$ of an hour in 1970 versus $1/8$ of an hour in 1996). The difference is due to technological change, which automated the process and saved on operator time. I then showed them the number of operators who would have been required to handle the number of calls made in 1996 if there had been no technological change versus the actual number required: 4.1 million operators versus the actual 164,000. (Of course, this is a little artificial: if the technological change hadn't occurred, the price wouldn't have fallen, and people would have made way fewer than 94.9 billion calls. But I was making a broader point.)

I then told them the title of the table: *Why We Have Starbucks*. I pointed out that a lot of the people who would have had jobs as telephone operators if technological improvements hadn't occurred were freed up to get jobs at Starbucks, Peet's, and other coffee shops.

That's the story of technological change. It also explains how we get increasing well-being. We produce more and more using the same number of people. If we didn't, an economy would stagnate.



THE EFFECTS OF TARIFFS

That brings us to tariffs.

I wrote above that we can know what goods we have a cost advantage in by looking at the goods we export and what goods we have a cost disadvantage in by looking at the goods we import. That's roughly, but not exactly, correct. The reason is tariffs and other trade restrictions.

Consider light trucks. In 1964, to retaliate against the French and West German governments' imposition of a tariff on US chicken, President Lyndon B. Johnson imposed a 25 percent tariff on light trucks. It was supposed to be temporary. It is still with us.

As a result, many light trucks are produced here rather than in other countries. It's not clear that our producers have a comparative advantage in producing light trucks. Evidence that they don't is the fact that [producers in other countries sometimes ship the parts here](#) and then have them assembled in the United States. Without the tariff, they might well produce the whole truck in their countries rather than in the United States.

The good news is that because foreign producers have found ways around the tax, light trucks are cheaper than if they hadn't found those ways. The bad news is that light trucks are more expensive for US buyers than they would be without this tax.



THE ONCE AND FUTURE TARIFFS

During his administration, President Donald Trump imposed higher tariffs on both consumer goods and inputs used in their production. President Biden, whom many economists expected to end or reduce those tariffs, kept them.

Now candidate Trump is proposing a 60 percent tariff on goods from China and a 10 to 20 percent tariff on goods from other countries. If Trump wins the 2024 election, which looks likely, and if he were to follow through on these proposals, US tariffs on imports would be higher than they have been in [over a century](#). They would be more than five times their current average rate on all imports, which the [Tax Foundation estimates](#) to be about 2 percent.

One result would be that many of our goods would be more expensive than before. Trump vehemently denies this. He claims that the whole burden of the tax would be on the foreign producers and that none would be on US consumers.

But a well-established conclusion in economics is that who actually pays a tax depends on the relative elasticities of supply and demand. Let's translate the economics. If buyers have many close alternatives, at close to the same price, to the good offered by the seller and the seller has few alternative outlets to sell to, then a tax on the good will be paid mainly by the seller. But if buyers have few alternatives to the good offered by the seller, or have alternatives that are substantially more expensive, and the seller has many other potential buyers to sell to, then a tax



on the good will be paid mainly by the buyer. Trump seems to be assuming that we have lots of alternatives to imports that are almost as cheap as the imports he would tax. He has never even tried to give a basis for his assumption and may not even know that that's what he's assuming.

The bottom line is that we Americans would bear a substantial percent of the burden of Trump's proposed tariffs. That means that, all other things equal, his tariffs would make us poorer than we would be without them.

A TRADE WAR?

I haven't even factored in the likelihood of a trade war. Once other governments see the US government raising tariffs, some are likely to follow suit. They won't make themselves better off by taxing their citizens' purchases in response to the US government's taxing of American citizens' purchases. But they will impose hurt on US exporters.

This happened in the 1930s in response to the infamous Smoot-Hawley tariffs imposed in 1930 while Herbert Hoover was president. Other countries responded by imposing tariffs. There's one big difference: international trade was much less important then. In 1929, imports were only 4.1 percent of GDP. (I make this point in my review of Douglas A. Irwin's excellent 2011 book, *Peddling Protectionism: Smoot-Hawley and the Great Depression*.) And the tariffs were imposed on only one-third of imports by value, meaning only 1.4 percent of GDP. By contrast, US imports of goods and services today are a [hefty](#)



[13.9 percent of GDP](#) and exports are [10.9 percent of GDP](#). A trade war today could do much more harm.

THE BALANCE OF PAYMENTS

Notice that US imports exceed exports by 3 percent of GDP. This trade deficit upsets a lot of people. But there is nothing worrying per se about a trade deficit. In a broader sense, there can't be an overall deficit. When we spend more on imports than foreigners spend on our exports, foreigners end up with dollars that they use to buy US government bonds, other US bonds, or US plant and equipment, or they directly invest in the United States or hold some of these dollars. The last is particularly sweet for us. To the extent those dollars stay out of the country, our inflation rate is that much lower. If the Federal Reserve wants more inflation, it can print more dollars. The cost of printing each \$100 bill is less than 10 cents, meaning that for each \$100 bill foreigners accept as payment and then hold, we get \$100 worth of imports in return for less than 10 cents. What a deal! It reminds me of the [1989 Jay Leno ad for Doritos](#): "Crunch all you want; we'll make more."

One person who wants more foreign investment is Donald Trump. [In his recent appearance before the Economic Club of Chicago](#), Trump said he wants to impose high tariffs so that foreign firms will move their production to the United States. In other words, he wants more foreign direct investment.

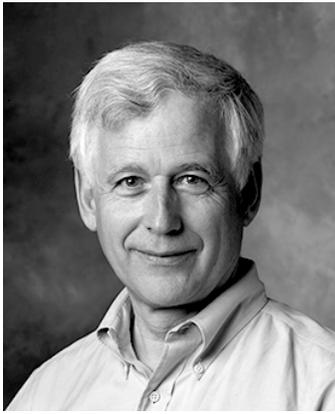
Note the irony. Donald Trump doesn't like large trade deficits. But he does like lots of foreign direct investment. He can't



have both.

The case for free trade, which economists have been making for well over two centuries, is strong. Free trade makes the vast majority of people in the countries that engage in it better off. High tariffs, in contrast, enrich the few at the expense of the many.





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He is the editor of *The Concise Encyclopedia of Economics*, coauthor of *Making Great Decisions in Business and Life*, and author of *The Joy of Freedom: An Economist's Odyssey*. A former senior economist with the President's Council of Economic Advisers, Henderson has written for *The Wall Street Journal*, *Fortune*, and other major publications. Born in Canada, he earned his Ph.D. in economics from UCLA.



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