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## The Virulence of Free Trade

Ramsi Woodcock

*University of Kentucky Rosenberg College of Law, [ramsi.woodcock@uky.edu](mailto:ramsi.woodcock@uky.edu)*

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# The Virulence of Free Trade

Ramsi Woodcock — 31 March 2020



*[TOTM: The following is part of a blog series by TOTM guests and authors on the law, economics, and policy of the ongoing COVID-19 pandemic. The entire series of posts is available [here](#).*

*This post is authored by [Ramsi Woodcock](#), (Assistant Professor of Law, University of Kentucky; Assistant Professor of Management, Gatton College of Business and Economics).]*

Specialists know that the antitrust courses taught in law schools and economics departments have an alter ego in business curricula: the course on business strategy. The two courses cover the same material, but from **opposite perspectives**. Antitrust courses teach how to end monopolies; strategy courses teach how to construct and maintain them.

Strategy students go off and run businesses, and antitrust students go off and make government policy. That is probably the proper arrangement if the policy the antimonomolists make is domestic. We want the domestic economy to run efficiently, and so we want domestic policymakers to think about monopoly—and its allocative inefficiencies—as something to be discouraged.

The coronavirus, and the shortages it has caused, have shown us that putting the antimonomolists in charge of international policy is, by contrast, a very big mistake.

Because we do not yet have a world government. America's position, in relation to the rest of the world, is therefore more akin to that of a business navigating a free market than it is to a government seeking to promote efficient interactions among the firms that it governs. To flourish, America must engage in international trade with a view to creating and maintaining monopoly positions for itself, rather than eschewing them in the interest of realizing efficiencies in the global economy. Which is to say: we need strategists, not antimonomolists.

For the global economy is not America, and there is no guarantee that competitive efficiencies will redound to America's benefit, rather than to those of her competitors. Absent a world government, other countries will pursue monopoly regardless what America does, and unless America acts strategically to build and maintain economic

power, America will eventually occupy a position of commercial weakness, with all of the consequences for national security that implies.

## When Antimonopolists Make Trade Policy

The free traders who have run American economic policy for more than a generation are antimonopolists playing on a bigger stage. Like their counterparts in domestic policy, they are loyal in the first instance only to the efficiency of the market, not to any particular trader. They are content to establish rules of competitive trading—the antitrust laws in the domestic context, the World Trade Organization in the international context—and then to let the chips fall where they may, even if that means allowing present or future adversaries to, through legitimate means, build up competitive advantages that the United States is unable to overcome.

Strategy is consistent with competition when markets are filled with traders of atomic size, for then no amount of strategy can deliver a competitive advantage to any trader. But global markets, more even than domestic markets, are filled with traders of macroscopic size. Strategy then requires that each trader seek to gain and maintain advantages, undermining competition. The only way antimonopolists could induce the trading behemoth that is America to behave competitively, and to let the chips fall where they may, was to convince America voluntarily to give up strategy, to sacrifice self-interest on the altar of efficient markets.

And so they did.

Thus when the question arose whether to permit American corporations to move their manufacturing operations overseas, or to permit foreign companies to leverage their efficiencies to dominate a domestic industry and ensure that 90% of domestic supply would be imported from overseas, the answer the antimonopolists gave was: “yes.” Because it is efficient. Labor abroad is cheaper than labor at home, and transportation costs low, so efficiency requires that production move overseas, and our own resources be reallocated to more competitive uses.

This is the impeccable logic of static efficiency, of general equilibrium models allocating resources optimally. But it is instructive to recall that the men who perfected this model were not trying to describe a free market, much less international trade. They were trying to create a model that a central planner could use to allocate resources to a state’s subjects. What mattered to them in building the model was the good of the whole, not any particular part. And yet it is to a particular part of the global whole that the United States government is dedicated.

## The Strategic Trader

Students of strategy would have taken a very different approach to international trade. Strategy teaches that markets are dynamic, and that businesses must make decisions based not only on the market signals that exist today, but on those that can be made to exist in the future. For the successful strategist, unlike the antimonopolist, identifying a product for which consumers are willing to pay the costs of production is not alone enough to justify bringing the product to market. The strategist must be able to secure a source of supply, or a distribution channel, that competitors cannot easily duplicate, before the strategist will enter.

Why? Because without an advantage in supply, or distribution, competitors will duplicate the product, compete away any markups, and leave the strategist no better off than if he had never undertaken the project at all. Indeed, he may be left bankrupt, if he has sunk costs that competition prevents him from recovering. Unlike the economist, the strategist is interested in survival, because he is a partisan of a part of the market—himself—not the market entire. The strategist understands that survival requires power, and all power rests, to a greater or lesser degree, on monopoly.

The strategist is not therefore a free trader in the international arena, at least not as a matter of principle. The strategist understands that trading from a position of strength can enrich, and trading from a position of weakness can impoverish. And to occupy that position of strength, America must, like any monopolist, control supply.

Moreover, in the constantly-innovating markets that characterize industrial economies, markets in which innovation emerges from **learning by doing**, control over physical supply translates into control over the supply of inventions itself.

The strategist does not permit domestic corporations to offshore manufacturing in any market in which the strategist wishes to participate, because that is unsafe: foreign countries could use control over that supply to extract rents from America, to drive domestic firms to bankruptcy, and to gain control over the supply of inventions.

And, as the new trade theorists **belatedly discovered**, offshoring prevents the development of the dense, geographically-contiguous, supply networks that confer power over whole product categories, such as the electronics hub in Zhengzhou, where iPhone-maker Foxconn is located.

Or the **pharmaceutical hub** in Hubei.

## Coronavirus and the Failure of Free Trade

Today, America is unprepared for the coming wave of coronavirus cases because the antimonopolists running our trade policy do not understand the importance of controlling supply. There is a shortage of masks, because China makes half of the world's masks, and the Chinese have **cut off supply**, the state having forbidden even non-Chinese companies that offshored mask production **from shipping home** masks for which American customers have paid. Not only that, but in January China **bought up** most of the world's existing supply of masks, with free-trade-obsessed governments standing idly by as the clock ticked down to their own domestic outbreaks.

New York State, which lies at the epicenter of the crisis, has agreed to pay **five times** the market price for foreign supply. That's not because the cost of making masks has risen, but because sellers are rationing with price. Which is to say: using their control over supply to beggar the state. Moreover, domestic mask makers report that they cannot ramp up production because of a lack of supply of raw materials, some of which are **actually made** in Wuhan, China. That's the kind of problem that does not arise when restrictions on offshoring allow manufacturing hubs to develop domestically.

But a shortage of masks is just the beginning. Once a vaccine is developed, the race will be on to manufacture it, and America controls **less than 30%** of the manufacturing facilities that supply pharmaceuticals to American markets. Indeed, just about the only virus-relevant industries in which we do not have a real capacity shortage today are **food** and **toilet paper**, panic buying notwithstanding. Because fortunately for us antimonopolists could not find a way to offshore California and Oregon. If they could have, they surely would have, since both agriculture and timber are labor-intensive industries.

President Trump's **failed attempt** to buy a German drug company working on a coronavirus vaccine shows just how damaging free market ideology has been to national security: as Trump should have anticipated given his resistance to the antimonopolists' approach to trade, the German government **nipped** the deal in the bud. When an economic agent has market power, the agent can pick its prices, or refuse to sell at all. Only in general equilibrium fantasy is everything for sale, and at a competitive price to boot.

The trouble is: American policymakers, perhaps more than those in any other part of the world, continue to act as though that fantasy were real.

## Failures Left and Right

America's coronavirus predicament is rich with intellectual irony.

Progressives resist free trade ideology, largely out of concern for the effects of trade on American workers. But they seem not to have realized that in doing so they are actually embracing strategy, at least for the benefit of

labor.

As a result, progressives simultaneously reject the approach to industrial organization economics that underpins strategic thinking in business: Joseph Schumpeter's theory of creative destruction, which holds that strategic behavior by firms seeking to achieve and maintain monopolies is ultimately good for society, because it leads to a technological arms race as firms strive to improve supply, distribution, and indeed product quality, in ways that competitors cannot reproduce.

Even if progressives choose to reject Schumpeter's argument that strategy makes society better off—a proposition that is particularly suspect at the international level, where the availability of tanks ensures that the creative destruction is not always creative—they have much to learn from his focus on the economics of survival.

By the same token, conservatives **embrace** Schumpeter in arguing for less antitrust enforcement in domestic markets, all the while **advocating free trade** at the international level and savaging governments for using dumping and tariffs—which is to say, the tools of monopoly—to strengthen their trading positions. It is deeply peculiar to watch the coronavirus expose conservative economists as pie-in-the-sky internationalists. And yet as the global market for coronavirus necessities seizes up, the ideology that urged us to dispense with producing these goods ourselves, out of faith that we might always somehow rely on the support of the rest of the world, provided through the medium of markets, looks pathetically naive.

The cynic might say that inconsistency has snuck up on both progressives and conservatives because each remains too sympathetic to a different domestic constituency.

## Dodging a Bullet

America is lucky that a mere virus exposed the bankruptcy of free trade ideology. Because war could have done that instead. It is difficult to imagine how a country that cannot make medical masks—much less a **Macbook**—would be able to respond effectively to a sustained military attack from one of the **many** nations that are closing the technological gap long enjoyed by the United States.

The lesson of the coronavirus is: strategy, not antitrust.

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### Ramsi Woodcock

#### Posts

Ramsi Woodcock is an assistant professor of law at the University of Kentucky's Rosenberg College of Law and an assistant professor of management at UK's Gatton College of Business and Economics.