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Free Enterprise: Choosing to 'Buy American' will cost you

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The debate has raged ever since this year's gigantic stimulus bill has been known to include "Buy American" provisions.

Although the language was tamed - to comply with international trade treaties - before it was reported out of Congress, it still effectively requires publicly financed projects to use iron and other goods made in the U.S.

As many economists had cautioned at the time, such populist provisions not only are seldom effective, but they also tend to inspire vicious circles of countermeasures and counter-countermeasures from nations that feel targeted by protectionist policies.

Moreover, in recent months Congress has quietly passed or proposed other bills that include "hidden" riders telling businesses working on taxpayer-financed projects where to buy (more expensive) inputs.

What is often lost in the debate is the fact that shutting out foreign competition tends to regularly impose a burden on consumers due to domestic prices that are liable to rise. Free trade and free enterprise, after all, are based on the notion of consumer sovereignty, which forces producers to heed their customers' wishes.

Imposing trade barriers and walling off markets inhibits or destroys this corrective process.

Recriminations have already started.

Not only are major trading partners of the U.S. currently debating how to respond in kind, but stories also abound about domestic employers that are struggling to comply with the "Buy American" conditions for receiving stimulus money and, as a result, having to lay off (American!) workers in the process.

Even more disconcerting is the fact that states and municipalities have found a renewed hunger for local purchasing, jumping on the "we first" bandwagon, no matter the likely efficiency losses in utilizing already-shrinking public budgets.

This type of "no matter the cost" attitude in order to gain a short-term, feel-good experience clearly is neither in the interest of workers nor taxpayers. Studies have shown that "unfree-trade" policies regularly end up costing more jobs than they (purportedly) protect. It will not be different this time unless the race for setting trade barriers is stopped in its tracks.

One frequently cited "Policy Brief" recently written by two senior fellows of the Peterson Institute for International Economics (available at http://tinyurl.com/aa2yjq [1]) concludes that "the Buy American provisions could well cost jobs if other countries emulate U.S. policies."

Interestingly, just in time to enliven the debate even more, an academic paper by three economists from the University of Michigan and the University of North Carolina Chapel Hill has a different take on the "Buy American" idea.

In "Foreign Ownership and Firm Performance" (available at http://tinyurl.com/r9rf4a [2]), the authors "... evaluate the post-acquisition performance of publicly traded U.S. firms that have been acquired by firms from emerging markets over the period 1980-2007."

They conclude that the profitability of these firms after the takeover by international investors increases on average, enabling firms to weather the vagaries of the business cycle.

There are other beneficial examples of behavior that could be described with the phrase "Buy American." Warren Buffet's exhortation from last October comes to mind, when he urged investors to buy American stocks. He was writing "Buy American. I am."

However, the protectionist variation of that theme should be banned from the political discourse. Americans know better and, as far as this kind of populism is concerned, they should not be buying it.

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