International conflict, trade and economic growth

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Over time, the U.S. has increasingly integrated into the world economy. Back in 1971, international trade was a minor part of the U.S. economy. Imports were 5.4 percent of the value of GDP. By 2021, this figure rose to 14.8 percent (data from the St. Louis Federal Reserve). The increase in the relative importance of trade had an important consequence: it allowed the U.S. economy to become more efficient, which in turn enhanced the economy's growth. This economic growth was substantial. While it may be hard to imagine, inflation-adjusted per capita GDP has more than doubled since 1971. To restate this in simpler terms, the U.S. economy is producing twice as much output per person now compared to what it produced in 1971.

How did trade make the economy more efficient? Economists give two reasons. First, trade allowed our country to make better use of our resources with our existing knowhow. For example, the U.S. did not waste resources producing clothes and low-tech electronic goods. Instead, it used fewer resources to produce enough pharmaceutical drugs and high-tech products to trade for these clothes and low-tech items. Second, trade – quite obviously – allowed the U.S. to find larger markets for its products. But not so obviously, this huge customer base gave U.S. firms a greater incentive to invent more efficient ways to produce goods. The resulting inventions contributed to economic growth.

I fear that the U.S. will become less integrated with the global economy in the coming decade. The reason is right in front of us. We have already taken the first step in that direction. The U.S. and its allies have mostly stopped trading with Russia in retaliation for Russia's invasion of Ukraine. These sanctions should make Russia poorer and limit its ability to wage wars. But the sanctions also make the U.S. and its allies poorer since they must also forfeit the benefits from trade. But that is a price they seem willing to pay in order to achieve their political goals.

The next step toward reducing our reliance on trade is uncertain and could play out in many different ways. If China invades Taiwan, the U.S. will likely stop trading with China, just like it stopped trading with Russia. This would be a big deal. China is one of our most important trading partners. There are other scenarios that lead to the same result. The U.S. may eventually cut off trade with China for political reasons that have nothing to do with Taiwan. As China has grown into a great power, it has become increasingly aggressive in enforcing its territorial claims. This could lead to a conflict with India or with a country in Southeast Asia. Any of these conflicts could lead the U.S. to stop trading with China.

History books may look back at the last 50 years as a golden age of trade expansion. During this golden age, many poor countries began to rapidly develop; as a result, countless people in those countries were lifted out of poverty. In rich countries, such as the U.S., their economies grew faster than they would have without trade. This rapid economic growth made more output available for these countries to distribute among their citizens. Economics explains the mechanism by which trade expansion created wealth during the last 50 years. It will also explain how curtailing trade can leave countries poorer.

Hopefully, today's politicians keep the economics of trade in mind as they face their international political challenges. If they navigate the rough waters of international relations with skill, they can avoid international confrontations that lead to reductions in trade. Avoiding these disruptions would make all of the countries involved wealthier.