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Free Trade Aids Stock Prices, Consumers

By David R. Breuhan

The residents of the Detroit area are more tied to trade than they realize. More commerce passes annually over the Ambassador and Blue Water Bridges between Michigan and Ontario than between America and many of its trading partners.

We are involved in a global economy where more than $1.5 trillion moves through international financial markets every day. Like it or not, we are linked to the rest of the world. Chances are the Honda, which has been manufactured in Ohio, possesses more domestically made car parts than your Pontiac. How's that for buying American? American equity markets are also linked to this nation's trading policies. There have been two peaks of the Dow Jones Industrial Average in the post-Sept. 11 world. Neither has to do with the war on terror. Both have to do with tariffs and their impact on future earnings of corporations, which have an immediate effect on the present value of stocks and the stock market.

The first post-Sept. 11 peak was on March 19, 2002 (see chart). The markets had actually recovered from the terrorist attack roughly 60 days after they occurred. The peak came one day before the U.S. government imposed a tariff on imported steel. The tariff was 30 percent, but some prices rose as much as 90 percent because of shortages, domestic rate hikes and market distortions. Lumber tariffs followed. Markets began dropping and fully recovered only after the steel tariffs were removed on Dec. 4, 2003.

The Dow reached a new peak last Feb. 11 and began dropping. The European Union's staged $4.2 billion tariff was due to take effect March 1, and the market began to anticipate its impact. The Dow dropped through midsummer and did not begin a sustained upturn until after President Bush signed a bill lifting an illegal U.S. export tax credit that was responsible for the EU's tariff. On Nov. 1, the EU said it would lift its tariff on Jan. 1, 2005.

In less than two months, the Dow rose more than 1,000 points, surpassing its Feb. 11 peak of 10,737.70, closing on Dec. 21 at 10,759.43. Free trade supports higher future earnings and causes the present value of stocks to rise in expectation. The primary reason that the market did not begin correcting before the steel tariffs was that since 1934 the United States had worked to reduce tariffs, not raise them.

There is an unwritten law of economics that the performance of equity markets is directly related to trade policies. Trade is the most vital element in macroeconomics. It provides for an exchange of commerce and ideas. It fosters innovation and competition. The United States' most important import is not goods and services; it's people.

Free trade was so important to the framers of the Constitution that a provision forbids taxation of interstate commerce, establishing the United States as the world's largest contiguous free-trade zone.

Opening the trading lanes not only will provide us with the goods and services we need, it will reduce consumer prices and raise the equity prices, especially needed to boost retirement plans for aging baby boomers. With a lumber tariff still in place and a furniture tariff soon to be imposed against China, we must liberalize our attitude and open our markets and those of our trading partners.

The most important aspect of open markets is that free trade means peace. You do not wage war against customers.

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