Testimony of Edward N.Luttwak before the US Senate Committee on Commerce, Science and Transportation August 1, 2001

FREE TRADE AS IDEOLOGY

extract from re-draft of *Turbo-Capitalism: winners and losers in the global economy* HarperCollins 1999, Harper Perennial, 2000

The god of the market-worshippers is Adam Smith, a devotion that crucially depends on not reading him. Being far wiser than his modern worshippers, Smith filled his work with exceptions, exclusions and reservations to the rule that free markets allocate most efficiently, maximizing the common welfare. As for the specific worship of free foreign trade--a varitable religion for the American and British ruling elites--it is just as important not to read either Adam Smith or his worthy predecessor, Henry Martyn. Merchant in the East India trade, a pithy writer, he was excessively clear-minded thinker from the viewpoint of today's true believers. Unlike them, Martyn recognized that wealth may point in one direction, welfare in another.

Seventy-five years before Adam Smith published his *Inquiry into the Nature and Causes of the Wealth of Nations*, seventy-seven years before Adam Smith became a commissioner of customs in Edinburgh through the influence of the Duke of Baccleuch, thereafter commending the bravely independent risk-taking of free enteprise and the superiority of unrestricted free trade while holding a secure government post charged with obstructing imports into Scotland, Henry Martyn's *Considerations upon the East India Trade* of 17O1, written to oppose the East India Company's monopoly, had already anticipated most of what is right and wrong about the theory of free trade:

> "Things may be imported from India by fewer hands than as good would be made in England, so that to permit the consumption of Indian manufactures is to permit the loss of few men's labor...A law to restrain us to use only English manufactures, is to oblige us to make them first, is to oblige us to provide for our consumption by the labor of many, what might as well be done by the labor of few, is to oblige us to consume the labor of many when that of few might be sufficient.."

Martyn captures the opportunity-cost essence of the free trade argument lucidly enough:

> "If nine cannot produce above three bushels of wheat in England, if by equal labor they might procure nine bushels from another country, to employ these in agriculture at home, is to employ nine to do no more work than might be done as well by three."

That is what is right about free trade theory. Import barriers artificially preclude efficiency gains identical to those achieved by better technology, better organization or any other source of domestic productivity. That goods or services originate from a point on the surface on the planet that happens to be classified as foreign at a given time (subject to change by conquest or voluntary union), is an entirely meaningless attribute in purely economic terms. Until the late 195Os there were still tariff (*Dazio*) barriers within Italy, so that trade-foreigners were as near as the next town.

Equally, all that is wrong about free trade is already evident in Martyn's pamphlet:

> "If the same work is done by one, which was done before by three; if the other two are forced to sit still, the Kingdom got nothing before by the labor of the two, and therefore loses nothing by their sitting still."

In other words, what benefits the Kingdom, or the Gross National Product as we would now say, need not benefit all its subjects, and may indeed turn some into paupers. Of course the same is true of any other increase in efficiency, such as might ensue from the use of better software for example. But simply because any change in trade barriers is a matter of presumptively democratic *political* decisions, unlike changes in computer usage done by private firms or individuals for their private reasons with private funds, the employment implications cannot be overlooked.

In poor countries, free trade can drastically alter the total economy given favorable circumstances including foreign investment, lifting much of the population to a much higher levels of income.
In affluent countries, however, long on total national wealth but now increasingly afflicted by the return of poverty in the most vulnerable fraction of their populations, it is not necessarily a good idea to enrich the Kingdom by replacing three with one, leaving the other two "sitting still".

Most economists would of course immediately point out that it is much better for all if the many gainers from any given market opening compensate the few losers, rather than to keep protectionist barriers that reduce the total incomes of all. They say that, sometimes offering a quick calculation--and then they leave the scene. That some workers may be protected by some trade barriers while compensation schemes are *never* implemented, is a political phenomenon outside the scope of the profession as now defined. For they who invoke the Master have abandoned his broad political economy for an abstract economics of "other things being equal", and purely theoretical compensations for any adversities.

In particular, most contemporary economists simply ignore the possibility that people might actually prefer to live in a country whose economy is somewhat less efficient than it could be, because of protectionism among other impediments. In fact they implicitly assume that societies exist to serve the needs of their economies, instead of the other way round, thereby attributing no importance to the stability of employment (as opposed to earning levels), the upkeep of traditions (e.g. Japan's rice-farming culture), or the avoidance of gross increases in the inequality of incomes and wealth.

True, many of those who attack the ruling orthodoxy go beyond societal welfare-versus-wealth arguments, intrude into purely economic analyses, and in so doing keep repeating the same elementary errors. They persistently and grossly over-estimate the importance of international trade and investment flows for the national economies of major countries, and most notably for the huge American economy.

In this "turbo-capitalism" critique of mine, by contrast, globalization ranks as a distant fourth after privatization, de-regulation and technological change.

Most commonly, the errant opponents of free trade keep confusing competition among goods with wage competition. It is each country's internal labor market that sets wages, so that, say, German workers whose employers are competing head-to-head with, say, Indian exports are not themselves competing with Indian workers, whose own wages are quite irrelevant to their own. Only the competition of other German workers matters--so that Indian exports can affect the wage rates of German workers indirectly, insofar as an unfavorable trade balance rather than any other reason causes unemployment reducing wages (in Germany's case only in theory, because German wages are kept downwardly rigid by trade-union power).

Some opponents of free trade are so overcome by their eagerness to translate Cold War animosities into "geo-economic" rivalries that they miscontrue them as *national* confrontations. Yet for each Boeing-Airbus Industrie truly zero-sum market war over airframes there is a American GE-French SNECMA alliance of engine manufacturers. Because for each major country the strongest trading competitors are also routinely the largest export customers, geo-economic rivalries are destined to remain strictly confined to the specific industries involved, without descending into emotional national rivalries. And moreover, most amazingly, even supposedly trained economists tend to reveal an inability to understand the ancient and elementary theory of comparative advantage when arguing against free trade. The advantages in question are *internally* comparative, so that even if Lazo is less efficient than Worko in producing everything, its least-bad industries can still profitably export to Worko, whose own resources are best employed by its better industries, not the weakest industries with which Lazo is competing.

But there is more to it than that. Most advocates of free trade do not merely oppose trade barriers, they are offended by them. For they know that only the free interplay of supply & demand, a.k.a the invisible hand, can set market-clearing prices with neither waste nor contrived shortages, thereby signalling to all producers what is the most efficient use of their scarce resources at any one moment in time. And they are frustrated in their knowledge that if all trade barriers were removed, the planetary income and standard of living would swiftly and greatly increase, because every producer would be free to fully exploit its own particular comparative advantages, eliminating a planet's worth of inefficiencies large and small. Instead, every state in the world artificially segments the planetary market, by imposing its own obstacles to imports by way of prohibitions, quota limits or tariffs--and sometimes to exports as well, often by pretending that only processed and not raw materials be sold abroad. Each state thus distorts not only its own internal market but by successive displacements of supply and demand, all markets, everywhere. By so doing, the entire world's efficiency in using scarce resources is diminished, leaving the planet much poorer than it need be.

Because all competent academic economists know these things to be true, and because so little else in their inventory of theories remains unrefuted, most economists are greatly irritated by any and all arguments for trade barriers. In addition to proving them costly for the standard of living, they are eager to expose them as the spurious excuses of domestic producers, out to exploit the consumer by raising

prices behind the shelter of import barriers.
When it could still be argued that food self-sufficiency was a strategic necessity, most economists asked why the agricultural interest should be allowed to levy its own permanent tax on all consumers, given that a one-time accumulation of reserve stocks of imported food would be far cheaper.
When it is argued that a particular industry could eventually become competitive if it can first grow to stength behind protective barriers, most economists assert that long-term lenders can finance the infancy of any industry far more efficiently than captive consumers. Nor would they ask for the indefinite continuation of enervatingly profitable import barriers, as protected industries always do.
When it is pointed out that import barriers can preserve employment, most economists trot out the compensation counter-argument, as if that theoretical construct were a practical remedy.

The emotional intensity of the free traders is particularly evident when they are confronted by important defectors from their own ranks. Richard Cobden lamented on his deathbed not his own imminent death but rather John Stuart Mill's apostasy in formulating the infant-industry argument:

> "I believe that the harm which Mill has done to the world by the passage in his book on *Political Economy* in which he favors the principle of protection in young communities has outweighed all the good which may have been caused by his other writings."

Alfred Marshall was mo less mournful over the same defection:

> "When John Stuart Mill ventured to tell the English people that some arguments for protection in new countries were scientifically valid, his friends spoke of it in anger--but more in sorrow than in anger--as his one sad departure from the sound principles of economic rectitude".

This is not so harsh as Cobden's condemnation but equally replete with sentiment. It was just the same with Keynes. Originally he was the purest of the pure:

> " We must hold to Free Trade, in its widest interpretation, as an inflexible dogma, to which no exception is admitted..even in those rare cases where by infringing it we could in fact obtain a direct economic advantage."

But Keynes too was to deviate from the path of economic rectitude. Reacting to Britain's very high unemployment rates after 193O, knowing that the government would not devalue sterling and that the unions would not accept wage reductions, Keynes "reluctantly" proposed tariffs as the only remaining method of increasing employment, through import substitution.
That utterly dismayed his earstwhile friends, colleagues and admirers, some of whom reacted with outright hostility. Lionel Robbins (my own teacher) spoke of Keynes's "extraordinary naivete"' in believing that import duties could easily be removed *once they had served their purpose*.
At the time millions were living on the dole, eating bread and jam for breakfast, lunch and dinner, but Keynes's opponents worried about the distortions that might linger in the aftermath, perhaps years later.

After accepting in full every possible objection, including the marginality of all foreign trade and investment in very large economies, Keynes has the last word: one should do what one can, even at the expense of sacrificing abstract principle for mere flesh and blood. END