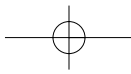
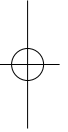
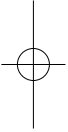


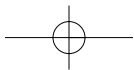
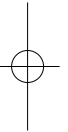
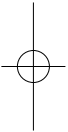


Readings in Free Trade





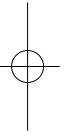
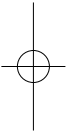
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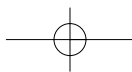


Readings in Free Trade

Selected, introduced and edited by
Detmar Doering



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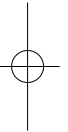
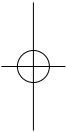
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Translation (unless texts are marked otherwise) by Ritu Khanna

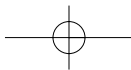
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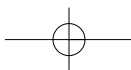
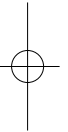
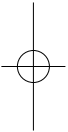


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Foreword

Dr. Otto Count Lambsdorff

“Free Trade, one of the greatest blessings which a government can confer on a people, is in almost every country unpopular.”

The British historian Thomas Babington Macaulay made this despairing remark in 1824. Many proponents of free trade can empathise with him.

The theories in support of free trade seem to contain truths that challenge our deeprooted prejudices and instincts. For instance, many people apparently cannot imagine that free and open world trade benefits the poorest and weakest sections of society. Free trade is, in fact, the best means we know of ensuring human development. The more an economy is shackled, the greater is its poverty.

The truth is that virtually no other economic doctrine has been confirmed so thoroughly in theory and practice like the theory of free trade. Thus Macaulay is not completely wrong but also not completely right. It is possible to convince peo-

ple of the merits of free trade, even though this is not always an easy task. One can, for example, point to practical examples: In countries where the policy of free trade has been consistently pursued, it has helped to eradicate poverty, secure peace and consolidate democracy. In fact, free trade is one of the greatest achievements of liberal policy.

However, one can and must, also win people over with the written word. They must first be convinced of the advantages of free trade before the policy can be implemented. These Readings in Free Trade contains selections from the writings of classical economists like Adam Smith and Ricardo, poets and writers like Kurt Tucholsky and Mario Vargas Llosa and economic experts like Carl Christian von Weizsäcker and Jagdish Bhagwati, which can offer valuable support. It offers a panorama of intellectual achievement that one would have hardly expected, given the subject matter.

The modern idea of free trade owes its origins to the Enlightenment in the eighteenth century. The task of enlightening people about free trade is, however, an ongoing one and it is in the service of this task that these readings are intended.



Introduction

This collection of classical texts about (or rather, in favour of) free trade starts with a poem by the German writer and satirist Kurt Tucholsky, and ends with an article by the Peruvian novelist, Mario Vargas Llosa. Poets and writers in favour of free trade? This may seem strange to most people. Economics, the 'dismal science', is generally seen as the embodiment of cold, calculating rationalism and rarely as the object of poetic inspiration. In fact, many who oppose globalisation today are from the ranks of writers and poets. It is, therefore, important to recall that this was not always the case, nor that it should be today.

Free trade is, perhaps, the most successful system yet invented for the promotion of human and cultural development. Virtually no other system has contributed as much to alleviating poverty and misery. During the Age of Enlightenment in the eighteenth century, free trade became the maxim of economic policy for the educated classes. The French Physiocrats, David Hume and Adam Smith helped to lay the theoretical groundwork. During the nineteenth century, the principles of free trade were not only advocated by promi-



ment intellectuals like David Ricardo, they served as practical guidelines for all progressive-minded reformers.

The campaign by British free-trade supporters for the repeal of the Corn Laws heralded the start of free-trade reform policy in Europe. The Corn Laws imposed a tariff on grain, which benefited only a small group of large landowners while the poor in industrial cities were left grappling with rising prices. The agitation against the tariffs was led by Richard Cobden and John Bright, two manufacturers from Manchester, prompting the Conservatives to coin the term “Manchester School,” as one of derision and abuse. In contrast to the distorted picture that we have today of the Manchester School, allegedly being anti-social and committed exclusively to fuelling the egotism of the propertied middle classes, the Anti-Corn-Law League founded by Cobden and Bright in 1840 was a mass movement of unprecedented proportions that was seeped in idealism. It even succeeded in winning over large sections of the urban working classes to the cause of liberal trade policy. Intellectuals and poets were lavish in their praise of the movement. In 1843, John Greenleaf Whittier, the American poet famous for embracing the anti-slavery movement, dedicated his poem, “To the Reformers of England” , to Cobden and Bright.

God bless ye, brothers! In the fight
Ye're waging now, ye cannot fail,
For better is your sense of right
Than king-craft's triple mail...

Press bravely onward! not in vain
Your generous trust in human-kind
The good which bloodshed could not gain
Your peaceful zeal shall find.¹

The enthusiasm of the people for the free-trade movement was due not least to the fact that its humanitarian aspects set an example in other policy areas too. The Manchester liberals, who were avowed opponents of imperialism and militarism, saw free trade as a means of securing world peace. Universal education was one of their main goals. Their dedication to promoting social issues was exemplary, even though their supporters were critical of social statism, preferring to be personally involved in the cooperative movement. Hermann Schulze-Delitzsch, father of the German cooperative movement, was one of the foremost German exponents of free-trade Manchesterism. In general it can be said that the European free-trade movement with its origins in Great Britain reflects the virtues of liberalism at its zenith.

However, it was important that the positive economic and social impacts of the free-trade movement were obvious to the people and this ensured the movement's widespread success. The repeal of the Corn Laws in 1846 conquered hunger and ushered in a period of prosperity in Europe. Since the 1847 famine in Ireland (a result largely of the pro-

1 John Greenleaf Whittier, *The Poetical Works of John Greenleaf Whittier*, New York/Oxford/ London/Toronto 1911, p. 386

tectionist policies of large landowners), Western Europe never again knew famine in peacetime. Contrary to the widespread belief of pessimistic early 19th century economists like David Ricardo and Thomas Robert Malthus that it was impossible for the working classes to secure more than a basic minimum subsistence level, suddenly genuine mass wealth became a real possibility. This is taken for granted by so many people today that they have no concept of exactly how great an achievement this was. Until then, starvation, mass starvation in fact, had always been accepted as the eternal lot of the poor and had never been questioned. In the eighteenth century, for example, there were eight instances of famine in France alone that decimated 5 percent of the population. The great liberal era of free trade and the Industrial Revolution put an end to this and gave the lie to the views of anti-liberal prophets of doom like Karl Marx and Friedrich Engels.

This reader is a compilation of excerpts from classical texts that laid the essential theoretical basis of free trade. Adam Smith is, of course, one of the authors. In his book, *The Wealth of Nations* written in 1776, he launches a broad-based attack on mercantilism, prevalent in Europe until then. This was the economic policy of absolutist monarchy and its primary objective was to fill the state coffers through positive trade balances and by promoting local manufacturers. It was protectionist to the core. Smith critically examines the prevalent theory that under conditions of international trade, the advantages that one country enjoyed were always at the

cost of the other. He comes to the conclusion that trade wars fuelled by such assumptions are really responsible for debilitating the economy of a country while free trade would benefit all countries.

Of course Smith was not the first to criticise mercantile protectionism. It had been criticised before and not only by his immediate predecessors, the French Physiocrats, François Quesnay, Marquis de Mirabeau and, above all, Anne Robert Jacques Turgot whose book, *Réflexions sur la formation et la distribution des richesses* (1766), Smith held in particularly high esteem. Even when mercantilism was at its peak, protectionism was being criticised (also from within the ranks of mercantilist thinkers). Mention may be made here of the Englishmen, Dudley North (*Discourses upon Trade*, 1691) and Henry Martyn (*Considerations upon the East India Trade*, 1701). The French reform mercantilist and critic of Ludwig XIV, Pierre de Boisguilbert (*Le détail de la France*, 1695), was also a particularly vehement supporter of free trade.

However, it is Adam Smith who gives the idea of free trade a form and develops its effectiveness, thereby making it the predominant trade policy of its time. He was, without doubt, the most influential of the free-trade economists. Many of his arguments are still current today.

Of all the theorists of free trade, David Ricardo deserves to be ranked alongside Smith. Along with Thomas Robert Malthus, William Nassau Senior and John Stuart Mill, Ricardo was one of the central figures of classical British eco-

nomics in the nineteenth century. The theory of free trade has him to thank for what is probably its most important thesis, namely the theory of comparative advantage. This theory demonstrates that economically weak countries (called 'developing countries' today) are not necessarily losers when international competition is governed by the rules of free trade. This is contrary to the theory of absolute advantage, which is based on the premise that developing countries can successfully export only those goods in which they have a clear cost advantage.

Comparative advantage showed that under conditions of free trade, both countries could hold their own on the market without this prerequisite. Producing a good could entail very high opportunity costs for a 'superior' country, even if it can manufacture the good more economically, because investment in production of the good could yield higher profits elsewhere. An analogy can be drawn from everyday life: Even if a successful businessman can type faster than his secretary, he would still employ her to type. If he were to take on the work of his secretary as well, he would not be able to practise his other, far more lucrative skill (managing a large company) to the optimum, and his opportunity costs would be very high. In other words, his secretary continues to be competitive in her field, although she is only "second-best". The businessman, in contrast, has a definite comparative advantage in managing the business over typing, because the former is more lucrative for him.

When applied to developing countries today, this means that they have a comparative advantage in a vast number of products. We are not referring only to the exploitation and export of raw materials where, in fact, many developing countries already enjoy an absolute advantage. In reality, the raw-material-based, one-sided nature of the export economy of many developing countries is only a result of the protectionism practised by industrial nations with regard to importing manufactured goods from developing countries. In other words, free trade could become the driving force of development in the Third World.

However, Ricardo's theory of comparative advantage exposes a problem often faced by proponents of free trade, namely the difficulty of communicating their position. While there are clear arguments, thanks to Ricardo, to prove that the weaker nation can benefit from international competition, this does not seem plausible at first glance. Paul Samuelson, who was awarded the Nobel Prize for economics in 1970, was prompted to call Ricardo's theory correct but "counter-intuitive". Clearly, even though it is difficult to do so, economists must continue to try and communicate their position.

Another great free-trade theorist was Gottfried Haberler who, in his book on *International Trade* (Der internationale Handel) written in 1933, used microeconomics to explain Ricardo's theory and updated it in the process. Haberler found that a policy of protectionist tariffs does not only alter macroeconomic variables, such as the general level of prices in a country, but also has a negative influence on the price structure

and economic activity. He proved, for example, that jobs could not be secured through protectionism; the resulting distortions in the labour market would jeopardise this objective.

This volume also tries to capture some of the diversity of the subject matter. One encounters the great nineteenth-century advocates of free trade like Richard Cobden and his French disciple Frédéric Bastiat. Cobden was unquestionably the leading supporter of free trade in the world, and a symbolic figure during his time. He was instrumental in repealing the Corn Laws in England in 1846 and negotiated the Anglo-French Free-Trade Treaty, also called the Cobden Treaty, in 1860. These were the historical turning points that launched the reform movement in Europe and America. Frédéric Bastiat was probably the most successful writer of the movement. His works were translated into all the important languages and became what one would probably call bestsellers today.

The policy implemented by British supporters of free trade in the 1840s fuelled an economic boom of such proportions that free trade became the undisputed economic policy, dominating the political agenda in Europe and the United States for a long time, and setting an example for other countries. In Germany, in 1906, Friedrich Naumann, a leading liberal representative and member of the German parliament, would write: "What happened there was a lesson to us."

The American, Henry George, who died of heart failure in 1897 when he was on the verge of winning the election for

mayor of New York, represents the next generation in the free-trade movement. For him social involvement (he was the most successful writer of his time in favour of land reform) and free trade form a combined agenda.

In the excerpt presented here, George argues against a theory developed in the 1840s by both the American Henry C. Carey (*Past, Present, and Future*, 1848) and the German Friedrich List (*Das nationale System der politischen Ökonomie*, 1841), which presented protectionists with what seemed to be an irrefutable argument. It claimed that protection was warranted for infant industries in industrial countries that were not yet highly developed, as it allowed them time to “grow up” and be fit for competition. Only once this has been achieved, should free trade be introduced. This argument ignored the Ricardian theory of comparative advantage and was a real setback in economic theory; George systematically proceeded to tear it apart. However, it was an argument that easily appealed to people, and it made things difficult for free-trade supporters. It also blended well with the resentment harboured by the nationalists. List, who was basically still a liberal, tentatively compared the abstract “cosmopolitanism” of the English School with the “domestic system of economics”, more suited to the Germans. His successors lost no time in opting for more aggressive language.

Carey and List notwithstanding, the nineteenth century on the whole was characterised by an optimism that believed in the inevitability of free trade, peace and social progress. It is always unwise to be complacent for there are no historical

laws that ensure victory for the liberal cause. Which is exactly what happened: At the end of the nineteenth century, liberalism, which had dominated the political agenda for decades, was now facing strong new opponents, namely socialism and a modernised version of conservatism that had learned to exploit the democratic instruments created by the liberals. By offering generous “gifts” both tried to buy freedom off the people. The fact that the liberals had been the first to achieve mass wealth was quickly forgotten; they were accused of being anti-social; there was a growing desire for paternalism. Manchesterism eventually became a term of abuse, and the climate was not conducive for free-trade policies. The German Chancellor, Otto von Bismarck, made a start in 1878/79 when he forged a national-conservative alliance in the Reichstag between industrialists and agriculturists. Turning its back on free trade, the alliance launched an aggressively protectionist tariff policy. Other European powers gradually followed suit. All that the advocates of free trade had prophesied about such a policy came true: Democracy degenerated to horsetrading between interest groups, there was a growing trend towards monopolies and cartels in the economy, distortions were introduced in the labour market and, not least, there was an outbreak of trade wars influenced by imperialistic colonialism. Nationalist trade policy did not play a small part in Europe’s rapid descent into the First World War.

Economic nationalism was often openly racist. List’s argument that free-trade advocates were too “cosmopolitan”

soon degenerated into primitive propaganda used by supporters of protectionist tariffs during the Wilhelman era in Germany. The economic outcomes, namely the incredible growth in wealth spurred by free trade, were no longer an issue. It was enough that the free-trade ideas stemmed from “Manchester” and hence were British and therefore un-German. Those who still accuse liberal economists of regressing to ‘Manchesterism’ should know that this is a xenophobic battle cry that was used primarily as an anti-Semitic term. One of the main ideologists of anti-Semitism in the late nineteenth century, Wilhelm Marr², wrote in his inflammatory piece, *The Victory of Judaism over Germanism* (Der Sieg des Judenthums über das Germanenthum) in 1879, “Judaism is Manchesterism applied and implemented to an extreme. It knows nothing other than trade and that too, only wheeling and dealing. It does not work itself, but makes others work for it; it trades and speculates with products produced by the labour and intelligence of others.”

There was a varied public response from both ends of the political spectrum to this murky mixture of anti-capitalist

2 Wilhelm Marr (1819–1904), politician and journalist, belonged to the left-wing radical democrats in Hamburg during and after the revolution of 1848. He was the first to coin the term ‘anti-Semitism’ as an expression of his hatred of the Jews, which he used in his writing, often inspired by socialism. Along with the above-mentioned work, he published the infamous ‘Judenspiegel’ or *Jewish Mirror* in 1862. Marr – along with Marx and Engels! – is one of the many left-wing authors who were the first to put forward the combination of anti-capitalist and anti-Semitic phrases later adopted by fascism that was rearing its ugly head on the right.

rhetoric (against international financial capital) and the demon of nationalism. The opponents of free trade with their anti-liberal views ultimately helped in preparing people for the totalitarianism of the Third Reich. Support for free trade is perhaps the political stance where the ideological gulf between liberals and anti-liberals is widest. It is the fundamental question of the political order where opinions differ. "The question of free trade", said Friedrich Naumann, "is not only a question relating to a mere aspect of economic policy, but concerns the overall question of the direction in which the economy should move."

The First World War and the subsequent new world order for peace negotiated in the Treaty of Versailles further exacerbated the anti-liberal trends of the late nineteenth century. The text by Ludwig von Mises was written at this time. In 1927, Mises described economic isolationist policy (with reference to immigration, too!) as a danger to peace. He was on the mark. The trade wars that had been wilfully started were largely responsible for intensifying and prolonging the Great Depression, (the global economic crisis after 1929). They certainly created the environment for the rise of authoritarian and totalitarian political movements, which then led to the outbreak of the Second World War. Whoever demonstrates against globalisation today, should bear this in mind. The end of globalisation is inevitably linked with unimaginable horror.

However, the Second World War, in which this trend culminated, seemed to bring about a change in thinking. Western countries in the post-war period saw that rapid economic

growth and economic liberalisation went hand in hand. Lessons had been learnt from the trade wars of the period between the World Wars. Admittedly, opposing forces continued to be active during the post-war era, too. That the opponents of free trade shook off the mothballs and tried to re-clad old arguments in new clothes, and that milder versions of some evil aspects of the nanny state were revived, are highlighted in the article included in this volume by the former German Minister of Economic Affairs, Dr. Otto Count Lambsdorff. Behind many modern forms of protectionism, he suspects a subtle form of imperialism at work.

All this was true not only of the planned economy of the Soviet empire, but also of many non-aligned developing countries that experimented with socialism. In Europe, for example, the book *The American Challenge* (Le défi américain) by the French politician and writer Jean-Jacques Servan-Schreiber, created a furore in 1967. The author was very critical of all backward-oriented protection of obsolete industries. In place of tariff policy, he recommended that the state identify *future* industries and systematically promote them. This would allow Europe to keep pace with the United States. Servan-Schreiber suggested that heavy industries such as mining, steel and shipyards were industries of the future. Politicians who became his enthusiastic supporters soon proved to be responsible for systematically promoting industries that were already obsolete. Until today, the ruins of their protectionist tariffs and subsidies hamper economic growth in Europe and heavily burden the taxpayer and consumer.

The old “infant-industry” argument put forward by Carey and List and refuted by Henry George and others was being freshly polished here. One could have predicted its failure in practice. The lesson we derive is: Do not trust politicians who talk about “industries of the future”!

Nevertheless, this should not divert our attention from the overall positive developments of the post-war era, which were primarily the result of the international multilateral trade policy introduced after 1945. Multilateral arrangements are founded on mutual treaties based on the “most-favoured nation clause” that curbs national arbitrariness in foreign trade policy. Based on this, tariff reductions cannot be implemented on a bilateral basis between individual states but should be passed on to all the members of the contract system. In other words, a country is obliged to grant all other countries the same tariff benefits as granted to the most-favoured nation. To facilitate the implementation of such an order, the General Agreement on Tariffs and Trade (GATT) was founded in 1948, which, in turn, led to the World Trade Organisation (WTO) in 1995. Their policies brought about a lowering of tariffs all over the world, on average from 40 percent to 4 percent. Even if some of this has been neutralised by non-tariff trade barriers, it is still an impressive achievement. In his article, Jagdish Bhagwati describes the rise of the GATT world trade order and some of the accompanying debates.

However, the story did not end with the collapse of the communist tyrannies in Europe in 1989, as had been predicted.

It is not enough to rest on one's laurels. Despite its successes, free trade continues to be under fire. An anti-globalisation movement that is ideologically still very incoherent has been gaining momentum in recent years, and has become particularly obvious during the violent demonstrations at WTO summits. This movement itself is an illegitimate child of the globalisation (i. e., greater integration of the world economy) brought about by free trade. It can no longer be fully judged by the nineteenth century standards of nationalist etatism. The interlinkages in production, the result of globalisation, have now made the issue of the country of origin to be "protected" increasingly irrelevant. Hence the current protests against free trade are themselves often globalised and de-nationalised. Today, cross-border issues like animal rights, international social standards, the rights of ethnic minorities and environmental protection form the core of the anti-free trade position.

However, here too, there is plenty of old wine in new bottles. The call for international social standards, for example, does not in any way serve a global concern for the poor but is in the interest of western welfare states that want to protect themselves against the competition of "cheap labour" from developing countries and even resort to hypocritical explanations for this protectionism by pointing to the poverty in these countries. Moreover, behind the wish to implement "fair" instead of "free" trade, hides a rather old-fashioned policy of international redistribution. In fact, even the idea that once originated in the anti-Semitic context, that each

global liberalisation policy is an example of an “international financial capital” conspiracy, is being revived either in its pure form or combined with anti-American feeling. In his article, Carl Christian von Weizsäcker points out that free capital markets are an important aspect of free-trade policy and one that primarily promotes wealth. According to Weizsäcker, free international capital markets will curb states and prevent them from pursuing policies that are harmful in the long term.

To put in briefly: A defence of free trade continues to be on the daily agenda and proponents of free trade must be constantly prepared to face new challenges. This reader puts forward arguments and ideas.

Potsdam, 2004

Detmar Doering

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Kurt Tucholsky (1932):

A Poem to Set the Tone

Kurt Tucholsky is not known for his views on economic policy. The writer, satirist and brilliant stylist started his literary career in 1912 with the short novel, "Rheinsberg – ein Bilderbuch für Verliebte" (Rheinsberg – A Picture Book for People in Love) and by writing literary and theatre reviews in the magazine "Die Schaubühne" (called "Die Weltbühne" after 1918; Tucholsky became editor of the magazine in 1926). A number of other works soon made him one of the most prominent German writers of the period between the world wars.

When the Nazis came to power, Tucholsky's books were publicly burnt. His German citizenship was revoked and he went into exile in Sweden where he committed suicide in 1935.

While his political orientation was to the left, (SPD, the Social Democratic Party, later the Independent Socialist Party of Germany, USPD; for a while his sympathies lay with the Communist Party of Germany, KPD), it was always clear to him that a nationalist (in other words, protectionist) economic policy was incompatible with progressive and cosmopolitan ideals. The following poem, "Europe", written in 1932, shows that free trade is really one of the mottos of progressive policy.

Europe

The wines from the Rhine are good, they say –
but you cannot sell them in the UK –
Buy British!

The people from Vienna make great cakes and pies
which can't be sold under Swedish skies –
Köp svenska varor!

Oranges rot in Italy –
but we have to protect German farmers, see?
Germans, buy German lemons!

And on each square inch of territorial space,
Dreams are dreamt of the glory of each race.
While quietly the wind whispers in the tree...
Territories are imaginary.

There lies Europe. What state is it in?
That of a garishly painted loony bin.
The nations indulge in a common sport:
Export! Export!

The Others! Let the others buy!
Let the others import our rye
Let the others rent our ships!
Let the others eat our chips!
We?

Import licence and customs raid:
we won't let anything into our state.
Not us. We follow an ideal:
We hunger. But with national zeal.
Into everything flags and anthems are crammed.

Europe? Europe? Europe be damned!
And if everything drifts towards ruin and decay:
Let the nation only stay!
A Person's an irrelevant quantity.
Long live England, Poland and Italy!
The state devours us. A ghost. A definition.
The state is a thing without much of inhibition.
The thing has grown huge, towards the stars it is reaching –
Even the church could learn from its teaching.
Each one should buy. No one can buy.
The ritual national pyres burns high.
The fires of national sacrifice roar:
the meaning of life is to let taxes soar!
May heaven be our bankruptcy court!
Modernity plays a medieval sport.

The nation is the eighth sacrament –!
May God bless this continent.

- * Translated by Siegfried Herzog, Friedrich-Naumann-Stiftung
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Adam Smith (1776):

A Critique of Mercantilism

At the risk of being unjust to his predecessors, Adam Smith (1723–1790) is considered the real intellectual father of free trade and the market economy. Smith, who taught moral philosophy at the University of Glasgow, wrote *An Inquiry into the Nature and Causes of the Wealth of Nations* in 1776, which became one of the great classics of economics. Many even regard the book as the very start of scientific economics and it quickly became a bible for all liberal economic reformers. Even today, Smith is often the great model at conferences where liberal economists have his image clipped onto their ties. This is due not least to his outspoken criticism, reproduced below, of the protectionist policy of absolutist mercantilism, which sacrificed free trade to the doctrine of positive trade balances.

Nothing, however, can be more absurd than this whole doctrine of the balance of trade, upon which, not only these restraints, but almost all the other regulations of commerce are founded. When two places trade with one another, this doctrine supposes that, if the balance be even, neither of them either loses or gains; but if it leans in any degree to one side, that one of them loses, and the other gains in proportion to its declension from the exact equilibrium. Both suppositions are false. A trade which is forced by means of bounties and monopolies, may be, and commonly is disad-

vantageous to the country in whose favour it is meant to be established, as I shall endeavour to shew hereafter. But that trade which, without force or constraint, is naturally and regularly carried on between any two places, is always advantageous, though not always equally so, to both.

By advantage or gain, I understand, not the increase of the quantity of gold and silver, but that of the exchangeable value of the annual produce of the land and labour of the country, or the increase of the annual revenue of its inhabitants.

If the balance be even, and if the trade between the two places consist altogether in the exchange of their native commodities, they will, upon most occasions, not only both gain, but they will gain equally, or very near equally; each will in this case afford a market for a part of the surplus produce of the other: each will replace a capital which had been employed in raising and preparing for the market this part of the surplus produce of the other, and which had been distributed among, and given revenue and maintenance to a certain number of its inhabitants. Some part of the inhabitants of each, therefore, will indirectly derive their revenue and maintenance from the other. As the commodities exchanged too are sup-posed to be of equal value, so the two capitals employed in the trade will, upon most occasions, be equal, or very nearly equal; and both being employed in raising the native commodities of the two countries, the revenue and maintenance which their distribution will afford to the inhabitants of each will be equal, or very nearly equal. This revenue and maintenance, thus mutually

afforded, will be greater or smaller in proportion to the extent of their dealings. If these should annually amount to an hundred thousand pounds, for example, or to a million on each side, each of them would afford an annual revenue, in the one case, of an hundred thousand pounds, in the other, of a million, to the inhabitants of the other.

If their trade should be of such a nature that one of them exported to the other nothing but native commodities, while the returns of that other consisted altogether in foreign goods; the balance, in this case, would still be supposed even, commodities being paid for with commodities. They would, in this case too, both gain, but they would not gain equally; and the inhabitants of the country which exported nothing but native commodities would derive the greatest revenue from the trade. If England, for example, should import from France nothing but the native commodities of that country, and, not having such commodities of its own as were in demand there, should annually repay them by sending thither a large quantity of foreign goods, tobacco, we shall suppose, and East India goods; this trade, though it would give some revenue to the inhabitants of both countries, would give more to those of France than to those of England. The whole French capital annually employed in it would annually be distributed among the people of France. But that part of the English capital only which was employed in producing the English commodities with which those foreign goods were purchased, would be annually distributed among the people of England. The greater part of it would

replace the capitals which had been employed in Virginia, Indostan, and China, and which had given revenue and maintenance to the inhabitants of those distant countries. If the capitals were equal, or nearly equal, there-fore, this employment of the French capital would augment much more the revenue of the people of France, than that of the English capital would the revenue of the people of England. France would in this case carry on a direct foreign trade of consumption with England; whereas England would carry on a round-about trade of the same kind with France. The different effects of a capital employed in the direct, and of one employed in the round-about foreign trade of consumption, have already been fully explained.

There is not, probably, between any two countries, a trade which consists altogether in the exchange either of native commodities on both sides, or of native commodities on one side and of foreign goods on the other. Almost all countries exchange with one another partly native and partly foreign goods. That country, however, in whose cargoes there is the greatest proportion of native, and the least of foreign goods, will always be the principal gainer.

If it was not with tobacco and East India goods, but with gold and silver, that England paid for the commodities annually imported from France, the balance, in this case, would be supposed uneven, commodities not being paid for with commodities, but with gold and silver. The trade, however, would, in this case, as in the foregoing, give some revenue to the inhabitants of both countries, but more to those of France

than to those of England. It would give some revenue to those of England. The capital which had been employed in producing the English goods that purchased this gold and silver, the capital which had been distributed among, and given revenue to certain inhabitants of England, would thereby be re-placed, and enabled to continue that employment. The whole capital of England would no more be diminished by this exportation of gold and silver, than by the exportation of an equal value of any other goods. On the contrary, it would, in most cases, be augmented. No goods are sent abroad but those for which the demand is supposed to be greater abroad than at home, and of which the returns consequently, it is expected, will be of more value at home than the commodities exported. If the tobacco which, in England, is worth only a hundred thousand pounds, when sent to France will purchase wine which is, in England, worth a hundred and ten thousand pounds, the exchange will augment the capital of England by ten thousand pounds. If a hundred thousand pounds of English gold, in the same manner, purchase French wine, which, in England, is worth a hundred and ten thousand, this exchange will equally augment the capital of England by ten thousand pounds. As a merchant who has a hundred and ten thousand pounds worth of wine in his cellar, is a richer man than he who has only a hundred thousand pounds worth of tobacco in his warehouse, so is he likewise a richer man than he who has only a hundred thousand pounds worth of gold in his coffers. He can put into motion a greater quantity of industry, and give revenue, maintenance, and employment, to a greater number of people than

either of the other two. But the capital of the country is equal to the capitals of all its different inhabitants, and the quantity of industry which can be annually maintained in it, is equal to what all those different capitals can maintain. Both the capital of the country, therefore, and the quantity of industry which can be annually maintained in it, must generally be augmented by this exchange. It would, indeed, be more advantageous for England that it could purchase the wines of France with its own hard-ware and broad-cloth, than with either the tobacco of Virginia, or the gold and silver of Brazil and Peru. A direct foreign trade of consumption is always more advantageous than a round-about one. But a round-about foreign trade of consumption, which is carried on with gold and silver, does not seem to be less advantageous than any other equally round-about one. Neither is a country which has no mines more likely to be exhausted of gold and silver by this annual exportation of those metals, than one which does not grow tobacco by the like annual exportation of that plant. As a country which has where withal to buy tobacco will never be long in want of it, so neither will one be long in want of gold and silver which has where-withal to purchase those metals.

It is a losing trade, it is said, which a workman carries on with the ale-house; and the trade which a manufacturing nation would naturally carry on with a wine country, may be considered as a trade of the same nature. I answer, that the trade with the alehouse is not necessarily a losing trade. In its own nature it is just as advantageous as any other,

though, perhaps, somewhat more liable to be abused. The employment of a brewer, and even that of a retailer of fermented liquors, are as necessary divisions of labour as any other. It will generally be more advantageous for a workman to buy of the brewer the quantity he has occasion for, than to 'brew' it himself, and if he is a poor workman, it will generally be more advantageous for him to buy it, by little and little of the retailer, than a large quantity of the brewer. He may no doubt buy too much of either, as he may of any other dealers in his neighbourhood, of the butcher, if he is a glutton, or of the draper, if he affects to be a beau among his companions. It is advantageous to the great body of workmen, notwithstanding, that all these trades should be free, though this freedom may be abused in all of them, and is more likely to be so, perhaps, in some than in others. Though individuals, besides, may sometimes ruin their fortunes by an excessive consumption of fermented liquors, there seems to be no risk that a nation should do so. Though in every country there are many people who spend upon such liquors more than they can afford, there are always many more who spend less. It deserves to be remarked too that, if we consult experience, the cheapness of wine seems to be a cause, not of drunkenness, but of sobriety. The inhabitants of the wine countries are in general the soberest people in Europe; witness the Spaniards, the Italians, and the inhabitants of the southern provinces of France. People are seldom guilty of excess in what is their daily fare. Nobody affects the character of liberality and good fellowship, by being profuse of a liquor which is as cheap as small beer. On

the contrary, in the countries which, either from excessive heat or cold, produce no grapes, and where wine consequently is dear and a rarity, drunkenness is a common vice, as among the northern nations, and all those who live between the tropics, the negroes, for example, on the coast of Guinea. When a French regiment comes from some of the northern provinces of France, where wine is somewhat dear, to be quartered in the southern, where it is very cheap, the soldiers, I have frequently heard it observed, are at first debauched by the cheapness and novelty of good wine; but after a few months residence, the greater part of them become as sober as the rest of the inhabitants. Were the duties upon foreign wines, and the excises upon malt, beer, and ale, to be taken away all at once, it might, in the same manner, occasion in Great Britain a pretty general and temporary drunkenness among the middling and inferior ranks of people, which would probably be soon followed by a permanent and almost universal sobriety? At present drunkenness is by no means the vice of people of fashion, or of those who can easily afford the most expensive liquors. A gentleman drunk with ale, has scarce ever been seen among us. The restraints upon the wine trade in Great Britain, besides, do not so much seem calculated to hinder the people from going, if I may say so, to the alehouse, as from going where they can buy the best and cheapest liquor. They favour the wine trade of Portugal, and discourage that of France. The Portuguese, it is said, indeed, are better customers for our manufactures than the French, and should therefore be encouraged in preference to them. As they give us their cus-

tom, it is pretended, we should give them ours. The sneaking arts of underling tradesmen are thus erected into political maxims for the conduct of a great empire: for it is the most underling tradesmen only who make it a rule to employ chiefly their own customers. A great trader purchases his goods always where they are cheapest and best, without regard to any little interest of this kind.

By such maxims as these, however, nations have been taught that their interest consisted in begging all their neighbours. Each nation has been made to look with an invidious eye upon the prosperity of all the nations with which it trades, and to consider their gain as its own loss. Commerce, which ought naturally to be, among nations, as among individuals, a bond of union and friendship, has become the most fertile source of discord and animosity. The capricious ambition of kings and ministers has not, during the present and the preceding century, been more fatal to the repose of Europe, than the impertinent jealousy of merchants and manufacturers. The violence and injustice of the rulers of mankind is an ancient evil, for which, I am afraid, the nature of human affairs can scarce admit of a remedy. But the mean rapacity, the monopolizing spirit of merchants and manufacturers, who neither are, nor ought to be the rulers of mankind, though it cannot perhaps be corrected, may very easily be prevented from disturbing the tranquillity of any body but themselves.

That it was the spirit of monopoly which originally both invented and propagated this doctrine, cannot be doubted;

and they who first taught it were by no means such fools as they who believed it. In every country it always is and must be the interest of the great body of the people to buy whatever they want of those who sell it cheapest. The proposition is so very manifest, that it seems ridiculous to take any pains to prove it; nor could it ever have been called in question, had not the interested sophistry of merchants and manufacturers confounded the common sense of mankind. Their interest is, in this respect, directly opposite to that of the great body of the people. As it is the interest of the freemen of a corporation to hinder the rest of the inhabitants from employing any workmen but themselves, so it is the interest of the merchants and manufacturers of every country to secure to themselves the monopoly of the home market. Hence in Great Britain, and in most other European countries, the extra-ordinary duties upon almost all goods imported by alien merchants. Hence the high duties and prohibitions upon all those foreign manufactures which can come into competition with our own. Hence too the extra-ordinary restraints upon the importation of almost all sorts of goods from those countries with which the balance of trade is supposed to be dis-advantageous; that is, from those against whom national animosity happens to be most violently inflamed.

The wealth of a neighbouring nation, however, though dangerous in war and politicks, is certainly advantageous in trade. In a state of hostility it may enable our enemies to maintain fleets and armies superior to our own; but in a state

of peace and commerce it must likewise enable them to exchange with us to a greater value, and to afford a better market, either for the immediate produce of our own industry, or for whatever is purchased with that produce. As a rich man is likely to be a better customer to the industrious people in his neighbourhood, than a poor, so is likewise a rich nation. A rich man, indeed, who is himself a manufacturer, is a very dangerous neighbour to all those who deal in the same way. All the rest of the neighbourhood, however, by far the greatest number, profit by the good market which his expence affords them. They even profit by his under-selling the poorer workmen who deal in the same way with him. The manufacturers of a rich nation, in the same manner, may no doubt be very dangerous rivals to those of their neighbours. This very competition, however, is advantageous to the great body of the people, who profit greatly besides by the good market which the great expence of such a nation affords them in every other way. Private people who want to make a fortune, never think of retiring to the remote and poor provinces of the country, but resort either to the capital or to some of the great commercial towns. They know, that, where little wealth circulates, there is little to be got, but that where a great deal is in motion, some share of it may fall to them. The same maxims which would in this manner direct the common sense of one, or ten, or twenty individuals, should regulate the judgment of one, or ten, or twenty millions, and should make a whole nation regard the riches of its neighbours, as a probable cause and occasion for itself to acquire riches. A nation that would enrich itself by foreign

trade is certainly most likely to do so when its neighbours are all rich, industrious, and commercial nations. A great nation surrounded on all sides by wandering savages and poor barbarians might, no doubt, acquire riches by the cultivation of its own lands, and by its own interior commerce, but not by foreign trade. It seems to have been in this manner that the ancient Egyptians and the modern Chinese acquired their great wealth. The ancient Egyptians, it is said, neglected foreign commerce, and the modern Chinese, it is known, hold it in the utmost contempt, and scarce deign to afford it the decent protection of the laws. The modern maxims of foreign commerce, by aiming at the impoverishment of all our neighbours, so far as they are capable of producing their intended effect, tend to render that very commerce insignificant and contemptible.

It is in consequence of these maxims that the commerce between France and England has in both countries been subjected to so many discouragements and restraints. If those two countries, however, were to consider their real interest, without either mercantile jealousy or national animosity, the commerce of France might be more advantageous to Great Britain than that of any other country, and for the same reason that of Great Britain to France. France is the nearest neighbour to Great Britain. In the trade between the southern coast of England and the northern and north-western coasts of France, the returns might be expected, in the same manner as in the inland trade, four, five, or six times in the year. The capital, therefore, employed in this trade, could in

each of the two countries keep in motion four, five, or six times the quantity of industry, and afford employment and subsistence to four, five, or six times the number of people, which an equal capital could do in the greater part of the other branches of foreign trade. Between the parts of France and Great Britain most remote from one another, the returns might be expected, at least, once in the year, and even this trade would so far be at least equally advantageous as the greater part of the other branches of our foreign European trade. It would be, at least, three times more advantageous, than the boasted trade with our North American colonies, in which the returns were seldom made in less than three years, frequently not in less than four or five years. France, besides, is supposed to contain twenty-four millions of inhabitants. Our North American colonies were never supposed to contain more than three millions: And France is a much richer country than North America; though, on account of the more unequal distribution of riches, there is much more poverty and beggary in the one country, than in the other. France, therefore, could afford a market at least eight times more extensive, and, on account of the superior frequency of the returns, four and twenty times more advantageous, than that which our North American colonies ever afforded. The trade of Great Britain would be just as advantageous to France, and, in proportion to the wealth, population and proximity of the respective countries, would have the same superiority over that which France carries on with her own colonies. Such is the very great difference between that trade which the wisdom of both nations has thought

proper to discourage, and that which it has favoured the most.

But the very same circumstances which would have rendered an open and free commerce between the two countries so advantageous to both, have occasioned the principal obstructions to that commerce. Being neighbours, they are necessarily enemies, and the wealth and power of each becomes, upon that account, more formidable to the other; and what would increase the advantage of national friendship, serves only to inflame the violence of national animosity. They are both rich and industrious nations; and the merchants and manufacturers of each, dread the competition of the skill and activity of those of the other. Mercantile jealousy is excited, and both inflames, and is itself inflamed, by the violence of national animosity: And the traders of both countries have announced, with all the passionate confidence of interested falsehood, the certain ruin of each, in consequence of that unfavourable balance of trade, which, they pretend, would be the infallible effect of an unrestrained commerce with the other.

There is no commercial country in Europe of which the approaching ruin has not frequently been foretold by the pretended doctors of this system, from an unfavourable balance of trade. After all the anxiety, however, which they have excited about this, after all the vain attempts of almost all trading nations to turn that balance in their own favour and against their neighbours, it does not appear that any one nation in Europe has been in any respect impoverished by this cause.

Every town and country, on the contrary, in proportion as they have opened their ports to all nations; instead of being ruined by this free trade, as the principles of the commercial system would lead us to expect, have been enriched by it. Though there are in Europe, indeed, a few towns which in some respects deserve the name of free ports, there is no country which does so. Holland, perhaps, approaches the nearest to this character of any, though still very remote from it; and Holland, it is acknowledged, not only derives its whole wealth, but a great part of its necessary subsistence, from foreign trade.

There is another balance, indeed, which has already been explained, very different from the balance of trade, and which, according as it happens to be either favourable or unfavourable, necessarily occasions the pros-perity or decay of every nation. This is the balance of the annual produce and consumption. If the exchangeable value of the annual produce, it has already been observed, exceeds that of the annual consumption, the capital of the society must annually increase in proportion to this excess. The society in this case lives within its revenue, and what is annually saved out of its revenue, is naturally added to its capital, and employed so as to increase still further the annual produce. If the exchangeable value of the annual produce, on the contrary, fall short of the annual consumption, the capital of the society must annually decay in proportion to this deficiency. The expense of the society in this case exceeds its revenue, and necessarily encroaches upon its capital. Its capital,

therefore, must necessarily decay, and, together with it, the exchangeable value of the annual produce of its industry.

This balance of produce and consumption is entirely different from, what is called, the balance of trade. It might take place in a nation which had no foreign trade, but which was entirely separated from all the world. It may take place in the whole globe of the earth, of which the wealth, population, and improvement may be either gradually increasing or gradually decaying.

The balance of produce and consumption may be constantly in favour of a nation, though what is called the balance of trade be generally against it. A nation may import to a greater value than it exports for half a century, perhaps, together; the gold and silver which comes into it during all this time may be all immediately sent out of it; its circulating coin may gradually decay, different sorts of paper money being substituted in its place, and even the debts too which it contracts in the principal nations with whom it deals, may be gradually increasing; and yet its real wealth, the exchangeable value of the annual produce of its lands and labour, may, during the same period, have been increasing in a much greater proportion. The state of our North American colonies, and of the trade which they carried on with Great Britain, before the commencement of the present disturbances, may serve as a proof that this is by no means an impossible supposition...

It is unnecessary, I imagine, to observe, how contrary such regulations are to the boasted liberty of the subject, of which

we affect to be so very jealous; but which, in this case, is so plainly sacrificed to the futile interests of our merchants and manufacturers.

The laudable motive of all these regulations, is to extend our own manufactures, not by their own improvement, but by the depression of those of all our neighbours, and by putting an end, as much as possible, to the troublesome competition of such odious and disagreeable rivals. Our master manufacturers think it reasonable, that they themselves should have the monopoly of the ingenuity of all their countrymen. Though by restraining, in some trades, the number of apprentices which can be employed at one time, and by imposing the necessity of a long apprenticeship in all trades, they endeavour, all of them, to confine the knowledge of their respective employments to as small a number as possible; they are unwilling, however, that any part of this small number should go abroad to instruct foreigners.

Consumption is the sole end and purpose of all production; and the interest of the producer ought to be attended to, only so far as it may be necessary for promoting that of the consumer. The maxim is so perfectly self-evident, that it would be absurd to attempt to prove it. But in the mercantile system, the interest of the consumer is almost constantly sacrificed to that of the producer; and it seems to consider production, and not consumption, as the ultimate end and object of all industry and commerce.

In the restraints upon the importation of all foreign commodities which can come into competition with those of our own growth, or manufacture, the interest of the home-consumer is evidently sacrificed to that of the producer. It is altogether for the benefit of the latter, that the former is obliged to pay that enhancement of price which this monopoly almost always occasions.

It is altogether for the benefit of the producer that bounties are granted – upon the exportation of some of his productions. The home-consumer is obliged to pay, first, the tax which is necessary for paying the bounty, and secondly, the still greater tax which necessarily arises from the enhancement of the price of the commodity in the home market...

It cannot be very difficult to determine who have been the contrivers of this whole mercantile system; not the consumers, we may believe, whose interest has been entirely neglected; but the producers whose interest has been so carefully attended to; and among this latter class our merchants and manufacturers have been by [518] far the principal architects. In the mercantile regulations, which have been taken notice of in this chapter, the interest of our manufacturers has been most peculiarly attended to; and the interest, not so much of the consumers, as that of some other sets of producers, has been sacrificed to it.

Adam Smith: *An Inquiry into the Nature and Causes of the Wealth of Nations*, 2 vols, ed. R.H. Campbell/A.S. Skinner, Indianapolis 1982, I p. 488–498, II 660–662

David Ricardo (1817):

The argument in Favour of Free Trade: Comparative Advantage

David Ricardo (1772–1823) is one of the foremost “classical” English economists. As a London banker who made a large fortune that helped him to become financially independent, he first devoted himself to politics. As a member of the British House of Commons, he created a name for himself primarily as an authority on how economic and monetary policy are interlinked. In later years he worked mainly on fundamental issues in economic theory. Besides several short pieces of writing, he made his name in the field of economic theory primarily with his book, *The Principles of Political Economy and Taxation* (1817). The excerpt from the book printed below uses the example of the exchange of cloth and wine between England and Portugal to explain the theory of comparative advantage, probably the pivotal argument in favour of free trade.

Under a system of perfectly free commerce, each country naturally devotes its capital and labour to such employments as are most beneficial to each. This pursuit of individual advantage is admirably connected with the universal good of the whole. By stimulating industry, by rewarding ingenuity, and by using most efficaciously the peculiar powers bestowed by nature, it distributes labour most effectively and most economically: while, by increasing the general mass of productions, it diffuses general benefit, and binds

together, by one common tie of interest and intercourse, the universal society of nations throughout the civilised world. It is this principle which determines that wine shall be made in France and Portugal, that corn shall be grown in America and Poland, and that hardware and other goods shall be manufactured in England.

In one and the same country, profits are, generally speaking, always on the same level; or differ only as the employment of capital may be more or less secure and agreeable. It is not so between different countries. If the profits of capital employed in Yorkshire should exceed those of capital employed in London, capital would speedily move from London to Yorkshire, and an equality of profits would be effected; but if in consequence of the diminished rate of production in the lands of England from the increase of capital and population wages should rise and profits fall, it would not follow that capital and population would necessarily move from England to Holland, or Spain, or Russia, where profits might be higher.

If Portugal had no commercial connection with other countries, instead of employing a great part of her capital and industry in the production of wines, with which she purchases for her own use the cloth and hardware of other countries, she would be obliged to devote a part of that capital to the manufacture of those commodities, which she would thus obtain probably inferior in quality as well as quantity.

The quantity of wine which she shall give in exchange for the cloth of England is not determined by the respective quanti-

ties of labour devoted to the production of each, as it would be if both commodities were manufactured in England, or both in Portugal.

England may be so circumstanced that to produce the cloth may require the labour of 100 men for one year; and if she attempted to make the wine, it might require the labour of 120 men for the same time. England would therefore find it her interest to import wine, and to purchase it by the exportation of cloth.

To produce the wine in Portugal might require only the labour of 80 men for one year, and to produce the cloth in the same country might require the labour of 90 men for the same time. It would therefore be advantageous for her to export wine in exchange for cloth. This exchange might even take place notwithstanding that the commodity imported by Portugal could be produced there with less labour than in England. Though she could make the cloth with the labour of 90 men, she would import it from a country where it required the labour of 100 men to produce it, because it would be advantageous to her rather to employ her capital in the production of wine, for which she would obtain more cloth from England, than she could produce by diverting a portion of her capital from the cultivation of vines to the manufacture of cloth.

Thus England would give the produce of the labour of 100 men for the produce of the labour of 80. Such an exchange could not take place between the individuals of the same country. The labour of 100 Englishmen cannot be given for

that of 80 Englishmen, but the produce of the labour of 100 Englishmen may be given for the produce of the labour of 80 Portuguese, 60 Russians, or 120 East Indians. The difference in this respect, between a single country and many, is easily accounted for, by considering the difficulty with which capital moves from one country to another, to seek a more profitable employment, and the activity with which it invariably passes from one province to another in the same country.

It would undoubtedly be advantageous to the capitalists of England, and to the consumers in both countries, that under such circumstances the wine and the cloth should both be made in Portugal, and therefore that the capital and labour of England employed in making cloth should be removed to Portugal for that purpose. In that case, the relative value of these commodities would be regulated by the same principle as if one were the produce of Yorkshire and the other of London: and in every other case, if capital freely flowed towards those countries where it could be most profitably employed, there could be no difference in the rate of profit, and no other difference in the real or labour price of commodities than the additional quantity of labour required to convey them to the various markets where they were to be sold.

Experience, however, shows that the fancied or real insecurity of capital, when not under the immediate control of its owner, together with the natural disinclination which every man has to quit the country of his birth and connections, and

intrust himself, with all his habits fixed, to a strange government and new laws, check the emigration of capital. These feelings, which I should be sorry to see weakened, induce most men of property to be satisfied with a low rate of profits in their own country, rather than seek a more advantageous employment for their wealth in foreign nations. Gold and silver having been chosen for the general medium of circulation, they are, by the competition of commerce, distributed in such proportions amongst the different countries of the world as to accommodate themselves to the natural traffic which would take place if no such metals existed, and the trade between countries were purely a trade of barter.

Thus, cloth cannot be imported into Portugal unless it sell there for more gold than it cost in the country from which it was imported; and wine cannot be imported into England unless it will sell for more there than it cost in Portugal. If the

- 3 It will appear, then, that a country possessing very considerable advantages in machinery and skill, and which may therefore be enabled to manufacture commodities with much less labour than her neighbours, may, in return for such commodities, import a portion of the corn required for its consumption, even if its land were more fertile and corn could be grown with less labour than in the country from which it was imported. Two men can both make shoes and hats, and one is superior to the other in both employments; but in making hats he can only exceed his competitor by one-fifth or 20 per cent., and in making shoes he can excel him by one-third or 33 per cent.; -will it not be for the interest of both that the superior man should employ himself exclusively in making shoes, and the inferior man in making hats?

trade were purely a trade of barter, it could only continue whilst England could make cloth so cheap as to obtain a greater quantity of wine with a given quantity of labour by manufacturing cloth than by growing vines; and also whilst the industry of Portugal were attended by the reverse effects. Now suppose England to discover a process for making wine, so that it should become her interest rather to grow it than import it; she would naturally divert a portion of her capital from the foreign trade to the home trade; she would cease to manufacture cloth for exportation, and would grow wine for herself. The money price of these commodities would be regulated accordingly; wine would fall here while cloth continued at its former price, and in Portugal no alteration would take place in the price of either commodity. Cloth would continue for some time to be exported from this country, because its price would continue to be higher in Portugal than here; but money instead of wine would be given in exchange for it, till the accumulation of money here, and its diminution abroad, should so operate on the relative value of cloth in the two countries that it would cease to be profitable to export it. If the improvement in making wine were of a very important description, it might become profitable for the two countries to exchange employments; for England to make all the wine, and Portugal all the cloth consumed by them; but this could be effected only by a new distribution of the precious metals, which should raise the price of cloth in England and lower it in Portugal. The relative price of wine would fall in England in consequence of the real advantage from the improvement of its manufacture; that is to say, its

natural price would fall; the relative price of cloth would rise there from the accumulation of money.

Thus, suppose before the improvement in making wine in England the price of wine here were 50 Pounds, per pipe, and the price of a certain quantity of cloth were 45 Pounds, whilst in Portugal the price of the same quantity of wine was 45 Pounds, and that of the same quantity of cloth 50 Pounds; wine would be exported from Portugal with a profit of 5 Pounds, and cloth from England with a profit of the same amount.

Suppose that, after the improvement, wine falls to 45 Pounds in England, the cloth continuing at the same price. Every transaction in commerce is an independent transaction. Whilst a merchant can buy cloth in England for 45 Pounds, and sell it with the usual profit in Portugal, he will continue to export it from England. His business is simply to purchase English cloth, and to pay for it by a bill of exchange, which he purchases with Portuguese money. It is to him of no importance what becomes of this money: he has discharged his debt by the remittance of the bill. His transaction is undoubtedly regulated by the terms on which he can obtain this bill, but they are known to him at the time; and the causes which may influence the market price of bills, or the rate of exchange, is no consideration of his.

If the markets be favourable for the exportation of wine from Portugal to England, the exporter of the wine will be a seller of a bill, which will be purchased either by the importer of the

cloth, or by the person who sold him his bill; and thus, without the necessity of money passing from either country, the exporters in each country will be paid for their goods. Without having any direct transaction with each other, the money paid in Portugal by the importer of cloth will be paid to the Portuguese exporter of wine; and in England by the negotiation of the same bill the exporter of the cloth will be authorised to receive its value from the importer of wine.

But if the prices of wine were such that no wine could be exported to England, the importer of cloth would equally purchase a bill; but the price of that bill would be higher, from the knowledge which the seller of it would possess that there was no counter bill in the market by which he could ultimately settle the transactions between the two countries; he might know that the gold or silver money which he received in exchange for his bill must be actually exported to his correspondent in England, to enable him to pay the demand which he had authorised to be made upon him, and he might therefore charge in the price of his bill all the expenses to be incurred, together with his fair and usual profit.

If then this premium for a bill on England should be equal to the profit on importing cloth, the importation would of course cease; but if the premium on the bill were only 2 per cent., if to be enabled to pay a debt in England of 100 Pounds, 102 Pounds should be paid in Portugal, whilst cloth which cost 45 Pounds, would sell for 50 Pounds, cloth would be imported, bills would be bought, and money would be exported, till the diminution of money in Portugal, and its accumulation in

England, had produced such a state of prices as would make it no longer profitable to continue these transactions.

But the diminution of money in one country, and its increase in another, do not operate on the price of one commodity only, but on the prices of all, and therefore the price of wine and cloth will be both raised in England and both lowered in Portugal. The price of cloth, from being 45 Pounds in one country and 50 Pounds in the other, would probably fall to 49 Pounds or 48 Pounds in Portugal, and rise to 46 Pounds or 47 Pounds in England, and not afford a sufficient profit after paying a premium for a bill to induce any merchant to import that commodity.

It is thus that the money of each country is apportioned to it in such quantities only as may be necessary to regulate a profitable trade of barter. England exported cloth in exchange for wine because, by so doing, her industry was rendered more productive to her; she had more cloth and wine than if she had manufactured both for herself; and Portugal imported cloth and exported wine because the industry of Portugal could be more beneficially employed for both countries in producing wine. Let there be more difficulty in England in producing cloth, or in Portugal in producing wine, or let there be more facility in England in producing wine, or in Portugal in producing cloth, and the trade must immediately cease.

No change whatever takes place in the circumstances of Portugal; but England finds that she can employ her labour

more productively in the manufacture of wine, and instantly the trade of barter between the two countries changes. Not only is the exportation of wine from Portugal stopped, but a new distribution of the precious metals takes place, and her importation of cloth is also prevented.

Both countries would probably find it their interest to make their own wine and their own cloth; but this singular result would take place: in England, though wine would be cheaper, cloth would be elevated in price, more would be paid for it by the consumer; while in Portugal the consumers, both of cloth and of wine, would be able to purchase those commodities cheaper. In the country where the improvement was made prices would be enhanced; in that where no change had taken place, but where they had been deprived of a profitable branch of foreign trade, prices would fall.

This, however, is only a seeming advantage to Portugal, for the quantity of cloth and wine together produced in that country would be diminished, while the quantity produced in England would be increased. Money would in some degree have changed its value in the two countries; it would be lowered in England and raised in Portugal. Estimated in money, the whole revenue of Portugal would be diminished; estimated in the same medium the whole revenue of England would be increased.

Thus, then, it appears that the improvement of a manufacture in any country tends to alter the distribution of the precious metals amongst the nations of the world: it tends to

increase the quantity of commodities, at the same time that it raises general prices in the country where the improvement takes place.

To simplify the question, I have been supposing the trade between two countries to be confined to two commodities to wine and cloth; but it is well known that many and various articles enter into the list of exports and imports. By the abstraction of money from one country, and the accumulation of it in another, all commodities are affected in price, and consequently encouragement is given to the exportation of many more commodities besides money, which will therefore prevent so great an effect from taking place on the value of money in the two countries as might otherwise be expected.

Beside the improvements in arts and machinery, there are various other causes which are constantly operating on the natural course of trade, and which interfere with the equilibrium and the relative value of money. Bounties on exportation or importation, new taxes on commodities, sometimes by their direct, and at other times by their indirect operation, disturb the natural trade of barter, and produce a consequent necessity of importing or exporting money, in order that prices may be accommodated to the natural course of commerce; and this effect is produced not only in the country where the disturbing cause takes place, but, in a greater or less degree, in every country of the commercial world.

This will in some measure account for the different value of money in different countries; it will explain to us why the

prices of home commodities, and those of great bulk, though of comparatively small value, are, independently of other causes, higher in those countries where manufactures flourish. Of two countries having precisely the same population, and the same quantity of land of equal fertility in cultivation, with the same knowledge too of agriculture, the prices of raw produce will be highest in that where the greater skill and the better machinery is used in the manufacture of exportable commodities. The rate of profits will probably differ but little; for wages, or the real reward of the labourer, may be the same in both; but those wages, as well as raw produce, will be rated higher in money in that country, into which, from the advantages attending their skill and machinery, an abundance of money is imported in exchange for their goods.

Of these two countries, if one had the advantage in the manufacture of goods of one quality, and the other in the manufacture of goods of another quality, there would be no decided influx of the precious metals into either; but if the advantage very heavily preponderated in favour of either, that effect would be inevitable.

In the former part of this work, we have assumed, for the purpose of argument, that money always continued of the same value; we are now endeavouring to show that, besides the ordinary variations in the value of money, and those which are common to the whole commercial world, there are also partial variations to which money is subject in particular countries; and to the fact that the value of money is never the same in any two countries, depending as it does on rel-

ative taxation, on manufacturing skill, on the advantages of climate, natural productions, and many other causes.

Although, however, money is subject to such perpetual variations, and consequently the prices of the commodities which are common to most countries are also subject to considerable difference, yet no effect will be produced on the rate of profits, either from the influx or efflux of money. Capital will not be increased because the circulating medium is augmented. If the rent paid by the farmer to his landlord, and the wages to his labourers, be 20 per cent. higher in one country than another, and if at the same time the nominal value of the farmer's capital be 20 per cent. more, he will receive precisely the same rate of profits, although he should sell his raw produce 20 per cent higher. Profits, it cannot be too often repeated, depend on wages; not on nominal, but real wages; not on the number of pounds that may be annually paid to the labourer, but on the number of days' work necessary to obtain those pounds. Wages may therefore be precisely the same in two countries; they may bear, too, the same proportion to rent, and to the whole produce obtained from the land, although in one of those countries the labourer should receive ten shillings per week and in the other twelve.

In the early states of society, when manufactures have made little progress, and the produce of all countries is nearly similar, consisting of the bulky and most useful commodities, the value of money in different countries will be chiefly regulated by their distance from the mines which supply the pre-

cius metals; but as the arts and improvements of society advance, and different nations excel in particular manufactures, although distance will still enter into the calculation, the value of the precious metals will be chiefly regulated by the superiority of those manufactures.

Suppose all nations to produce corn, cattle, and coarse clothing only, and that it was by the exportation of such commodities that gold could be obtained from the countries which produced them, or from those who held them in subjection; gold would naturally be of greater exchangeable value in Poland than in England, on account of the greater expense of sending such a bulky commodity as corn the more distant voyage, and also the greater expense attending the conveying of gold to Poland.

This difference in the value of gold, or, which is the same thing, this difference in the price of corn in the two countries, would exist, although the facilities of producing corn in England should far exceed those of Poland, from the greater fertility of the land and the superiority in the skill and implements of the labourer.

If, however, Poland should be the first to improve her manufactures, if she should succeed in making a commodity which was generally desirable, including great value in little bulk, or if she should be exclusively blessed with some natural production, generally desirable, and not possessed by other countries, she would obtain an additional quantity of gold in exchange for this commodity, which would operate on the price of her corn, cattle, and coarse clothing. The dis-

advantage of distance would probably be more than compensated by the advantage of having an exportable commodity of great value, and money would be permanently of lower value in Poland than in England. If, on the contrary, the advantage of skill and machinery were possessed by England, another reason would be added to that which before existed why gold should be less valuable in England than in Poland, and why corn, cattle, and clothing should be at a higher price in the former country.

These I believe to be the only two causes which regulate the comparative value of money in the different countries of the world; for although taxation occasions a disturbance of the equilibrium of money, it does so by depriving the country in which it is imposed of some of the advantages attending skill, industry, and climate.

David Ricardo: *The Principles of Political Economy and Taxation*, ed. by F.W. Kolthammer, London 1911, 81–90.

Richard Cobden (1844):

Against the Economy of Privileges

Richard Cobden (1804–1865) came from a poor family, but through sheer hard work he became a respected and successful textile manufacturer in Manchester. His personal involvement in his highly idealistic campaign for a repeal of protectionist tariffs in general and the Corn Laws in particular, repeatedly brought him to the verge of financial ruin but he pressed on nonetheless. He encompassed the ideals of the liberal reform movement that was taking place all over Europe. And all over the continent, enthusiastic followers founded “Cobden Clubs” in an attempt to foster free trade. Cobden was never concerned exclusively with the economic issues. In his opinion, public education, peace and anticolonialism were in no way to be sacrificed to economic considerations.

Excerpts from Cobden’s speech on 8 February 1844 at a meeting in London are reproduced below. The speech summarises the agenda of the movement against the Corn Laws, which criticises the monopolies enjoyed by the privileged.

Now, we are ‘Free Traders’ and what is Free Trade? Not the pulling down of all custom-houses, as some of our wise opponents the dukes and earls have lately been trying to persuade the agricultural labourers; I should think it would do with nobody else. By, Free Trade we mean the abolition of all protective duties. It is very possible that our children, or at all events their offspring, may be wise enough to dispense

with custom-house duties altogether. They may think it prudent and economical to raise their revenues by direct taxation, without circumventing their foreign trade. We do not propose to do that; but there are a class of men who have taken possession of the Custom-house, and have installed their clerks there, to collect revenue for their own particular benefit, and we intend to remove them out of the Custom-house.

Now, I want to impress on our new friends, these students in Free Trade, to remind them of that which I have frequently dwelt upon, and which cannot be too often repeated, that this system of monopoly is analogous in every respect to that which existed 250 years ago under the Tudors and the Stuarts, when sovereigns granted monopolies to the creatures of their courts for the exclusive sale of wine, leather, salt, and other things, and which system our forefathers, at great labour and heavy sacrifice, utterly extirpated. One by one these monopolies were abolished; and, not content with destroying the existing monopolies, they passed a law, which became, as it were, a fundamental principle in our Constitution, that no sovereign, thenceforth or for ever, should have the power of granting a monopoly to anybody for the exclusive sale of any necessary commodity of life. Now, what I want to impress on our young learners is this, that that which sovereigns cannot do, a band of men united together – the selfish oligarchy of the sugar-hogshead and the flour-sack – have done. They have got together in the House of Commons, and by their own Acts of Parliament

have appropriated to their own classes the very privileges, the selfsame monopolies, or monopolies as injurious in every respect to the interests of the people as those monopolies were which our forefathers abolished two centuries and a half ago. There is no difference whatever in the effect of a monopoly in the sale of sugar held by a few men, the owners of those specks of land in the West Indies (for specks they are compared with the South American continent, the East Indies, Siam, China, the Indian Archipelago, and those other countries from which sugar might be supplied); there is no earthly difference in its effect on the community, whether a body of men in London take to themselves a monopoly in the sale of sugar, or whether Queen Victoria granted that monopoly to one of the noblemen of her court. Well, our forefathers abolished this system; at a time, too, mark you, when the sign manual of the sovereign had somewhat of a divine sanction and challenged superstitious reverence in the minds of the people. And shall we, the descendants of those men, be found so degenerate, so unworthy of the blood that flows in our veins, so recreant to the very name of "Englishmen", as not to shake off this incubus, laid on as it is by a body of our fellow-citizens ?

I believe some of our visitors here tonight are of what is called "the agricultural interest." They are probably curious to know why it is that we, professing to be Free Traders in everything, should restrict the title of our association to that of "The National Anti-Corn-Law League." I will explain the reason. We advocate the abolition of the Cornlaw, because

we believe that to be the foster-parent of all other monopolies; and if we destroy that – the parent, the monster monopoly – it will save us the trouble of devouring all the rest...

Now, what are the objections alleged against the adoption of Free-trade principles ? First of all, take the most numerous body – the working class – by far the most important in the consideration of this question: for probably ninety-ninths of all the population of this country are dependent on labour, either the hard work of hands, or the equally hard toil of heads. I say, take their ease first. We are told this system of restriction is for the benefit of the labourers. We are informed by the earls, dukes, and the squires, that the price of corn regulates the rate of wages; and that, if we reduce the price of corn by a free trade in that article, we shall only bring down the rate of wages. Now, I see a good many working people in this assembly, and would ask them whether, in any bargain ever made for labour in London, the question of corn or its price was ever made an element in that agreement? ...

Now, the first and greatest count in my indictment against the Corn-law is, that it is an injustice to the labourers of this and every other country. My next charge is, that it is a fraud against every man of capital engaged in any pursuit, and every person of fixed income not derived from land. I will take the trader, I am a manufacturer of clothing, and I do not know why, in this climate, and in the artificial state of society in which we live, the making of clothes should not be as honourable – because it is pretty near as useful – a pursuit as

the manufacture of food. Well, did you ever hear any debates in the House to fix the price of my commodities in the market? ...

Why, then, do you look at this monopoly of corn with such complacency? Simply because you and I and the rest of us have a superstitious reverence for the owners of those sluggish acres, and have a very small respect for ourselves and our own vocation. I say the Corn-law monopolists, who arrogate to themselves power in the House of Commons, are practising an injustice on every other species of capitalists...

The repeal of the Corn-laws will be carried when men understand it. And when you understand it, if you are honest men, you will feel it; if you feel it, at least as I have, you will not be able to be quiet without doing something to put down this great injustice. I exhort you each in your several circles to spread abroad light on this subject. Knowledge is the power – knowledge alone – by which we shall bring this foul system to the dust.

From: John Bright/James E. Thorold Rogers (Ed.): *Speeches on Questions of Public Policy by Richard Cobden*, 2 vols., London 1870, I S.113ff, 116, 118f, 133

Frédéric Bastiat (1846):

Protection from the Sun

Frédéric Bastiat (1801–1850) was probably the most important free-trade economist in France in the nineteenth century. His theoretical achievements include challenging the pessimism of some of his contemporaries (such as Malthus) who believed that population growth prevented the real income of the working classes from rising above the subsistence minimum. He believed that a liberal economic order would facilitate genuine mass wealth. He was proved right, as wealth did increase overall in the nineteenth century despite rapid population growth.

However, theoretical economics was not enough to satisfy for Bastiat. Inspired by the success of the English Anti-Corn Law League, he founded the French Free-Trade Association in 1846. In 1848, he was elected to the National Assembly of the Revolution. In the same year, he organised the first world peace congress together with Victor Hugo.

Today, however, the world remembers Bastiat mainly as a gifted writer with a good, consistent style, who attacked the flaws of protectionism in numerous essays and satirical pieces. The most well-known example is “The Candlemaker’s Petition”, which appeared in 1846 in the *Sophismes économiques*. In the piece, candlemakers ask for protection from competition from the sun. This article prompted Josef Schumpeter to call him the “most brilliant economic journalist ever to have lived.”

A Petition

From the Manufacturers of Candles, Tapers, Lanterns, Candlesticks, Street Lamps, Snuffers, and Extinguishers, and from the Producers of Tallow, Oil, Resin, Alcohol, and Generally of Everything Connected with Lighting.

To the Honorable Members of the Chamber of Deputies.
Gentlemen:

You are on the right track. You reject abstract theories and have little regard for abundance and low prices. You concern yourselves mainly with the fate of the producer. You wish to free him from foreign competition, that is, to reserve the domestic market for domestic industry.

We come to offer you a wonderful opportunity for applying your – what shall we call it? Your theory? No, nothing is more deceptive than theory. Your doctrine? Your system? Your principle? But you dislike doctrines, you have a horror of systems, and, as for principles, you deny that there are any in political economy; therefore we shall call it your practice – your practice without theory and without principle.

We are suffering from the ruinous competition of a foreign rival who apparently works under conditions so far superior to our own for the production of light that he is flooding the domestic market with it at an incredibly low price; for the moment he appears, our sales cease, all the consumers turn to him, and a branch of French industry whose ramifications are innumerable is all at once reduced to complete stagnation. This rival, which is none other than the sun, is waging

war on us so mercilessly that we suspect he is being stirred up against us by perfidious Albion (excellent diplomacy nowadays!), particularly because he has for that haughty island a respect that he does not show for us.

We ask you to be so good as to pass a law requiring the closing of all windows, dormers, skylights, inside and outside shutters, curtains, casements, bull's-eyes, deadlights, and blinds in short, all openings, holes, chinks, and fissures through which the light of the sun is wont to enter houses, to the detriment of the fair industries with which, we are proud to say, we have endowed the country, a country that cannot, without betraying ingratitude, abandon us today to so unequal a combat.

Be good enough, honorable deputies, to take our request seriously, and do not reject it without at least hearing the reasons that we have to advance in its support.

First, if you shut off as much as possible all access to natural light, and thereby create a need for artificial light, what industry in France will not ultimately be encouraged?

If France consumes more tallow, there will have to be more cattle and sheep, and, consequently, we shall see an increase in cleared fields, meat, wool, leather, and especially manure, the basis of all agricultural wealth.

If France consumes more oil, we shall see an expansion in the cultivation of the poppy, the olive, and rapeseed. These rich yet soil-exhausting plants will come at just the right time

to enable us to put to profitable use the increased fertility that the breeding of cattle will impart to the land.

Our moors will be covered with resinous trees. Numerous swarms of bees will gather from our mountains the perfumed treasures that today waste their fragrance, like the flowers from which they emanate. Thus, there is not one branch of agriculture that would not undergo a great expansion.

The same holds true of shipping. Thousands of vessels will engage in whaling, and in a short time we shall have a fleet capable of upholding the honor of France and of gratifying the patriotic aspirations of the undersigned petitioners, chandlers, etc.

But what shall we say of the specialties of Parisian manufacture? Henceforth you will behold gilding, bronze, and crystal in candlesticks, in lamps, in chandeliers, in candelabra sparkling in spacious emporia compared with which those of today are but stalls.

There is no needy resin-collector on the heights of his sand dunes, no poor miner in the depths of his black pit, who will not receive higher wages and enjoy increased prosperity.

It needs but a little reflection, gentlemen, to be convinced that there is perhaps not one Frenchman, from the wealthy stockholder of the Anzin Company to the humblest vendor of matches, whose condition would not be improved by the success of our petition.

We anticipate your objections, gentlemen, but there is not a single one of them that you have not picked up from the musty old books of the advocates of free trade. We defy you to utter a word against us that will not instantly rebound against yourselves and the principle that guides your entire policy.

Will you tell us that, though we may gain by this protection, France will not gain at all, because the consumer will bear the expense?

We have our answer ready:

You no longer have the right to invoke the interests of the consumer. You have sacrificed him whenever you have found his interests opposed to those of the producer. You have done so in order to encourage industry and to increase employment. For the same reason you ought to do so this time too.

Indeed, you yourselves have anticipated this objection. When told that the consumer has a stake in the free entry of iron, coal, sesame, wheat, and textiles, "Yes," you reply, "but the producer has a stake in their exclusion." Very well! Surely if consumers have a stake in the admission of natural light, producers have a stake in its interdiction.

"But," you may still say, "the producer and the consumer are one and the same person. If the manufacturer profits by protection, he will make the farmer prosperous. Contrariwise, if agriculture is prosperous, it will open markets for manufactured goods." Very well! If you grant us a monopoly

over the production of lighting during the day, first of all we shall buy large amounts of tallow, charcoal, oil, resin, wax, alcohol, silver, iron, bronze, and crystal, to supply our industry; and, moreover, we and our numerous suppliers, having become rich, will consume a great deal and spread prosperity into all areas of domestic industry.

Will you say that the light of the sun is a gratuitous gift of Nature, and that to reject such gifts would be to reject wealth itself tinder the pretext of encouraging the means of acquiring it?

But if you take this position, you strike a mortal blow at your own policy; remember that up to now you have always excluded foreign goods because and in proportion as they approximate gratuitous gifts. You have only half as good a reason for complying with the demands of other monopolists as you have for granting our petition, which is in complete accord with your established policy; and to reject our demands precisely because they are better founded than anyone else's would be tantamount to accepting the equation: $+X=+-$; in other words, it would be to heap absurdity upon absurdity.

Labor and Nature collaborate in varying proportions, depending upon the country and the climate, in the production of a commodity. The part that Nature contributes is always free of charge; it is the part contributed by human labor that constitutes value and is paid for.

If an orange from Lisbon sells for half the price of an orange from Paris, it is because the natural heat of the sun, which is, of course, free of charge, does for the former what the latter owes to artificial heating, which necessarily has to be paid for in the market.

Thus, when an orange reaches us from Portugal, one can say that it is given to us half free of charge, or, in other words, at half price as compared with those from Paris.

Now, it is precisely on the basis of its being semigratuitous (pardon the word) that you maintain it should be barred. You ask: "How can French labor withstand the competition of foreign labor when the former has to do all the work, whereas the latter has to do only half, the sun taking care of the rest?" But if the fact that a product is half free of charge leads you to exclude it from competition, how can its being totally free of charge induce you to admit it into competition? Either you are not consistent, or you should, after excluding what is half free of charge as harmful to our domestic industry, exclude what is totally gratuitous with all the more reason and with twice the zeal.

To take another example: When a product – coal, iron, wheat, or textiles – comes to us from abroad, and when we can acquire it for less labor than if we produced it ourselves, the difference is a gratuitous gift that is conferred upon us. The size of this gift is proportionate to the extent of this difference. It is a quarter, a half, or three-quarters of the value of the product if the foreigner asks of us only three-quarters,

one-half, or one-quarter as high a price. It is as complete as it can be when the donor, like the sun in providing us with light, asks nothing from us. The question, and we pose it formally, is whether what you desire for France is the benefit of consumption free of charge or the alleged advantages of onerous production. Make your choice, but be logical; for as long as you ban, as you do, foreign coal, iron, wheat, and textiles, in proportion as their price approaches zero, how inconsistent it would be to admit the light of the sun, whose price is zero all day long!

From: Frédéric Bastiat: *Economic Sophisms*, transl. by Arthur Goddard, Irvington-on-Hudson (Foundation for Economic Education) 1996, p. 56–60.

Henry George (1886):

Should “Infant Industries” be Protected?

He was not only the “best-selling” economist of his time but was, above all, one of the most influential social reformers that the United States has ever produced. Henry George (1839–1897) wrote the best-selling book, *Progress and Poverty* (1879), which resulted in a very popular land reform movement all over the world. He claimed that all taxes, with the exception of a single high tax on the ownership of land, should be abolished as they reduced wealth. George argued that the single land tax was not a tax against the free market, as it abolished unjust monopoly rent that distorted the market; it was a tax that created the market in the first place and was for the benefit of all, mainly the poor. He consequently rejected the favouritism of protectionist policies towards the economically powerful, and in his book, *Free Trade and Protection* (1886), from which the following section has been taken, he consistently supported a laissez faire trade policy. His critique of the argument that infant industries should be protected by tariffs to promote a country’s development is as relevant today as it was then.

WITHOUT questioning the end sought by them we have seen that protective tariffs are to be condemned as a means. Let us now consider their end – the encouragement of home industry.

There can be no difference of opinion as to what encouragement means. To encourage an industry in the protective sense is to secure to those carrying it on larger profits than they could of themselves obtain. Only so far and so long as it does this can any protection encourage an industry.

But when we ask what the industries are that protection proposes to encourage we find a wide difference. Those whom American protectionists have regarded as their ablest advocates have asked protection for the encouragement of “infant industries” – describing the protective system as a means for establishing new industries in countries to which they are adapted.* They have scouted the idea of attempting to encourage all industry, and declared the encouragement of industries not adapted to a country, or already established, or for a time longer than necessary for their establishment, to be waste and robbery. As it is now popularly advocated and practically applied in the United States, the aim of protection, however, is not the encouragement of “infant industries” but the encouragement of “home industry” – that is to say, of all home industries. And what has proved true in our case is generally true. Wherever protection is once begun, the imposition of duties never stops until every home industry of any political strength that can be protected by tariff gets some encouragement. It is only in new countries and in the beginnings of the system that the encouragement of infant industries can be presented as the sole end of protection. European protectionists can hardly ask protection, on the ground of their infancy, for industries

that have been carried on since the time of the Romans. And in the United States to ask now the encouragement of such giants as our iron, steel and textile industries as a means for their establishment would, after all these years of high tariffs, be manifestly absurd...

As an abstract proposition it is not, I think, to be denied that there may be industries to which temporary encouragement might profitably be extended. Industries capable, in their development, of much public benefit have often to struggle under great disadvantages in their beginnings, and their development might sometimes be beneficially hastened by judicious encouragement. But there are insuperable difficulties in the way of discovering what industries would repay encouragement...

So it is with the encouragement of struggling industries. All experience shows that the policy of encouragement, once begun, leads to a scramble in which it is the strong, not the weak; the unscrupulous, not the deserving, that succeed. What are really infant industries have no more chance in the struggle for governmental encouragement than infant pigs have with full grown swine about a meal tub. Not merely is the encouragement likely to go to industries that do not need it, but it is likely to go to industries that can only be maintained in this way, and thus to cause absolute loss to the community by diverting labor and capital from remunerative industries. On the whole, the ability of any industry to establish and sustain itself in a free field is the measure of its public utility, and that "struggle for existence" which drives out

unprofitable industries is the best means of determining what industries are needed under existing conditions and what are not. Even promising industries are more apt to be demoralized and stunted than to be aided in healthy growth by encouragement that gives them what they do not earn, just as a young man is more likely to be injured than benefited by being left a fortune. The very difficulties with which new industries must contend not merely serve to determine which are really needed, but also serve to adapt them to surrounding conditions and to develop improvements and inventions that under more prosperous circumstances would never be sought for.

Thus, while it may be abstractly true that there are industries that it would be wise to encourage, the only safe course is to give to all "a fair field and no favor." ...

Nothing could better show the futility of attempting to make industries self-supporting by tariff than the confessed inability of the industries that we have so long encouraged to stand alone. In the early days of the American Republic, when the friends of protection were trying to ingraft it upon the Federal revenue system, protection was asked, not for the maintenance of American industry, but for the establishment of "infant industries," which, it was asserted, would, if encouraged for a few years, be able to take care of themselves. The infant boys and girls of that time have grown to maturity, become old men and women, and with rare exceptions have passed away. The nation then fringing the Atlantic seaboard has extended across the continent, and instead of

four million now numbers nearly sixty million people. But the “infant industries,” for which a little temporary protection was then timidly asked, are still infants in their desire for encouragement. Though they have grown mightily they claim the benefits of the “Baby Act” all the more lustily, declaring that if they cannot have far higher protection than at the beginning they dreamed of asking they must perish outright...

Protectionist writers have not yet given up the “infant industry” plea, for it is the only ground on which with any semblance of reason protection can be asked; but in the face of the facts they have extended the time in which it is averred that protection can establish an infant industry. The American people used to be told that moderate duties for a few years would enable the protected industries to stand alone and defy foreign competition. But in the latest edition of his *Political Economy* (p. 233), Professor Thompson⁴, of the University of Pennsylvania, tells us that “it will ordinarily take the lifetime of two generations to acclimatize thoroughly a new manufacture, and to bring the native production up to the native demand.”

4 Robert Ellis Thompson (1844–1924), was Dean of the Wharton School of Finance and Economics of the University of Pennsylvania. In several economic textbooks he further developed the protectionist argument (originating from Henry C. Carey) of “infant industries”. George here quotes Thompson’s book “*Elements of Political Economy*,” of 1882. George felt wary about Thompson not only because he was a protectionist, but because he was also one of the fiercest critics of “Georgist” ideas on land reform (editor’s note).

When we are told that two generations should tax themselves to establish an industry for the third, well may we ask, "What has posterity ever done for us?" Yet even this promise is not borne out by facts. Industries that we have been protecting for more than two generations, now need, according to protectionists, more protection than ever.

The popular plea for protection in the United States to-day is not, however, the encouragement of infant industries, but the encouragement of home industry, that is, all home industry.

Now it is manifestly impossible for a protective tariff to encourage all home industry. Duties upon commodities entirely produced at home can, of course, have no effect in encouraging any home industry. It is only when imposed upon commodities partly imported and partly produced at home, or entirely imported, yet capable of being produced at home, that duties can in any way encourage an industry. No tariff which the United States imposed could, for instance, encourage the growth of grain or cotton, the raising of cattle, the production of coal oil or the mining of gold or silver; for instead of importing these things we not only supply ourselves, but have a surplus which we export. Nor could any import duty encourage any of the many industries which must be carried on where needed, such as building, horseshoeing, the printing of newspapers, and so on. Since these industries that cannot be protected constitute by far the larger part of the industries of every country, the utmost that by a protective tariff, can be attempted is the encouragement of only a few of the total industries of a country...

Yet it is as true of encouragement by tariff as of encouragement by bounties that the gain to some involves loss to others, and since encouragement by tariff involves far more cost and waste than encouragement by bounty, the proportion which the loss bears to the gain must be greater. However protection may affect special forms of industry it must necessarily diminish the total return to industry – first, by the waste inseparable from encouragement by tariff, and, second, by the loss due to the transfer of capital and labor from occupations which they would choose for themselves to less profitable occupations which they must be bribed to engage in.

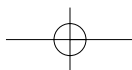
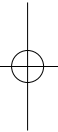
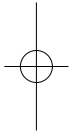
If we do not see this without reflection, it is because our attention is engaged with but a part of the effects of protection. We see the large smelting works and the massive mill without realizing that the same taxes which we are told have built them up have made more costly every nail driven and every needleful of thread used throughout the whole country. Our imaginations are affected as were those of the first Europeans who visited India, and who, impressed by the profusion and magnificence of the Rajahs, but not noticing the abject poverty of the masses, mistook for the richest country in the world what is really the poorest.

But reflection will show that the claim popularly made for protection, that it encourages home industry (i. e., all home industry), can be true only in one sense – the sense in which Pharaoh encouraged Hebrew industry when he compelled the making of bricks without straw. Protective tariffs make



more work, in the sense in which the spilling of grease over her kitchen floor makes more work for the housewife, or as a rain that wets his hay makes more work for the farmer.

Henry George, *Protection or Free Trade. An Examination of the Tariff Question with Especial Regard to the Interests of Labour*, London 1886, p. 103–111.



Ludwig von Mises (1927):

Free Trade as a Peace Policy

His radically liberal views were a thorn in the flesh of many political opponents, and during Hitler's Annexation of Austria in 1938, Ludwig von Mises (1881–1973) was forced to flee the National Socialists and go into exile in the United States where he taught economics in New York. As early as 1922, his book "Socialism: An Economic and Sociological Analysis" proved that every planned economy (and, in the long term, even every "milder" interventionist economy) would be doomed to fail, as it was not based on rational cost calculations. This statement, which was ultimately proved accurate, caused a lively debate amongst economists, in which several of his gifted students (such as F. A. Hayek) took part.

In his book *Liberalism* (1927), von Mises defended the ideals and political vision of liberalism against the increasingly antiliberal "Zeitgeist" of the years between the world wars. He also appealed for a peace policy based on free trade and labour mobility, as is evident in the following excerpt from the book.

For the liberal, there is no opposition between domestic policy and foreign policy, and the question so often raised and exhaustively discussed, whether considerations of foreign policy take precedence over those of domestic policy or vice versa, is, in his eyes, an idle one. For liberalism is, from the very outset, a world-embracing political concept, and the same ideas that it seeks to realize within a limited area it

holds to be valid also for the larger sphere of world politics. If the liberal makes a distinction between domestic and foreign policy, he does so solely for purposes of convenience and classification, to subdivide the vast domain of political problems into major types, and not because he is of the opinion that different principles are valid for each.

The goal of the domestic policy of liberalism is the same as that of its foreign policy: peace. It aims at peaceful cooperation just as much between nations as within each nation. The startingpoint of liberal thought is the recognition of the value and importance of human cooperation, and the whole policy and program of liberalism is designed to serve the purpose of maintaining the existing state of mutual cooperation among the members of the human race and of extending it still further. The ultimate ideal envisioned by liberalism is the perfect cooperation of all mankind, taking place peacefully and without friction. Liberal thinking always has the whole of humanity in view and not just parts. It does not stop at limited groups; it does not end at the border of the village, of the province, of the nation, or of the continent. Its thinking is cosmopolitan and ecumenical: it takes in all men and the whole world. Liberalism is, in this sense, humanism; and the liberal, a citizen of the world, a cosmopolite.

Today, when the world is dominated by antiliberal ideas, cosmopolitanism is suspect in the eyes of the masses. In Germany there are overzealous patriots who cannot forgive the great German poets, especially Goethe, whose thinking and feeling, instead of being confined by national bounds, had a

cosmopolitan orientation. It is thought that an irreconcilable conflict exists between the interests of the nation and those of mankind and that one who directs his aspirations and endeavors toward the welfare of the whole of humanity thereby disregards the interests of his own nation. No belief could be more deeply mistaken. The German who works for the good of all mankind no more injures the particular interests of his compatriots – i. e. those of his fellow men with whom he shares a common land and language and with whom he often forms an ethnic and spiritual community as well – than one who works for the good of the whole German nation injures the interests of his own home town. For the individual has just as much of an interest in the prosperity of the whole world as he has in the blooming and flourishing of the local community in which he lives...

It is from the fact of the international division of labor that liberalism derives the decisive, irrefutable argument against war. The division of labor has for a long time now gone beyond the boundaries of any one nation. No civilized nation today satisfies its need as a self-sufficient community directly from its own production. All are obliged to obtain goods from abroad and to pay for them by exporting domestic products. Anything that would have the effect of preventing or stopping the international exchange of goods would do immense damage to the whole of human civilization and undermine the well-being, indeed, the very basis of existence, of millions upon millions of people. In an age in which nations are mutually dependent on products of foreign

provenance, wars can no longer be waged. Since any stoppage in the flow of imports could have a decisive effect on the outcome of a war waged by a nation involved in the international division of labor, a policy that wishes to take into consideration the possibility of a war must endeavor to make the national economy self-sufficient, i. e., it must, even in time of peace, aim at making the international division of labor come to an end at its own borders. If Germany wished to withdraw from the international division of labor and attempted to satisfy all its needs directly through domestic production, the total annual product of German labor would diminish, and thus the well-being, the standard of living, and the cultural level of the German people would decline considerably...

One would think that after the experience of the World War the realization of the necessity of perpetual peace would have become increasingly common. However, it is still not appreciated that everlasting peace can be achieved only by putting the liberal program into effect generally and holding to it constantly and consistently and that the World War was nothing but the natural and necessary consequence of the antiliberal policies of the last decades.

A senseless and thoughtless slogan makes capitalism responsible for the origin of the war. The connection between the latter and the policy of protectionism is clearly evident, and, as a result of what is certainly a grievous ignorance of the facts, the protective tariff is identified outright with capitalism. People forget that only a short time ago all the nation-

alistic publications were filled with violent diatribes against international capital (“finance capital” and the “international gold trust”) for being without a country, for opposing protective tariffs, for being averse to war and inclined toward peace. It is altogether absurd to hold the armaments industry responsible for the outbreak of the war. The armaments industry has arisen and grown to a considerable size because governments and peoples bent on war demanded weapons. It would be really preposterous to suppose that the nations turned to imperialistic policies as a favor to the ordnance manufacturers. The armaments industry, like every other, arose in order to satisfy a demand. If the nations had preferred other things to bullets and explosives, then the factory-owners would have produced the former instead of the materials of war.

One can assume that the desire for peace is today universal. But the peoples of the world are not at all clear as to what conditions would have to be fulfilled in order to secure peace.

If the peace is not to be disturbed, all incentive for aggression must be eliminated. A world order must be established in which nations and national groups are so satisfied with living conditions that they will not feel impelled to resort to the desperate expedient of war. The liberal does not expect to abolish war by preaching and moralizing. He seeks to create the social conditions that will eliminate the causes of war. The first requirement in this regard is private property. When private property must be respected even in time of war,

when the victor is not entitled to appropriate to himself the property of private persons, and the appropriation of public property has no great significance because private ownership of the means of production prevails everywhere, an important motive for waging war has already been excluded. However, this is far from being enough to guarantee peace. So that the exercise of the right of selfdetermination may not be reduced to a farce, political institutions must be such as to render the transference of sovereignty over a territory from one government to another a matter of the least possible significance, involving no advantage or disadvantage for anyone. People do not have a correct conception of what this requires. It is therefore necessary to make it clear by a few examples...

If there are no tariff boundaries and no limitations on the movement of persons, animals, or goods, then it is of no consequence whether a train ride in a few hours crosses over the borders of the state more or less often...

Transfer from one "economic zone" (in the etatist sense) to another has serious economic consequences. One need only think, for instance, of the cotton industry of upper Alsacia, which has twice had to undergo this experience, or the Polish textile industry of Upper Silesia, etc. If a change in the political affiliation of a territory involves advantages or disadvantages for its inhabitants, then their freedom to vote for the state to which they really wish to belong is essentially limited. One can speak of genuine selfdetermination only if the decision of each individual stems from his own free will,

and not from fear of loss or hope of profit. A capitalist world organized on liberal principles knows no separate “economic” zones. In such a world, the whole of the earth's surface forms a single economic territory...

Large areas of the world have been settled, not by the members of just one nationality, one race, or one religion, but by a motley mixture of many peoples. As a result of the migratory movements that necessarily follow shifts in the location of production, more new territories are continually being confronted with the problem of a mixed population. If one does not wish to aggravate artificially the friction that must arise from this living together of different groups, one must restrict the state to just those tasks that it alone can perform...

The theoretical demonstration of the consequences of the protective tariff and of free trade is the keystone of classical economics. It is so clear, so obvious, so indisputable, that its opponents were unable to advance any arguments against it that could not be immediately refuted as completely mistaken and absurd.

Nevertheless, nowadays we find protective tariffs – indeed, often even outright prohibitions on imports – all over the world. Even in England, the mother country of free trade, protectionism is in the ascendancy today. The principle of national autarky wins new supporters with every day that passes. Even countries with only a few million inhabitants, like Hungary and Czechoslovakia, are attempting, by means

of a high-tariff policy and prohibitions on imports, to make themselves independent of the rest of the world. The basic idea of the foreign trade policy of the United States is to impose on all goods produced abroad at lower costs import duties to the full amount of this difference. What renders the whole situation grotesque is the fact that all countries want to decrease their imports, but at the same time to increase their exports. The effect of these policies is to interfere with the international division of labor and thereby generally to lower the productivity of labor. The only reason this result has not become more noticeable is that the advances of the capitalist system have always been so far sufficient to outweigh it. However, there can be no doubt that everyone today would be richer if the protective tariff did not artificially drive production from more favorable to less favorable localities.

Under a system of completely free trade, capital and labor would be employed wherever conditions are most favorable for production. Other locations would be used as long as it was still possible to produce anywhere under more favorable conditions. To the extent to which, as a result of the development of the means of transportation, improvements in technology, and more thorough exploration of countries newly opened to commerce, it is discovered that there are sites more favorable for production than those currently being used, production shifts to these localities. Capital and labor tend to move from areas where conditions are less favorable for production to those in which they are more favorable...

Antiliberal policy, by abolishing the free mobility of labor in international trade and considerably restricting even the mobility of capital, has, to a certain extent, eliminated the difference that existed in the conditions of international trade between the beginning and the end of the nineteenth century and has reverted to those prevailing at the time the doctrine of free trade was first formulated. Once again capital and, above all, labor are hindered in their movements. Under the conditions existing today, unhampered trade in consumers' goods could not give rise to any migratory movements. Once again, it would result in a state of affairs in which the individual peoples of the world would be engaged in those types and branches of production for which the relatively best conditions exist in their own countries.

But whatever may be the prerequisites for the development of international trade, protective tariffs can accomplish only one thing: to prevent production from being carried on where the natural and social conditions are most favorable for it and to cause it to be carried on instead where conditions are worse. The outcome of protectionism is, therefore, always a reduction in the productivity of human labor. The free trader is far from denying that the evil that the nations of the world wish to combat by means of a policy of protectionism really is an evil. What he maintains is only that the means recommended by the imperialists and protectionists cannot eliminate that evil. He therefore proposes a different way. In order to create the indispensable conditions for a lasting peace, one of the features of the present international situ-



ation that the liberal wishes to change is the fact that emigrants from nations like Germany and Italy, which have been treated like stepchildren in the division of the world, must live in areas in which, because of the adoption of antiliberal policies, they are condemned to lose their nationality...

Ludwig von Mises, *Liberalism in the Classical Tradition*, Irvington 1985, p. 105–108, 110–113, 117–118, 130–131, 135–136.



Gottfried Haberler (1933):

Free Trade, Monopolies and Wages

He was a member of Ludwig von Mises' famous private seminar at the University of Vienna, which produced many distinguished liberal intellectuals (including the Nobel laureate Friedrich August von Hayek). Gottfried Haberler (1900–1995), who emigrated from Austria to the USA in 1936 to take up a professorship at Harvard where he remained until 1971, is one of the leading foreign trade theorists of the twentieth century. In his book, *Der internationale Handel* (International Trade), published in 1933, he reformulated Ricardo's free-trade theory by substituting a subjective value theory based on macroeconomics for the labour theory of value (misused by Marxism). This put free trade on a new solid scientific basis. The book also made him one of the most important new representatives of the Austrian School of Economics. According to Haberler, efficient cost calculation is only possible when the market takes account of the subjective preferences of the individual. Therefore free trade provides for growth and raises the standard of living.

The most attractive argument for Free Trade is to point out that free import lowers the prices of imported goods. That is, of course, correct; and the extent of the price reduction affords (with certain reservations) some measure of the gain to the economy from international trade, and an approximate measure of the injury which an impediment to the import of these goods would involve. This argument has the advan-

tage, not to be despised, that it is useful for purposes of propaganda, since everyone is a consumer and, as such, desires lower prices. Nevertheless, this is only one side of the matter, and gives only a partial view of the problem. This explains why the objection is always raised against Free Trade doctrine that it considers only the interests of consumers and ignores the question of employment and, in general, the interests of producers. The Free Trader can answer this objection by pointing out that not only will prices fall, but, in addition, there will result a movement of factors of production to other parts of the economy, where they can earn more. But this brings us back to our first and fundamental argument. Those who find a sufficient reason for free import in the consequent price reduction should logically desire export duties, since the increased difficulty of exporting would reduce the prices of exportable goods in the exporting country.

Another point is that free import and export benefit all participating countries in that they prevent, or at least make more difficult, the establishment of injurious monopolies. This fact must again be considered from the two standpoints of the increase in the social product and of the effect on its distribution.

We have already pointed out, when speaking of the law of decreasing costs, that there is a danger in small areas shut off by import duties that in many branches of industry, in which large-scale production yields a significant advantage, the optimum size of the production unit cannot be attained

because the market is too small. The complement of this is the formation of a monopoly. This involves a threefold injury to the economy.

First, under Free Trade each country can specialise in a few branches of production, and the optimum size of the production unit can be attained and costs reduced everywhere. Restrictions on the freedom of trade will not only lead to a loss of these advantages of international division of labour but will also – secondly – raise the prices of the goods, produced by the resulting monopolies, above costs of production which, owing to the relatively small output due to the restricted market, are already at a relatively high level.

Thirdly, experience shows that the restriction of free competition may lead to a less efficient conduct of economic affairs. Free Trade has an educative effect. Home producers are spurred by foreign competition to become more efficient and to adopt quickly any improvement in methods of production, no matter where it is first introduced.

Nevertheless, Free Trade does not provide a complete safeguard against the formation of monopolies. Even under Free Trade there may emerge international monopolies, of which more will be said later, and local monopolies. These local monopolies owe their existence, in the absence of a tariff, to transport costs, which have much the same effects as tariffs. In those branches of production whose products can be transported only at a high cost, the lower production costs due to a larger production-unit may be more than offset by

the increased costs of marketing the greater output over a wider area. When this is the case, there will not be a single market with a uniform price, such as is described in general price theory, but a series of adjoining monopoly districts, partly overlapping one another, with competitive prices in the contested regions and monopoly prices inside each district. These monopoly prices can exceed production costs, but only to the extent of the freight charges...

The general public usually considers the existence of unemployment in an industry as a very good reason for the imposition of a tariff. Of course, it is beyond dispute that unemployment in one single industry – provided that its products do in fact compete with similar imported goods, and provided that the demand for such products is not completely elastic – can be diminished by a tariff on the competing imports. Such a diminution, the possibility of which is freely admitted by Free Traders, is one consequence of the expansion of production in that industry due to the tariff. But this proves nothing whatever as to the total effect of such a tariff.

The real question in this context is whether total unemployment can be diminished or whether its diminution in some industries will be offset by its increase in others; in concrete terms, whether the number of workers dismissed in the export industries may not be as great as or greater than, the number of additional workers taken on in the protected industry...

We turn now to labour. In the long run, and apart from certain exceptions, this is the least specific and most adaptable factor of all. But, in the short run, it is more specific and less mobile. Whenever the appropriate response to a change in economic conditions involves more employment of labour in one industry, or even in one firm, and less in another, this will mean a temporary or permanent diminution in wages and other unpleasant effects for some workers, and will therefore arouse opposition. Moreover, it is beyond dispute that various modern developments have tended, and still do tend, to lessen the mobility and adaptability of labour. On the one hand, the strength of organised labour, including the influence of trade unions, and State intervention in labour questions, especially in connection with unemployment insurance and unemployment relief, have both increased greatly. On the other hand, the rapid growth of population, which in the past made possible a great redistribution of labour between industries by the diversion of new entrants towards the expanding industries, has now been replaced by an approach to stationary populations, so that a redistribution now involves an actual movement of workers out of the contracting industries and into the expanding ones.

We may conclude that in the long run the working-class as a whole has nothing to fear from international trade, since, in the long run, labour is the least specific of all factors. It will gain by the general increase in productivity due to the international division of labour, and is not likely to lose at all seriously by a change in the functional distribution of the nation-

al income. Hence the political representatives of labour lean as a rule towards Free Trade. But, in the short run, specialised and immobile groups of workers, like the owners of specific material factors, may suffer heavy reductions in income when for one reason or another they are faced with more intense foreign competition. They are rendered more vulnerable by the fact, already mentioned, that wages are less flexible than most prices. The price of a material factor must sink to zero before it ceases to be used, but workers, especially when they have strong trade unions and are supported directly or indirectly by State intervention, will withhold their labour if wages fall below a certain limit. The consequence may be chronic unemployment in the industries affected by the change in conditions.

Gottfried Haberler: *The Theory of International Trade*, transl. A. Stonier/F. Benham, London/Edinburgh/Glasgow 1954, p. 222–224, 259–60, 194–195.

Jagdish Bhagwati (1988):

Multilateralism and Development

The economist Jagdish Bhagwati, born in India in 1934, is one of the most active proponents of free trade amongst economists today. Bhagwati teaches at Columbia University, New York, and his many functions include Special Adviser to the General Secretary of the United Nations on foreign trade and globalisation issues. He is also External Advisor to the World Trade Organisation (WTO). Bhagwati argues that free trade is particularly beneficial for third-world countries and protectionism is detrimental. He always uses examples from his home country, India, to support his thesis.

Bhagwati believes in multilateralism while opposing unilateral national tariff policy that circumvents the most favoured nation clause. In 1948, the General Agreement on Trade and Tariffs (GATT) led to international agreements that initiated the large-scale dismantling of trade restrictions. The following excerpt from Bhagwati's book, *Protectionism* (1988), illustrates the success of this political approach to economic development after the Second World War. We should not lose sight of this when we witness the World Trade Organisation (WTO), which was created when GATT was overhauled in 1995 and today is the nerve centre of multilateralism, as a target of criticism from opponents of globalisation in recent years.

The architects of the liberal postwar order and the ensuing trade liberalization were not merely intellectual believers in the virtues of freer trade. They were also the beneficiaries

of a splendid historical example: an experience with tariffs that was widely perceived to have been a spectacular failure.

The Great Depression had been associated with beggar-my-neighbor policies of competitive exchange-rate depreciation and tariff escalation, each aimed at preserving and deflecting aggregate demand toward one's own industries at the expense of those of one's trading partners. Few believe that such policies caused the Depression; there are many more plausible candidates for the role of villain. But it is certainly arguable that the tariff escalations deepened the Depression.

In any event, the perception grew and persisted that the Smoot-Hawley tariff⁵-raising binge, in which virtually every industry was rewarded with its own "made-to-order" tariff (with the apparent consequence of foreign tariff retaliations and a worsening depression), was a disaster.

As John Kenneth Galbraith has wittily said of an economist foe, his misfortune has been that his theories have been applied: blooming in the ivory tower, they have wilted in the real world. For the proponents of free trade, the magnitude

5 Smoot-Hawley Tariff: Protectionist tariffs passed by the USA in June 1930; prolonged the 1929 Depression by many years and instigated bitter trade wars all over the world. Named after its authors, Congressman Willis C. Hawley and Senator Reed Smoot, both Republicans (editor's note).

of the failure of tariffs, and indeed of their seemingly counterproductive results, during the Depression was a real dividend. It helped to stack the cards in favor of the pro-trade forces, providing the ideological momentum for liberal trade that persists to this date.

Whereas this pro-trade bias was shared by all the countries that the Depression afflicted, its principal convert was the United States. This would be critical, as the United States was steadily emerging as a major force and the Second World War would leave it as the dominant power shaping the world economy. The immediate result, even before the war, was a dramatic (indeed drastic) shift in trade policy by a chastened group of American policymakers.

The institutional structure that had facilitated the enactment of the Smoot-Hawley tariff was modified. Stung by its own failure and by a severe electoral judgment, the Congress—which had given in to each sectional interest's demand for tariff protection – acquiesced in a classic shift of power in trade-policy initiatives and management to the executive branch, which was less amenable to constituency pressure. This was coupled with an active, negotiated dismantling of the post-depression tariff walls under the 1934 Reciprocal Trade Agreements Act by an executive branch that was not only freer from protectionist constituency pressures (directly and indirectly via the Congress) but also eager to indulge the newly acquired pro-trade bias. The pro-trade bias would also underlie the institutional design of GATT at the end of the war...

GATT did not eliminate trade restrictions in one fell swoop; it was an umbrella under which a series of tariff-cutting exercises were undertaken. The process of tariff reduction was spread over seven rounds (not counting the ongoing Uruguay Round, launched in September 1986). In the United States, the average tariff declined by nearly 92 percent over the 33 years spanned by the Geneva Round of 1947 and the Tokyo Round. By the early 1980s, the tariff level had gone down to 4.9 percent in the United States, 6.0 percent in the European Economic Community, and 5.4 percent in Japan...

Whereas the post-World War II trade liberalization was driven by the pro-trade bias generated by the negative example of the Smoot-Hawley tariff, today's pro-trade bias can be traced to the positive example of the successful postwar liberalization. And the perception that postwar prosperity was fueled (if not led) by the freeing of trade has greatly strengthened the pro-trade bias inherited from before the Second World War.

The postwar experience has also served to dispel the anti-trade bias that once afflicted policymakers in the developing countries and led to the unusually high reliance on protection that I sketched above. The example that produced this shift in attitudes was the superlative economic performance of those countries (in particular, the Four Tigers' of East Asia) that unilaterally liberalized their trade regimes during the 1950s.

This phenomenon is of extraordinary significance. Not only did it demonstrate to developing countries that trade liberalization pays handsome dividends even to a country that, because of its underdevelopment, is presumably some-how beyond the reach of the pro-trade doctrine; in addition, it inevitably generated revisionist reactions addressed to the question whether protection rather than freer trade had been the key to these countries' success.

Let us take a closer look at these issues in the context of the trade policies of the developing countries. We shall then turn to the broader questions they raise – questions that touch directly on the new intellectual developments in the theory of commercial policy.

The intellectual traditions that legitimated the protectionist policies of the developing countries define the pro-protectionist elements that the successful trade liberalization of the Four Tigers helped to contain.

The inwardlooking protectionist strategy of policy-induced import substitution had four distinct elements, which occurred in various combinations in different developing countries in the 1950s:

- The dominant element was clearly the widespread pessimism concerning the export prospects of the developing countries. Ragnar Nurkse (1959)⁶ articulated this pessimism

6 Ragnar Nurkse: *Patterns of Trade and Development*, 1959.

splendidly. The fear was that the growth of the developing countries would require export levels that could not be absorbed by the outside world or by other developing countries. An investment policy of “balanced growth,” whereby a country would increasingly have to produce what it wished to consume, would then be dictated by this scenario. Import substitution, assisted by the government, would be both necessary and efficient. This argument does not actually justify blanket protection, but that is essentially what it led to in practice. Because economists are susceptible to the herd instinct, it is not surprising that the writings of many influential development economists of the 1940s and the 1950s reflect pessimism about exports. For instance, Paul Rosenstein-Rodan (1943)⁷ argued that investment would not be undertaken by one investor unless it was undertaken simultaneously by others, and that planned coordination of investment, assuring each investor of a market, was therefore necessary. This difficulty, however, would not necessarily arise if there were international markets capable of absorbing what an investor produced and sold. Raul Prebisch (1952)⁸ produced the celebrated and captivating thesis that the primary-product exports of the developing countries faced a long-run decline, and that these countries would therefore have to protect their way into producing manufactures.

7 Paul Rosenstein-Rodan: *Problems of Industrialization of Eastern and South-Eastern Europe*, in: *Economic Journal*, 53, 1943.

8 Raul Prebisch: *Problemas Teoricos y Practicos del Crecimiento Economico*, 1952.

• Although export pessimism generated an inward-looking ethos for trade policy, the coup de grace to freer trade was delivered, in many cases, from an altogether different direction. Contrary to the expectations of the architects of the International Monetary Fund, who had the interwar experience of knee-jerk competitive devaluations in mind when they stipulated restrictions on exchange-rate changes, the postwar exchange-rate regime turned out to be one of reluctant adjustments. Particularly in much of Latin America, exchange rates were sluggishly adjusted to high inflation rates, causing substantial currency overvaluation with supporting exchange and trade controls. As we now fully appreciate, such overvaluation is tantamount to protection. It also led to blanket, made-to-order “automatic” protection in some developing countries. For instance, in Brazil the “Law of Similar” and in India the principle of “indigenous availability” were utilized to exclude imports, regardless of cost, if domestic substitutes (however unsuitable or uneconomical) were available; the rationale was that this would “save foreign exchange.”

• However, we should not forget that infant-industry protection had a perfectly legitimate role, even within the classical theory of gains from specialization and trade. Yet infant industries do not justify blanket protectionism; besides, promotion (i.e., support through domestic subvention that does not discriminate against foreign trade) rather than protection (which does discriminate against foreign trade) is what is called for. Nonetheless, both the infant-industry argument

and the balance-of-payments foreign-exchange-scarcity argument outlined above were accepted indiscriminately, and in GATT Article XVIII(B) they were given international approval.

- Further reinforcement for the idea of broadly protecting infant industries came from the notion that specialization in primary production was politically unacceptable for a modern state. A destiny of “hewers of wood and drawers of water,” no matter how advantageous economically, would be at the expense of political status in the international community of nations. (As Oscar Wilde said of the prime example of prosperity through primary production, “There is this world and the next, and then there is New Zealand.”) This political preference for industrialization often coexisted with a conviction that manufacturing had considerable externalities – such as creation of a scientific mentality conducive to innovation and technical change—that were not fully reflected in market prices. Whatever the precise mix of the “political status” and “economic externalities” motivations in any specific context, there is little doubt that the developing countries were particularly susceptible to this line of argumentation in the 1950s, when they were both newly independent and heavily specialized in primary production and exports. The historian Edward Carr, writing in 1951⁹, put the argument eloquently:

9 Edward H. Carr: *The New Society*, London 1951.

What Asia and Africa are fundamentally in revolt against – what-ever forms, political or economic, the revolt may take in day-to-day actions – is the nineteenth-century division of the world between advanced and backward peoples and the basis of that division in the intensive industrialization of certain areas of the world to the exclusion of others. Political independence and political equality are no longer enough. These achievements, which seemed all-important so long as they were out of reach, are now seen to be hollow and unreal unless they are backed up by the reality of economic independence and economic equality... The lesson has been thoroughly learned and digested that large-scale modern machine industry confers a high material standard of living and a widely diffused education and culture, as well as political and military power and prestige. Backward nations have been transformed into advanced nations through the process of industrialization – and in no other way... Industry is the symbol of progress. Imitation is the last and sincerest form of tribute paid by the colonial East to the industrial West. (p. 94; emphasis added)

These notions reinforced the other economic arguments that prompted the pursuit of protectionist, import-substitution strategies.

As the postwar period unfolded, the above arguments weakened. The mere fact of industrialization in many developing countries over two decades meant that, at the margin, the pro-industrialization arguments for protection would be less compelling. But far more effective was the demonstration by

the trade-liberalizing countries that their superior export performance had led to more successful and substantial industrialization than what the more protectionist nations had managed. By making external markets at least as attractive as home markets, and even by creating a certain pro-export bias by policy design, these countries made their new industries register rapid growth by breaking out of the confines of the smaller domestic markets.

Take the compelling contrast between South Korea and India-prime examples of trade-liberalizing and protectionist regimes. South Korea's manufactured exports, negligible in 1962, amounted by 1980 to nearly four times those of India. South Korea's manufacturing sector was less than 25 percent as large as India's in 1970 (measured in terms of value added); by 1981 it was already up to 60 percent. The contrasts in success with *industrialization* – not just economic growth in general – have been so enormous between trade-liberalizing and the protectionist countries that the old-fashioned view that protection favors manufacturing in developing countries has lost its appeal.

The main changes, however, were in the demise of the pattern of reluctant exchange-rate adjustment, so that currency overvaluation became a far less serious source of protection. As was demonstrated well (though by no means exclusively) by the Four Tigers, the removal of such anti-export policies and the establishment of a pro-export bias could improve export performance so dramatically that the protection-legitimizing export pessimism of Nurkse et al.

turned out to have been unwarranted. Indeed, the improvement in export performance mapped rather well onto better economic performance—a relationship that was especially striking in the case of the Four Tigers but was also corroborated by finer empirical studies of those countries and by time-series analyses of other countries as they moved toward greater trade liberalization through the 1960s and the early 1970s.

The intellectual orthodoxy therefore shifted rather sharply away from the early emphasis on the virtues of protectionism and the attendant import-substitution strategy and toward the merits of trade liberalization and the outward-looking strategy of export promotion...

But this merely underlines how the current situation offers both opportunities and vulnerabilities, calling for a skillful, long-sighted, and continuous exercise of leadership, informed by economic science and by political skills.

Let me conclude by reasserting my guarded optimism in regard to the long-run prospects for keeping protectionism at bay. My mind turns back to Ragnar Nurkse, whose pessimism about the prospects for world trade was invalidated by the glorious 1950s and 1960s. I hope that my optimism encounters a more indulgent future.

Jagdish Bhagwati: *Protectionism*, 2nd ed., Cambridge/London (MIT Press) 1989, p. 20–23, 3, 87–94, 129–130.

Otto Graf Lambsdorff (1995):

Protectionism: The Modern Imperialism

Otto Count Lambsdorff, born in 1926, is the chairman of the board of the Friedrich Naumann Foundation. From 1972 to 1998 he was a member of the German Bundestag (the Lower House in the German Parliament), from 1977 to 1984, the German Minister of Economic Affairs, from 1988 to 1993, leader of the German Free Democratic Party (FDP) and between 1991 and 1994, president of Liberal International. In all these positions he has distinguished himself with his clear-cut position on free trade and the market economy.

In this day and age, the thought that protectionism may have something to do with imperialism may, at first glance, not be too obvious to many people. It rather seems to be the other way round.

It looks like free trade – i.e. unrestricted capitalism on an international level – is fons et origo of all imperialist evils.

However, those who take the trouble of studying the history of the idea of free trade without bias will quickly be much the wiser.

It is, indeed, true to say that it was the Free Trade Movement of the 19th century that was the first to cast shadows of moral doubt upon imperialism.

In the pre-liberal era of mercantilism, wars and conquests were the standard – and by no means subtle – forms of exploitation. They were inevitable consequences of the economic ideas on which the mercantilist system was founded. It was not until the beginnings of the liberal movement began to take hold and spread – particularly in England – that a kind of politics began to emerge which not only discredited imperialism as immoral but aimed at eroding its economic foundations at the same time. Quite some time before all this, in 1776, Adam Smith had suggested this type of policy in his classic book *The Wealth of Nations* in which he quite openly sympathized with the American colonies which, at that time, were aspiring to gain their independence.

The Manchester Liberals of the 19th century are, wrongly, much defamed in this day and age although it was they who forged the ideas of free trade, national prosperity, peace and anti-imperialism into a strong and great movement.

In a letter he wrote in 1842, Richard Cobden, one of the masterminds of the Manchester Liberals, made it quite plain that he was not merely interested in economic advantages for his country or, even worse, in establishing a “bourgeois class of capitalists” (as was frequently suggested the Manchester Liberals intended). He wrote: “... the Colonial policy of Europe has been the chief source of wars for the last hundred and fifty years. Again, Free Trade, by perfecting the intercourse, and securing the dependence of countries one upon another, must inevitably snatch the power from the governments to plunge their people into wars.”

In the end, the struggle of the Free Trade Movement had created a world in which an end to wars, colonialism and imperialism seemed to be within easy reach. John Maynard Keynes gave a colourful description of this situation in 1919 in his book *The Economic Consequences of the Peace*: “What an extraordinary episode in the economic progress of man that era was that came to an end in August 1914! The greater part of the population, it is true, worked hard and lived a low standard of comfort, yet were, to all appearances reasonably contented with this lot. But escape was possible, for any man of capacity or character at all exceeding the average into the middle or upper classes, for whom life offered, at a low cost and with the least trouble, conveniences, comfort, and amenities beyond the compass of the richest and most powerful monarchies of other ages... The projects and politics of militarism and imperialism, of racial and cultural rivalries, of monopolies, restrictions and exclusion, which were to play serpent to this paradise, were little more than the amusement of his daily newspaper, and appeared to exercise almost no influence at all on the ordinary course of social and economic life, the internationalization of which was nearly complete in practice.”

However, the disaster that struck in 1914 and which put an end to this liberal vision was not brought about purely by chance. Its antagonists had already and imperceptibly reconquered the terrain they had lost before.

In Germany, it had all begun in 1878 with Bismarck abandoning the idea of free trade, an attitude in which, unfortu-

nately, many liberals were soon to join him. Almost all of the European powers then followed this example.

Worse, though, than free trade's foes were, then as today, its false friends. The high moral standards to which the Free Trade Movement of the 19th century had laid claim must have been the reason why, this time, even those who otherwise had very openly attacked liberal ideas did not broadcast their hostility so much in public.

To this very day it is true to say that even the most eminent critics of economic freedom only rarely venture to come out in open support of protectionism. More often than not, opponents have adorned themselves with borrowed plumes by confessing to free trade with the intention to pave the way for other causes which have not been of much help neither to the high moral principles of the Free Trade Movement nor, in practical terms, to free trade as such.

It may sound like one of life's ironies that it was the imperialists, of all people, who were the first to put on this magic hood, free trade's very enemies whom the original Manchester Liberals had fought tooth and nail.

Countless numbers of others were to follow in their footsteps, each one of them adding, in their own way, to the fad that the moral radiance of the term "free trade" has lost some of its lustre and does no longer shine as brightly as it used to when the term was first conceived. It is not so much the idea of free trade itself which is to be blamed for this but

the fact that the concept of free trade has been abused and taken advantage of again and again.

Sir John Seeley, probably the most eminent literary protagonist of aggressive imperialism in England around the end of the 19th century, provides us with a telling illustration of this in his book *The Expansion of England* which was published in 1883. In this book he writes: "Commerce in itself may favour peace, but when commerce is artificially shut out by a decree of Government from some promising territory, then commerce just as naturally favours war."

Which indicates that, according to Seeley, free trade needs an expanding state in order to be able to successfully forge ahead and establish itself. Competition between nations would then be nothing but a consequence of competition between national economies.

Seeley went on: "But inseparable from the commercial stimulus was the stimulus of international rivalry. The object of each nation was now to increase its trade, not by waiting upon the wants of mankind, but by a wholly different method, namely by getting exclusive possession of some rich tract in the New World."

With that, Seeley painted a distorted picture of the principle of free trade, a picture which we still find haunting many politicians today. They raise their voices every day.

It is well worth our while taking a closer look at their modern guise. If we do, we are sure to find nothing but the same old

misconceptions just vamped up and dressed in new enticing clothes.

Let me get this straight right up front: it goes without saying that the kind of imperialism that was based on conquest and coercion, and practised by the world powers at the time of Seeley, is nothing more than a marginal problem these days – at least so we hope. Today's modern form of protectionist imperialism acts with considerably greater subtlety.

At their very core, however, the arguments used in justification have remained the same. Take, for example, the proposition that a free market presupposes a uniformly organised political area, an assumption which forms the very foundation of Seeley's theory. Strip it of its warlike trimmings and you will end up with a concept that we can also find in many of the would-be market oriented ideas as put forward by the Eurocracy in Brussels.

And what about the European Commission which keeps harping on about so-called “harmonization” being an absolute prerequisite of the Single European Market?

While in the field of European product regulations harmonization has been shackled at least somewhat by the judiciary, it seems that in the fields of social and fiscal politics the principle of political “action for action's sake” has been and continues to be on the advance without anyone ever having any qualms about it.

And yet, it is free trade's great advantage that it will take a favourable influence on the very rules of politics even under competing political systems.

I should like to venture the statement that a comprehensive harmonization of fiscal systems will, in the long run, result in an altogether higher tax burden for all of us, since to-date the chance that public revenue might decrease as a result of an exodus of capital into other countries has at least imposed some restraint on the ministers of finance.

Furthermore, there is reason to doubt that harmonised rules will de facto always result in lower transaction costs. Will this really hold true if such harmonised rules will themselves be exempted from competition later on?

To put it in a nutshell: It is correct to say that free trade does not necessarily require harmonized rules. It works the other way round: the very rules of politics need free trade.

Therefore, even in this modest and peaceful guise, Seeley's imperialist claim that it is necessary to enforce uniform market conditions "from the top" should be viewed with caution.

And there is another one of Seeley's, the imperialist's, notions that continues to haunt many people in our modern times. This is the belief that free trade itself is the very factor which furthers political expansion since it is supposed to depend on this expansion for its survival.

During the course of history, there have been many attempts made to corroborate this untenable statement by establish-

ing underneath it a foundation of twisted and abused economic theory. It never worked.

Leninist theory which says that the capitalist market economy's chronic surplus production must inevitably lead to the coercion of new sales markets, may serve as an example.

This theory ignored not just Say's Law which was discovered by the French economist Jean-Baptiste Say in 1803 and established that production, while developing, always creates demand at the same time, which was why general sales crises would be almost impossible to occur in a genuine market economy.

It also ignored the fact that, even at Lenin's time, the bulk of the European powers' rising capital exports and their growth in export sales continued to be directed at the allegedly monopolized and saturated markets of Europe, America and Australia – rather than at the colonies. And what is more, right from the outset, the colonies turned out not to be very profitable – or even not profitable at all.

Profits that were made through the colonies were mainly based on speculation or unconcealed government protection.

Frequently, there was an openly protectionist idea behind it right from the start, i.e. the thought that if a country could lay its hands on raw materials it would become largely self-sufficient. As a result, it would be able to better hold its own in economic wars with other major empires. Spiteful commen-

tators might consider certain intensified efforts at establishing large trade blocks (NAFTA, EU, TAFTA etc.) – which were originally meant to serve free trade but are increasingly closing themselves off to the rest of the world – to be a parallel case of the present time. Anyway, the causal link established between military expansion and a professedly radical kind of free trade as postulated by Seeley has particularly contributed to the fact that countries most in need of free trade took the most hostile attitude towards it for a long time.

Since the sixties, the catchword of “neocolonialism” has come to be the battle cry of the poor South (mostly former colonies which were only too familiar with the practical side of Seeley's theories) against the North. The UNCTAD conferences of the seventies and eighties were dominated by this slogan. Therefore, it is humanly quite understandable why the developing countries have equated free trade with the law of the jungle.

Economically speaking, however, this view was incorrect. Free trade, as is evident from its early European history, has always been a tool of the weak.

It was mainly the workers who gave their wholehearted support to the cause of free trade during the struggle of the Manchester Liberals around Cobden. Similarly, the Third World countries should have become devoted “free traders” as well.

Yet, up until far into the eighties it was mainly the rich industrialised nations which in their development politics placed

their confidence in free trade – at least verbally – while the poorer countries were deeply distrustful of any type of free trade.

The fact that the industrialised nations were never too serious about opening their own markets to the countries of the Third World did not help at all but just helped to erode further the moral reputation enjoyed by the idea of free trade.

And last but not least, in the early eighties ideas became prominent like that advocated by the then UNESCO Director-General M Bow who went as far as demanding a protectionist kind of control of the international media market which, he said, was required to protect Third World politicians from allegedly unfair reporting by Western media.

Just like this „New World Information and Communication Order” would have done nothing but stabilise inhuman and cynical regimes and prolong oppression, any other kind of protectionism would have prolonged destitution, hardship and misery in the same way.

In this context, another argument that we come across frequently – and, unfortunately, it also was thought up by a German, Friedrich List, has resulted in disastrous effects. His argument claims that the “infant” industries of underdeveloped countries need initial protection in order to be able to become competitive in the long run.

As I said elsewhere: “Behind protective fences no improvements will take place”. Quite the contrary. We can be pret-

ty sure that the ones who will prevail behind such fences will not be those who are economically competitive but those who know the ins and outs of politics and keep best company with political circles.

Or, to say it with the words of the American economist Henry George who expressed it like this at the end of the last century: "What are really infant industries have no more chance in the struggle for governmental encouragement than infant pigs have with their full grown swine about a meal tub."

And yet it seems that one particular conviction is turning out to be true, i.e. the conviction held by all those economists who think so highly of themselves and who believe that, in the long run, economic forces will always prevail over false ideas. It seems that in many Third World countries – and this goes particularly for Latin America and Asia – reform processes based on the ideas of market economy and free trade are developing much more dynamically than in the so-called First World. The Uruguay GATT round of talks was another indicative of this change.

The Indian economist Jagdish Bhogwati who lives in New York even speaks of "ironic reversal", that is to say that, today, those rich nations of the "North" which in the past always used to press for "more market" in international trade, have turned round to doubt its blessings, while the countries of the "South" have increasingly become convinced of them. Which gives us hope that humanity may be capable of learning its lessons after all – at least in this field.

So, after a long time, the very countries with weak economies have now begun to discover the benefits of free trade for themselves, and one of the reasons why this is so may have something to do with the moral quality of protectionism – or rather: its fundamental moral deficiency.

You can turn it whichever way you want – protectionism is always an inexcusable aggressive act against other human beings or nations. It is always an attempt to secure one's own advantage not by way of voluntary cooperation but by coercion. And almost always it serves the purpose of imposing on other people a policy which they do not want to accept voluntarily.

And this, in turn, is clearly in line with imperialist logic.

Imperialist logic also demands that this inevitable fact be glossed over by empty moralising phrases. Sir John Seeley provides us with a beautiful example of this, quite in the style of classic imperialism. He writes that the Indian nations subdued by Great Britain were nothing but “robber states” and that the British Empire had been established by conquering those nations also because of “a philanthropic desire to put an end to enormous evils”.

There is no doubt that modern protectionism, too, is a policy which directly hurts people in other countries.

The EU's despicable banana import regulation is an outrageous case in point that goes to show how arbitrariness may

equally violate the interests of producers in developing and of consumers in industrialised nations.

Currently, there is a discussion going on in the Federal Republic of Germany about the so-called Posting of Workers Law ("Entsendegesetz") which is meant to prevent cheap foreign labour from gaining access to the German building industry. The justification given is solidarity with the German building workers in the face of unemployment running high in this industry.

I do not intend to discuss the economic repercussions of this measure which, I am certain, will, before long, whet the appetite for similar action in other industries.

This law will do much harm to Germany's national economy.

What is even more surprising, though, is that nobody even cares to mention the Portuguese or other foreign workers who will be deprived of their livelihood in this way. "Social" rhetoric, it seems, has successfully managed to conceal an outrageously arbitrary act of government. Which goes to show that since Seeley's days, the principle has remained unchanged.

I have, so far, made an effort to show up the analogies between a classic imperialism of the Seeley type and the subtle forms of modern protectionism. This might give us the impression that people have hardly learnt anything worth mentioning since the 19th century.

But they have! At least as regards their practice of glossing over with empty moral phrases their aggressive politics of patronising other nations and telling them what they should do. In this field, modern-time protectionists have been pretty creative.

Their latest battle cry goes to prove it: Fair Trade.

This term had been used before at around the end of the 19th century by English protectionists who paid lip service to free trade but believed it could only work if everybody else abided by the same rules.

In case some nations did not, it was necessary, according to those “Fair Traders”, to “reciprocate” by taking counter-measures against those who did not play ball.

We do not need to waste too much time on this idea. If it were taken seriously, the beginnings of politics of free trade would be postponed until the end of history. And, what's more, in most cases not even the protagonists of this idea really mean what they say when they say it.

These “counter-measures” are generally not truly meant to enforce free trade but rather to promote one's own protectionist interests. Just take the Clinton Administration's dispute with the allegedly protectionist Japanese about automotive parts. The catchword here was to coerce Japan into accepting the principles of free trade, while the real objective was to ensure that American manufacturers would be given guaranteed quotas in the Japanese market.

Economically speaking, each reciprocated “counter-protectionism” means adding insult to injury. It will aggravate the damage done by the original protectionist act by reciprocating with yet another protectionist act, thus adding further damage to that already done.

Milton Friedman once compared this scenario with two people sitting in a boat. As one of them drills a hole into the bottom of the boat, the boat slowly starts to go down. To compensate for this damage, the other one then drills another hole into the boat. To those who have their doubts about this metaphor let me recommend the study of the history of the American politics of “reciprocating” counterprotectionism between the wars which culminated in the famous Smoot-Hawley Tariff Act of 1930.

The consequences of this act were the abolition of the most favoured nation clauses in almost all industrialised countries and an international trade war based on national selfishness, a trade war which resulted in the total international trade volume of 1938 dropping 60 % below that of 1929. This led to an aggravation of the economic depression which may, in the final analysis, have contributed to the rise of totalitarianism in Europe.

It has to be admitted, though, that those who adorned themselves with the label “Fair Trader” in the late 19th century by advocating their notion of “reciprocating counter-measures” were representatives at least of a clear, if false, idea.

The Fair Traders of this modern day and age have understood this weakness and done away with it. Clear ideas, after all, can be countered by clear arguments, which may make life difficult for any preacher of false ideas. On the other hand, blurred and vague ideas can protect themselves quite easily against criticism. This very effect is exploited by the Fair Traders of today. After all, the word “fair” sounds pretty nice; nobody can seriously have anything against it.

The term “Fair Trade” might, of course, be interpreted as requesting free access to all markets for everyone. But then, the term “fair” would have nothing to add to the term “free”. It would be superfluous.

In reality, the term Fair Trade characterises a rather vague notion with the purpose of legitimising ad-hoc intervention into free trade if its outcome is thought, by whoever, to be somehow “discriminating” or “detrimental”.

Behind it all, there is a notion of “economic justice” which is just as vague and blurred. This “economic justice” has nothing whatsoever to do with real justice. It rather bears some analogy to the term “social justice” which was at one time torn to pieces by great liberal Nobel prize winner FriedrichAugust von Hayek's merciless criticism.

While justice “without an adjective”, as a justice of rules, postulates that every man be equal before the law and thus defines unambiguous limits of power, “economic” or “social” justice does not define anything at all. All it does is supply “justification” to politics of ruthlessly catering for

special interests in society at the expense of the public at large.

In this context, the American author James Bovard speaks of a "Fair Trade Fraud" which, he says, is a sham, a policy that pretends to work in the interest of the general public but in reality represents a "gun boat economy" which is detrimental mainly to the majority of the respective country's own consumers.

Recently, this kind of fraudulent story has been supplemented to by a number of heart-rending sob stories. These are mainly stories told by people calling for "social standards" or people who express their concern about the "natural environment".

Now, as concerns social standards, these are, unfortunately, not just demanded at UN summit meetings which do not (yet?) have too much of an influence on politics. This kind of discussion has also been going on at the WTO, international free trade's most important representative body, where heated debates have been held about the so-called Social Clause. Let me at least venture some reservations against this kind of clause.

If the WTO is serious about the issue of international competition, it will have to realize that it is this very diversity of rules which is essential to, and forms part and parcel of, this competition.

On the other hand, imposed "universal" standards will, in reality, not be able to reflect anything but the protectionist

interests of those who were strong enough to gain the upper hand in the negotiations, while other nations will be discriminated against.

But apart from the economic argument, there is also a moral one.

Hardly anybody, it seems, is worried about the fact that, in the face of the diversity of people and cultures on this globe, it is simply impossible to establish something like universally applicable standards in the first place.

Even in such supposedly obvious cases like, e.g., banning child labour, the consequences may be disastrous. In some countries, such a ban might mean starvation, child prostitution and destitution for the very people who are supposed to be protected by such action.

So we may ask ourselves: isn't this, again, a piece of imperialism creeping in stealthily by the back door, trying to impose the values and standards of some – mostly the more prosperous – nations on others?

The same question needs to be asked when it comes to the issue of “ecology”. It is not quite without reason that the catchword of “eco-imperialism” has lately emerged in some Third World countries.

Let me say this right at the outset: Free trade is the best international kind of ecological policy there is, because the kind of protectionism we see frequently practised by the

industrialized nations forces the poor countries to ruthlessly overexploit and destroy their natural resources.

Furthermore, it is just by free trade that it will be possible to generate prosperity in the countries of the Third World to such an extent that the people living there will be lifted from destitution and rescued from starvation and that, as a result, they can actually afford an awareness that duly takes care of their natural environment.

And last but not least, pollution control and protection of natural resources is also a matter of technical progress and putting it to practical use. To be able to do this, growth and accumulation of capital are required. We must not prevent the Third World, where most people still use primitive and unecological economic practices, from growing and accumulating capital by discriminating against it on the basis of our “ecologically” founded protectionist attitude.

There is the risk that universal rules to protect nature will end up eroding this very process of development.

In any case, the nations of the Third World will always feel patronized – particularly if one considers that these countries are expected to curtail their own economic capacities because we, the industrialized nations, pollute the air. For all the urgent need to control pollution and protect nature, this moral aspect should never be forgotten.

As you can see, those opposed to free trade often adorn their full-mouthed arguments with moral principles – woolly

as they may be. It is to be regretted that the protagonists of free trade do not put forward its moral aspects as often, although they would be much more entitled to do so. And free trade needs all the moral support and encouragement it can get in order to overcome the opposition it meets with.

Free trade will have to remember the simple wisdom put forward by John Prince-Smith, the English-born leader of the German Free Trade Movement, in 1860: "To introduce coercion into the economic process would be tantamount to putting arbitrariness in the place of justice".

Free Trade faces opposition by strong and selfish pressure groups. Even options that would make economic sense, such as venturing unilateral measures of free trade in a protectionist world, will take a lot of courage and power of persuasion.

It may be quite helpful in this context to remind one's contemporaries of the fact that somewhere in each form of protectionism there lurks a little piece of anachronistic imperialism.

Indeed, protectionism is the modern form of imperialism. We can easily do without it.

Speech delivered at the Berlin-Meeting of the Friedrich-Naumann-Stiftung on September 24th, 1995.

From: Friedrich-Naumann-Stiftung (ed.): Return of Socialism?, St. Augustin 1997, p. 81–91.

C. Christian von Weizsäcker (1999):

The Ethics of the International Capital Market

The international capital markets have been dramatically liberalised over the last decades. Foreign exchange controls have been lifted virtually everywhere. This aspect of free trade policy has been subject to frequent criticism because one suspects that there is a particularly immoral form of capitalism and speculation lurking behind. In the following article, Carl Christian von Weizsäcker proves that this criticism is unjustified. Weizsäcker teaches at the University of Cologne, has been a member of the advisory committee on scientific matters of the German Ministry of Economic Affairs and was the chairperson of the Monopolies Commission from 1986 to 1998. According to Weizsäcker, the free international capital market is an effective weapon against the destructive populist economic policy of some states.

Until well into the nineteenth century the predominant view of Western political thought was that democracy would not work. Sceptics believed this was because people were susceptible to demagogues who made impossible promises. A temporary redistribution of wealth from rich to poor would create a brief illusion amongst the poor that their lot would now definitely improve. However, expropriating the wealthy classes would destroy what, until then, had been the very basis of overall wealth, leading to an imminent economic col-

lapse. This fear of populism also repeatedly prompted framers of constitutions in the late eighteenth and nineteenth centuries to create a two-house system in parliament. The upper house had the task of reining in the lower house, i. e., the people's representatives, when the latter wanted to adopt such short-sighted, temporarily popular redistribution measures. Hence the composition of the upper house was also less democratic (or not at all democratic) than that of the lower house. In the Federalist Papers, written by Hamilton, Madison and Jay, in defence of the new draft of the US constitution, one can read about the discussions that led to the creation of the American senate, which was originally not elected by direct public vote but made up of delegates from individual states nominated by the respective governors.

While the historical development of democracy had its ups and downs, it became clear that democracy was functioning in North America and Western Europe and would continue to do so. Nevertheless, the problem of populism has not completely disappeared but has, perhaps, shifted slightly with regard to the earlier fears. If, at that time, the danger of radical change played on the minds of sceptics, then a certain political lassitude with regard to constitutional change is possibly the main problem today.

How does one define populism? This is not easy if one wants to coin a term that does not merely mirror one's own prejudices. Obviously one cannot classify those measures as populist, which one does not agree with but which are clearly popular. I would suggest the following definition: A pop-

ulist policy, while popular, would not be so if the electorate were well informed. The difficulty here is, of course, to provide practical proof of a policy not being popular if the electorate were well informed.

However, the following comparison can be formulated in this context. We had ascertained that a democratic majority has a tendency to inflate the state budget deficits more than the electorate would like, if the latter were to take the time to delve deeper into the subject. We showed there that this is an example of delegation-induced, short-term orientation. Perhaps the following comparative observation can be made here: The larger the budget deficit tolerated by a state's fiscal policy in times of normal economic activity, the more popular the policy tends to be.

The opponents of globalisation now claim that the international capital market violates national democratic sovereignty to the extent that domestic fiscal policy is bound by the rules laid down by international creditors with regard to the creditworthiness of debtors. Often orchestrated by the International Monetary Fund, conditions are imposed by international creditors on a country's domestic policies, leading to cutbacks in the social services, for example, thereby affecting the poorest people in the country.

This can naturally be seen as interference on the part of the international capital market in the decision-making sovereignty of a country. But what distinguishes this from the case of the private debtor? ... (It has been said) that an individual

person who requires a loan to further his plans must put them forward for approval, and that this process of reconciling future expectations and reality is socially very beneficial, as these realistic expectations replace the utopias to which we all incline. Under the leadership of a government, if unrealistic budget plans and expectations are used to justify continuously high deficits, is the intervention of international creditors a violation of national sovereignty or a wake-up call for a country of dreamers led by a populist government? The answer cannot be generalised. Of course this nation can have far more confidence than international creditors have in its own future. After all, it is also possible that this nation is in the same situation as the brilliant inventor who seeks a loan and is unfairly turned away by banks because they do not understand him. But it is just as possible and, based on all objective historical experience, in fact far more likely that banks are right when they are less optimistic in their assessment of a country than the government of the country itself is, or pretends to be, in order to raise the loan. International creditors could make a useful contribution in this case by exposing the populism of the government in question. In laying down conditions for further loans they would have seen to it that the populism of a policy is toned down.

Keeping in mind the tendency of policies to be short-term and status-quo oriented, it is not implausible that international capital markets often have a disciplinary influence on local politics in the sense of consolidating public finances

and facilitating changes that are necessary but difficult to implement. It is not absurd to think that a realistic statesman in a responsible position is willing to exploit the pressure applied by foreign banks to implement constitutional changes that he considers necessary in his party and in parliament.

The Italian example may help to clarify what I mean when I speak of disciplining. As long as there were no free international flows of capital, people's savings were tied up in local shares, local property or local fixed-interest securities. Under these conditions, it was no problem to finance the growing national debt as long the majority of people thought that it was less risky to invest in fixed-interest securities than in the stock exchange. In keeping with their strong family tradition, the Italians had an exceedingly well-developed system of providing for themselves. When combined with the risk-aversion of Italians, this enabled the Italian state to finance a national debt that was far higher than the gross domestic product. Italy's national debt spiralled upwards because Italian politics, rather than being oriented to the long-term needs of the population, was extremely short-term oriented. The populism of Italian politics was hard to beat.

The rules of the EU have eventually given the Italians the option of investing their savings outside their own country. The borrower, namely the 'State of Italy', now has to compete for people's savings. This is the real reason for the relatively non-violent revolution that has taken place in Italy in the last ten years. The old and, in the end, corrupt regime

abdicated. Under pressure from international financial markets, public opinion in Italy came to understand that the state had lived far beyond its means. Massive cutbacks in public spending were the outcome, and the taxation policy was modernised, thereby consolidating the state's finances. The opportunity of being one of the founding countries of the Euro furthered the consolidation efforts. However, the Maastricht membership criteria are no different from the criteria applied by international capital investors before taking investment decisions. In other words, the disciplining influence of the Maastricht criteria on European populism helped the Euro off to a very good start.

As we had pointed out . . . , in a democracy, it is easier for anti-populist forces to gain ground if there are free international flows of capital. Capital markets created central banks independent of the government; capital markets "rewarded" a country with an independent central bank by offering lower interest rates because it was considered a more secure country for investment. This made it politically easier to isolate monetary policy from the populist temptations of respective governments and, by doing so, directly stimulating the growth of local capital markets.

It can generally be said that if a country can convince capital markets that it is pursuing and can pursue a policy of monetary stability and fiscal realism, it can immediately start capitalising on the confidence of these markets. The state can right away start incurring debts at interest rates that are lower than they would be if capital markets had no confi-

dence. Thus this confidence effect alone can consolidate the state's funds. Anti-populists can already start reaping political success even before they have begun their vigorous clean-up campaign.

Thus capital market expectations can considerably reduce the length of time spent waiting for short-term-oriented policy to deliver anti-illusionary, long-term-oriented economic policy results. The idea of stability that prevails on professional capital markets can be of help to the political campaigner against populism. A very important part of Prime Minister Romano Prodi's successful consolidation policy was the drop in interest rates as confidence grew. These interest rates were paid by the Italian exchequer on outstanding debts. Similarly, after initial scepticism, Margaret Thatcher's highly successful economic policy was helped by international capital markets. Britain's national debt came down from about 75 percent of gross domestic product when she came to power, to 35 percent of gross domestic product eight years later.

It is essential to balance future expectations of individuals with reality and the domestic capital market (as)... a "truth mechanism" that serves this purpose. As such it functions well if it is subsequently found that the majority of the loan transactions were profitable. There are apparently many cases where projects that could only be implemented with the help of loans have proved to be lucrative for the investor and eventually, as a rule, lucrative for the economy, too. We obviously do not know how many projects not granted the

required loans would have been as lucrative. However, the empirical material that we have at our disposal supports the assumption that the success rate of these projects would have been much lower.

Similar observations can be made of the international capital market. There is much that speaks in favour of quality control of projects, including those in the public sector, being conducted by experienced, professional creditors, particularly by international lenders, as this is a useful filter if public funds are to be used appropriately. In this context, like the domestic capital market, the international capital market can be seen as a truth mechanism.

Conclusion: The international capital market supports the political forces in a country that combat illusionism, populism and excessive public debt.

From: C. Christian von Weizsäcker: *Logik der Globalisierung*, Göttingen 1999, p. 107ff. (transl. by Ritu Khanna).

Mario Vargas Llosa (2000):

More Globalisation, More Democracy!

The Peruvian writer, Mario Vargas Llosa (born 1936) is one of Latin America's most distinguished contemporary writers. He made his debut in 1963 with the novel *La ciudad y los perros* (The City and the Dogs) that was immediately translated into more than 20 languages. This was followed by a number of bestsellers that brought him an equal number of literary awards, such as the 1996 peace prize awarded by the German Book Trade. From the very beginning, Mario Vargas Llosa has been a politically involved writer. If he initially identified with the extreme left, he soon recognised the totalitarian nature of leftist political understanding. He then turned to liberalism and called for reforms in his own country that focused on the rule of law and the market economy. In 1990, he lost in the second round of Peru's presidential elections to the authoritarian Alberto Fujimori. Although this loss also meant his withdrawal from active politics, he continues to be a writer who expresses his political opinions, as is illustrated in the following contribution directed against the opponents of globalisation.

A short time ago, the town council of El Borge, a tiny town in the Spanish province of Málaga, held a plebiscite of its thousand inhabitants. The citizens were asked to decide between two alternatives: humanity or neoliberalism. The result of the poll was 515 votes for humanity and 4 votes for neoliberalism. Since that time, I have not been able to chase those four votes from my thoughts. In the face of such a dra-

matic dilemma, those four musketeers did not hesitate to charge against humanity in the name of the macabre scarecrow of neoliberalism. Were they four clowns or four sages? Was this a “Borgean” joke or was it the only sign of sense in the entire farcical plebiscite?

Not long after, in Chiapas, an International Congress against Neo-liberalism was convened by Subcomandante Marcos, the latest hero of the frivolous, media-driven politics of the West. Among the attendees were numerous Hollywood luminaries, a belated Gaullist (my friend Régis Debray), and Danielle Mitterrand, the incessant widow of President François Mitterrand, who gave her socialist benediction to the event.

Those are quaint episodes, but it would be a grave error to write them off as the insignificant fluttering of human idiocy. In truth, they are but the tense and explosive extremes of a vast political and ideological movement, solidly rooted in sectors of the left, center, and right, and united in a tenacious distrust of liberty as an instrument for the solution to the problems of humanity. They have built up their fears into a new phantom and called it “neoliberalism.” ...

Brainy professors from the universities of Paris, Harvard, and Mexico pull their hair out trying to show that free markets serve for little more than making the rich richer and the poor poorer. They tell us that internationalization and globalization only benefit the giant multinationals, allowing them to squeeze developing countries to the point of asphyxiation

and entirely devastate the planetary ecology. So it should not surprise us that the uninformed citizens of El Borge or Chiapas believe that the true enemy of mankind-guilty of all evil, suffering, poverty, exploitation, discrimination, abuses, and crimes against human rights committed on five continents against millions of human beings-is that terrifying, destructive entelechy known as neoliberalism. It is not the first time in history that what Karl Marx called a "fetish" – an artificial construction, but at the service of very concrete interests – acquired consistency and began to provoke such great disruptions in life, like the genie who was imprudently catapulted into existence when Aladdin rubbed the magic lamp.

I consider myself a liberal. I know many people who are liberals, and many more who are not. But, throughout a career that is beginning to be a long one, I have not known a single neoliberal. What does a neoliberal stand for? What is a neoliberal against? In contrast with Marxism, or the various kinds of fascism, true liberalism does not constitute a dogma, a closed and self-sufficient ideology with prefabricated responses to all social problems. Rather, liberalism is a doctrine that, beyond a relatively simple and clear combination of basic principles structured around a defense of political and economic liberty (that is, of democracy and the free market), welcomes a great variety of tendencies and hues. What it has not included until now, nor will include in the future, is that caricature furnished by its enemies with the nickname neoliberal.

A “neo” is someone who pretends to be something, someone who is at the same time inside and outside of something; it is an elusive hybrid, a straw man set up without ever identifying a specific value, idea, regime, or doctrine. To say “neoliberal” is the same as saying “semiliberal” or “pseudo-liberal.” It is pure nonsense. Either one is in favor of liberty or against it, but one cannot be semi-in-favor or pseudo-in-favor of liberty, just as one cannot be “semipregnant,” “semiliving,” or “semidead.” The term has not been invented to express a conceptual reality, but rather, as a corrosive weapon of derision, it has been designed to semantically devalue the doctrine of liberalism. And, as we enter the new millennium, it is liberalism-more than any other doctrine-that symbolizes the extraordinary advances that liberty has made in the long course of human civilization.

We should celebrate the achievements of liberalism with joy and serenity, but without triumphalist hubris. We must be clear in understanding that although the achievements of liberalism are notable, that which remains to be done is more important still. Moreover, as nothing in human history is fated or permanent, the progress obtained in these last decades by the culture of liberty is not irreversible. Unless we know how to defend it, the culture of liberty can become stagnant and the free world will lose ground to the forces of authoritarian collectivism and tribalism. Donning the new masks of nationalism and religious fanaticism, those forces have replaced communism as the most battle-hardened adversaries of democracy...

Despite the gloomy geography of persistent dictatorships, liberals have much to celebrate in these last decades. The culture of liberty has made overwhelming advances in vast regions of Central and Western Europe, Southeast Asia, and Latin America. In Latin America, for the first time in history, civilian governments-born of more or less free elections-are in power in nearly every country. (The exceptions are Cuba, an explicit dictatorship, and Peru, a subtle dictatorship.) Even more notably, those democracies are now applying-sometimes with more gritting of teeth than enthusiasm, some-times with more clumsiness than skill-market policies, or at least policies that are closer to a free economy than to the interventionist and nationalizing populism that traditionally characterized the governments of the continent.

Perhaps the most significant thing about that change in Latin America is not the quantity, but the quality. Although it is still common to hear intellectuals who have been thrown out of work by the collapse of collectivist ideology howling at neoliberalism, their howls are like those of wolves to the moon. From one end of Latin America to the other, at least for now, a solid consensus exists in favor of the democratic system and against dictatorial regimes and collectivist utopias. Although that consensus is more restricted with regard to economic policy, Latin American governments are also bowing to liberal economic doctrine. Some governments are embarrassed to confess that, and others-including some real Tar-tuffes-cover their bases by spewing out volleys of rhetoric against neoliberalism. Nevertheless, they

have no other recourse than to privatize businesses, liberalize prices, open markets, attempt to control inflation, and try to integrate their economies into international markets. They have come to learn-the hard way-that in today's economic environment, the country that does not follow those guidelines commits suicide. Or, in less terrifying terms-that country condemns itself to poverty, decay, and even disintegration. Many sectors of the Latin American left have evolved from being bitter enemies of economic liberty to embracing the wise confession of Václav Havel: "Though my heart may be left of centre, I have always known that the only economic system that works is a market economy.... This is the only natural economy, the only kind that makes sense, the only one that can lead to prosperity, because it is the only one that reflects the nature of life itself." ...

The present battle is perhaps less arduous for liberals than the one that our teachers fought. In that battle, central planners, police states, single-party regimes, and state-controlled economies had on their side an empire that was armed to the teeth, as well as a formidable public relations campaign, conducted in the heart of democracy by a fifth column of intellectuals seduced by socialist ideas. Today, the battle that we must join is not against great totalitarian thinkers, like Marx, or intelligent social democrats like John Maynard Keynes but, rather, against stereotypes and caricatures that attempt to introduce doubt and confusion in the democratic camp; hence the multiple offensive launched from various trenches against the monster nicknamed neo-

liberalism. The battle is also against the apocalyptics, a new species of skeptical thinker. Instead of opposing the culture of democracy, as did Georg Lukacs, Antonio Gramsci, or Jean-Paul Sartre, the apocalyptics are content to deny it, assuring us that democracy does not really exist and that we are dealing with a fiction, behind which lurks the ominous shadow of despotism.

Of that species, I would like to single out an emblematic case: that of Robert D. Kaplan. In a provocative essay,¹ he maintains that, contrary to the optimistic expectations about the future of democracy heralded by the death of Marxism in Eastern Europe, humanity is actually headed toward a world dominated by authoritarianism. In some cases, this authoritarianism is undisguised; in others, it is masked by institutions of civil and liberal appearance. For Kaplan those institutions are mere decorations. The real power is-or will soon be-in the hands of giant international corporations, the owners of technology and capital that, thanks to their ubiquity and extraterritoriality, enjoy almost total impunity in their actions.

“I submit that the democracy we are encouraging in many poor parts of the world is an integral part of a transformation toward new forms of authoritarianism; that democracy in the United States is at greater risk than ever before, and from obscure sources; and that many future regimes, ours especially, could resemble the oligarchies of ancient Athens and Greece more than they do the current government in Washington.”

His analysis is particularly negative with regard to the possibility that democracy may be able to find root in the developing world...

Contrary to the pessimistic conclusions that Kaplan reaches, globalization opens up a first-class opportunity for the democratic countries of the world-and especially for the advanced democracies of America and Europe-to contribute to expanding tolerance, pluralism, legality, and liberty. Many countries are still slaves to the authoritarian tradition, but we should remember that authoritarianism once held sway over all of humanity...

With the advent of the new millennium, however, the advanced democracies of the world have a stronger incentive to act with firm and principled conviction in favor of democracy. That incentive comes from the existence of a new danger, a danger that Kaplan mentions in his essay. In apocalyptic terms, Kaplan prophesies the emergence of a future nondemocratic world government composed of powerful multinational corporations that operate without restraint in all corners of the globe. That catastrophic vision points to the real danger of which we are conscious. The disappearance of economic borders and the proliferation of world markets stimulate fusion and alliance between businesses as they attempt to compete more effectively in all areas of production.

The formation of giant corporations does not constitute in and of itself a danger to democracy as long as democracy is

a reality, that is to say, as long as there are just laws and strong governments. (For a liberal, “strong” means “small and effective,” rather than “big.”) In a market economy that is open to competition, a big corporation benefits the consumer because its scale enables it to reduce prices and multiply services. It is not in the size of a business in which danger lies; the danger lies in monopoly, which is always a source of inefficiency and corruption. As long as there are democratic governments that command respect for the law—governments that will even prosecute Bill Gates if he transgresses that law—there is no danger. As long as democratic governments maintain markets that are open to competition and are free of monopolies, then there is nothing to fear from giant corporations, which frequently serve society by spearheading scientific and technological progress.

The capitalist firm has the nature of a chameleon. In a democratic country, it is a beneficent institution of development and progress. However, in countries in which there is no rule of law, no free markets, and in which everything is resolved by the absolute will of a leader or a ruling clique, the capitalist firm can be a source of catastrophe. Corporations are amoral, and they adapt with ease to the rules of the game in the environment in which they operate. If in many developing countries the behavior of multinationals is reprehensible, the ultimate responsibility rests on those who fix the rules of the game in economic, social, and political life. We cannot blame firms for following those rules in their quest for profits.

From that reality, Kaplan extracts this pessimistic conclusion: the future of democracy is gloomy because in the coming millennium the giant corporations will act in the United States and Western Europe with the same impunity that they currently do in, say, the Nigeria of the late Colonel Abacha.

In truth, there is no historical or conceptual reason for such an extrapolation. Instead, we should reach the following conclusion: it is imperative that all countries today under dictatorship evolve quickly toward democracy and develop the kind of free legal order that can demand of corporations that they act decently and equitably, as they are required to do in the advanced democracies. Without the globalization of legality and liberty, economic globalization presents a serious danger for the future of civilization-and, above all, for the planetary ecology. The great powers have a moral obligation to promote democratic processes in the developing world. They also have a practical obligation. With the evaporation of borders, the greatest guarantee that economic forces will benefit all people is to ensure that throughout the world economic life flows within the limits of liberty and competition, and is guided by the incentives, rights, and restraints imposed by democratic society.

None of that will be easy, and none of it will be achieved in a short time. For liberals, however, it is a great incentive to know that we are working toward an attainable goal. The idea of a world united around a culture of liberty is not a utopia but a beautiful and achievable reality that justifies our efforts. As Karl Popper, one of our greatest teachers, said, "Opti-

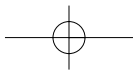
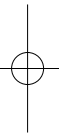
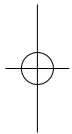


mism is a duty. The future is open. It is not predetermined. No one can predict it, except by chance. We all contribute to determining it by what we do. We are all equally responsible for its success.”

From: Mario Vargas Llosa: *Liberalism in the New Millenium*, in: Ian Vásquez (Hrsg.): *Global Fortune. The Stumble and Rise of World Capitalism*, Cato Institute, Washington 2000, S. 15–20, 24–26.

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Kräfte des Wandels? (with Lieselotte Stockhausen-Doering), 1990.

Die Wiederkehr der Klugheit: Edmund Burke und das Augustan Age, 1990.

Kleines Lesebuch über den Liberalismus (editor; translated into 16 languages), 1992.

Liberalismus: Ein Versuch über Freiheit 1993.

Freiheit: Die unbequeme Idee (editor; with Fritz Fliszar), 1995.

Frédéric Bastiat: Denker der Freiheit, 1997.

Fred E. Folvary: Das Lexikon der Freien Marktwirtschaft (editor; with supplementary notes), 2000.



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Vernunft und Leidenschaft. Ein David-Hume-Brevier, 2003.

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