How sound is the policy of free trade coupled with unlimited growth, which is so firmly entrenched among economists? Herman Daly, an economist with the World Bank in Washington, D.C., examined these ideas in a paper presented at a Conference on Environment and Development held at Milan, Italy, on March 24-26, 1988. The arguments excerpted here from that paper are developed in more detail in For the Common Good *by Herman E. Daly and John B. Cobb, Jr., (Boston: Beacon Press), especially in Chapter 11.*

GROWTH, INTERNATIONAL TRADE, AND DESTRUCTION OF COMMUNITY

By Herman E. Daly

No economic tenet commands greater consensus among economists than the doctrine of free trade and comparative advantage. Academic economists have become so enamored of the logical argument for comparative advantage (a beloved *pons asinorum* in the standard pedagogy), that they have failed to notice that the fundamental assumption of the whole argument, capital immobility between nations, no longer represents even a weak approximation to the real world. Even though nine out of ten arguments for tariffs, quotas, or other trade restrictions can be exposed as special pleading, there is nevertheless a compelling case against free trade which Adam Smith [1723-1790] and David Ricardo [1772-1823] themselves would have found convincing had they lived in a world of free capital mobility, rapid population growth, and pervasive externalities resulting from the large scale of throughput.

Free trade remains dogma because it serves the Central Dogma of growth. But it does not serve community, and in fact works strongly toward the destruction of community. To see this, consider, for example, what US capitalists are in effect saying to US laborers. They are saying that US labor must compete in the world labor market with the masses in the Third World, otherwise capital will have to move abroad. Nowadays technology and managerial skills move with capital. Capital mobility means that wages will tend to equality worldwide in the interest of efficiency and growth. Wages in the US will decline. Wages in the Third World will rise — or will they? Not really, because the supply of labor is very large and becoming larger thanks to the demographic explosion. Also, half of the world's supply of low-wage labor is in India and China, countries which have not traditionally competed in the world market, but are now entering. The isolationist policies of Chairman Mao and the restrictive trade policies of British imperialism are over. The equilibrium wage under free trade will be the Third World level. Capital will benefit from cheap labor at home as well as abroad. Low wages mean a low standard of living for the great majority of our citizens.

We are assured by mainstream economists that this is just an irrational phobia of poor ignoramuses who have never been able to understand comparative advantage. But it is *they* who do not understand comparative advantage, because they are trying to apply a doctrine that depends on capital immobility between nations to a world in which capital crosses national boundaries at the speed of light in response to a tenth of a percent difference in rate of return! Many international transactions are now internal transfers between divisions of multinational corporations and take place with even greater ease.

Ricardo points out that if capital were as freely mobile between England and Portugal as between London and Yorkshire, then trade between the two countries would be governed by the labor theory of value (absolute advantage in terms of labor costs) rather than comparative advantage.[1] Everything that differentiates domestic from international trade depends, for Ricardo, explicitly on the international immobility of capital (labor mobility between nations was taken for granted). Moreover, Ricardo's explanation of capital immobility invokes the theme of community:

> *Experience, however, shews 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 connexions, 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.*[2]

For Ricardo it is the force of community that keeps capital at home even in the face of higher profits abroad. Furthermore he affirms that he would be sorry to see these feelings of community weakened. Perhaps he already suspected that they would be weakened by the individualistic postulates of classical economics, and its faith in the invisible hand's ability to transform private vice into public virtue.

Interestingly, the famous invisible hand passage in Adam Smith also occurs in the context of a defense of free trade. Smith takes it for granted that it is in the public interest for national capital to be employed at home, and then goes on to show that, by and large, because of the same community attachments to the home market mentioned by Ricardo, the capitalist will find it in his own personal interest to invest at home. As Smith put it:

> *By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention.*[3]

Smith presupposes that the capitalist is first and foremost a member of the community. Smith's capitalist is so thoroughly British that his very personal identity is defined by internal relations of community with `the country of his birth and connexions'. It is not the competitive external relations of the cash nexus that generate the invisible hand in this case, but rather the internal relations of community that constitute this capitalist's very identity. Of course he acts in his self interest, but when the self is constituted by internal relations of community it is not surprising that private interest should promote community welfare. The invisible hand, in its classic statement at least, presupposes the force of community operating within the personal identity of the individual capitalist. By his very self-identity the capitalist feels a `natural disinclination' to invest abroad, and therefore invests at home for his own satisfaction and security, and incidentally promotes the general welfare even though that was not his direct intention.

"...cosmopolitan money-managers and transnational corporations which in addition to having limited liability and immortality conferred on them by national governments, have now transcended those very governments..."

It is clear that Smith and Ricardo were considering a world in which capitalists were fundamentally good Englishmen, Frenchmen, etc., not a world of cosmopolitan money managers and transnational corporations which in addition to having limited liability and immortality conferred on them by national governments, have now transcended those very governments and no longer see the national community as their context. They may speak grandly of the `world community' as their residence, but in fact, since no world community yet exists, they have escaped from community into the gap between communities where individualism has free rein.

The modern textbook explanations of free trade and comparative advantage make no mention of the assumption of factor mobility. Perhaps one reason this central assumption is downplayed is that frequently the principle is explained in terms of specialization between individuals. A classic example is a lawyer who is a better typist than her secretary. Even though the lawyer has an absolute advantage both in knowledge of the law and in typing, she nevertheless finds it advantageous to specialize in law (her comparative advantage) and employ the secretary to do the typing. Since there is no possibility for labor power, human capital, or any other productive capacity to flow out of the secretary and into the lawyer in response to absolute advantage the assumption of factor mobility is guaranteed, and the principle of comparative advantage governs. But the argument cannot be generalized to nations without the explicit requirement that their productive capacities (factors) not flow across national boundaries.

Consider, for example, the dismissal of the (so-called) `low-wage foreign labor fallacy' found in one of the best and most widely-used texts:...*stop and think what the argument would imply if taken out of the international context and put into a local one, where the same principles govern the gains from trade. Is it really impossible for a rich person to gain from trading with a poor person? Would the local millionaire be better off if she did all her own typing, gardening, and cooking?*[4]

In the next paragraph we are assured that "gains from trade depend on comparative, not absolute advantages," which is all very well if capital is immobile. But there is not a word in the discussion about international mobility of factors. Moreover, the shift of context from nations to individuals, far from illuminating the situation, obscures it by abstracting from it the very possibility of transfer of productive capacity between the exchanging entities. Economists want free trade, which means that for economic purposes national boundaries are erased. Yet they justify this policy in terms of a doctrine whose central assumption is that national boundaries limiting the flow of capital *not* be erased!

"Free trade, as a way of erasing the effect of national boundaries, is simultaneously an invitation to the `tragedy of the commons'."

One might object that although the principle of comparative advantage developed historically on the assumption of internationally immobile capital, that does not prove that the assumption is logically necessary, and in fact all one needs to demonstrate the existence of comparative advantage is different relative costs. This is true as far as it goes, but the point is that once capital is mobile absolute advantage takes control, and comparative advantage is superseded as a guiding principle. Capital follows absolute advantage when mobile internationally. Only when capital is immobile internationally will it be reallocated within the nation according to the principle of comparative advantage.

A high wage level is not the only good thing that depends on community. Once community is devalued in the name of free trade and global integration there will be a generalized competing away of all community standards that raise costs of production. Social security, medicare, and unemployment benefits all raise the cost of production just like high wages, and they too will not survive a general standards-lowering competition. Likewise, the environmental protection and conservation standards of the community also raise costs of production and will be competed down to the level that rules in over-populated Third World countries. Free trade, as a way of erasing the effect of national boundaries, is simultaneously an invitation to the `tragedy of the commons'. Few people would advocate free migration because they can intuitively see the tragic consequences. Free trade and free capital mobility have exactly the same consequences for wages and community standards, but are widely advocated in the false belief that comparative advantage guarantees mutual benefit.

These arguments should not be taken as advocacy of autarky. The idea is not to oppose international trade, but to suggest that balanced trade between national communities rather than free trade between individuals across international boundaries offers a better context for reflecting and protecting the dimension of community in our economic relations. Individual employees of Exxon cannot trade freely with individual employees of General Motors seeking only their own interests. They must demonstrate that the deals they make are in the mutual interest of the two corporations.

John Maynard Keynes stated the issue judiciously:

> *I sympathize, therefore, with those who would minimize, rather than with those who would maximize, economic entanglements between nations. Ideas, knowledge, art, hospitality, travel — these are the things which should of their nature be international. But let goods be homespun whenever it is reasonably and conveniently possible; and above all, let finance be primarily national.* [5]

SUMMARY AND CONCLUSIONS

The major conceptual issue we must resolve in thinking about economic development and the environment as the next century begins is to integrate the one-way throughput as a central concept, even more basic than the circular flow, and to distinguish clearly the problem of its optimal scale from its optimal location. Our attention will then naturally become focused on how collectively to limit scale to an optimal, or at least sustainable, level. But the community cohesion necessary for such collective action is being eroded by free trade and free capital mobility. Contrary to common opinion the principle of comparative advantage does not solve the problem. New thinking is required. ■

NOTES

[1] *David Ricardo,* On the Principles of Political Economy and Taxation *in* The Works and Correspondence of David Ricardo, *edited by Piero Sraffa (Cambridge, England: Cambridge University Press, 1951) p. 136.*

[2] *op. cit. pp. 136-137.*

[3] *Adam Smith,* Wealth of Nations, *(New York: Random House, 1977) p. 423.*

[4] *Richard Lipsey, Peter Steiner, and Douglas Purvis,* Economics. *(New York: Harper and Row, 1987) eighth edition, p. 795.*

[5] *John Maynard Keynes, "National Self-Sufficiency,"* The Yale Review*, Summer 1933.*

[The views expressed in this paper are those of the author and should not in any way be attributed to the World Bank or any other institution. I am indebted to S. Davis, R. Goodland, and E. Wessels for helpful comments. —HED]