Revised for presentation
Lindau, Germany
September 2004

Anti-Globalization, Democracy, and the Logic of Trade*

by

James M. Buchanan

Abstract: Economists have failed, generally, to secure wide public acceptance of their most central proposition to the effect that trade is mutually beneficial, and especially across national boundaries. This failure is due, in part, to the scientific dominance of the Ricardian logic of comparative advantage over the simpler Smithean logic of extended specialization. Adjustments to dynamic market changes become less onerous in the Smithean version; rents are more quickly dissipated.

I. Introduction

Why do we trade? Economists find their *raison d'etre* in answering this question. Persons trade because, by so doing, they secure mutual gains. All parties gain; no one loses.

How is this basic logic of trade transformed into the gainer-loser logic that informs the modern anti-globalization rhetoric? How has the most beneficent institution of human interaction come to be interpreted as malevolent in its effects?

Can it be that the most sophisticated of the anti-globalists lack even the rudimentary elements of economic understanding? Are we simply missing more Bastiats who could excel in public exposure of mercantilist absurdities?

Neither party to a voluntary exchange loses value in the process. Since both direct traders must gain, any losses must be incurred by others who remain outside the internal nexus of

---

*An earlier version of this paper was presented at the regional meeting of the Mt. Pelerin Society in Hamburg, Germany, April 2004.

exchange itself; these losses must be spillovers, or externalities in the jargon of economists. But, ruling out sheer envy, why should I ever object when others trade and secure mutual gains? I might do so if, in initiating a new exchange, others withdraw their custom from me, whether as buyer or seller. The spillover damages would be measured by the net gains or surplus I might have continued to enjoy in trading relationships with those who have shifted their custom away from me, who have displaced me as a trading partner by substituting others in my stead.

In their traditional argument in favor of trade, economists have paid little attention to these spillover damages because of the underlying presumption that those who might be initially displaced have available to them alternative buyers or sellers to whom custom may be shifted at relatively low cost. The presumed availability of low-cost, alternative custom is a critically important element of the standard defense of free trade.

In this paper, I suggest that developments in the elementary theory of trade itself are significant in the effects on public attitudes toward trade and open markets. I shall argue that this basic theory itself took a wrong turn after the early contribution of Adam Smith. David Ricardo, in effect, switched the elementary explanatory model and in such fashion as to make spillover or third-party damages from market extension more likely to command public attention. The neoclassical theory of markets finds its logic in Ricardo's theory of comparative advantage—a theory that is wholly absent from Adam Smith's more general explanation for trade. And the antiglobalization arguments that seem dominant in the turn of the century public discourse exploit elements of the Ricardian logic that would not be available under the simple Smithian mindset.

I shall first lay out, in summary, the elementary logic of exchange as presented by Adam Smith. I shall then contrast and compare this logic with that attributed to David Ricardo and demonstrate the differing implications of the two logics, both for economic theory itself and for generalized public understanding. The discussion will suggest why the opposition to extension in trade tends to be concentrated on economic interactions among traders in separate nation-states rather than on trade patterns within the confines of a single political authority. In other words, why "anti-globalization" and not "anti-nationalization"?

Answering this question requires explicit attention to the political structure that defines the framework within which trade, whether inside or across political boundaries, takes place. Modern public choice theory offers relatively simple explanation for the relatively greater politically imposed restrictions on trade that takes place across political boundaries, but it does not help explain why general public attitudes seem favorable to such restrictions, over and beyond the rent-seeking interplay of specialized interests.[1]

In presenting the Adam Smith story in section II and the David Ricardo story in section III, I make no claim that I have interpreted either economist in wholly accurate accord with history-of-ideas exegesis. I use these familiar figures as labels for contrasting explanatory models. Also, and perhaps more importantly, I do not advance hypotheses concerning the empirical relevance of either model, both of which surely embody empirical content.

II. Exchange and Specialization: The Smithean Story

Return to the question posed at the beginning. Persons trade because they secure mutual gains. These gains are possible because specialization is productive. Even if persons are identical, both in their capacities (endowments) and in their preferences, trade becomes mutually beneficial because the value of product increases more than proportionately as specialization in production

---

[1]Elements of the argument presented in this paper are discussed, in a separate and different format, by Buchanan and Yoon (2002).

occurs. And, as the number of persons in an economic nexus, in "the market," increases further and further specialization becomes possible. "The division of labor is limited by the extent of the market"—this famous statement is central in Adam Smith's story. And it implies that any and all extensions in the size of the economic nexus promise gains to all participants. The gains from specialization are inexhaustible; there are no arbitrary limits beyond which such gains fail to materialize. And there is no distinction at all between trade among persons within a single organized political community and among persons who are members of separated polities, that is, between domestic and international trade. The selfsame advantages of specialization remain throughout any and all extensions in market size.

In this simple Adam Smith story, persons are "natural equals"; they are not hierarchically classified. The specialization that may be observed is not, in itself, a natural characteristic of those who are specialized. As Smith noted, again in a famous passage, there is little or no natural difference between the philosopher and the street porter. In Smith's system of natural liberty, persons can choose among specializations as dictated by the relative returns promised by the market, and, by inference, they can shift among alternative specializations as demands change. The costs of such shifts are, at their worst, transitory, and are eliminated as adjustments take place toward natural equilibria in which all participants in the nexus secure the benefits. There need be little or no concern with long-lasting or permanent costs arising from market displacements. In Smith's world of natural equals, the distribution of specializations observed emerges from the responses to the demands of the market rather than from any natural distribution of personal capacities.

In somewhat more technical economic terms, the owners of specialized inputs may secure quasi-rents as demand conditions shift, but any differential returns tend to be eliminated as persons respond to market incentives. There are no permanent rents, as such, in the Smithean understanding.

III. Comparative Advantage: The Ricardian Story

A second, and categorically different, basic logic of trade introduces differences among persons. Or, more generally, among national characteristics of productive factors. We gain from trade because we are different, one from another, and trade allows us to exploit our comparative advantages. In other words, we are *naturally* specialized (biologically or locationally), and trade makes it possible for persons to find their own niches. If I can bake better bread than you, while you can make better shoes, we both gain if we exploit our comparative talents. I make all the bread; you make all the shoes, and we both get both better bread and better shoes than if we should have worked in isolation. We do indeed specialize, but there need be no gains from specialization, as such. Rather the gains arise from the innate differences among us. In its limiting setting, this logic would imply that, if persons were not different either in capacities or in preferences, there would be no mutual advantage from trade.

David Ricardo introduced the theory of comparative advantage to explain why separate countries secure mutual benefits from international trade. Ricardo would, presumably, have recognized Adam Smith's argument to be applicable for economic interactions among relatively small numbers of traders. And, quite possibly, Ricardo might also have been willing to work within a model in which persons do not differ, one from another. He concentrated on differences in natural geographic characteristics among countries. But by making international trade categorically different in its basic logic from domestic trade, Ricardo implied that the gains from specialization, as such, were exhausted within the internal nexus of exchange, allowing economists throughout the history of the science to neglect the Smithean argument. And, by such neglect, they were led to ignore the basic relationship between the extent or size of the market and the prospects for mutual gains.

Why is the distinction between these two logics of trade important in understanding general public reactions to globalization? In the Ricardian model, persons differ in their natural capacities to produce goods that are valued (whether for geographic or other reasons). Trade permits them to occupy the niches for which they are naturally best suited. If we think of an initial or benchmark equilibrium, the allocation of natural skills or capacities to alternative lines of employment will be dependent on the pattern of demands for final products, but this equilibrium will not include equalization of relative wages-salaries across differing categories of employment. To revert again to Adam Smith's crude society, there is no Ricardian-based equalization between the rewards of the beaver and the deer hunters. The relative returns, as between these two occupations, depend on the relative demands for the products and upon the relative numbers of those who are comparatively advantaged in beaver hunting and in deer hunting.

We may stay within this simple story for illustrative purposes. Suppose that, in the initial equilibrium in a closed economy, there are 100 deer hunters and 50 beaver hunters, and that relative demands are such that the deer hunters earn 2 deer per day (deer is the numeraire good), and the beaver hunters earn only 1 deer per day. Note that, in the limiting case, the natural specialization is such that, despite the difference in wages, there is no tendency for persons to shift as between the two occupations.

Now, suppose that the closed economy is opened up; trade is now allowed to extend beyond the limits of the earlier nexus of production-exchange. Suppose, further, that the ratio of the natural specializations among the workers in the extended nexus is different from that in the closed economy. In the inclusive "world" economy, resources will now be allocated more efficiently; more value will be produced than before the separate economies were opened. But the gains need not be uniform and losers as well as gainers may be produced by the opening of markets.

Return to the simple example. Suppose that the closed economy is opened up and that the added production-exchange nexus is predominantly described as a concentration of naturally specialized deer hunters. In this case, the opening of the initially closed economy will clearly harm the naturally specialized deer hunters in that economy, who are now faced with a deterioration in the terms of trade for the good in which they are advantaged. Their rents are reduced as a result of the change in the terms of trade. For converse reasons, deer hunters in the extended sector gain, as do beaver hunters in both sectors, but there is no mechanism within the market itself to insure that those who are damaged, in this example the deer hunters in the initially closed economy, secure compensation for their losses.

The contrasting implications of the two logics or explanations for trade become clear. In the Smithean logic, the losses suffered from extensions in the size of the market nexus are transitory only because those who are harmed by shifts in terms of trade can readily move into alternative employment-occupational categories. In the Ricardian logic in which trade stems from differences in natural capacities, there are less effective within-market limits to losses suffered by particular groups as terms of trade shift. These damages may be permanent to the extent that persons are unable to shift as among differing employments.

IV. Anti-Globalization and Public Attitudes

Much of the economic argument made against globalization concentrates on the alleged "loss of jobs" in advanced industrial countries that is attributed to the extension of the worldwide trading nexus. In the United States, in particular, this job loss is alleged to stem from outsourcing practices on the part of corporations who substitute workers outside the country for domestic workers, notably in the manufacturing sector. The argument for politically orchestrated measures to prevent this manifestation of globalization resonates more generally among public attitudes than traditional arguments supporting protection for particular industries.

To the extent that public attitudes and understandings about economic exchange are informed, even if vaguely and inchoately, by the Ricardian rather than the Smithean logic, the job loss emphasis in the anti-globalization position is heightened. The workers whose employment opportunities in particular sectors (for example, in manufacturing in the United States) may be understood as being forced to suffer permanent or quasi-permanent utility losses as their natural skills and capacities can no longer find gainful usage. And these concentrated losses may not be outweighed, in public consciousness, by the overall gains for the world economy that are generated by the more efficient allocation of world resources.

By rather dramatic contrast, consider the situation when and to the extent that public understanding of economic exchange is based, again even if vaguely, on the Smithean model. The observed job losses in one sector would be seen as transitory, and the machine tool worker would be looked upon as a potential medical technician rather than as someone locked into one particular occupational category. Adam Smith's "simple system of natural liberty" embodies the presumption that persons remain mobile as among different possible employments and locations in the integrated economy.

In the technical terms of economics, the elasticity of supply of workers to particular occupational categories is quite high in the Smithean model, and especially over a reasonable period of transition. By contrast, in the Ricardian model, this elasticity may be quite low.

These differing public understandings about the workings of markets carry relevant implications for politically implemented policy. The Smithean logic remains consistent with collectivized efforts to facilitate the interoccupational shifts made necessary by developing patterns of exchange as globalization proceeds. Policy emphasis on retraining and retooling for differing skills is appropriate here, as opposed to efforts aimed at preventing the extended specialization that more inclusive markets make possible. And, importantly, the direction of political actions is different in the two frameworks. Collective actions aimed to facilitate occupational shifts made necessary by the extension of the size of the trading network are aimed in the direction of securing the promised benefits of the larger market, of globalization. By contrast, collective actions aimed at preventing or forestalling the incentive-induced shifts that market opening threatens reflect a trade-off of allocative efficiency losses for a *status quo* that is "propped up" artificially.

V. Explanation versus Justification for Protectionistic Political Action

It is useful to make a distinction between explanation of the anti-globalization arguments, and their possible translation into political policy stances, and the justification of these arguments in public attitudes, along with the implied public acquiescence toward the closing up of market opportunities. Any single industry or occupational group will prefer that the market for its own product be closed off from entry by outsiders, whether these be newcomers within or without the domestic economy. A single group acting alone, however, could scarcely expect to be able to secure legally enforced protection, since such a policy would be demonstrably against the interest of all other groups in the collectivity. In majoritarian democracies, however, a coalition of such groups may be successful in implementing protectionistic political action, even at the expense of losses imposed generally on the inclusive citizenry. And rotations among separate majority coalitions in legislative bodies may extend market-closing restrictions widely across the economy.[2]

Public choice theory readily explains why anti-globalization arguments against the opening of markets are often successful in democratically organized countries. There is nothing in the workings of democratic process that elevates the general welfare of the whole citizenry to center stage as the objective for collective action. The promised benefits from measures that prevent entry into particular sectors are concentrated, whereas the offsetting, even if larger, benefits from open markets are shared widely among all citizens. It may, nonetheless, seem paradoxical that the basic gains-from-trade logic seems to be denied when exchanges are among traders across political boundaries. If trade is harmful to particular groups, sufficiently so to warrant the closing off of market entry, why does not the selfsame argument apply within and without the political boundaries? Why not anti-globalization, as among traders across limits of village communities, or among traders in separate states within the United States, or among units located over the whole European Union?

I suggest that history, technology, and economic theory combined to allow the categorical separation between domestic and foreign trade to be introduced, with the modern consequences as expressed in politicized efforts against globalization. The nation-states, as political entities, emerged in the seventeenth, eighteenth, and nineteenth centuries, and the

---

[2]See Buchanan (1989) and Buchanan and Lee (1991) for extended discussion.

technology of production and exchange over these centuries dictated that most economic transactions were those carried out within the limits of these nation-states. Economics, exemplified in Adam Smith, emerged as a separate science aimed at explaining how the actions taken by separate actors within a network of interdependence generated results deemed beneficial to all persons within a polity.

How could exchange between citizens in separate nation-states be explained and justified? Unfortunately, as it turns out, David Ricardo successfully answered this question by his introduction of the theory of comparative advantage, which explains the gains from trade as emerging from differences, rather than from the advantages of extended specialization, as such. The result for the history of ideas is clear; economists almost universally analyzed the workings of the domestic economy on a fundamentally different logical basis from that applied to the international economy. Adam Smith's argument about the advantages of specialization, generating the division of labor, was accepted, but these advantages were presumed to be limited to relatively small ranges of production and exchange, sufficiently so as to allow for internal competition among separate firms within the national economy.

Economists needed the postulate of constant returns, at the level of separate lines of production, in order to explain the presence of and to justify the efficacy of the structure of competition among firms within the national economy. Since the basic Ricardian logic did nothing to undermine this analytical structure, economists were willing to accept, uncritically, the comparative advantage explanation for trade, at the expense of neglect of the more fundamental Smithean logic. Economists confused increasing returns, defined in relation to scale economies in specified lines of production, with generalized increasing returns to the size of the whole economic nexus. They failed to sense that the second of these characteristics need not imply increasing returns to scale as defined in the standard way. The categorical separation between internal and external trade need never have been made.[3]

VI. Globalization and the Framing of Economic Understanding

The discussion in this paper is limited to the economic elements of the globalization and anti-globalization arguments. I have totally neglected those anti-globalization arguments that stem from noneconomic sources. I suggest, nonetheless, that the economic arguments are central and that the criticism of market extension and integration informs almost all the ongoing discussion. My theme is straightforward. Economists have been responsible for allowing the whole set of globalization issues to be framed in such a way that the spillover damages from the extension and opening of markets worldwide are made to seem more severe and disruptive than they would be if informed by a different understanding of the logic of trade itself.

The analogy is between the half-full, half-empty image of the bottle. What image do we have, and should we have, of the workings of the market process? If we have images of persons with quite different natural talents distributed among employments as these talents dictate, with returns being described properly as rents, the possible losses inflicted on some groups may seem unduly burdensome. In a sense, this image treats "jobs" as rights, akin to property claims, and the "loss of jobs" that globalization may introduce may be a central object for political concern. Standing opposed to this half-empty image of the workings of the market is the Smithean presupposition to the effect that persons are, at best, natural equals, and that mobility among differing occupational categories remains relatively high, and especially as some time for

[3]For a comprehensive treatment of the whole economic interaction process that is based on the postulate that persons are equals in all respects, see Yang (2001). For a general history of the development of ideas related to these matters, see, Buchanan and Yoon (1994).

transition is allowed. Persons can claim no right in "jobs" since, so long as entry into alternative categories is open, relative wages will tend toward uniformity when measured in net utility terms. The job losses attributed to outsourcing by domestic firms will, of course, require readjustment, retaining, and possibly relocation. But as demands for other goods increases, these adjustments become tolerable. And, with it all, there is the basic economic proposition that aggregate value is increasing as markets are opened for entry everywhere.

Economists, generally, have supported free and open trade, domestic and foreign, based on this proposition, and they have continued to remain mystified at the refusal of political leaders and the members of the public to understand the simple principles. As noted above, there are elementary public choice reasons why political leaders cater to the demands of identified special interests in disregard of the generalized "public" interest. My point in this paper is to suggest that economists have, themselves, been misled in their elevation of the Ricardian comparative advantage logic to the central role in their basic explanation-justification of exchange, with the subsequent consequences for public understanding. Consistent adherence, from the outset, to the fundamental Smithean logic that gains from trade arise from the productivity of specialization rather than differences in endowments among traders would have framed the working of markets in such fashion as to create a public emphasis on the dynamics of economic progress.

Critics will suggest that I exaggerate the importance of framing for public attitudes toward markets and market adjustments. Perhaps I do so, but before we allow the anti-globalists to carry the day, we should at least get our own intellectual-analytical house in order. We should attend to the rhetoric of our discourse and reckon on the likely implications of our analyses on public attitudes. We have demonstrably failed, as economic *scientists*, to make the public case for our simplest of propositions. Some emphasis on explaining this failure seems in order.

REFERENCES

Buchanan, James M. “Free Trade and Producer-Interest Politics,” *Essays on the Political Economy* (Honolulu: University of Hawaii Press, 1989).

Buchanan James M. and Dwight R. Lee, “Cartels, Coalitions and Constitutional Politics,” *Constitutional Political Economy* 2 (1991): 139–61.

Buchanan, James M. and Yong J. Yoon, eds. *The Return to Increasing Returns* (Ann Arbor: University of Michigan Press, 1994).

Buchanan, James M. and Yong J. Yoon. “Globalization as Framed by the Two Logics of Trade,” *Independent Review* 6 (Winter 2002).

Yang, Xioakai. *Economics: New Classical versus Neoclassical Frameworks* (Malden, Mass.: Blackwell, 2001).