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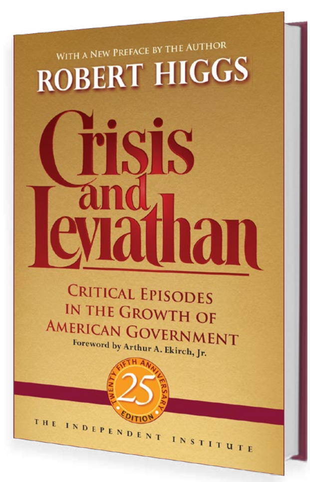

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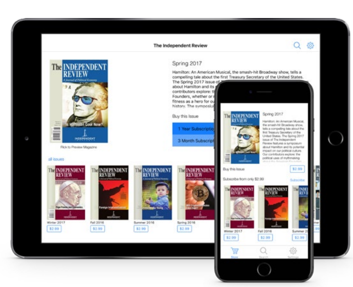

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Globalization as Framed by the Two Logics of Trade

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Economists are professionally biased in favor of free trade and open markets. Indeed, normative support for open markets is so universal among practicing economists that the logical origins of their positions are often obscured. Observers and sometimes economists themselves may fail to recognize that two categorically different logical arguments inform economists' thinking and that these arguments, these separate "logics," may have different consequences for generalized public and political attitudes toward the openness of markets. Globalization, as a catch-all term for movements toward more inclusive trading networks, may be viewed quite differently by persons who, even if vaguely, locate its normative bases differently. Such differences may surface more or less directly as explicit policies for moving toward or away from further globalization become alternatives for choice in democratic polities.

For expository purposes, we may label the two logics of trade as Smithean and Ricardian, with reference to the two leading figures of classical political economy, Adam Smith and David Ricardo. Neoclassical economic analysis, which dominated the discipline of economics from 1870 to 1970, was informed during that century by the Ricardian logic before returning partially and somewhat reluctantly to the Smithean logic in the 1980s and later. As the scientific arguments spill over into

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public and political attitudes, however, the Ricardian logic continues to hold its place, with obvious implications for the public perception of the effects of policy alternatives.

Specialization and Exchange

The Smithean logic is straightforward. Why do persons trade with one another? They do so because specialization is productive; people can produce more economic value if each person does one thing instead of trying to do everything. Concentration of productive effort on one good followed by exchange for other goods becomes a means of getting more of all goods than can possibly be attained in autarky. Trading is, quite simply, a more efficient means of producing.

Note particularly that in this model of exchange people need not differ either in their relative capacities to produce goods or in their preferences for the goods in consumption. Specialization and subsequent trade emerge between the parties because of a recognition that mutual gains are available, that there are *increasing* returns to be secured from concentrating effort in one activity or the other. Note also that if people do not differ, it is impossible to identify in advance which persons will specialize in which activity involved in the production of which good. Specialization will be observed, but there will be no naturally specialized factors of production.

Comparative Advantage

The Ricardian logic that explains the origins of trade differs categorically from the Smithean argument just outlined. As noted, Adam Smith's account of the benefits of specialization explains why exchange will be mutually beneficial even if the trading parties are initially identical in all respects. By contrast, the Ricardian logic locates the origins of exchange in the *differences* among persons—differences in their capacities to produce separate final goods. If such differences exist, specialization and exchange will always prove mutually beneficial. Trade emerges because different persons (or trading units, including countries) have different *comparative advantages* in producing different goods.

Consider what we might call a pure Ricardian setting in which there are no potential gains from specialization as such, even over small ranges of production. If persons are identical in both their capacities to produce and their preferences, trade produces no benefits. For mutually beneficial trade, persons must be presumed to differ in either productive capacities or preferences. Note the somewhat subtle reversal of the logical sequence in the two stylized settings outlined. In the Smithean setting, exchange emerges because of the advantages of specialization; in the Ricardian setting, specialization and subsequent trade become advantageous because of the inherent differences among potential trading parties.

The differences in the constraints in the two models warrant attention. In the Smithean model, as stylized, persons can freely choose their specializations, and because they can do so, equilibrating forces are present to ensure against permanent differentials in rewards. Adam Smith's familiar deer-beaver illustration is useful here. Because persons may become either deer hunters or beaver hunters, no differential in the net rewards of the two occupations need exist in the natural or long-term equilibrium. By contrast, in the pure Ricardian setting some persons are by nature relatively more adept at hunting deer than at hunting beaver, given any relative demand for the two goods. The net returns from the two occupations may remain different, even in a long-term equilibrium.

Generalization

Empirically, economic exchange, from its simplest to its most complex forms, is explained by some combination of the two elements emphasized in the contrasting logics we have just outlined. Specialization has inherent advantages, as each of us recognizes in managing our personal affairs. Each of us can produce more economic value by concentrating on one thing than by trying to do a little of everything. But people also differ: each of us presumably has a comparative advantage in one sort of productive activity or another. Each of the two basic arguments or any combination of them can be readily generalized into a normative defense of free trade. The articulation of this defense may be considered a fundamental task of economists, who may rest secure in their conviction that everyone's well-being is advanced by generalized public acceptance of the elementary principles.

Our thesis here is that the relative weights assigned to the quite different Smithean and Ricardian logics, as they are transmitted from economists and ultimately translated into public attitudes, are important factors in determining the level of support for extensions of the trading network, especially as that support—or opposition—comes to be institutionalized in political coalitions in democracies. Specifically, we suggest that an incorporation of the basic Smithean logic generates stronger support for extensions of the market nexus than does a comparable incorporation of the Ricardian logic. Unfortunately, as we later discuss, neoclassical economics tends to assign almost exclusive weight to the Ricardian explanation.

Extending the Market

In discussions of globalization, the question is not whether or not to engage in trade, but whether or not to allow reciprocal entry and exit opportunities to a larger number of potential traders.

In any economy, trade is carried out primarily among persons and groups within a defined polity, and goods and services are produced largely by specialized producers. In the Smithean conception, production takes place under generalized increasing returns but without any natural or inherent differences among persons. How will an increase in the size of the nexus for potential exchange affect market participants? The additional exploitation of specialization will increase the ratio of output value to input value for *all* participants. Aside from possible transitional adjustments, there are no net losers, and ultimately everyone gains.

In the Ricardian conception, the observed preexpansion patterns of production and exchange reflect, in part, the prevailing differences in natural capacities. Differences in the net rewards of workers in separate occupational categories are determined by their relative capacities to produce and by the prevailing patterns of demand for final goods. In this setting, what are the predicted effects of extending the trading nexus?

Persons who find it advantageous to enter the now opened market and to offer goods for exchange will resemble some groups of internal or domestic producers more closely than others. Net losers in the process may be those persons who prior to the expansion had relative advantages in the production of goods that after the expansion are offered for importation, even after transitional adjustments, despite the aggregate gains resulting from the enhanced exploitation of comparative advantage. By comparison, those to secure net gains will be persons whose comparative advantage does not lie in the production of importable goods. In their role as consumers, all persons will secure gains, but those gains may be overwhelmed by losses as producers for the groups threatened by imports.

The Ricardian logic necessarily draws attention to the differential effects of extending market size on separate groups of specialized producers, a feature that is totally absent from the basic Smithean logic.

Economics within Neoclassical Limits

The possibly conflicting implications of the two basic logics of trade have not adequately informed the thinking of economists because economists implicitly have been quite willing to add up gains and losses, despite the putative rejection of naive utilitarianism in their normative judgments. Because the gainers from market extensions can, in principle, always overcompensate the losers, the fact that such compensation does not normally occur has not received much attention. Economists might therefore accept and employ the Ricardian explanatory framework without sensing the dramatic difference of normative implications between it and the Smithean framework.

Importantly, acceptance of the Ricardian explanatory logic became necessary for economists once the classical intellectual enterprise was replaced by the neoclassical analytical structure, a shift that dates roughly from the 1870s. The presumed lasting contribution of early neoclassical analysis was its success in "closing the circle," by which we refer to the incorporation of a theory of distributive shares into the general theory of prices. Neoclassical economics offered a theory of both input prices and output prices.

In order to effect this contribution, however, the so-called imputation problem had to be resolved. How were economists to prove that the amount paid for inputs equaled the amount paid for the total product created by those inputs? How were they to explain the absence of either a surplus or a deficit? Economists resolved this problem by imposing the constraint that the market economy was characterized by constant returns to scale, that production functions were everywhere "linear and homogeneous." In arriving at this solution, however, they almost universally failed to recognize that the constraint of constant returns conflicted with Adam Smith's basic precept about specialization. Smith's principle was placed in the dustbin, to be dredged up only now and again over the course of a century until being recovered in the last decades of the twentieth century.

The neoclassical constraint of constant returns forced economists to adopt the Ricardian logic as their basic explanation of trade. In their textbook examples, trade emerges under conditions of comparative advantage even when constant returns are imposed down to the level of individual effort. In other words, there is no inherent conflict between the Ricardian principle of comparative advantage and the neoclassical constraint of constant returns. It is small wonder that economists subconsciously locate the origins of trade in a Ricardian framework.

From Markets to Politics

Our elaboration of the distinction between the two basic logics of trade might be viewed as an esoteric intellectual exercise if the subject of concern were only the natural emergence and operation of markets. The distinction becomes more significant, however, when we recognize that ultimately the extent of the effective market nexus is determined *politically*—that is, through explicit collective action. Nation-states exist and draw boundaries. Almost everywhere throughout history, the activities of participants in markets within the boundaries of the polity have been treated differently from the activities of participants in markets that extend beyond political borders. Only in a relatively few instances have markets been opened to all who might choose to enter into trading relationships, regardless of political identity.

Because "the extent of the market" is subject to political choice, questions about its appropriate size are central to present-day discussions of *globalization,* a term that has become a catchall for a whole set of related issues. We suggest that people's understandings of the two separate logics of trade may, and perhaps do, exert an important influence on public attitudes and hence on political attitudes toward restrictions or expansions of markets, toward immigration policies, and toward the increasing integration of historically separated national economies, as exemplified by attitudes toward such institutions as the European Union, the North American Free Trade Association, Mercosur, and others.

The basic Smithean logic lends more or less direct and more or less universal support for market extension. The central principle of this logic, enunciated by Smith himself, states that the division of labor is limited by the extent of the market, with the implication that the "wealth of nations" increases directly with the size of the market nexus. Importantly, in this intellectual-analytical structure, no need arises for a measure of gains to gainers as against losses to losers. Basically, there are no permanent losers, and everyone is a gainer. The expanded market nexus makes for further specialization, with generalized gains in economic value.

In contrast, the Ricardian logic offers a much more questionable rationale when a polity faces a necessary political choice concerning a proposed extension of the scope of the market. Overall, the gains in aggregate value consequent on a fuller exploitation of comparative advantages may be acknowledged, but identifiable persons and groups may be affected differently by the extension of the market precisely because persons differ among themselves in productive capacities. Persons and groups who possess comparative advantages internally in the production of the same goods in which potential entrants possess comparative advantages may be damaged by the proposed extension of the market. Members of such groups would tend to oppose proposals for integration of markets across national boundaries, and their opposition would influence the formation and impact of political coalitions.

Those economists locked implicitly into the Ricardian framework may still be willing to defend the proposed expansion of markets by resort to concealed utilitarian evaluation, even if they acknowledge the improbability of compensation payments. But even such economists will for the most part accept that the defense of "economic efficiency" in the abstract is a weak reed for political argumentation.

The Mind-Set of the Market

The Smithean and the Ricardian models offer differing lenses through which we may view the observed processes of market exchanges. The phenomena themselves, of course, are the same, and empirically observed exchange relationships surely embody elements of both explanatory models. Persons specialize (including specialization in the organization of institutions) because specialization as such produces gains. As Adam Smith noted, the differences between the philosopher and the street porter may be small prior to their commitments to a specialty.

But persons also differ in their relative capacities to produce economic value. Presumably there exist noncompeting groups that would retain relative advantages even after a full temporal adjustment to reach equilibrium. Only a few persons are seven feet tall and adept at playing basketball.

The two contrasting mind-sets about the origins of trade are important in determining how people evaluate the composite reality they observe. Persons will be observed to differ, perhaps widely, in income and wealth. In the stripped-down Smithean model, in which exchange is explained exclusively by choice-driven specialization, people will tend to view the observed differences as temporary and subject to elimination as market prices move toward their "natural" levels. If philosophers currently earn much more than street porters, we can predict that more persons will begin to specialize in philosophy. Moreover, because the Smitheans' mind-set suggests that street porters indeed can become philosophers, they feel no need to express great concern about the immigration of additional street porters or about the importation of goods that are or might be produced domestically.

The Ricardian mind-set, by contrast, leads people to make a quite different evaluation of the observed reality that contains major differences in incomes among persons in differing occupational categories. Ricardians will view those economic differences as more permanent and the forces of adjustment that tend to reduce them as less effective. In particular, as may be the case in the United States, if the opening of markets suggests that more of the types of goods currently produced by relatively unskilled members of the domestic labor force will be imported, political coalitions organized in opposition to market extension will find support among unions and their political representatives. Further, schemes for payments of compensation to those that seem likely to suffer from the opening of markets will command more sympathetic hearings.

Thus, the basic mind-set about the origins of exchange may exert important effects on public and political attitudes toward globalization and therefore on the ultimate political choices that may be made. By exclusively following the Ricardian digression, economists have perhaps been responsible for unwittingly making movements toward open markets more difficult than they otherwise would have been.

Smitheans, Ricardians, and Democracy

Finally, a note about politics and economics in general. The "open politics" that democrats putatively hold as an attainable ideal depends on the presumption that all persons in the polity are competent to participate fully in collective choices. Democracy, as a plausible ideal, seems much more compatible with the Smithean conception of personal capabilities than with the Ricardian. If our mind-set allows for equality among all persons in their ultimate competencies as citizens, should not our mind-set also allow for equality among all persons in their ultimate competencies as creators of economic value?

An Adam Smith "democrat" is not at all self-contradictory. But what about a David Ricardo "democrat," who is forced, willy-nilly, to judge that some of us are more equal than others?[1]

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1. The argument in this article implicitly incorporates our interpretation of a research program that has emerged since the early 1980s. For a collection of the important contributions to this program, including relevant precursory materials, see Buchanan and Yoon 1994. For the most comprehensive treatment of the approach, see Yang 2001.